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Guest Editorial
Governance and Ethics: An Indispensable Relationship

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One of the fascinating questions of our time is why, when so much effort has gone into implementing corporate governance guidelines and raising the awareness of business ethics, stories of unethical conduct and poor governance continue to emerge on the front pages in our newspapers. Around the world financial scandals continue to occur and each time seekers of an antidote to the latest disaster call for more governance. This was evident after the 1987 securities market collapses when the Cadbury Committee and the OECD (Cadbury 1992; OECD 1999) were among many organisations which were to introduce governance regulations and guidelines over the next decade, and it is again prominent today.

In response to the increase in governance regulation, many listed companies have produced governance reports and social and human relations reports on their activities. Some such as Rio Tinto, BHP, Shell, Western Mining, Toyota and ANZ, for example, have developed major corporate programs that support governance and ethical initiatives. Various publications from the companies suggest that they consider these reports play an important part in promoting their corporate brand image.

The causes of the present financial crisis (Andrews 2008), again reported to be associated with poor governance, are evident in poor risk management, poor prudential and financial market regulation, greed, lack of ethics, and a decade of 'narrow' teaching and scholarship leading to a failure to deliver a cadre of professionals who care about ethical and social issues. These factors appear to be only marginally explained by governance theories.

Among the major theories of governance are agency theory, stakeholder theory, managerial hegemony theory, and stewardship theory (For a review see Clarke 2004). Agency theory describes the potential conflict in interests between the owners of a corporation and its managers (the owners' agents). Based on economic theory, it assumes first, that a firm operating in a market environment has a single commitment to profit maximisation and the assumption that shareholders have a contract with the manager and, second, that the manager being a rational decision maker, will operate in their own interests to the exclusion of others' objectives. Studies of management hegemony describe how CEOs in the US controlled US boards to the point where they determined board members, controlled information and disclosure and even executive compensation. Stewardship theory is almost the opposite: managers interests are complementary to the owners and because of the managers' psychological motives, needs for achievement and responsibility, and commitment to the company, they will operate in its best interests. The fourth theory, stakeholder theory, argues that firms have a responsibility to those who are impacted by and have an impact on the firm. Because of this an enterprise operates at the centre of a set of relationships in which risk management and corporate citizenship are important aspects of operations.

The most researched theory is agency theory and much of the governance best practices found in governance guidelines can be seen as initiatives to curb the self-interests of directors and managers, by for example, by safeguarding their independence, auditing performance of boards and companies, and ensuring reporting transparency. Stakeholder theory, on the other hand, is an attempt to take a more positive view of the best of human motives by having regard to values and ethics which would influence decisions and behaviours, such as recognising the 'social contract' with a community in which a corporation operates, exercising corporate social responsibility and being a good corporate citizen (den

Hond, de Bakker et al. 2007). All the theories have something to offer but are not the subject of this special edition.

This special edition is oriented towards raising governance issues, with less concern given to providing an in-depth analysis of governance theory or illustrating a particular disciplinary approach. The aim has been to give concrete reality to some of the specific governance problems that arise in our contemporary business environment.

The argument underlying the papers is that corporate leaders, (i.e. the boards of directors, commissioners in the case of the police force, and politicians in government), make decisions that impact on the organisations which they control. The members of company boards have not only legal duties emerging form the Corporations Law but responsibilities to comply with governance guidelines and also, because of their positions of power and influence, to their other stakeholders among whom are suppliers, creditors and employees. In particular, the purpose of this volume of papers is to add to our understanding of the factors that show how corporations continue to fail to meet governance and ethical standards and to suggest some initiatives that could address some of these factors

Rules and standards in governance and ethics provide a framework for what should be ethical decisions and practices that safeguard the financial system and investors. Yet, it appears that a lack of their implementation is associated with financial disasters. So, the first paper "Loss of Integrity: the true failure of the corporate sector" described three cases of financial failure. ENRON and HIH illustrated how lack of appropriate governance by the board, dubious accounting practices, greed and lack of respect for social values, and lack of, or incompetent, leadership led to their failure. Opes Prime, the most recent failure reported in Australia showed how a company misled and abused the trust of its clients. In this case, despite a commitment to governance, by its leading bank the ANZ, the bank's staff decisions appeared to be contaminated by conflicts of interest and driven by opportunities for personal gain. These are ethical issues.

The second paper in this special edition suggests that a new approach is needed to foster ethics in an organisation. A board's responsibilities should include the environment in which their people work. Most large corporations are now multinational with less "ties that bind" to their country of origin and even fewer commitment to the countries in which their workforce may be located. This was recognised in the issue by the OECD of the governance standards for multinational corporations (OECD 2001). The uncertainty of accountability across jurisdictions means that it is more urgent than ever before for the leaders of business to appreciate their ethical responsibilities. The paper recommends the selection of leaders based on ethical attributes and proposes the development of an ethical climate that supports ethical decision making and could promote wellbeing at work equally as health and safety measures do.

In response to a need to identify ethical leadership, the paper on the ethical component in transformational leadership takes one of the most researched leadership theories and explores whether it has an ethical component. It concludes from the research that ethics are important to leaders but that their values, rather than leadership style, determines their approach to ethical relationships with their staff.

Original versions of the final two papers were presented to the Police Audit Conference held in Melbourne. The papers present two different but complementary views on governance in public sector organisations such as a police force. The first paper discusses the context in which governance operates in a police environment, the power of the law, the relationships between morals and the law and how values underlie all principles of corporate governance. The authors conclude that the principles of corporate governance can only be evaluated if there is a standard by which it may be judged.

The second paper reviewed different means of evaluating governance. It discusses the benchmarks for governance structures, governance policy and principals and the structures and performance of boards. It introduces the 'partnership' model of governance which is today so prevalent in all public sector arrangements with business. Finally it discusses the functions and roles of police boards and the self-assessment checklist for assessing the effectiveness of a board.

While one can bemoan the lack of governance and ethics in corporate Australia, nevertheless, the current scandals are an opportunity to seize the moment for business to implement the innovations that lead to better performance of our business and financial markets and in so doing to make for better businesses and civil societies.

The issues raised in this special edition of the Journal of Business Systems Governance and Ethics are important to all of us. The threats of terrorism and climate change are indicative of the uncertainty of our future. Decisions about the governance of corporations affect all of us. The efforts to improve governance must not waver. One cannot legislate to halt greed, opportunism or fraud, but social values and expectations can exert a powerful influence on corporations to do more than meet minimum compliance with regulations. Business is the third great institution in society, after government and the law. It can be instrumental in delivering the moral and ethical standards that society expects. We are at a time of great conflict and massive change in society. As we strive to decide what is of value, what is important to us, and what kind of society we want in the future, governance and ethics are indispensably linked.

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Loss of Integrity: The True Failure of the Corporate Sector

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Abstract

Despite the introduction of legislation and corporate governance standards designed to promote business integrity, prosecution of the directors of many companies for fraud and other offences has continued. This paper describes the changing environment in which the members of the boards of companies operate, and their legal duties and responsibilities. The authors illustrate the traps for, and liabilities of, directors with reference to vignettes of three corporate investigations, Enron, HIH and more recently Opes Prime. This paper argues that, in many instances, the failures of the corporate sector were due to loss of integrity by the major actors. Whether this was related to a belief in their invulnerability, or whether a climate of fraud was seen as acceptable hard-nosed business practice is a moot point. An alternative point, that the collapses could be mediated by ignorance, or by malice, is a critical point, and one deserving of further investigation.

Keywords

Corporate Governance, Governance Standards, Corporate Integrity

Introduction

In recent memory, company after company has collapsed leaving a record of dubious (or *creative)* accounting practices, (plus those termed *feral,* i.e. designed to deceive, by Clarke, Dean and Oliver, 2003). This was combined with a lack of transparent and truthful reporting to the capital market.

One of the responses is the call for more stringent corporate governance with the result that there are a number of international research projects investigating a wide range of topics that include regulation, board performance, governance standards, legal structures, insolvency, accounting, auditing, corruption and ethics.

Current interest in these topics has been stimulated by some of the insights and developments that have emerged from inquiries into companies such as ENRON, ONE TEL, HIH and more recently Opes Prime. The resulting spate of convictions suggest that directors and office bearers (including internal and external auditors), are deficit in their knowledge of their duties and responsibilities, and good governance practice.

The interest in corporate governance is often traced back to the 18th Century (refer to Beatty, 2006, for a review of its historical development) when companies under government patronage first began to conquer the ‘new’ world via the sea. Companies, such as the Dutch East India Company which operated out of Amsterdam from 1700, needed investors to band together so that sufficient capital could be raised for their venture, and also to share the risk. Apparently there were 70 members of the Dutch East India company board. About the same time, gossip around the town was focused on topics such as:

- Mismanagement at the biggest companies
- Insider trading
- Misstated profit and loss accounts
- Excessive remuneration of executives
- The need for accounting standards
- The need for independent directors
- Shredding of internal documents

They sound familiar! The Dutch East India Company eventually went under because of corruption. Nevertheless, it was not for nothing that it was said: fortunes were made 'when the ship came home'.

In the UK, during the middle Ages, the trade guilds and merchants' associations were the forerunners of companies. They existed as the beneficiary of some special right conferred by the Crown, such as the right or entitlement to control a particular trade. Subsequently, the establishment of a venture, with multiple members, required the issue of a Royal charter conferring on them the right to trade in a particular region.

Well known examples include the British East India Company and the Hudson's Bay Company operating in Canada. As incorporation required a Royal Charter, which was difficult to obtain, an alternative mechanism for business ventures was a "joint stock" company in which people were entitled to a share of the profit in proportion to their investment in the venture.

By the 18th century there was a well developed market for shares in these ventures. However, speculation was rife. For example, shares in the South Sea Company rose from 100 pounds to 1000 pounds in a matter of days. The South Sea bubble collapsed in 1720 setting corporate development on hold for a century. It was such a calamity that it closed down parliament, directors of the company were arrested and their estates forfeited. In fact, for many years investing in private companies was regarded with suspicion. It was not until 1844 that corporate laws to regulate companies were formally introduced.

Australia was quick to follow suit and by 1850 the Australian States were introducing individual corporate regulation of private companies. By the 1880s, Australia was experiencing its first corporate boom.

A century later corporate history repeated itself. Connel, Bond and Skase, labeled the "corporate cowboys", were among those whose companies failed leaving shareholders with sizable losses. Companies that failed were: Ariadne, Qintex, Adstream, Budget, Tricontinental, Pyramid, State Banks in Victoria and South Australia. There were also rumbles at some of the major listed companies, Fosters, Westpac and Coles/Myer, all of which left shareholders feeling very uncertain.

By the 90s, the latest rash of collapses, that included HIH and OneTel, provided evidence that poor quality financial reporting was a major factor in the continued criticism of accounting and auditing practices following large, and often, *unexpected* corporate collapses. Indeed, prior to failure the accounts of many of those who failed had shortly before shown the companies to be profitable, and sometimes "highly successful" (Clarke, Dean and Oliver, 2003). Clarke *et al* (2003, p.22) put the position concisely '….. the failure of the publicly available financial information to disclose a true and fair view of companies' financial positions facilitated deception and in some cases exacerbated the losses'.

In the US the Sarbanes-Oxley Act and in Australia the CLERP Act 2004 were designed to strengthen financial reporting, oversee best practice guidelines for corporate governance and to oversee standards for accounting.

Table 1. Major corporate disasters

Company	Auditor	Shareholder loss
Adelphia	Deloitte & Touche	Family used Adelphi credit to purchase shares in the company $5.6B
Enron	Arthur Anderson	$63B deficiency in shareholder value
Microstrategy	Pricewaterhouse Coopers	Revenue overstatement
Waste Management	Arthur Anderson	Revenue overstatement $1.7B
Worldcom	Arthur Anderson	Capitalised US $3.9B in operating costs US$103b bankruptcy
Xerox	KPMG	Revenue overstatement
State Bank of SA	KPMG Peat Marwick & Price Waterhouse	Out-of-court settlement for $120m.
HIH	Arthur Anderson	Losses :$5.3B

These failures, especially because they were often unexpected, raise serious questions about the extent to which company directors understand their duties and responsibilities and whether integrity is a value that is lost to the corporate sector.

The Duties and Responsibilities of Directors and Officers

All boards of registered companies must comply with the Australian Corporations and Securities Legislation, 2001 and the subsequent provisions of the Corporate Law Economic Reform Program (CLERP) issues 1 to 9. The Act is a mixture of both common law and statutory law. Note that the provisions of the Law in regard to duties apply to both directors and officers. The term 'officer' applies to anyone participating in decisions on behalf of a company that affect the business, its financial standing or with whose instructions the directors are accustomed to act. Corporate governance guidelines are intended to complement the law and support the ethical conduct of business leaders.

Corporate Governance

Governance is essentially concerned with the structures and processes for decision-making, accountability, control and behaviour at the top of organisations(Armstrong and Francis 2004b; Armstrong and Francis 2004a). Standards for good practice in governance have been introduced by Standards Australia (Standards Australia 2003a; Standards Australia 2003d) and Guidelines by the Australian Securities Exchange (Australian Securities Exchange 2003). In both cases, there is an emphasis on the values and ethics that should underlie corporate behaviour. Among the values that support the good governance principles are transparency, accountability, fairness, honesty and integrity (Francis 2000). As the ASX (2003) states p.3 'There is a basic need for integrity among those who can influence a company's strategy and financial performance, together with responsible and ethical decision-making'.

This paper argues that the conduct in the following three cases raises questions about the success of legislation and governance guidelines in achieving integrity in the business community.

Compliance with Legislation

The following addresses five of major duties of the members of boards and then discusses how they were breached by the officers of ENRON and HIH. Similar duties may be found in corporation laws and in governance codes in most countries and are reflected internationally in the OECD (1999, 2001) governance guidelines.

1. *The duty to act (honestly) in good faith in the best interests of the corporation and for a proper purpose (Section 184 of the (Australian Corporations and Securities Legislation 2001)*

Directors hold a position of trust, i.e. they owe a fiduciary duty to their company. They must act in what they honestly believe to be in the interests of the company and exercise their powers for the purpose for which they were conferred. They cannot, for example, as the Family did in the case of Adelphi, use credit lines for the company to purchase shares ($5.6 billion worth) in the company for the family.

An act of dishonesty includes making a statement that is false or misleading. It is not necessary to show that the false information actually affected the market place or that the information was issued with fraudulent intent. A civil penalty may require compensation to the company for an offence committed where a director was dishonest. Being intentionally dishonest or reckless is a criminal offence.

Jeffrey Lucy (2006), then Chairman of ASIC, defined 'reckless' as being aware of substantial risk and proceeding with a transaction where it is not justifiable and being indifferent to the consequences.

2. *duty to avoid conflict in the position of a director and/or any interest that a director may have (S191)*

Directors must not vote on matters in which they have a personal interest, disclose any interests in a contract with the company, and disclose any secret commissions. If a director does have a conflict of interest, the safest course of action is disclosure in writing at a board meeting and, of course, refraining from voting on the issue, and even absenting themself from the meeting while the issue is discussed.

3. *duties which prohibit the misuse of a director's position or information (S183)*

This duty requires members to respect the confidentiality of the board papers and discussion, and not to cause detriment to the company or use information to gain an advantage for themselves, such as engaging in insider trading.

Officers or any employees of a company may not use their position (S182) or information to gain an advantage for themselves or to cause detriment to the corporation (S183) nor can they use knowledge gained within a company to set up in competition or place themselves in a position where their personal interests are in conflict (i.e. where their powers are restrained) This commonly arises in cases of hostile takeovers. This means, for example, that members may not allocate new shares simply to safeguard their own positions and maintain control of a company.

Table 2. Duties of Directors and Officers of Corporations: Specify the Act

Duty to act (honestly) in good faith in the best interests of the corporation and for a proper purpose (Section 184).
Duty to act with care, diligence and skill (S180)
Duty to avoid conflict in the position of a director and/or any interest that a director may have(S191)
Duties which prohibit the misuse of a director's position or information (S183)
Duty to prevent a company trading while it is insolvent (S588G)

4. *duty to act in good faith with care, diligence and skill (S 180)*

Gone are the days when the director arrived late for a Board Meeting, slept through the agenda and enjoyed a good lunch before going home. Under the Corporations Law members are required to devote the time necessary to prepare for meetings, actively participate in the board's work and have an adequate level of knowledge and skills.

In assessing whether a person has met their duty of care, diligence and skill, a judge will assess whether an officer of a corporation has acted honestly in the best interests of the corporation and exercised the degree of care and skill that another person, in a like position, would be expected to exercise in a similar situation.

5. *Duty to prevent a company trading while it is insolvent (S588G)*

Section 588G of the Corporations Act 2001 places a duty upon directors to prevent their company trading while it is insolvent.

Directors are personally liable for debts if a company trades while insolvent, becomes insolvent because of a debt or there are reasonable grounds for suspecting that a company is or would become insolvent.

In the case of insolvency, an administrator may be required to investigate the past conduct of the officers of a company. Compensation may be recovered for the benefit of creditors or the officers may be liable for prosecution if they have contravened the Companies Law by trading while insolvent or incurring a debt that causes the company to become insolvent. The criteria is if there were grounds for suspecting that the company was insolvent or a reasonable person is a like position in a company, in the company's circumstances, would be aware that a company was insolvent.

When judging whether or not a company is able to pay its debts, a court would look at what a director would be expected to know, i.e. they should be familiar with the operations of the entity and informed about its financial status. Being ignorant is not an excuse for failing to exercise due diligence or issues shares or trade while insolvent.

However, directors are not liable for honest errors of judgement and are protected by the Business Judgment Rule (S180.2) which refers to decisions in respect to its business operations. A defence is that a director informed themselves, and decisions which were made in good faith, and the best interests of the corporation.

Additional offences connected with liquidation are for an officer to:

- Fail to disclose or to deliver up company property
- Fraudulently deal with the company's books fraudulently obtain property for the company on credit or dispose of company property obtained on credit
- Fraudulently make a material omission in a report as to the company's affairs
- Prevent the production of the company books to the liquidator
- Falsely deal with the company's books

How were these duties met, or breached, in the case of Enron and HIH?

ENRON

Enron was formed in 1985 by a merger between two state-based natural gas companies, its main activity being to operate interstate gas pipelines. Its early share price reflected these beginnings and it was not until the early 1990s that its share price nearly doubled to US$20. It then began a meteoric rise to peak at US$89 in the mid to late 90s. Only a year later the share price would dive to under US$1 (Clarke, Dean and Oliver 2003)(Clarke *et al* 2003). According to Clarke *et al*, a new phrase was coined "Enronitis" referring to the securities market's loss of confidence due to concerns that accounting practices were being abused and that the market was not being fully informed.

At its peak, Enron was the seventh largest listed company in the US. It had been diversified and transformed into a major conglomerate with e-business such as Enron on-line, hundreds of subsidiary and other related entities, numerous limited liability partnerships and SPEs (Special Purpose Entities). What went wrong?

In their review if the collapse, Clarke *et al* (2003) concluded that it was its inability to service its debt. It then bent the accounting rules and made use of SPEs (special purpose entities) to keep debt off the group consolidated balance sheet and to hide numerous losses. Another factor was the so called mark-to-model estimations of profits on future contracts. The computer model estimates, recorded on the balance sheet as profits earned, allowed ENRON to borrow externally. "When the contracts fell over, so did the SPEs and in sequence, ENRON" (p.261).

The directors failed in all the above directors' duties of care and diligence, operating in the best interests of the corporation, avoiding conflicts of interest and trading while insolvent. In 2002 The Justice Department opened a criminal investigation and the Chief Financial Officer, Andrew Fastow was indicted on 78 charges of conspiracy, fraud, money laundering and other counts (Table 3; The AGE 2006). His wife was also charged. He subsequently agreed to 10 years in prison and to forfeit $23.8 million with his wife serving only one year so that she could take care of their children. Jeffrey Skilling, the CEO, was sentenced to 24 years and fined $59 million for fraud, conspiracy and insider trading.

Table 3. Events at ENRON

Date	Event
1996	Jeffrey Skilling became Enron's president and chief operating officer
Feb 12, 2001	Jeffrey Skilling became Chief Executive
August14, 2001	Skilling resigns citing personal reasons Kenneth Lay returns to chief executive job
October 22, 2001	Enron admits that the Securities and Exchange Commission is looking at possible conflict of interest between Enron and its partnerships
October 24, 2001	Enron sacks Chief financial officer Andrew Fastow
November 29, 2001	SEC investigation is extended to cover Arthur Anderson
December 2, 2001	Enron files for bankruptcy
December 3, 2001	Enron lays off 4000 employees
January 9, 2002	The Justice Department opens a criminal investigation of Enron
January 17, 2002	Enron fires Arthur Anderson blaming the auditor for destroying documents
January 14, 2002	Lay resigns
March 14, 2002	Arthur Anderson indicted for obstruction of justice
August 31, 2002	Arthur Anderson surrenders licence to practice in the US; 85,000 people lose jobs
October 31, 2002	Andrew Fastow indicted on 78 charges of conspiracy, fraud, money laundering and other counts
May 1, 2003	Fastow's wife Lea and seven former executives charged
January 14, 2004	Andrew and Lea Fastow plead guilty. Fastow agrees to 10 years in prison and to forfeit $23.8 million. His wife serves one year.
July 8, 2004	Lay surrenders to FBI
January 30, 2005	Trial of Lay and Skilling begins
July 2006	Lay dies of heart disease
October 25, 2006	Skilling sentenced to 24 years and fined $59 million for fraud, conspiracy and insider trading

Source: The Age, October 25, 2006 Business 7

Remember those additional duties occurring during liquidation. Arthur Anderson, one of the biggest global accountancy firms was blamed for destroying documents. One of the Anderson accountants was reported as saying, during the Enron days, "Ship the Enron documents to the Feds", but his secretary heard "Rip the Enron documents to shreds". Andersons was indicted for obstruction and closed down.

Being a partnership, even members of the firm in Australia were required to meet the firm's debts. Andersons was also the auditor for HIH.

HIH: the Biggest Collapse in Australian Corporate History

We have seen how directors' duties were breached at Enron and the consequences for the company officers. Now, how were directors' duties addressed in the case of HIH? The final submission of the Counsel Assisting the HIH Royal Commission (Commission 2003) suggested that there might be over 1000 breeches of the law at HIH and FAI. I will touch on some of them.

HIH in 2000 was the second largest insurance company in Australia. Comprising over 240 separate companies, the HIH Group at one time operated in 16 countries including the UK, US, New Zealand, Hong Kong, Argentina, Malaysia, Sweden, Greece, Russia, Fiji, Papua New Guinea and the Philippines as well as Australia.

It was founded in 1968 by Ray Williams (and a colleague Michael Payne) who began his working life as a messenger boy with an insurance company when he was 14. The British insurance company took over the company he founded in 1971 and the emerging entity, C.E. Heath International, listed on the Australian stock exchange in 1992 with a stock market capitalization of $240 million.

In 1995 the company established a partnership with the Swiss insurer, Winterthur and HIH Winterthur was established. Five years later, in September 2000, Ray Williams resigned and in 2001 the company collapsed, shares were suspended and an administrator was appointed.

It was reported as the biggest corporate disaster in Australian history. A Royal Commission was appointed to inquire into the collapse of the company and to determine the extent to which actions of HIH's directors, officers, auditors, actuaries and advisors contributed to the failure of HIH. The Government then funded ASIC to establish a taskforce to investigate the referrals from the Commission.

Among the factors the Commission (Commission 2003) identified as contributing to HIH's problems were:

- Poor business decisions;
- hailstorms in Sydney;
- the acquisition of FAI insurances;
- failure of the auditors;
- failure of the actual financial outcomes to be reflected in the financial statements;
- failure of the regulators;
- the failure of the board to perform their duties.

To address the major issues here it is noted that:

Business decisions

Poor business decisions exposed the company to high risks such as marine insurance and film investments in the UK; and the Florida typhoon and overseas' workers compensation claims resulting from industry deregulation in California and altered court-awarded benefits in the US; and the acquisition of FAI insurance.

Table 4. Key Directors and associates of HIH found guilty of not meeting their duties and responsibilities

Name	Position	Failure in duties	Penalties
Ray Williams	Founder, Chairman	Reckless and failed to properly exercise his powers and discharge his duties for a proper purpose: Party related transactions to prop up share price Signed a letter that was misleading Authorized issue of a prospectus by HIH that contained a material omission Made statements in the annual report which he knew to be misleading that overstated the operating prit*? before abnormal items by $92.4m.	$650,000 4.1/2 years jail
Rodney Adler	FAI chairman and MD, director of HIH	Party related transactions to prop up share price Two charges of disseminating false information to induce people to buy HIH shares Obtaining money by false statements Failing to discharge his duties in good faith and in the best interests of the company (did not disclose conflicts of interest to board)	$450,000 4.1/2 years jail (nonparole 2.1/2)
Bill Howard	General Manager of HIH Insurance, Financial Services and Investment Manager	Dishonestly received from Brad Cooper $124,000 in return for facilitating payments; Facilitated payment of $737,000 to cooper knowing the debt had already been discharged	3 years jail Suspended for giving assistance to the HIH Investigation
Bradley Cooper	Entrepreneur	6 charges of bribing Howard to pay false claims 7 charges publishing false and misleading statement	8 years jail

Courts do not usually hold directors accountable for poor business decisions. A Good Judgment Rule (S180(2)) provides some protection for officers provided that directors comply with their duties. If they have informed themselves about the subject-matter of the judgment, acted in good faith for a proper purpose and in the best interests of the company, and did not have a material personal interest in the outcomes, they will not be held accountable for poor decisions. However, note that despite this defence, the Act still requires a member of a board to act with care and diligence, to avoid conflict of interest and most importantly to act in the best interests of the company.

The purpose of the business judgment rule is to protect the authority of members of boards so that they are not constrained from making business decisions which contain a certain amount of risk but not to excuse them from negligence or fraud.

Acquisition of FAI: Failure to act with care, diligence and skill

Deliberations in the HIH Royal Commission suggested that the acquisition of FAI and the practices that followed were the 'nail in the coffin' for HIH. Directors were accused of being negligent in their due diligence of FAI, and that it may, in fact, have been insolvent when acquired. HIH reported the purchase of FAI in 1999 for $300 million.

Evidence at the Royal Commission suggested that the real value was nearer $100 million rather than the $300million recorded.

Failure of the actual financial outcomes to be reflected in the financial statements

Section 296 and 297 of the Act require the financial report to comply with accounting standards and to present a true and fair view of the financial position. The Annual Report following the acquisition of FAI reported a 112% rise in profits in the first half of 2000. The reported increase in profits were said to be the due to the generally accepted, but dubious, accounting practices:

- The capitalization of expenses such as deferred acquisition costs,
- Deferred information technology costs,
- Bookkeeping debits such as future income and goodwill. Goodwill of FAI was recorded as $400million in the 2000 accounts, and not the $100 million previously recorded.

Failure of the auditors

The audit opinion reported that the accounts gave a true and fair view of the company's financial performance, complied with the accounting standards and corporate regulations and other professional reporting requirements.

In the Notes to the Accounts of 30 June 2000, the auditors had provided an unqualified opinion in respect of the financial accounts showing a net profit of $939 million. If it was operating with this much profit, how could it have collapsed only 9 months later?

The regulators

The assessment of solvency requires assessment of the capacity of an entity to meet its debts when they fall due. In an insurance company actuaries calculate the likelihood of future claims based on current financial data.

It appears that information about HIH's position was disputed on actuarial grounds and that this information was conveyed to the Australian Prudential Regulation Authority (APRA) (Clarke et al, 2006). No action was taken and the HIH Administrator, Tony McGrath, pursued a $5.6 billion lawsuit against APRA claiming that the government and its prudential regulator were negligent in allowing HIH to collapse in March 2001.

Failure of governance

The minimum requirements for good governance practices demand independence of the board, audit committees composed of independent directors, independent external auditors and a reliable independent information and reporting system (Armstrong 2004a). How independent were the board members? Two of the board members were members of Andersons, the Auditing firm and had been members of the board from its earliest days. Further, the Chairman, Ray Williams, was a very dominating leader, even charismatic, and he dominated the board room. Clarke *et al* (2003) believed that the Board suffered from 'Groupthink ', a term used to describe a situation where peer pressures ensure that everyone votes the same way and are reluctant to express a differing opinion.

Did the board accept that the auditors, Arthur Anderson, were actually independent or was there a conflict of interest? In addition to being on the board, and providing audit services, members of the Arthur Anderson firm had been providing other consulting services to the company.

Other questions were: When did the officers of the company know that the company was unable to meet its debts? Did they *notify ASIC* of changes in the financial position of the company and the impact on its share price? Did they *trade while insolvent?*

Listed companies are obliged to warn the market of material information that might impact on their share price. The HIH Board failed to publicly disclose its deteriorating financial position. In fact, the Chairman did the opposite, claiming in a letter to brokers that it was 'rock solid'. The unexpected collapse of HIH in 2001 with losses of $5.3 billion defrauded not only investors, creditors and staff but all those who held policies with the company.

Not only was there a failure of the actual financial outcomes to be reflected in the financial statements but HIH's share price was propped up by a series of party-related transactions. A subsidiary of HIH, Pacific Eagles Equities, purchased $10 million of HIH shares on-market. The directors were subsequently charged with using funds for *an improper purpose.*

Tony McGrath of KPMG in his report as provisional liquidator identified problems of "reckless management, incompetence, fraud, greed and self-dealing". In 2002, Ray Williams was disqualified as a director for 10 years and Rodney Adler for 20 years and both directors, and the finance director Dominic Federa received heavy fines, Williams $650, 000, Adler $450,000 and Fedora $5,000.

For recklessly failing to properly exercise his powers and discharge his duties for a proper purpose by authorizing a prospectus and an Annual Report that contained false information, Ray Williams was sentenced to four and a half years jail. Adler also received a similar sentence for issuing false information and not disclosing his conflict of interest. Brad Cooper received the heaviest sentence, eight years for 6 charges of bribing Bill Howard to pay false claims and seven charges of issuing false information.

Table 5. Creative accounting

First tier
Moving capital gains and losses in and out of the same statement
Accruing profits of related companies
Off-balance sheet financing
Transfer of assets between related companies
Second tier
Arrangements to reverse transactions after balance date
Pyramiding asset values through related-party transactions
Other
Tax effect accounting (deferred tax debits are included in profit and loss and balance sheets, FITB)
Recording beneficial effects of foreign exchange movements as part of operating profits or additions to reserves
Capitalising expenses as assets
Abnormal/extraordinary items classifications
Using debt and off-balance sheet financing in the form of derivatives

Source:(Bosch 1990)Bosch, 1990; Clarke *et al*, 2003

What did Enron and HIH have in Common?

We will comment on only three factors.

- First was incompetence of the leaders and their failure to meet their duties under the Act.
- Second was the use of creative accounting practices.

- Third was the lack of ethics, honesty and integrity in the face of collapse

The leaders

Skilling was a Harvard graduate, Williams was a product of rising through the ranks to the top. Both seemed out of their depth in the face of the fast growth in the complexity and magnitude of their businesses. However, even if they were incompetent, their major crime was deliberate dishonesty and fraud.

Creative accounting practices are those which are not illegal but could be considered unethical. Feral accounting practices are those purposely designed to mislead (Clark *et al*, 2003).Some of the accounting practices (Table 5) used by both of these companies included moving capital gains and losses in and out of the same statement, accruing profits of related companies, off-balance sheet financing, transfer of assets between related companies. A major deception of shareholders was the blatant use of dubious estimates of potential future profits as collateral for loans.

Both companies ran into debt and could not meet their debts as they fell due. The directors failed not only in their business decisions but, in trying to conceal the problems, they also breached all of their duties as company directors. What made the directors totally disregard their ethical responsibilities? And what were the ethical stances of the professionals in the accounting firm?

Opes Prime

Reports of Opes Prime also suggest that dubious financial practices and a failure by the Directors and Officers to appreciate the unethical nature of some of their business practices led ultimately to the company's problems.

Newspapers reported that Opes Prime (Table 3) had used client funds for its own purposes, and experienced lack of disclosure and transparency, conflicts of interest, etc

Opes Prime is a stockbroking business which offered clients a facility for margin investment. Clients placed their shares with Opes Prime as security for a loan with which to invest in further shares in the market. While the share prices of these new shares went up, the value of the investment increased. When the share market fell, investors were called upon to provide additional funds to cover the margin between the former value of the shares and the new value.

Opes Prime bundled clients' shares into large packages and used these as security to borrow from ANZ and Merrill Lynch. The first difficulty arose because Opes Prime borrowed the full value of the shares clients deposited with them from the banks, but only lent a proportion of this back to the clients. The difference was then used by Opes Prime to speculate on hedge funds. This included short selling intended to manipulate the market.

When the market began to fall, a call was made by the banks to Opes Prime to meet the margin. Opes Prime did not have the funds to meet their proportion of the loan and then their clients discovered that the outstanding margin on their shares was much greater than they had been led to believe. Furthermore, many clients were unaware of the conditions of the contracts with Opes Prime. In many cases, OpesPrime had deposited the clients' shares and their control with the banks. Clients no longer had control of their shares many of which represented the assets of their own companies.

Warning bells went off in the banks which then found themselves owners of shares in a number of smaller companies whose owners were suddenly disenfranchised. They then began to unload the shares in order to safeguard their loans. This further depressed the market and increased the margin to be funded by clients, even if they could regain control of their shares. It was also reported that employees of the ANZ bank were among the OpesPrime margin lending clients.

Table 3. Opes Prime events, directors' duties and ethical values underlying governance standards

Opes Prime	Directors duties	Ethical Values
Borrowed funds secured by clients' shares for its own purposes	Act in good faith and for a proper purpose	Accountability
Lack of disclosure of terms (Australian Market Securities Lending Agreement, Sunday Mail, 6 April, 2008)	Act with care and diligence	Transparency
Client shares lent out to hedge fund managers for a fee	Avoid conflict of interest	Fairness and balance
Discrepancy between amount borrowed and margin lending to clients		Integrity and Honesty
Bundled shares into large packages and used as security to borrow from ANZ, Merrill Lynch		Dignity
Accepted higher loan-to-value ratios and riskier shares as security		Legal compliance
Did not keep separate client accounts		Good will
Short sold shares to force prices down		
Failed to make margin calls on major and strategic clients, moved stock to and from these accounts to cover margin calls (The Age April 5, 2008, Business p.6)		
Included employees of ANZ among margin lending clients(Australian, 27 April, 2008)		
ANZ/Merrill Lynch sell the shares Opes used to secure funding		

A number of court cases are pending and the issues are yet to be resolved. However, as Table 3 suggests, directors and officers of the company appear to have disregarded directors' duties including acting in good faith and for a proper purpose, executing these duties with care and diligence and avoiding conflicts of interest. The ethical issues of transparency, accountability and honesty and integrity are not in evidence.

Conclusion

In the above cases were the duties of directors blatantly disregarded, or not understood? Or do values such as accountability, fairness, honesty and integrity, which underlie the principles of good corporate governance no longer have currency in the modern corporate world?

Knowing and practicing the ethical principles underlying corporate governance is the first step in safely negotiating directors duties and responsibilities. Lawyers and others advocate further governance regulation and compliance to prevent people from being dishonest. Further regulation may not be the answer. An alternative, perhaps, is that demonstrating knowledge of community values and ethics should be an integral part of the qualifications for company directors and officers.

What is most obvious here is that the failure to accommodate the ethical dimension of business has disastrous consequences. Corporates fail, directors are imprisoned, and the reputation of business is besmirched. Put at its bluntest, bad ethics is poor risk management. Regulation and compliance have a proper and powerful place: so too does the climate of ethical dealing.

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An Ethical Climate Is a Duty of Care

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Abstract

The current emergence, once again, of corporate collapses due in no small way to unethical behaviour raises questions about the duties and responsibilities of boards of major organisations for building an ethical organisation. This paper argues that the legal duty of care to employees extends to creating an ethical work environment. It describes different types of ethical climates, how they are recognised and the consequences of their impact on the behaviours of their members. It illustrates this with some of the findings from our research into measuring ethics and ethical decision making. In conclusion, it identifies the key factors that boards should address to promote a desirable ethical climate.

Keywords

Directors Duties, Duty Of Care, Ethical Climate

Introduction: What do we Mean by a Duty of Care?

When people accept an appointment as a director of a company they are legally bound by the requirements of the corporations law (Corporations Act 2001). These duties and responsibilities have gradually been extended and now apply to voluntary or appointed members of all incorporated organisations, government funded entities and a host of non-for-profit organisations incorporated under various Acts.

A Director has a greater duty than simply representing a particular field of experience.

Duties of Care and Diligence require a director to be:

- Familiar with the business of the organisation and how it is run.
- Sure that the board has sufficient means to audit the management of the company.
- Satisfied that the company is being properly run.
- Attend board meetings plus allow time to complete their responsibilities.

A Member of a Board must not make improper use of inside information to gain advantage for themselves, cause detriment to their organisation or engage in improper conduct which is inconsistent with the proper execution of their duties.

Furthermore Directors cannot place themselves in a position where their powers are restrained: ie where their personal interests are in conflict with those of the organisation.

At first glance this appears fairly straight forward but it is not sufficient for a Director to rely solely on the company's officers or other persons. Think for example of the recent legislation which makes company directors responsible should a company be negligent in health and safety. The James Hardy case is a good example. The behaviour of management, subordinates and peers can also impinge on the duty of care of company directors. Taking or offering bribes are uppermost in our thinking.

Many such actions may not be illegal but they are unethical and often unethical attitudes and behaviours lead on to more serious fraud and other corrupt behaviour. Examples abound of company leaders setting an example that employees are too ready to follow. The managing director of Enron protested to the end of his trial that “he had done nothing wrong”. Opes Prime is a good example of where greed in one organisation corrupted the morals of those with whom it had dealings. Opes Prime (Table 3) has been reported in newspapers as using client funds for its own purposes, lack of disclosure and transparency, conflicts of interest, etc

When a board fails to provide an ethical example to those dependent on them, and an ethical climate in which to work, these types of problems arise.

Throughout the world, corporate governance standards have proliferated in an effort to curtail these types of behaviour (Armstrong 2004b); (Standards Australia 2003a; Standards Australia 2003b; Standards Australia 2003c; Standards Australia 2003d; Armstrong and Francis 2004b; Armstrong and Francis 2004a; Standards Australia 2004) in its principles of good governance, states that a board should approve and foster an appropriate corporate culture matched to the entities values and strategies (Standards Australia 2003a, p.14). The ethical vales underlying the corporate governance standards are:

- Accountability
- Transparency
- Fairness and balance
- Honesty
- Dignity
- Legal compliance
- Good will

The type of climate promoted in an organization starts with the board. (Francis 2000; Australian Stock Exchange 2003, 2007; Standards Australia 2003b). The ASX in Principle 3 of its Good Corporate Governance guide states (p.25):

The company should clarify the standards of ethical behaviour required of the company directors and key executives (that is, officers and employees who have the opportunity to materially influence the integrity, strategy and operation of the business and its financial performance) and encourage the observance of those standards

Ethical Climate

Ethical climates are the stable, psychologically meaningful, shared perceptions that employees hold concerning ethical procedures and policies existing in their organisations. “Ethical climate is the perception of what constitutes right behaviour, and thus becomes a psychological mechanism through which ethical issues are managed” (Martin and Cullen 20006). Studies into ethical climate suggest that different climates may be related to various forms of individual behaviour and organisational performance.

Table 1: Theoretical dimensions of ethical climate

Ethical Criteria	Locus of analysis		
	Individual	**Local**	**Cosmopolitan**
Egoism	Self-interest	Company profit	Efficiency
Teleological theory	Friendship	Team interest	Social Responsibility
Deontological theory	Personal morality	Company rules and procedures	Laws and professional codes

Source: Victor and Cullen (1987, 1988)

Based on a theoretical framework drawn from three ethical theories, Victor and Cullen (1987,1988) using an Ethical Climate Questionnaire, found five types of climate (Table 2) that are called instrumental, caring, independence, rules, law and code.

Looking at the three ethical theories and relating these to the level of analysis (local or individual, company or society), a climate reflecting egoism, labeled instrumental, was characterized at the individual level by self interest and put instrumental values such as profits before anything else.

People operating in an instrumental climate may have good intentions, for example, the sustainability of a firm, but lack a moral basis for their reasoning. The model suggests that the locus of ethical reasoning shifts from individual, to company, to society at large. Goodpaster (quoted in van Hooft 2001) describes the single most serious threat to ethical decision making as *teleopathy*. The symptoms of this pathology are fixation, rationalisation and detachment. "'Fixation' is the inability to let go of one's goals or to compromise them in any way. 'Rationalisation' is the willingness to justify one's activities in pursuit of one's goals with any plausible sounding reason. And 'detachment' is the inability to acknowledge or embrace the larger scheme of social and ethical values which ought to be expressed in one's decisions (Van Hoft 2001, p.92). This results in being too strongly wedded to one's goals. In business, the goals are likely to be exclusively profit and competitive advantage. Board decisions in such a climate would be based on serving the organisation's interests or providing personal benefits.

The second ethical climate type was caring. Those whose decisions were influenced by caring for the well-being of others, the teleologists, were influenced by friendship, identifying with the team and at a societal level, were supporters of social responsibility issues. Concern for and consideration of others is perceived to be supported by policies, practices and strategies of a firm, and by its actions. The final category of climates, associated with deontologists, were divided into three categories; independent, rules and law and code.. Individuals working in an independent climate believe that they should act on deeply held moral convictions. Decisions on ethical quandaries should have little regard for external forces and outside influences.

Table 2. Five common empirical derivatives of ethical climate

Ethical Criteria	**Locus of analysis** Individual	Local	Cosmopolitan
Egoism	Instrumental		
Teleological theory	*Caring*		
Deontological theory	Independence	Rules	Laws and Codes

Source: Victor and Cullen (1987, 1988)

In a rules climate, a company's rules and standards such as a code of conduct or governance principles are likely to set the climate. The law and codes climate will most likely suit professional people, whose activities are bound by laws and professional codes.

Our studies into ethical climate replicated aspects of the work of Victor and Cullen (1987, 1988); Wimbush and Shepard, (1994) Joseph and Deshpande (1997), and Deshpande (1996a, 1996b). In one study (Armstrong, Kasuma and Sweeney (1999) a survey of the 548 staff of a university in Victoria, Australia used a similar procedure to that used by Joseph and Deshpande (1997) and Deshpande (1996). In a second study, (Cockerell and Armstrong, 2000) our research explored the ethical climate in six gaming organisations.

Findings from our studies were similar to those found by previous researchers. The type of ethical climate was linked to various forms of organizational behaviours. Different organizations exhibited different ethical climates. Undesirable climates, reflecting an instrumental climate associated with egoism, were related to staff turnover, absenteeism, stealing, lying, falsifying reports and accepting gifts. Desirable ethical climates were related to various factors including the commitment to the organization, quality of working life and performance.

The conclusions from our studies were that an organization can influence behaviours in an organisation by promoting the ethical climate of an organisation. Consequently, the norms that guide a board's decisions about an organisation's policies, procedures, and practices have moral consequences. They provide both a reflection of the ethical climate supported by a board and a framework to guide employees' behaviour

How do we Achieve an Ethical Board?

Evidence of an ethical board would be:

- Compliance with its legal duties, in particular, those relating to due diligence and duty of care, and corporate governance standards affecting the performance of the board, audit committees and disclosure and transparency (See for example, Armstrong, 2004)
- A formal Code of Conduct.
- Regular reporting to the board on compliance with the Code.
- Procedures for detecting, recording and dealing with breaches of the Code and complaints;
- A training scheme for fostering of ethical conduct.

The first strategy is that a board should approve a written Code of Conduct:

The Code of Conduct should set out ethical and behavioural expectations for both directors and employees. It is critical that both the board and the senior management team demonstrate through both their words and actions, absolute commitment to that Code and consistency in its execution. (Standards Australia 2003, p. 16)

The Code should address such issues as conflicts of interest, improper use of company information, information security, insider trading, outside employment, gifts, entertainment and political contributions, confidentiality, and conducting business overseas. It should also include details of the consequences of non-compliance.

Ethical issues faced by a board also involve decisions about: employee issues such as fair wages, safe working conditions, work morale and industrial relations; consumer issues such as safety of products, honest advertising; and corporate responsibility demonstrated in relationships with suppliers and the community in which it operates, and its impact on the environment..

Sound data collection, not only statistics on corporate prosecution of white collar crime, but also about values and ethical climates across the corporate sector and within companies can support careful diagnosis of a situation and inform future action (Armstrong, 2003).

Ethics and the law have complementary roles. Ethics is about values and behaviour . There seems to be general agreement that regulation is not the answer to changing attitudes. However, it is possible to change behaviour by building capacity, training and getting data on the current climate to support the implementation of the right corporate culture.

Studies of the introduction of innovations (Ramage and Armstrong, 2005) show that both rational/technical and political/cultural factors are involved in a two stage process of adoption and operation of any innovation.

At board level, rational factors include the availability and commitment of resources, ethical skills, knowledge management techniques and externally-imposed requirements. A Board promoting an ethical climate would issue policy statements, develop a code of conduct and commit resources to data gathering In the adoption phase, the process is one of identifying the requirement for the changes and organising the organisation resources and skills, such as training, that may be required. During the adoption phase, board control and commitment, communication and sharing information become important.

Political/cultural factors to be addressed in the adoption phase are the influence of internal and external interest groups, conflicting priorities and the board members' concerns. Implementation requires leadership, addressing board attitudes to ethics and ethical decision-making, and identifying those who will be involved in the changes.

Conclusion: Is Ethics Simply the Latest Fad?

There has been a heightened interest in ethics because of the misconduct in and failure to control organisations such as Enron. HIH, AWC, OneTel, and the increased concern to shareholders and other stakeholders. In an increasingly global world, media exposure and public backlash to unacceptable behaviour are probable. Heightened visibility in a networked global world means "everyone knows about it" and comopanies are concerned for their reputations. Furthermore, research suggests that, 4 out of 5 employees (78%) prefer a good workplace culture over a good salary (Commonwealth Bank Australia Newspoll Survey 2004)

Further support for promoting ethics on a Board is provided by Principle 3 of the ASX Principles of Good Governance and Best Practice (Australian Stock Exchange 2003, 2007) which include establilshing a code of conduct, and reporting and investigating unethical conduct. One can only conclude that the importance of personal and board member ethics is here to stay. This is not to say that introducing an ethical climate is an easy matter. As Transparency International (2004) reports:

> a major constraint on the operationalisation of integrity systems is scepticism towards the integrity of senior management in many Australian organisations. This theme needs to be tackled through greater transparency relating to role expectations, remuneration, and material interests perceived as influencing corporate duties.

In the light of this, the corporate leaders of organisations, the board members, and their ethical stance demands further investigation.

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The Ethical Dimension in Transformational Leadership

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Abstract

Few empirical studies have been done that directly address the underlying values that drive leadership or distinguish its ethical dimensions. As a result the development of a theory about how values and ethics affect transformational leadership lacks empirical support. This has important implications for the study of transformational leadership. The purpose of this study was to establish a range of values and implied approaches to ethics that are associated with transformational styles of leadership, to use an inductive approach to determine the values and ethical approaches associated with transformational leadership, and to determine whether such a style is always right in itself. The study used interview data from senior executives to address the questions: What kinds of values do people associate with the dimensions of transformational leadership? Are these values related to ethical conduct and positive outcomes for followers and organisations? What are the values that drive transformational leadership behaviour? Is there an ethical or moral dimension to it? Do these represent ethical or immoral dimensions in the "Full range leadership model? The results of this study suggest that leaders' values are more important in driving ethical behaviour among leaders, than the operationalisation of the management practices suggested by transformational leadership theory,

Keywords

Ethics, Values, Ethical Leadership, Transformational Leadership Introduction

Introduction

Prior to discussing this study, it is important to set the context of the present study by a review of some of the traditional approaches to understanding leadership, the development of transformational leadership and its dimensions, and how various researchers suggest that an ethical dimension supported by values provides the underlying principles that set acceptable standards and criteria for the ethical behaviour of individual transformational leaders. The next section defines different categories of values and four traditional ethical theories. The paper argues that if transformational leadership has an ethical dimension then leaders using a transformational leadership style should exhibit the values and behaviours that are compatible with the ethical theories. The final section describes the research methodology and discusses the results of the findings.

Personality traits, although found to relate to leadership (Stoghill, 1974), have not always been good predictors of good leaders. Most theories of leadership have in fact shied away from looking at personality.

After all if leadership could be learned, (and it was not an inherent part of personality), there was a role for academia in teaching it. So, academics concentrated on different dimensions in the management styles of leaders such as an orientation towards achieving tasks and/or relationships with people (Blake and Mouton, 1985). A difficulty with these models was that researchers were unable to associate the behaviours of leaders with outcomes such as morale, job satisfaction and productivity. It also seemed that different situations demanded different kinds of leadership. Situational models examined the demands of the situation in which leadership occurred (Hersey and Blanchard, 1993). Contingency theory was another well researched approach bringing together elements of both leadership style theory and the influence of the situation in which leadership was exhibited. An example was Feidler's (1967) contingency model which suggests that situations can be characterized by assessing three factors: leader-member relations (confidence, loyalty and attraction that followers feel for their leader, (b) clarity of a task structure or requirements, and (c) position power or authority of a leader. Combinations of the three variables predicted the preferred leadership style in different situations. (Northouse, 2001). The most favourable situations are those having good leader-follower relations, defined tasks, and strong leader position. This theory was useful in describing the appropriateness of using leaders with different styles in different situations, but did not explain why this was so.

Some conclusions from these leadership models were that all of the elements, personality traits, the situation, leader member relations, and power, have an influence on the practice of leadership. In response, Bass and Avolio, (1997) developed a "Full Range of Leadership model" to include all of these elements. Their model proposes three types of leadership behaviour: laissez-faire or no leadership, transactional leadership, and transformational leadership.

Laissez-Faire represents the absence of leadership. The leader abdicates responsibility, delays decisions, gives no feedback, and makes little effort to help followers to satisfy their needs. An example would be the Managing Director of a firm who calls no meetings with the firm's managers, has no long range plans for his or her company and makes little contact with employees within the organisation.

Transactional leaders exchange things of value with subordinates to advance their own as well as their subordinates' agenda. Political leaders who win votes by promising no new taxes are demonstrating transactional leadership. Similarly, managers who offer bonuses to employees based on their performance are exhibiting transactional leadership. Bass and Avolio distinguish three components of transactional leadership: management-by-exception in an active form, (involving corrective criticism, negative feedback, and negative reinforcement such as when a leader closely watches followers to find mistakes or rule violations); management-by-exception passive when intervention occurs only after problems arise; and contingent reward which occurs when a leader tries to negotiate with a follower what needs to be done to get what payoffs. Northouse (2001) gives the example of the latter in an academic setting when a dean negotiates with a professor the number of publications that he or she needs in order to receive tenure and promotion.

In contrast to transactional leadership, transformational leaders are people who:

> Attempt and succeed in raising colleagues, subordinates, followers, clients or constituencies to a greater awareness about issues of consequence. This heightening of awareness requires a leader with vision, self-confidence, and inner strength to argue successfully for what is right or good, not for what is popular or is acceptable according to established wisdom of time"(Bass, 1985, p. 17).

The four transformational leadership factors are described as (Northouse, 2001):

- Idealized Influence describes leaders who are change agents, set standards and vision and act as strong role models for followers. They are deeply respected by followers , who identify with them and usually place a great deal of trust in them.
- Inspirational Motivation describes leaders who communicate high expectations to followers, inspiring them through motivation to become committed to and a part of the shared vision in the organisation.

- Intellectual Stimulation is a style of leadership that stimulates followers to be creative and innovative, and to challenge their own beliefs and values as well as those of the leader and the organisation.
- Individualized Consideration represents leaders who provide a supportive climate in which they listen carefully to the individual needs of followers. Leaders act as coaches and advisers while trying to assist individuals become fully actualised.

Research into transformational leadership suggests that it is perceived to be more effective than transactional leaders, and is related to better work outcomes, satisfaction of followers. Furthermore, its dimensions are relevant across cultures (Muenjohn and Armstrong, 2001, 2007,2008; Boehnke et al 2003), that is, transformational leadership appears to have universal application.

A strength of transformational leadership is the wealth of research that supports the existence of the dimensions. It is seen as a process that incorporates the action of both leaders and followers in satisfying the needs of both, and supporting the development of a continuous path towards higher standards of moral responsibility. It includes motivating followers to transcend their own self-interests for the good of the team, organisation, or community (Muenjohn and Armstrong, 2008). In particular, Avolio and Bass 1995, p.202) suggest, in regard to the dimension of Individualized Consideration, “Individualized Consideration may concentrate on changing followers’ motives, moving them to consider more than their self-interest but also the moral and ethical implications of their actions and goals”.

Elliott (2002, 2004) explored this ethical component in transformational leadership in a number of studies. He said (Elliott, 2002, p.31) that transformational leadership enables “adaptation to change, empowerment, the achievement of potentials, and high levels of motivation and commitment”. It encourages followers to develop to their fullest potential and indeed “exceed performance expectations by ethical and appropriate impression-management behaviours which engender trust and commitment”.

Some of the critics of the model suggest that transformational leadership theory based on data collected from leaders at the top of organisations may not necessarily apply to leaders within an organisation. Others claim that transformational leadership is elitist and antidemocratic because transformational leaders take a direct role in creating changes, establishing directions, creating the vision and that this “gives a strong impression that a leader is acting independently of followers or putting himself or herself above followers’ needs” (Northouse, 2001,p.147). Allied with this is the fear that transformational leaders, especially charismatic leaders, may prey on followers and manipulate them. As Howell and Avolio (1992) suggest, the same qualities that make great leaders can also lead to unethical behaviour. Rather than motivating followers to pursue higher ideals, leaders may in fact lead followers in negative, unethical and immoral directions (Giampetro, Brown, Browne, & Kubasek, 1998; Parry & Proctor, 2001; Yukl, 1998). Reports in the press of company directors’ misuse of funds, insider trading, and unconscionable conduct are indicative of a lack of ethical integrity among some business leaders.

Bass (2000) addressed some of the criticism by making a distinction between authentic transformational leadership, which is seen as ethical, and pseudo-transformational leadership which may be a pose by a leader who practices transformational leadership behaviour but in fact is motivated by meeting self-serving interests. Bass and Steidlmeir (1999) suggest that values provide the underlying principles that set acceptable standards and criteria for the ethical behaviour of individual transformational leaders. They argue that while pseudo-transformational leaders use moral persuasion but their motivation is power and personal gain authentic transformational leaders are motivated by acceptable values and ethics.

This distinction has stimulated a growing discussion about the ethics of transformational leaders. Leaders who are transformational have an undoubted influence on the values of followers and play a major role in establishing the values and ethical climate exhibited by an organisation (Cockerell and Armstrong 1998). Because of their influence and power, they have an ethical responsibility for how they affect other people.

Research into transformational leadership (Kuhnert, 1994; Parry & Proctor, 2001) indicates that individuals who exhibit transformational leadership have a strong set of internal values and ideals, and are effective in motivating followers to act in ways that support the greater good rather than their own self interests.

Values are defined as the beliefs and principles individuals use to guide their actions, behaviours, and judgments of what is right or wrong, and the selection of the social goals or ends that are desirable. Something valued is considered worthwhile, good, desirable, important, and esteemed or prized. Something that is valueless is considered to be worthless.

Sarros and Butchatsky (1996, p.12) in referring to the difference between values and beliefs said: "Beliefs are basic assumptions about the world and how it works, and they guide our behaviour in terms of underlying principles. For instance, we believe that money is a motivator, and act accordingly. Values are basic assumptions as are beliefs. But values are assumptions that are normative. That is, what we believe is of worth, and should actively pursue and represent in our actions and behaviours. A belief represents the information a person has about an object and links an object to some attributes (Fishbein and Ajzen, 1975). The object of the belief may be a person, a group of people, an institution, a behaviour, a policy, an event, etc., and the associated attribute may be any object, trait, property, quality, characteristic outcome or event. Beliefs may not determine actions as much as do values .

A set of governing values might include how leaders behave with others, or what is expected of others. They could include fairness, justice, honesty, freedom, equality, loyalty, self-fulfillment, courtesy, and cooperation.

Values are important to leaders because they influence preferences and aspirations. It is alignment of the values of leaders and followers that allows leaders to exert influence that in transformational leadership leads to changes in behaviours. Lagen (1998, p.28) states "a shared values system can energise an organisation and meld a disparate group into a self-organising community. For those who get it right, management by values renews employee morale as control give way to a more flexible and trusting environment-the ideal conditions from which high-performing workplace cultures emerge"

Various researchers have attempted to explain the differences found in national cultures through preferences for different value systems (Feather, 1986; Hamden-Turner & Trompenaars, 1993; Hofstede, 1980) Hamden-Turner and Trompenaars argue that values drive business behaviour and that different cultures produce and develop effectively that which is most valued. Among the values of western cultures is the value of competition in the market place. They suggest that a loss of respect for "values" is at the heart of the moral crisis of western society. Values have been devalued because of the emphasis on science, which declared itself "value free". (They ask: when is scepticism not a value?)

Rokeach (1973) differentiated values into two kinds, 18 terminal values concerned with desired end states, and 18 instrumental concerned with modes of conduct divided into moral and competence values. Terminal values were grouped into personal-oriented category (a comfortable life, an exciting life, a sense of accomplishment, etc) or an interpersonal (or social) category (a world at peace, a world of beauty, equality, national security). Instrumental values or what Rokeach refers to as a "mode of conduct" can be further divided into those which have a competence value orientation (ambition capable, imaginative, independent, intellectual logical, responsible and those with a moral value orientation (cheerful, clean, courageous, forgiving, helpful, honest, loving, obedient, polite). Moral values "have an interpersonal focus which, when violated, arouse feelings of guilt for wrongdoing" (Rokeach, 1973, p.8). Competence values, however, "have a personal rather than an interpersonal focus and do not seem to be especially concerned with morality. Their violation leads to feelings of shame about personal inadequacy rather than to feelings of guilt about wrong-doing "(1973, p.8).

Francis (2000, p.10) distinguishes between ethics, morals and values:

> The terms ethics and morals are sometimes used interchangeably, although one can make distinctions (the word ethics is from Greek, whereas the word morals is from Latin). More commonly, 'morals' refers to the standards held by the community, often in a form not explicitly

> articulated. 'Ethics', on the other hand, concerns explicit codes of conduct as well as value systems… Ethics is a highly explicit codified form of behaviour designed to produce particular ends and act in accordance with particular values. There are admirable values (such as wealth or success); there are other values that are of direct concern (such as honesty or fairness).

Ethics concern the actions and practices that are directed at improving the welfare of society, determining what is good or right for human beings and society, what goals people and society ought to pursue and what actions they ought to perform. Individuals draw on their experiences with others in determining the rules that ought to govern human behaviour and the values worth pursuing. Hence, the study of ethics is a systematic attempt to make sense of the reasoning that people apply when making decisions and questioning the values and rules of our society.

Four major types of ethical philosophical theories are virtue ethics, egoism, teleology and deontology. Virtue ethics is based on the idea that morality is primarily about virtue or character and that people of good character are more likely to make right decisions, so ethics should concentrate on moral development (Elliott & Engebretson, 2001). Ethical egoism is a theory that states that an individual should follow the greatest good for oneself. People who use an egoistic criterion to make ethical decisions are exclusively concerned with self-interest, the central posit of pseudo-transformational leadership. Comparing deontology and teleology: deontology concentrates on the correctness of the intentions of the decision maker and the means chosen to accomplish a task, and teleology concentrates on the consequences of actions. Deontological theories address duty and moral obligation, which are met by satisfying the legitimate claims or needs of others. Teleological theories, such as utilitarianism, emphasise the greatest good and minimal harm for the greatest number. While egoism is seen as being immoral, the other two theories promote ethical values that could be seen to be consistent with authentic transformational leadership.

Although research into transformational leadership suggests that it has a moral dimension,, the relationships with leaders' values are unclear. Few empirical studies have been done that directly address the underlying values that drive transformational leadership or distinguish its ethical dimensions. As a result the development of a theory about how values and ethics affect transformational leadership lacks empirical support. This has important implications for the study of transformational leadership and raises the questions of: What are the values that drive leadership behaviour? Is there an ethical or moral dimension to it? Are values reflected in behaviours represented in the "mode of conduct" as Rokeach (1973) suggests? Do these represent ethical or immoral dimensions in the "Full range leadership model?

Theoretical framework

The theoretical framework for the study is shown in figure 1. If transformational leadership has an ethical dimension then leaders using a transformational leadership style should exhibit the values and behaviours that are compatible with the ethical theories. The framework assumes that the values identified will have characteristics which allow them to be categorized along the Rokeach (1979) dimensions of terminal and instrumental values. It should be noted that these are espoused values as they are the values reportedly shown by experienced leaders. The enacted or values-in-use are illustrated by the ethical behaviours demonstrated in the practice of transformational leadership.

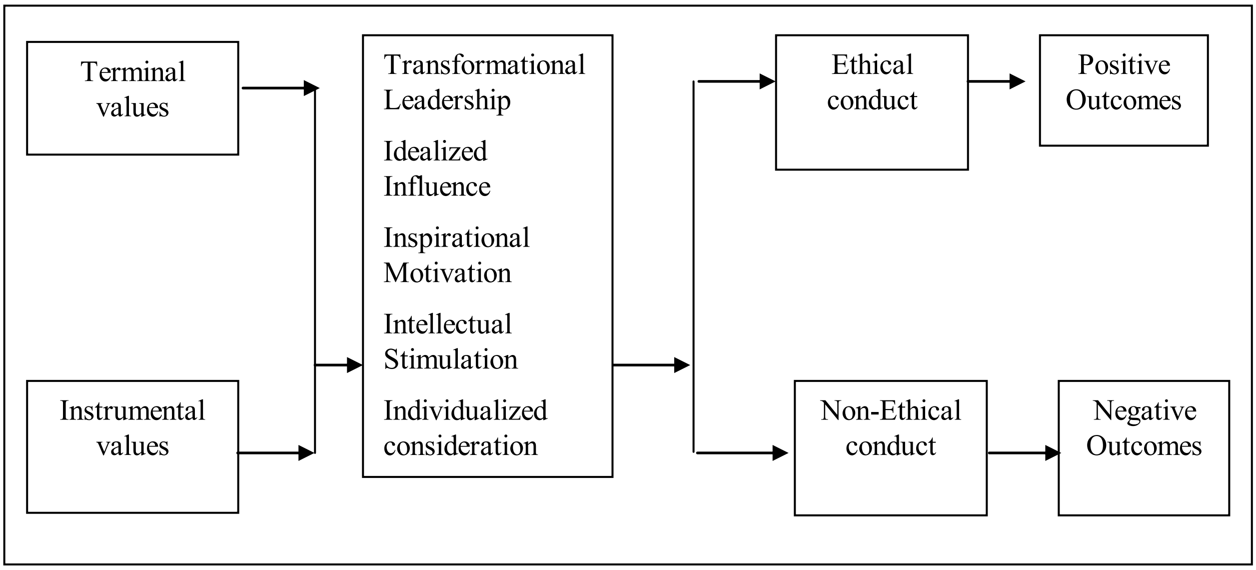
The model (Figure 1) assumes that determining values will influence the practice of transformational leadership, that this will lead to ethical or unethical conduct, and that such conduct will produce positive or negative outcomes for individuals and an organisation.

This study attempted to identify the implicit values that are associated with leadership, the behaviours associated with the four dimensions of transformational leadership and some effects associated with the four transformational leadership styles.

The research questions were:

- What kinds of values do people associate with the dimensions of transformational leadership?
- Are these values related to ethical conduct and positive outcomes for followers and organisations?
- What are the values that underlie ethical leadership?

Figure 1. Theoretical Framework



Method

The purpose of the study was to establish a range of values and implied approaches to ethics that are associated with transformational styles of leadership, to use an inductive approach to determine the values and ethical approaches were associated with transformational leadership, and to determine whether such a style is always right in itself.

The study reported here is one of three studies undertaken as part of a larger study by three researchers using a triangulation design to address similar issues (Elliott, Armstrong, & Alder, 2001). Ray Elliott (undertaking item analysis) and John Alder (analyzing focus groups) are responsible separately for other parts of the overall research design. Triangulation has been identified as a means to enhance the validity of research findings of complex and multifaceted phenomena such as leadership (Herman & Egri, 2002). In this arm of the research interviews supported a grounded theory approach to data collection and analysis.

Roberts (2002) suggests that in a "grounded" theory approach practitioners are best placed to make sense of the realities they experience. Researchers have the abilities to make sense of meaningful lived experiences and to contribute to knowledge by combining reflection with the generation of ideas from understanding of the phenomenon being studied. This present study contributes to the development of a theory that is yet to articulate the relationships between values, ethics and transformational leadership.

Despite awareness of the previous research that categorized values, an inductive approach was preferred so as to allow the data to drive the development of the theory rather than a deductive approach in which the theory shapes the collection of data. As Dubin (1978, p.18) states "descriptions of the real world are essential points of origin for theories in applied areas like industrial psychology, if not in all areas…. Any generalization that starts from the data points generated by observation and description is arrived at through an inductive process". He argues (p.19) that organisational psychologists are forced to start with induction theory because the discipline involves investigation of "men of affairs- who usually possess a good descriptive knowledge of their affairs and can test our theorizing against the real world they know". From the data conclusions and hypotheses can be drawn which can then be tested using a deductive process.

The method in this study was to develop a framework based on the search of previous literature, select a sample of recognised leaders, develop an interview schedule of open ended questions, and conduct interviews with the respondents. The respondents were 10 leaders (2 female, 8 male) from industry, academia, and politics. Ethics approval was obtained from Victoria University's Human Ethics Committee and confidentiality assured to participants. An open ended interview approach was designed to overcome the problems associated with interviewer involvement and bias, and to allow the emergence of responses unbiased by the structure of the questions asked. The respondents were asked to recall examples of the four transformational leadership styles, to give examples of leadership decisions that would demonstrate the four styles, to identify the key values reflected in each of the examples and evident in the best and worst leadership behaviours, and the associated implied approach to ethics.

A purposive and convenience sampling approach was used in which eleven people recognised as senior leaders in their fields (politics, law, education and business) were invited to participate. It is likely that people who are experienced leaders will be more knowledgeable about what drives their behaviour and they are also important in the maintenance and transmission of values within their organisations.

A content analytic approach for comparing values has been widely used (Lasswell, et al 1952; Kabanoff and Daly, 2000). The approach used in this study categorized the concepts according to (a) the Rokeach categories of values; (b) the four dimensions of transformational leadership and (c) the reported values and outcomes associated with leadership behaviours.

Results

Reported below are the respondents' perceptions of the results of experiencing the worst leadership styles, i.e. the perceptions of the values motivating this kind of behaviour, the behaviours exhibited and the outcomes for leaders and follower; positive and negative outcomes associated with each of the four transformational dimensions, the values associated with transformational leadership, the relationship of the values to ethical theory and how the findings relate to the propositions inherent in the theoretical framework described above. The items in tables 1- 5 are the reports from respondents.

Positive and negative outcomes associated with the four transformational dimensions

Respondents were asked to identify the effects associated with the best and worst leadership styles and then to identify the key values associated with the best and worst leadership practices and the implied approach to ethics. Table 2 reports how respondents perceived the positive outcomes from transformational leadership.

Idealized Influence resulted in high standards of performance, and reciprocal feelings of happiness and confidence between the leader and followers. A good leader must be competent in the true sense, setting goals, and providing the 'cause'. Their high levels of passion and energy draw people to them.

Inspirational Motivation was seen as stretching and challenging followers to perform at their full potential when followers were empowered, but being demotivating when it was exhibited as bullying people to take responsibilities they may not want. One respondent described the mutual satisfaction experienced when he gave an officer in a department a task of implementing or working out how to implement a practical goal rather than telling them how to do it. The success of this dimension was also dependent on transparency and having the infrastructure to support the initiatives.

The success of ***Intellectual Stimulation*** depended on the competence of both the leader and employee. There needed to be a balance and agreement about what should be challenged and how. One leader reported as his common practice to develop a position, ask for comment, and assess the objections.

Individualized Consideration, operationalisation as promoting individual development, was seen to be a positive outcome. Most successful were the leaders who try to bring out the qualities of all, not just a few. Respondents saw this demonstrated by referring to situations where there were many disparate positions Leaders demonstrated this dimension through the way work was allocated so that people could operate in an area that allowed them to productively use their skills and were encouraged to venture into new horizons. An associated practice was to give people a task to accomplish and then let them work out how to implement a practical goal rather than being told how to do this. A major issue is how the leaders deal with mistakes by themselves as well as subordinates. Admission of mistakes, forgiveness and using a 'carrot' was seen to be a better practice than punishment. This approach, as was "needing a sense of humour", was also seen to be ethical.

The Limitations of Transformational Leadership

Responses to the issue of whether transformational leadership is always the "right" leadership style drew a number of criticisms and negative perceptions (Table 4).

Idealized Influence sets and portrays the standards and vision for reference and/or the inspiration of staff. It has limitations when the vision is wrong and/or bad or too domineering. Negative effects associated with ***Idealized Influence*** were the inappropriateness of this kind of leadership to some people, that it could be seen as distant from followers and lacking flexibility to motivate followers in other ways. Leaders strong in this dimension could also be seen as 'distant' and ignoring the possibilities for accomplishing a goal in another way. Finally, it could be ineffectual if there was not the supporting infrastructure to enable leaders to deliver promises, or inappropriate if it was exercised for a bad cause, examples being leaders such as Hitler or leaders instigating a prison revolt.

Inspirational Motivation encourages participation and empowerment. On the one hand this takes time and some managers would see it as losing control or not meeting their responsibilities. On the other it may be unsuitable for some followers who prefer to be 'told' and seek direction. ***Inspirational Motivation*** was not always appropriate as circumstances arose on occasions when decisions had to be made without consultation. "People who can't live up to the standards can be bullied into a common mould". One respondent thought that 'empowerment" was an abused term more likely to be interpreted as abrogation

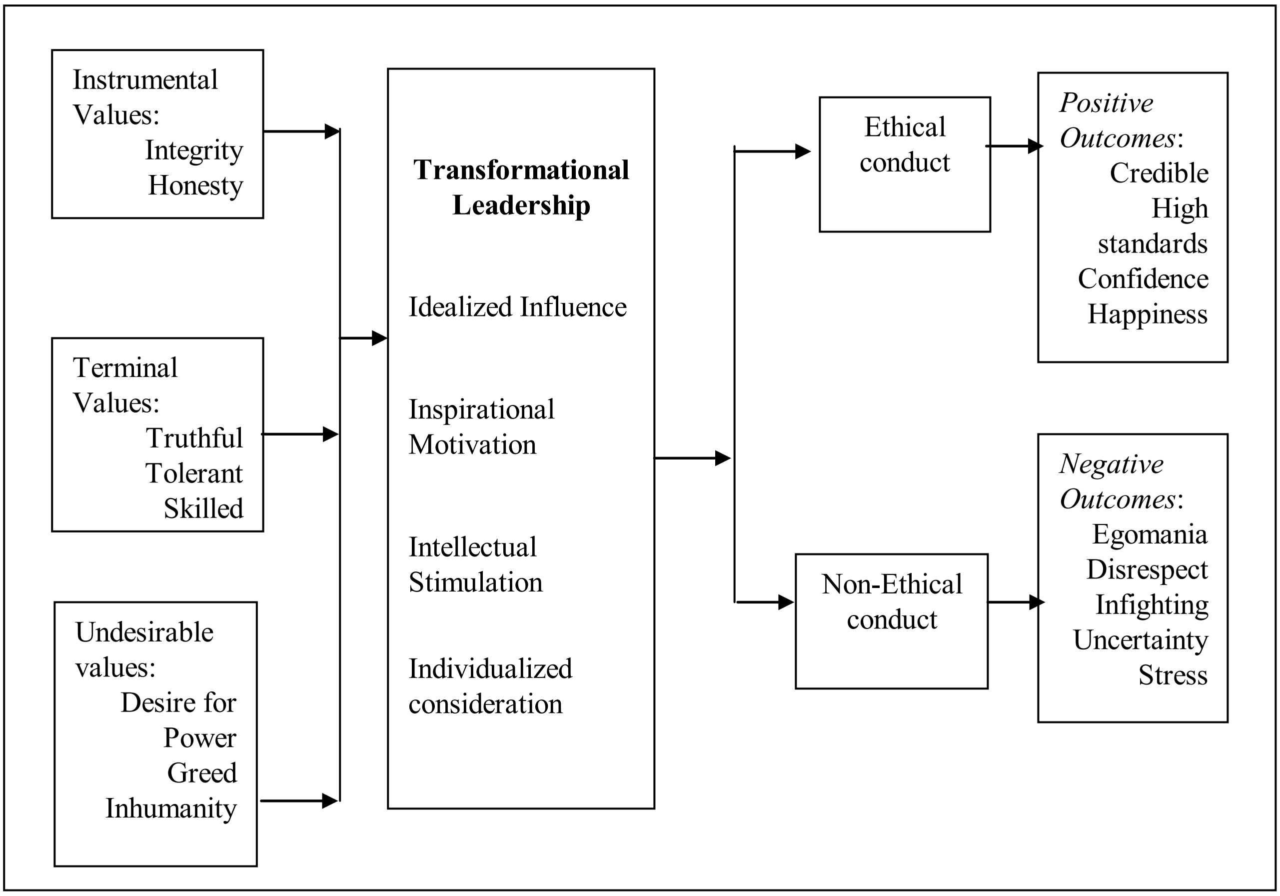
Intellectual Stimulation is the process in which leaders are supposed to present clear directions while allowing challenge and contradiction. The downside is perceptions of a weak leader without credibility and this style can only work in a supportive culture. ***Intellectual Stimulation*** that produced wise delegations that were effective. However, people must be particularly courageous to challenge their leaders and there were dangers in contradicting leaders who could find challenges difficult to cope with. The leader needs to have listening skills, not criticize or challenge views, and have a supporting culture in which to operate; otherwise challenges in groups are likely to disintegrate into conflict situations. Teams can be sidetracked into achieving activities such as forming alliances rather than the performance of the team task. Further, some followers prefer more harmony and a consensus style of decision making.

The success of ***Individualized Consideration,*** the fourth dimension, in which followers' individuality is promoted, depended too much on the competence of the leader to judge each follower's skills and abilities and assumes that the leader has the time available and the ability to recognize differences in abilities between people. In this case, teamwork was seen as more important than individual activities. In many situations leaders faced with opposition can develop favorites. Alternatively, when people do not want to be 'developed", difficulties arose in knowing what leaders could do with them.

Values, behaviours and outcomes associated with the worst leadership styles

Respondents had no difficulty describing the values that influence the behaviours of the worst leadership styles (Table 2) as a desire for control, greed, disregard of people's welfare and an absence of ethical principles. Behaviours ranged from the extreme ends of a dimension of imposing controls to lack of willingness to make decisions. As a result leaders experienced egomania, lack of support from followers, and an atmosphere of conflict, infighting and uncertainty generating stress. The impact on followers ranged from anger and despair to non-cooperation and eventually leaving an organization.

Figure 2. Confirmation of the Theoretical Framework



The Terminal and Instrumental Values Associated with Transformational Leadership

The answers to the questions asking respondents to identify the values associated with the best leadership styles, and with transformational leadership in particular are categorized in table 3 into the two types of values identified by Rokeach (1973), instrumental and terminal.

Instrumental values included integrity, honesty, caring, fairness, respect for people, and other personal attributes such as truthfulness, calmness, hopeful, confident, risk taking and fearless. Terminal values were self-worth, respect, dignity, pride, justice, equity, and personal competencies shown as clarity of mind, interpersonal skills, love and respect for life.

Rokeach (1973) argued that those values indicating a moral dimension were instrumental values that had an interpersonal focus which when violated arouse a sense of guilt or wrongdoing. The instrumental values reported by the responding leaders to be associated with transformational leadership and categorized in Table 3 are similar in many respects but have the additional values added to include "caring, understanding the needs of others", "not doing things in your own interest", "able to hold conflicting views", "not needing to agree with others", "transparent", "risk taking" and "fearless". Although it could be argued that these values could be categorized differently, there is nevertheless, considerable overlap with the values of integrity, honesty, etc that Rokeach identified as reflecting a moral dimension.

What are the Values that Underlie Ethical Transformational Leadership?

The final research question was "What are the values that underlie ethical leadership?" In Table 5, values identified as instrumental and terminal values associated with positive aspects of transformational leadership are categorized into the three dimensions associated with the three ethical theories identified above. Egoistic theory is about the self-interest of the leader. Some of the values, which are of worth to a leader, could include instrumental values such as honesty with self and terminal values such as personal happiness, dignity and pride. Teleological theories are concerned with the outcomes achieved.

Here, truthfulness, tolerance and politeness are some of the instrumental values and equity, justice and respect for life are some of the end states that leaders could hope to achieve. Deontology is about principle, duty and rules, it the 'means' of achieving the outcomes. In this case, examples of the instrumental values associated with transformational leadership are caring, and commitment to ethical behaviour, which are required to achieve understanding, love and respect for life.

Discussion

Figure 2 summarizes the results of the study. The study showed that leaders held both positive and negative values, and both kinds of values could be associated with transformational leadership. The negative values were most likely to be associated with unethical conduct and produce negative outcomes. In contrast, where positive values were held, the behaviour of leaders was likely to be associated with the instrumental and terminal values identified by Rokeach (1973) and to produce positive outcomes for both leaders and followers.

In response to the research questions: What kinds of values do people associate with the dimensions of transformational leadership? Negative values included desire for control/power at all cost, greed, and disregard of people's welfare. Positive values included integrity, honest, caring, and truthfulness, tolerance, personal control. Are these values related to ethical conduct and positive outcomes for followers and organisations? The results were unambiguous. Leaders who held positive values achieved high standards, happiness, and feelings that work was worthwhile. Leaders who exhibited negative values produced anger, despair, non-cooperation and lack of commitment.

What are the values that underlie ethical leadership? The positive values that are associated with the positive aspects of transformational leadership demonstrate the type of values that support the three ethical theories of egoism, teleology and deontology. Although egoism is often associated with self-serving interests, it could be argued that values such as honesty with oneself, and aiming for personal happiness, dignity and pride although self-centered are not undesirable endstates. It is when negative values are associated with self-serving interests to the exclusion of others' rights and interests that egoism is undesirable. Positive values of truthfulness, tolerance, politeness, equity, justice and respect for life reportedly held by transformational leaders substantiate a link between transformational leadership and teleology. Similarly, the relationship of transformational leadership to deontological theory is supported by the respondents' beliefs that instrumental values such as caring, commitment to ethical behaviour and terminal values such as love, understanding and respect for life underpin transformation leadership.

Is a transformational leadership style always "right"? Comments from respondents suggest that in an ideal situation with a coherent organization, the right staff, a leader with the right abilities, and access to the right knowledge and information it can work very well. Without these, when an inspirational leader takes advantage of the trust of staff, when there is a change in the organization situation (for example, a crisis or a change in leadership) then it is probably not right.

Is there an implied approach to ethics in transformational leadership? Yes, but transformational leadership, of itself, is not ethical. The results of this study would suggest that leaders' values are more important than the operationalisation of the management practices suggested by transformational leadership theory, in driving ethical behaviour among leaders.

Conclusion

Some of the limitations of this study are the relatively small number of leaders interviewed, discrepancies in the participants' knowledge of transformational leadership, and that the type of study did not allow statistical analysis of the relationships. Nevertheless, there is no doubt that those interviewed had no difficulty in responding and identifying values, ethical behaviours and leadership practices (even if they did not always appreciate the meaning of transformational leadership). As such, it is a useful starting point that confirms a relationship between values and ethics and transformational leadership.

Elliott (2002, p.32) stated "The extent to which leadership actively aligns actual and espoused values of an organization within the framework of a strategic vision probably accounts for one quarter of all organization behaviour." In these times with increasing numbers of accounts of unethical business practices in the press, the significance of our leaders' ethics and values to society cannot be ignored.

Values and ethics are important topics for the leaders of organisations because they clarify the moral obligations and ethical responsibilities of the leaders who make business decisions. Ethics refers to more than compliance with laws and regulations such as those applying to occupational health and safety regulations, sexual harassment or insider trading. Criteria based solely on legality are insufficient to effectively inform managers about how to respond to complex crisis that have far-reaching ethical consequences. Complex moral problems require an understanding and concern for ethical values fairness, justice, and due process to people, groups and communities. However, in regard to transformational leadership, the conclusion from the results of this study is that leaders' values are more important in driving ethical behaviour among leaders, than the operationalisation of the management practices suggested by transformational leadership theory. This study contributes to the debates on these issues.

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Table 1. Positive outcomes associated with the four transformational dimensions

	Idealized Influence	Inspirational Motivation	Intellectual Stimulation	Individualized consideration
Positive effects associated with each dimension	Absolutely credible Sets high intellectual standards Makes you think that work is worthwhile Happiness: feeling of being wanted Leading by example: ensures the future pride staff want to feel about themselves Builds confidence Articulates clearly commands to staff Not establishing or imposing objectives is immoral Leader leads by example	People who are stretched respond better Cannot make people do what they do not want to do	Wise delegation is effective	Recognised individuality and promoted individual development Forgiveness and admission better than punishing

Table 2. Values, behaviours and outcomes associated with the worst leadership styles

Leaders Values	**Behaviours**	**Outcomes for leaders**	**Outcomes for followers**
• Desire for control/ • power at all costs • Motivation of greed • Inhumane • Disregard or people's welfare • No recognition that ethical principles apply	• Over control • Not caring • Out of touch/ did not listen • Some lack courage • Lack of trust • No understanding of ethics • Instead of "how well I can do" is "protect my back" • Won't make a decision • Sits on the fence • Discusses ad nauseam • Believes everyone agrees	• Egomania • Earns disrespect • Seen to whinge about current situation • Creates conflict, infighting • Uncertainty • Loss of energy • Stress • Constant state of vigilance • Exaggeration of problems because unable to deal with them • Puts pressure on others • Tries to impose a view without discussion • Confers only with those who agree • Tries to impose views without thought • Fails to talk with people and get them on board • Superficial charm hides objectives	• Despair • Anger • Incredulity • A wish to change things • Non-cooperation • Collapse of projects • Resentment • Leaving the organisation • People concentrate on the wrong things • Destabilizing • Lack of commitment • Nothing done properly

Table 3. The limitations of transformational leadership

	Idealized influence	**Inspirational Motivation**	**Intellectual stimulation**	**Individualized consideration**
Negative perceptions of transformational leadership	Can be too unified/too string and overbearing (e.g. the parish minister) If the leader has a wrong vision, it can be bad for the organization, career and clients	Time constraints: "not enough time to service the demands of inspirational motivation" Some people are more influenced or susceptible…weak, vulnerable people looking for hope. People submit, give up control of life, seeking some meaning Some people are not motivated except by being told Managers see it as losing power Employees see it as being dumped on Leaderless groups don't work	Goals become fuzzy and the direction indistinct The leader looks weak, loses credibility Some organizations need a strong, authoritative leader because of the nature of the circumstances (e.g. war) Needs a culture for it (culture of "don't tolerate mistakes means no risk taking, don't challenge the protocol) Get conflict all the time Most of the time is spent working out alliances Some people expect more harmony in decision making	Depends on the situation: leader must make a decision Success depends on the judgment of the leaders – which individual, when. Are people there as individuals or part of the team? Individual recognition is good but subject to the stability and interests of the organization Some organizations want their people to be conforming – don't like differences in individuals and aim for a common culture Differences are hard to manage The organizational culture breaks down if there are dissenting pockets in the organization

Table 4. Terminal and instrumental values associated with transformational leadership

Values	Instrumental (mode of conduct)	Terminal (end state)
	Moral	Self-worth/respect
	Integrity	Dignity
	Honesty (with self and others)	Pride
	Caring/understanding the needs of others/human role	Survival
		Happiness
	Fairness	Buoyancy
	Not doing things in your own interests	Involvement
	Responsible	Achievement
	Respect for People	Respect for Life
	Inspiring	Love
	Able to hold conflicting views	Clarity of mind
	Politeness	Clarity of interpersonal skills
	Commitment to ethical behaviour	Equity
	Not needing others to agree with them	Justice
	Transparency (why you did what you did)	Understanding
	Risk taking	
	Fearless (in raising issues of concern)	
	Competence	
	Holds opinions	
	Hope	
	Truthful	
	Tolerance	
	Calmness	
	Personal control	
	Confident/sure footed	
	Intellectual mastery	
	Skilled	
	Commitment to quality work	
	Clarity of mind	
	Facilitative	
	Accessible	
	Measured approach	
	Interpersonal skills	

Table 5. Positive Values associated with transformational leadership and three ethical theories.

Ethical Theory	Values Instrumental (competence	Terminal (end state)
Egoism	Honesty with self	Happiness Dignity Pride
Teleology	Truthfulness Tolerance Politeness	Equity Justice Respect for Life
Deontology	Caring Commitment to ethical behaviour	Understanding Love Respect for life

Corporate Governance in Policing: Standards and Ethics

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Abstract

The purpose of this paper is twofold: one is to canvass some issues relating to corporate governance for police work, particularly to emphasise the importance of expressing appropriate values. The second point is to illustrate that suggestion by providing examples of strategic governance issues of importance for police functioning: these latter points derive from the principles of corporate governance, and from the behavioural sciences. The conclusion is drawn that as policing is a constantly evolving process and organisation that can and should learn from recent developments. The paper also argues that the values expressed in a Code of Ethics are vital to efficient and moral functioning, and invests the principles of governance with both meaning and a means of judging the worth of such principles. The concept of paradoxical cause is mentioned in outline. It is designed to alert practitioners to issues which may be counterproductive in implementation. Five moderate suggestions are itemised and documented which are: the importance of the formal rules for meetings; using the strategies proposed by master strategists; the importance of having an ethical infrastructure; in discussions and debates the importance of separating issues from personality; and the setting of key performance indicators for assessing success.

Keywords

Strategic Corporate Governance, Code of Ethics, Policing

Introduction

The purpose of this paper is to address the impact of the value of corporate governance on police standards and on police practice. It argues that sensitivity to ethics is crucial to both efficient functioning and to reputation. Modern policing is not so much a fixed entity as an evolving set of functions and values. As such attention to mission statements, to governance, and to ethics is essential.

Evolving police work came, inevitably, to be seen as both generalist and specialist. Thus the ordinary foot patrols had specialist functions added: among them were the mounted police, the water police, the air wing, the dog squad, the drugs squad, and homicide. Police come in various forms: semi-military, secret, political, military, religious, community, and secular civic control. The civil guard originally had various functions that have since separated (such as fire control). The invention of policing went hand-in-hand with the development of the notion of due process and of civil liberties. The point here is to emphasise that policing, like all other social functions, is a constantly evolving process; and one which

1 Some of the issues addressed here are based upon a paper presented to the Australasian Police Audit Conference in Melbourne in 2006

has intimate connections to other parts of our social system (such as politics and the judicial system).

Corporate governance has, underlying it, both legislation and of ethical principles. The role of police has connections to very many other legislated matters. It is interesting to observe that if Victorian legislation is searched for Acts which are police relevant, there are 201. They cover a broad spectrum that includes witness-protection, the magistrates court act, seafood, and gambling. The main Act seems to be the 1958 Police Regulation Act (version 105). It is worthy of note that the Act does not have a mission statement such as the '… purpose of a police force is …'. Perhaps that is seen as too constricting: whatever the reason it would be good to see a high level aim given explicit expression.

Governance Issues

The general approach taken here is that of analysis rather than empirical evidence. The value of this approach is seen to be one in which governance in a quasi-military organisation may be viewed not only for its own sake but also as a means of throwing light on governance in general. The findings of this analysis are believed to have wider application, being derived from governance considerations rather than from a specific empirical study.

Police governance is of various forms. First there is the Act that sets up and sanctions a police force: in Victoria, for example, it is the 1958 Police Regulation Act. That enabling legislation and, in its ideal form, is one of general control rather than control of particular issues. Thus a government would set up and fund a police force, provide the necessary general support, but not instruct the Commissioner on how to do the job, nor would it interfere in particular cases. Governments do, however, take account of issues that emerge, and legislate accordingly.

One form of governance is that of internal control within the force itself. Among other things this takes the form of the regulation of conduct, internal procedures, the Office of Police Integrity, and the information flow both up and down. Yet another form is that of how the public are to be treated. This involves reference to principles such as court procedures and requirements, the use of courtesy, the presumption of innocence, and the separation of powers. Finally, there is an emerging form of governance – that of research governance.

In Victoria, a fairly typical Australian state, the chain of governance is that the Chief Commissioner reports directly to the Minister of Police. As the official statement holds: 'the Corporate Committee has responsibility for setting corporate policy positioning, setting strategic direction and policy, organisational performance targets, corporate budget and for monitoring organisational performance. It also has the responsibility of mentoring the various departments and developing senior staff'. That corporate committee has six standing committees, each has its own terms of reference and charter, and each is responsible for the development and oversight of core strategies and projects in their own area.

In praise of corporate governance

One of the most persuasive arguments for corporate governance is that it provides stability as well as conforming to values. It is worth noting that stability is an essential part of organisational conduct. Standard accounting procedures, corporate regulators, the stock exchange, and banking processes are all instances of stability in commerce. Regularity and a reasonable degree of predictiveness are highly desirable qualities.

Perhaps a significant additional contribution that good corporate governance provides is that of both reducing the incidence of, and providing solutions for, whistleblowing. Some may believe that instituting ethics policies and procedures sensitises employees to ethical matters and, thereby, fosters a climate of whistleblowing. While we have no firm evidence for such a belief we may conclude that a well ordered organisation is less likely to have problems if the commitment to good governance is strict. Good governance principles also provide a reference point by which breaches may be judged, and hence make the resolution of disputes easier. To that end a whistleblower policy is a substantial help.

Ethical Issues

The law gives police extraordinary powers and, at the same time, circumscribes those powers in a manner that ensures that they are not abused. This form of expression of the doctrine of the separation of powers not only ensures that power is not abused but also has the consequence of enhancing the reputation of the police as a fair-dealing body. It is the very values that underlie police governance that ensure it.

One of the often unexpressed problems with morals is that it is not measurable. The values that people do have may, however, be assessed with a modicum of precision by using various scaling techniques commonly used in the behavioural sciences. That point of being able to assess is also true of broader concepts such as 'ethical climate'

Ethics, morals and the law

The general issue of the relationship between morals and the law was the subject of an extended debate in the UK in the 1960s, known as the Hart-Devlin debate. Lord Devlin's original paper compared morals and torts, and distinguished between those things that are wrong in themselves (e.g. those things which impinge on the sanctity of life), and those things that are wrong because they are prohibited (e.g. a minor breach of a trading act). As Devlin (1963) wrote, 'real crimes are sins with legal definition'. Devlin's view is that lawmakers need the stuff of morals in order to fashion the law .

That view was contested by Professor Hart of Oxford (1987), who noted that it is not possible for a community as large and diverse as the UK to have a firm and unambiguous moral position. The supposedly common stock of ideas on right and wrong do not exist, a point that has even greater force in countries that are yet more socially pluralistic.

No matter that there might be diversity of opinion - that interchange is about values, and reveals the importance that values-debates play. What is most evident is that any principle of corporate governance can only be evaluated for worth if there is a standard by which it may be judged.

The argument in favour of codes

Codes have specific application. The code of practice for medical practitioners does not apply to lawyers: the police are bound by the police codes. That specific application is captured in *The Australasian Police Practice Standards* as:

- Ethical practice
- Professional service delivery
- Knowledge-based practice
- Continuing competence
- Professional responsibility and accountability

Prominent here is the ongoing nature of police, of continual updating, and of the critical issue of accountability. Such principles are at the top of the hierarchy, followed by strategic issues, with tactical issues being further down, and day-to-day operational matters being the guide for police work at the primary face.

Human Values, Ethics and Corporate Governance

Human values inevitably invest corporate governance decisions. The notion that we stop sending small boys up chimneys to clean them does not have its origins in economics but, rather, in the physical danger, degradation, and exploitation. In addition to the direct links to business, and such questions as 'Is ethics profitable?', there is the issue of the whole framework in which we work. No matter how good it is for the economy we do not agree that child labour is humane or just: no matter what the economic justifications we do not agree that unsafe work practices are acceptable. In just the same way one would not wish to have police so efficient at catching criminals that they erred on the side of wrongful arrests. These sorts of issues are now part of the fabric of our thinking and are not questioned. So many such issues are such a part of our frame of reference that we no more notice them than a fish notices water.

The unfettered use of power is against common and widely accepted covenants, such as the United Nations *Declaration of Human Rights*, and against the precepts of the world's major religions. Privileges carry corresponding responsibilities. One cannot imagine admiring any social institution which takes upon itself all of the benefits without acknowledging and adopting corresponding responsibilities. Similarly, organisations operate within a wider social framework that gives them life, and sustains their activities. It is this debt which business repays to society by making the lives of its citizens that much better. These wider responsibilities find expression in various ways: by economic betterment, by health and educational improvements, by corporate philanthropy, and by operating within a structured framework of values.

Self Regulation

Ethical self regulation is a complement to the law – it is not in competition. While the law very properly sets minimum standards and sanctions transgressions, ethics complements that by being positive rather than punitive. It is about being solution-oriented rather than judgemental. The trend to self regulation has much to commend it, and may be materially assisted by adopting the *Australian Standards on Corporate Governance*, having been worked out in detail. This developed model owes much to other approaches (such as the OECD code) but has particular value in Australia, and is applicable to a variety of organisations from the commercial to the voluntary. Among the pressing arguments for adopting a code of corporate governance is that where self regulation fails, where organisations are driven by minimum standards, the law will intervene. That intervention is costly in time, money, and in reputational damage.

Verbal definitions often confuse what we do. There is, clearly, a world of difference between health-damaging exploitative slavery on the one hand, and recruiting from another country cheap contract labour. It is so easy to fall into the comfortable position of assuming the superiority of the ways with which we are most familiar and becoming moral imperialists. It is well to remind ourselves yet again that cultural variations tend to distract us from the very real differences that exist within our own society. Cultures do not come as an invariant unit. The guidelines that apply to inter-cultural interchange can apply with equal force to dealing with the substantial personality variations that we see in our own everyday lives.

The treatment of stakeholders as cypher entities instead of human beings is most likely to result in a failure to achieve organisational goals. The harsh treatment of personnel does not promote productivity. The promotion of goodwill is an instance of treating stakeholders as dignified and sensible people; it not only promotes organisational efficiency, but also results in goodwill in commercial terms that may have a substantial monetary value.

Police Codes

It is pleasing to see that the Victoria Police have a self imposed code: interestingly it uses a useful mnemonic to remind the busy practitioner of the four basic principles.

Will your decision stand scrutiny?	S
Is your decision ethical?	E
Is your decision lawful?	L
Is your decision fair?	F

Importance now attaches to the notion of integrity as an essential ingredient of policing. The introduction of the *Office of Police Integrity* in the state of Victoria is a concrete expression of that recognition. Formed in late 2004, the Office is the monitor of high ethical standards and, at a practical level, handles complaints against the police and conducts investigations into police corruption. The standards that prevail rightly include the concept of natural justice. The Manual puts those points precisely.

Paradoxical cause

In dealing with governance issues, and acting from the best of motives, it is quite possible that a proposed policy or intervention may be self-defeating. Some police-related instances are: the construction of physical barriers may invite destruction; high speed chases may result in the injury they are designed to prevent; the use of suspended sentences in the UK was designed to keep the prison populations down. As a suspended sentence was not perceived as a punishment, it did not have the desired deterrent effect. Re-offenders collected their original sentence and the new one - thereby filling the prisons.

The recent declarations by governments that we need to be deprived of some of our civil liberties in order to protect our way of life has become more pressing. It does have the curious conclusion that we need to be deprived of something in order to protect the thing of which we are deprived. There may be pressing reasons to suspend some civil liberties in order to protect others – but it is a judgement that is fraught with difficulty in that it may end up destroying the very thing that one wishes to preserve.

In ethics there is the now recognised conclusion that to try and capture ethics into a series of compliance acts is often counter-productive. Ticking the correct boxes leads to a mind-set of doing minor compliance acts rather than attending to higher principles. When the correct boxes have been ticked then there might be a switch-off for values leading to lower ethical standards.

A rise in complaints against the police may reflect an increasing dissatisfaction with the police. Alternatively, it might also be interpreted as a good sign in that there is now a good protective system for making complaints effective, without adverse effects on the legitimate complainant. For an excellent article on this topic see Grabosky (1996).

Suggestions for Implementation of Corporate Governance

Having suggested what does not work we now consider what does. The first prescription would have to be to avoid that which does not work. Having said that there are several positive approaches that we might use, the first of which is to appeal to reason. These rational arguments might be divided into three broad categories.

The first category is in-house to the organisation. This will include addressing employee concerns, improving morale, avoiding debilitating internal criticism, and having the measurable qualities of decreasing absenteeism, and of improving productivity as well producing s a better-motivated force. It is also highly likely that it will both attract and retain better staff.

Another principle that the present author believes has much to commend it is that of what we might *Gradualism* (see Francis, Gius, & Coin, 2004). Here the notion is not to be intransigent and immediate; not to be too pressing nor too inflexible but, rather, to have a longer-term goal in mind. To take a commercial example: one might deal with product from (say) India. Where a group of families in a village have a small commercial enterprise they might provide an economic commercial product, but do so using child labour. That issue is not always clear-cut; for example, the family and village are socially cohesive and provide excellent emotional support for the children even though they work hard.

A police instance is one where (say) a policeman in early days of experience committed a tactical mistake – not too serious a one. Suspecting that a crime may have been committed let us suppose that such a new officer breaks into premises only to find the place empty. A more senior colleague could use that experience to build up the experience and confidence of judgement in someone in need of experienced guidance.

We do need to recognise that values underlie all principles of governance. If one did not have expressed values and someone suggested a new principle for governance one would not know if it had any merit unless one had a reference point: ethical values are just such.

Five strategic suggestions

Given that the accepted values that underlie police work it is seemly to offer some strategic suggestions for continued improvement: these suggestions are:

1 Rules of meetings

There are basic procedural rules for policy making bodies, and those involved in other forms of corporate governance. Among such requirements are their duties, responsibilities, actions, measures of protection, and the accountability of those who exercise corporate governance. It is a truism that corporate governance is exercised mostly by decisions made at formal meetings. While it is recognised that many, if not most, meetings work on a consensual basis it is crucial that there be agreed rules by which problematic decisions are made and recorded. Such a process affords fairness, economy of time, and a defensible position should any contentious points be raised at a later date.

It does deserve emphasis that compliance with formal requirements is necessary, but not sufficient. Formal rules are there as a guide, and capture the collective experience of what works: that function is aided immeasurably by the addition of goodwill to others and good intent of purpose. We do need to recognise that rules help us deal with contentious situations: as such they are of great value but not if the rules are used as weapons rather than as tools.

2 Strategies

Like Clausewitz on war or Machiavelli on politics, the master organisational strategist will always have in mind the means by which their aspirations might best be achieved. Anthony Jay in his *Machiavelli and Management* (1980), and by von Ghyczy et al (2001) in *Clausewitz on Strategy* are prime instances. Jay took the principles from *The Prince* and gave them application to modern management: Ghysczy took the Clausewitzian principles of military strategy and extended it to the econo-political realm. So long as we bear our values in mind there is much to be learnt from master tacticians. Knowing what works in implementing values, knowing the dangers and appreciating strategic approaches is crucial. Mission statements and the clear expression of values keep us focused. One suggested set of organisational objectives is: preventing crime, protecting individuals and organisations, keeping the peace, and catching the wrongdoer.

3 Ethical infrastructure

An infrastructure that demonstrates commitment to ethics would, at a minimum, consist of four features: a Code; an Ethics Committee; training in ethics; and regular reporting on ethical matters. Although this is no guarantee of ethical success it does provide both and effective approach and an indication of sincerity.

4 Separate the issues from personalities

One of the hard lessons that professionals learn is that of separating issues from personalities. Among senior experienced people it is commonplace to find polar opposite views on an issue while personal respect is still maintained. This division of view may be of various forms but, commonly, takes one of two views. One is an agreement of aims and principles but a difference in the preferred method of achieving them; the other is that of having vastly different views on a subject. The expression 'we will have to agree to disagree' portrays it nicely. Formal tuition for the less experienced could improve professionalism.

5 Set criteria for success

Finally, to make something work it is necessary to know what has worked: without markers of some kind one would never know. For this reason the criteria of judgement should be set out clearly and explicitly. Having the criteria is no guarantee, but it is an excellent start. For example, using the infrastructure instance above, an organisation with a Code of Conduct, a Committee which exercises it and suggests improvement, has a program that trains in values, and has regular reporting to command on its achievements is well on the way to success.

Conclusions

This paper argues for clear expression of the human values that underpin good codes of corporate governance. It is argued that such well-based codes benefit organisations in various ways. It is, in other words, an argument for the consequential view of ethics. When the agreed values are clearly expressed then, and only then, might we think about the strategies and tactics that would help achieve the agreed goals. Among the implications of this study are those of the value to police governance, to the wider issue of quasi-military organisations, application to firm hierarchical structures, and to governance in general. Issues, such as the 'rules of meetings', ethical underpinnings of governance, paradoxical cause, etc. all have general relevance. The suggestions offered may help move highly professional forces in appropriately governed directions: it is by a commitment to such developments and new insights that governance may progress not only in effectiveness but also in organisational and moral stature.

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Assessing Ethical Governance in a Policing Environment

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Abstract

Governance describes the processes by which organisations are directed, controlled and held to account. It encompasses authority, accountability, stewardship, leadership, the direction and control exercised in the organisation. This paper argues that the shape of policing has changed in recent years; the service is more innovative and less risk averse than ever before. In this environment, governance structures are needed that support the complexities of the change in police roles and functions and assessment of corporate performance must include criteria such as ethical values and codes of conduct.

Keywords

Governance, Police Governance, Board Assessment, Evaluation

Introduction

Although governance relates to issues such as risk assessment and audit, this paper addresses evaluation and benchmarking of governance issues related to boards and committees. It reviews why governance is important in a police environment, how governance is related to an organisation's values and ethics and identifies some criteria for assessing best practice in governance arrangements in this context.

Let us start by putting governance into the context of a police environment. In 2004 while the authors were visiting Cambridge University, a Chief Inspector was also studying there. Richard Morgan, a Chief Inspector with 17 years operational experience, wrote of his experiences in the Magazine of the Cambridge Society. In his article, he captured the complexity of the environment in which police work and the challenges facing police today. He said (Morgan, 2004, p. 24):

> The constant effort to encourage, cajole, intervene, reassure, prevent, enforce, negotiate, develop, maintain and celebrate is truly extraordinary. The shape of policing had to change in recent years; the service is more innovative and less risk averse than ever before. The complexities of the role, and society's problems, have forced a tide of change that has seen the service develop closer links with the communities we serve. We work more closely with partners, too, who share, and often own, the responsibility for solving the problems. These relationships are never easy, and working together towards a common purpose never quite happens in an environment full of differing priorities and overstretched resources. Community representatives and leaders do not

2 This paper was based on a keynote address delivered to the Police Audit Conference, Melbourne, 2006.

> always truly represent and rarely lead, making the goal of delivering tailor made, locally accountable services, particularly problematic. There are communities within communities and complex affiliations that often go back many decades; friendships, family ties, criminal networks and racism combine to frustrate commendable efforts to create a better environment. Some of those problems – racism, deprivation, and the erosion of community cohesion – pose a constant risk of civil disorder; the disintegration of civic society with all its diabolical consequences. Challenging yet rewarding, we, all of us, cannot afford to get it wrong.

While Richard Morgan captures the police experience, other changes in the wider society are also affecting police work. These include accelerating flows of resources, people, information, rising ecological environmental pressures, growing inequalities, and rising citizen expectations about access to information and services. The types of crime have also changed. Organised white collar crime, money laundering and corruption, and the threat of terrorism, while not new, have a new edge to them.

Chief Inspector Morgan spoke of the complexity of the police environment. Understanding the governance of this environment, that is the structures, legislation and practices of governance in this environment, is equally as difficult.

Why is Understanding Governance Important?

Governance is the latest innovation that comes on the back of a massive change in the ways that citizens interact with government and the arm of the law, police. Innovations implemented under both liberal and labor governments in Australia, and in most western jurisdictions, include the new managerialism with its emphasis on corporate models of management and the three Es, efficiency, effectiveness and economy; competition in a market economy; privatisation of many police services (e.g. prisons, security, investigation of white collar crime); performance management; new controls evident in the setting of objectives and targets; and evaluation and accountability.

Table 1. Why understanding governance is important

Changes driving new modes of governance
Growing complexity of the police environment
Latest of public sector management initiatives
Changes in relationships between politicians/ police commissioner/boards
New roles of citizens
Customer Statistics
Community governance
Changes in Government policy:
Whole of government
Joined up government
Networked government
Changes in police roles and skills

In this context governments determine priorities, direct resources to address a priority, set performance targets that are measured by financial and social indicators, and evaluate performance against the targets. Treasuries have the capacity to arbitrate which programs will be funded and therefore decision making is strongly influenced by Cabinet and implementation endorsed through setting performance targets and auditing performance.

Not only relations with politicians, but relations with citizens have also changed. Citizens are now classified as a customer to be served, a cog in a statistical profile, or a committee member to be co-opted to take a role in the resolution of problems in their communities.

Customer service, service response times, etc are forming part of the police performance reviews. With current information technology and communications (ITC) police are more visible, more accessible and citizens are now better informed and more able to voice any concerns.

Another trend driven by better information management is described by O'Malley (1999) as the 'the Risk Society' which has emerged in response to the growth of 'risk based government'. Dupont (2001) who agrees says: "They redefine how Australian communities are being policed, discarding the legal obligation to enforce the law and maintain police for the public good, and replacing it with a more pragmatic approach, which consists of managing the risks posed by the 'dangerous classes'" (Dupont 2001). What this means is that individuals are commonly attributed with the characteristics of the risk category to which they are assigned. Among the consequences is the emergence of an actuarial model of policing in which individual profiles assign members of the public to risk categories where their treatment, e.g. sentencing or parole, can be influenced by their membership.

Another consequence is the shift in responsibilities for risks, which can be minimised or reduced, to communities in which problems are located.

Community/Network Governance

Terms such as 'Community' governance, 'participatory' governance or 'network' governance are used to describe the community level management and decision making that is undertaken by, with, or on behalf of a community by a group of stakeholders. Local government, business, not-for-profits and other community representatives are brought together in a committee structure to address community problems. An example is the Local Safety Committees established by Victoria Police.

Similarly, partnerships with other departments and service providers in 'whole of government' and 'joined up government' initiatives provide the leverage that allows police to address complex problems whose solution require multiple services. An example is a whole-of-government approach to crime prevention. This is intended to coordinate activities from various departments, each with its own specialisation, but working together to achieve a common objective. The metaphor is often given of a symphony orchestra in which the 'score' tells each of the players when to come in and make their contribution. An example in crime prevention is the strategy directed at reducing youth crime by contributions from education to reduce truancy, human services to address drug problems and police to ensure regulation.

Partnerships with the community or other agencies involve various forms of committee structures, allocations of resources and accumulation of credit for successful performance. This can lead to a certain amount of rivalry between agencies about who 'owns' the committees formed to oversee any activities, and uncertainty among government representative committee members re their roles and responsibilities.

Competitive bids to deliver services by the private and not-for-profit sectors have also changed the way services are being provided, heightened the need for professional expertise in these areas, and added, to the traditional roles and functions of many government agencies such as police, co-coordinating and facilitating functions.

These changes infer a shift in police and other public sector organisations from traditional bureaucratic structures to structures that engage police in a variety of boards and committees, many of which include aspects of network governance.

Why is Governance Important in the Police Environment?

Governance provides the framework, the formal system governing:

- roles and responsibilities throughout the force;
- legality for decisions and actions;
- the structure roles and responsibilities of the members of an executive or other board; and

- the relationships between police executive boards, the political executive, and other departments and the community. These latter can include membership of portfolio boards, boards of state owned enterprises, whole of government committees, industry boards and advisory committees.

What do we Mean by Governance?

Governance is not new. It has existed since people formed into groups and surrendered their individual freedom for the security offered by a united front. "The word "governance" is derived from the Latin, *gubernare*, to steer, and it is helpful to keep that root in mind. The task of the helmsman is to set the course for the ship and to maintain her on that course. This is in line with the definition of corporate governance used in that first definition by the Cadbury Committee, "the system by which companies are directed and controlled" (Cadbury and Millstein 2005) p.7.

In Australia, both Commonwealth and State Auditors-General have presented models of governance.

Governance is defined by the ANAO (1999) as:

> 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. For CAC bodies, key elements of corporate governance include transparency of corporate structures and operations, the implementation of effective risk management and internal control systems; the accountability of the board to stakeholders through, for example clear and timely disclosure; and responsibility to society.

Similar elements of governance are found in all models of governance such as that proposed by the Victorian Auditor-General (Cameron 2003).

Leadership refers to how well a chair and board set the strategic vision and direction for the entity and add value to its organisation. It relies on clarity about roles and responsibilities and compliance with ethical and governance standards. Stewardship refers to the structures, systems and processes for decision making and control, communication and financial responsibilities, risk management and compliance. Accountability addresses standards of behaviour and systems in place for auditing, risk management and reporting procedures such as disclosure, transparency and the role of audit committees. It also includes the ways in which relationships are managed with various stakeholders: the relevant ministers, various partners, and external bodies such as the ombudsman and Office of Police Integrity, media and society.

In general, a framework for exploring governance in the public sector is concerned with:

- the underlying principles that describe the basic values and ethics of an organisation;
- the relevant law; and
- best practice in governance.

One should mention that the only reason for focussing on governance at all is to add value to the organisation.

In this paper I would like to talk a little about values and the law but the major focus of this paper is world best practice because the attributes identified as best practice are those addressed in evaluation and benchmarking.

The Values and Ethics of an Organisation

Values that have particular relevance to governance (Standards Australia 2003a) are honesty, integrity, accountability and transparency (Table 2). The public sector values set out in the Public Administration Act are: responsiveness, integrity, impartiality, accountability, respect and leadership. Victoria Police have similar values but also value professionalism and flexibility.

Table 2. Values

VicPolice	Victorian Public Sector	Governance Standards Australia
Integrity	Integrity	Accountability
Leadership	Leadership	Transparency
Flexibility	Impartiality	Honesty
Respect	Respect	Fairness and balance
Service	Responsiveness	Dignity
Professionalism	Accountability	Legality
		Goodwill

Francis (2000) suggests that one of the principle mechanisms for embedding agency values throughout an organization can be through its values embedded in a code of conduct. Unique to the governance principles in Australian Standards International's 8000 Series on governance is publication of their underlying ethical values attached as an Appendix to the Standard. The argument for the values is that while legal standards requiring compliance provide a guide for the minimum standard of behaviour, adherence to the ethical principles contained in the values fosters an ethical climate in organisations that prevents corruption and *'is aspirational to higher standards and not oriented to legal minima'(p.25).*

The relevant law

The second element of the governance framework is the law. All public sector organisations are subject to a variety of legislation. Many entities have their own Acts and others are established by regulations.

The statutory law governing Victoria Police are the Police Act, the Public Administration Act 2004, the Financial Management Act, Audit Act 1999 Freedom of Information Act 2004 and directives from other departments such as the Departments of Treasury and Cabinet (for example, Guidelines for appointment of boards and requirements for Annual Reports) and Workcover, (OH&S, Whistleblower protection).

All entities are required, the same as a natural person, to act within the boundaries of the law.

Best practice in governance arrangements

The last element in the framework is 'World Best Practice' in governance which addresses such things as: governance structures, board roles and responsibilities, leadership, stewardship, direction, control, independence, skills, appointment and succession criteria, remuneration practices, board assessment, accountability.

An effective scheme of governance should incorporate systems for monitoring the effectiveness of governance arrangements.

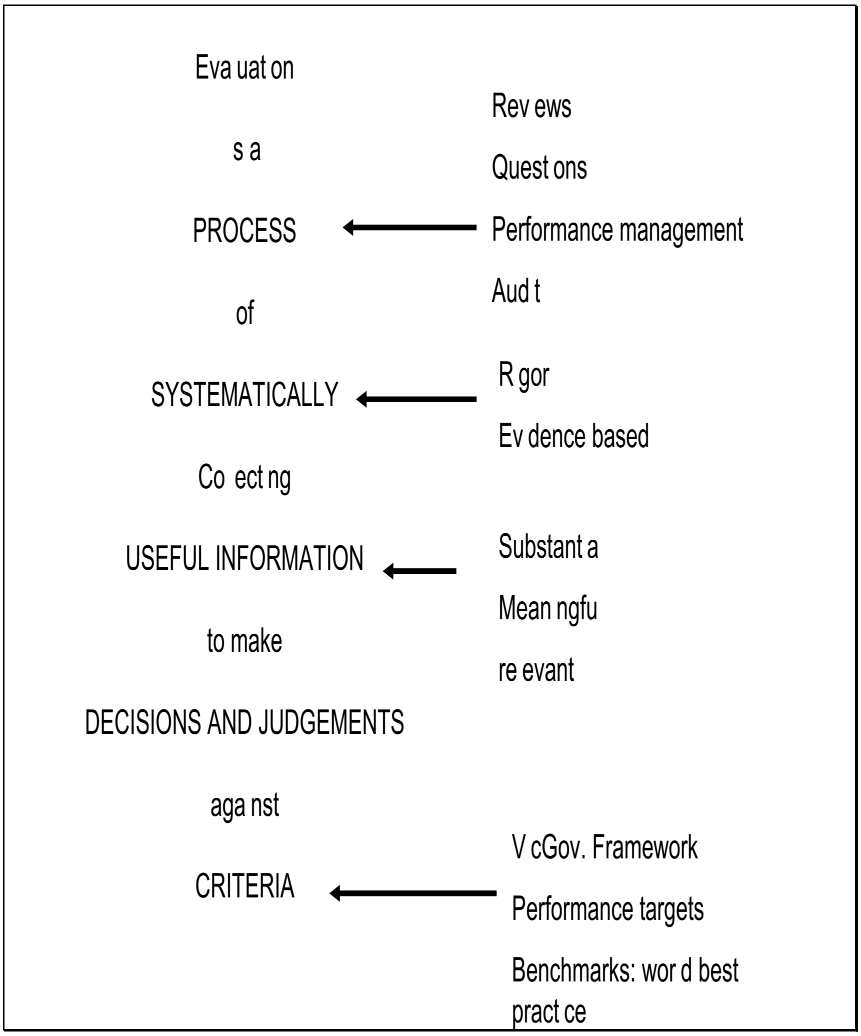
Evaluation and benchmarking of governance

Evaluation is a process applying systematic methods to collect substantial, meaningful, and relevant information to make decisions or judgments about performance. The process of evaluation is not any one particular procedure but can take the form of reviews, quantitative or qualitative data collections directed at answering evaluation questions, or financial, compliance or other audits. The selection of the method depends on what is most useful for the evaluation audience. The distinctive features of evaluation compared with other types of information collection activities is its emphasis on systematic and rigorous approaches to data collection, and secondly, the use of the information to make judgments about performance. The judgments are not arbitrary but judge performance against transparent criteria.

The Victorian Department of Treasury and Finance in its Evaluation Framework (Victoria 2000) uses both whole of government and department evaluation frameworks to provide a means of assessing existing and ongoing implementation of management reform. The process aligns department activities with government priorities and reports the extent to which each department achieves its desired performance outputs, the resources involved and the management of risk. The indicators of performance, or 'reform elements' are output management, best value services provision and financial management.

The criteria for judging performance are similar to those used in a project management approach in which progress is assessed against the percentage of a 'reform element' which is completed.

Figure 1. Definition of Evaluation



Performance is measured against percentages that indicate commencing, commitment, capability and completion (Figure 1) of an activity. Boards are responsible for ensuring that there is a financial risk management policy and internal control system in place, and a financial code of practice. (Wong, 2003).

Figure 2. Evaluation Framework. Source: Victoria, Department of Treasury and Finance, 2000

	Commencing	Commitment	capability	Completeness
% complete	10	20 30 40	50 60 70	80 90 100
Systematic performance improvement				
Improved service delivery choices				
Management of risk				

In general, the type of evaluation conducted depends on its purpose and what questions are being asked. For example, questions about efficiency and effectiveness are answered by performance measures. In the police environment efficiency indicators are concerned with the resources required to solve crimes, attend traffic accidents or other operations. Effectiveness indicators deal with the target of activities or services and measure such things as crime, clearance rates and also public satisfaction with police services, fear of crime and repeat victimisation. In the Victorian government framework example, "Best value service provision" is captured by measures of performance improvement, service delivery choices and management of risk.

An alternative to internal continuous improvement as the criteria for evaluating performance, are benchmarks.

Benchmarks are the performance targets achieved by the best performer in an industry or *world's best practice*. Usually they describe *how* things are done, that is, the processes used to achieve the desired outputs and outcomes. They are useful to show how an organisation is performing compared with the best, for identifying how things should be done and for establishing future performance targets.

There are many criticisms that can be made in regard to both types of measures. (See for example, Armstrong and Francis(Armstrong and Francis 2003). In regard to police work, (Dupont 2001)Dupont (2001) criticises performance indicators for, among other things, failing to capture the complexity of police work and that their aggregation masks the huge disparities within local communities. Benchmarks are criticised for encouraging organisations to 'follow' the leader instead of 'being' the leader.
Despite the criticisms, both types of measures are useful tools for evaluating performance. The criteria for making an assessment of governance performance could be indicators measuring benchmarks for performance targets or world's best practice. There are many reports of benchmarks related to corporate governance in the private sector. One example published by the Age is The Good Reputation Index in which the top 100 companies are ranked by 22 experts and community stakeholder groups on six performance categories one of which is ethics and governance.

Guidelines that are applicable to the public sector for evaluation of world's best practice in governance have been issued by numerous international organisations such as the OECD (OECD 1999) and the International Federation of Accountants (IFAC 2000). In the Public Sector in Australia, widely used corporate governance guidelines include those distributed by the Australian Auditor-General (Australian National Audit Office 1999), the NSW Audit Office Corporate Governance Guidelines (NSW 1998), the Victorian Auditor General (Cameron 2003) and the Municipal Association of Victoria and the Victorian Local Government Association Code of Good Governance for local governments(MAV 1997). (Refer to Armstrong (Armstrong 2004)for a review). More recently, the State Services Authority in Victoria is producing its own recommendations for governance practice in Victorian government entities.

A body which intended its governance standards to apply to both the public and private sectors is Standards Australia (Standards Australia 2003a). Standards Australia International is the body responsible for the establishment and maintenance of ISO quality standards and this philosophy has influenced the development of their corporate governance standards. These Standards are complementary to the SAI standards on risk management and compliance.

The five AS 8000 series of Corporate Governance Standards issued by SAI consists of a set of Principles and four specific standards.

The Standards are:

AS 8000, *Corporate governance—Good governance principles*

AS 8001, *Corporate governance—Fraud and corruption control*

AS 8002, *Corporate governance—Organizational codes of conduct*

AS 8003, *Corporate governance—Corporate social responsibility*

AS 8004, *Corporate governance—Whistleblower protection programs for entities*

AS 8000 Corporate Governance-Good Governance Principles (Standards Australia 2003a)is the foundation both underlying and complementing the other Standards.

The objectives of the Standards are to:

- assist members of boards, chief executive officers and senior managers to develop, implement and maintain a robust system of governance that fits the particular circumstances of the entity;
- provide the mechanisms for an entity to establish and maintain an ethical culture through a committed, self-regulatory approach; and
- provide shareholders, or stakeholders, as the case may be, with benchmarks against which to gauge the entity's performance.

AS 8000 *Corporate governance—Good governance principles*, aims to '*provide a blueprint for the development and implementation of a generic system of governance suitable for a wide range of entities*' and is intended for application in all public and private sector entities with boards including small business and not-for-profit organisations.

To assist organisations in the implementation of the standards, Standards Australia has also published two accompanying Handbooks, Introduction to Corporate Governance and Applications of Corporate Governance (Armstrong and Francis 2004; Armstrong and Francis 2004), which provide detailed case studies, a history to the development of standards, and a check list to evaluate adherence to the standards. The checklists provide a means for organisations to conduct an evaluation of best practice in governance in their organisations. The checklist used in the exercise is based on one of these.

As not all the standards can be addressed here and issues in ethics, audit and fraud are addressed by other speakers in this conference, this paper is limited to evaluation of world best practice as it applies to:

- Governance Structures: types of boards and committees
- Governance policy and principles
- Board composition
- Selection of board members
- Duties and responsibilities of board members
- Asking the right questions
- Self-assessment: The role of the board

Governance structures

The governance structures of organisations refer to the models of authority, control and accountability within the organisation. Government sector boards are not usually elected, as happens in the private sector, but appointed by the Minister under relevant legislation to be responsible for the vision of the organisation and overseeing its execution.

Table 3. Examples of different types of boards found in the Police environment

Examples of Government Boards found in a police environment
Governing Board (Canada)
Executive Board (Victoria Police Corporate Committee)
Agency initiated boards: Regional Boards
State Owned Enterprises
Statutory Authorities
Representatives of government on private/public partnerships: prisons
Advisory committees
Local community committees: Local Safety Committees

Boards can be governing boards, as is the case of the Municipal Police boards in British Columbia which are responsible for selection and appointment of the Chief Commissioner as well as the other functions of boards.

Best practice suggests that the best boards are limited in size to 7-15 members; have a balance of power and authority; a majority of independent directors, a diversity of gender, age and experience and appropriate expertise. The expertise differs with the type of board but between them members should have financial, business, legal, and management expertise and knowledge of the particular industry in which the organisation operates.

Boards are increasingly used in portfolios and representatives of an agency can serve on a variety of entities including State Owned Enterprises, statutory authorities, advisory committees, and in partnership arrangements.

The accountabilities of agency boards, such as those found in police forces, include financial and other legal responsibilities. Their structure may include subcommittees responsible for such things as internal audit, governance and appointments.

The Victoria Police board has a slightly different structure. The Chief Commissioner is accountable to both the Minister of Police and the Minister of Finance. She is the head of the Police Corporate Committee and its six standing committees: People Management and Development, Information Technology, Ethical Health, Organisation Development, Policy Operations, Finance and Physical Resources. The Victoria Police Audit operates as a separate unit outside the Board committees.

External accountability is to the Auditor General, the Office of Police Integrity and the Ombudsman. External auditing is conducted by the Auditor-General and a formal report is made to the Portfolio Minister and the Minister for Finance.

The governance structures of many government entities, similar to the Police board, fall somewhere between a governing board and an advisory committee. An example is the Victorian Police Board which has a different structure to either an Advisory Committee or the Board of a government business entity. Although it is called a ‘Board’, it does not exhibit many of the characteristics expected of a Board. It sets the strategic directions of the organisation, controls the budget, reports on activities, but does not appoint or review the performance of its Chair, the Chief Commissioner, and it has limited autonomy or independence.

I noted that ratings of the performance of the Chief Commissioner appeared in the AGE newspaper on Monday 6 Feb 2006: Minister Tim Holding gave her a score of 10 out of 10; Police Association Secretary Paul Mullett gave her 9 for the first three years and 5 for the last two; and even the Shadow Minister gave her 7.5 out of 10. Although no credence should be attached to these ratings, the use of ratings is indicative of the wide acceptance and expectations that there should be ratings of the performance of boards and their members.

Members of the Victorian Police Board include representatives of the major entities responsible for implementing the various programs and it also acts as a board of review in relation to implementation of programs. This type of structure is not unusual to many boards in the public sector today.

State Owned Corporations and Advisory Committees

It is useful to distinguish between a board appointed to manage a government business corporation and an advisory committee. Businesses are incorporated under the corporations law and members have the same duties and responsibilities as boards in the private sector.

The Australian Wheat Board enquiry is an example of where a government has divested itself of direct responsibility for an activity, in this case wheat sales, to a corporation in the private sector. Yet, to the public at large the government is still perceived as being responsible. It is a good example of how political responsibility is not as easily divested as financial responsibility.

In addition to agency board committees, there are many advisory committees, particularly in statutory authorities, to advise and make recommendations to a minister in relation to their industry. Therefore, it is also useful to distinguish between a board appointed to manage a government entity and an advisory committee.

Statutory and Advisory Committees

There are major differences between the responsibilities of government sector boards and advisory committees. An executive board is not seen as a representative institution but is appointed, usually by legislation, to be responsible for the vision of the organisation and overseeing its execution.

The accountabilities of boards include financial and other legal responsibilities and consequently, a board acts with independence in setting its targets and its structure may include subcommittees responsible for such things as audit, governance and appointments. Auditing is conducted by the Auditor-General and a formal report is made to the Minister. Membership should be based on the merit principle and the requirements of a board for particular skills or expertise.

In contrast, an advisory committee is often a representative committee, appointed by the Minister. There is little independence and accountability rests with the Minister or Senior Officer of the relevant government agency. In making appointments the key criteria for appointment is often the extent to which members represent some particular group or constituency. In making appointments the key criteria for appointment is often the extent to which members provide knowledge of or represent some particular group or constituency.

In a review of statutory and other authorities Uhrig stated that the board committees set up in the public sector are unlike the board committees that operate in the private sector, and have their own independent decision making power. They are only to (Uhrig 2003: 97):

> assist in the efficiency of operations and for reasons of accountability, (and) committees should operate with a clear written mandate from the full board. The operations of committees should also be agreed including how committees will report to the board and how committees will interact with management and other relevant parties. This will clarify whether a committee has the power to make decisions and approve management proposals or report to and make recommendations to the board.

In the public sector, apart from the general model of minister-board-management, there are also different governance arrangements such as the partnership models of governance between agencies or between a department and the community.

The partnership model of governance

Among the new models of governance is the partnership model of governance, a response to the complexity of the problems addressed and the environment in which police work. In a recent study of Local Safety Committees, we found that local committees were successfully collaborating across agencies in whole of government and joined up government initiatives, and with local government, business and non-profit organisations to address local problems. Among the major problems hindering their performance were governance issues of ownership of the initiatives, lack of resources, and uncertain leadership and accountability.

Governance Policies and Principles

Governance principles refer to: governance policies, the roles and powers of the various boards and committees, and the provision of governance infrastructure.

Compliance with Governance Principles

In a recent study of governance in the Victorian Department of Treasury and Finance CICGR used a series of questions to evaluate whether the Department was complying with good governance infrastructure requirements (Table 4).

Table 4. Evaluation of compliance with governance policy and principles

Is there a top-level governance/audit/ethics committee of the governing body?
Is governance a standing item on the governing body's agenda?
Does this body have a term of reference attuned to managing governance issues and does it meets regularly to discuss these issues?
Is there a senior executive with overall responsibility to governance in the organization?
Is there an organisational governance plan that is endorsed by top management, implemented and monitored?
Is there a "Governance" Manager, i.e. someone who has the day-to-day responsibility of ensuring the smooth running of the program i.e. implementation and maintenance of the organisation's governance plan?
Is there a cross-functional middle management governance committee that oversights and pulls together the relevant aspects of governance?
Are there adequate resources to ensure governance outcomes?
Is corporate governance training provided?

Source: CICGR Evaluation of Governance in the Victorian Department of Treasury and Finance

The premise underlying these principles is that good governance infrastructure is required if governance practices are to work. These are evident in the commitment of the top management demonstrated by the presence of governance policies, governance sub-committees, adequate resources and regular reporting of governance issues to the board.

Board Composition

A general consensus in the literature is that effective boards have between 7 and 15 members, a balance of power and authority between the members, a diversity of representation of gender, age, skills and international experience where appropriate. In private boards a majority of members should be independent members. Many public sector boards include independent members because they offer a different perspective on activities and in some boards can offer a balance of power when a board is chaired by the CEO.

Table 5. Board composition

Structures: Board Composition
Size: 7-15 members
Balance of power and authority
Majority of independent directors
Appropriate expertise(financial, business, legal, management, industry)
Diversity of members (to meet needs gender, age, international)

In regard to Board committee structures best practice suggests that a board’s committees should include at least Nomination and Audit Committees but could also include Remuneration, Governance/ethics, corporate social responsibility, Investment and Public policy committees.

In Victoria, under the Financial Management Compliance Framework from the Department of Treasury and Finance, government entities must establish and Audit Committee with at least 2 independent members unless an exemption is obtained. Where the responsible body is a board, the Audit Committee must have at least 3 non-executive directors and the Accountable Officer and CFAO are not to be members of the committee.

Selection of Board Members

The NSW Audit Office has summarised best practice on the selection, appointment and removal of board members in state owned enterprises (Table 5). Selection and appointment decisions and processes should be recorded and maintained, and, with board policies, disclosed to new directors and supported by induction training. A board should review the mix of skills and experience of its members to ensure it has an appropriate mix of skills (but stopped short of indicating what these could be) supported by induction and professional development programs. Legislation should provide a clear basis for removal of a board member and the Chair and CEO should resign from a board when they resign from those positions. A Code of conduct approved by the board should set out the ethical and behavioural expectations for both directors and employees.

Duties of Members of a Board

Members of a board have both duties and responsibilities. Duties are defined by legal requirements. The prime duties are duties of loyalty and good faith, care and skill. The first of these, a duty of loyalty and good faith, means to act in good faith in the interests of the organisation and for a proper purpose, to retain discretions and to avoid conflicts of interest.

Table 6. Responsibilities of individual members

Fulfil functions of the board:
o Legislation should clearly define roles, responsibilities and relationships of key stakeholders
o Government and Ministers should provide boards with written guidance on the boards decision making authority
o Internal control: procedural, financial and operational systems
o Stewardship:
    o ensure public funds are safeguarded, used economically, efficiently and appropriately
    o risk management
o Appropriate and balanced reporting to stakeholders (board and organisation, external interests)

Responsibilities: Meetings o Attend meetings regularly o Read background material and minutes o Be willing to serve on committees o Ask questions and contribute to the discussion o Keep comments relevant o Keep confidential information confidential o Request and be open to feedback from the community, police members and other members
Responsibilities to the board: Source: BC Police Board Handbook o Represent the interests of the whole police board and department o Be willing to negotiate and compromise o Respond quickly and effectively to issues/problems o Anticipate issues/problems before they develop o Be willing to set aside personal agendas o Respond objectively to department and community o Demonstrate discretion and common sense in communications
Responsibilities to other members: o Work as a team o Model appropriate behaviour (Code of ethics & conduct, management of conflicts of interest)

A duty of care requires a board member to act in a prudent and diligent manner keeping informed as to the policies, business and affairs of the department. Meeting the duty of skill requires members to use their knowledge and expertise effectively when dealing with the affairs of the department.

Responsibilities

Responsibilities (Table 6) are more closely aligned to best practice. They concern fulfilling the functions of a board, following the relevant legislation, following standing orders or rules for procedures at meetings, and managing performance at meetings and relationships with the other members of the board including working as a team and modelling appropriate behaviour. Standards Australia suggests that Boards should have a Code of Board behaviour.

Board independence

It is entirely appropriate for a government to determine priorities. An issue is the extent to which the independence of the Commissioner and the police board is compromised, the Commissioner because of political influence and the board because of an imbalance in power and authority.

One of the tenets of the Westminster tradition has been the independence of the law enforcers from political interference. Police have traditionally guarded that distinction. Yet, with the new controls and requirements for accountability, political intrusion is more possible, if not probable. A study reported in the Australian Journal of Public Administration of the experiences of senior Commonwealth public servants reported that in many supposedly ‘independent’ authorities, ministers interfere in ways as diverse as inconsistency in interpretation of the role of the minister or ministerial staff, ‘informal’ meetings or communication giving directions to board members, appointing ‘friendly’ chairs or members to boards (Cosmo and Seth-Purdie 2005), and exercising control of budgets. Others have described instances in NSW where a police commissioner suffered from being sidelined by the relevant police minister who began making appointments and other operational decisions.

These raise governance issues about the roles and responsibilities of politicians, Police Commissioners, and boards.

Board independence in the private sector can be evaluated by measures such as a majority of independent members, the independence of the Chairperson from management, disclosure of and protocols to manage conflicts of interest, the active involvement of directors in Agenda setting and opportunities for periodic meetings, separate from the CEO and management, by non-executive members..

While the independence of directors on private sector boards may be compromised by dominant shareholders (such as was the case with News Limited), the independence of boards in government entities is more complex. Often they are chaired by the Commanding Officer, their responsibilities are to approve major decisions made by others, and they can only make recommendations (rather than decisions) to the Minister.

In public sector boards we have studied, we found that when the CEO was the chair, the power and influence of the CEO was seen as an advantage for the board but that the down side was that it also stifled comment and questions especially by those who were members of staff.

The best practice criterion is that there should be formal definitions of the roles, responsibilities, and duties of the Chair, members and ministers. The process for decision making should be transparent and directives from Ministers should be in writing. A separate issue is that members of boards should have the right to seek independent advice on an issue before the board.

Best practice suggests that there should be a distinct distinction between the responsibilities of a board and the operational responsibilities of management. Cadbury and Millstein (2005, p.7) Cadbury and Millstein 2005state that: “This functional division may be achieved by separating the governing board from the management board, or by separating the roles where those who direct also manage. The task of the governors is to direct and control, and that of the executive to manage”. Cadbury and Millstein 2005 make the distinction between direction and management. Direction and control are the task of governors, while that of executives is to manager. In their article they are referring to the private sector. In the public sector, once again, this distinction is not so clear.

Evaluation of best practice in maintaining board independence in the public sector would see a separation of the governing board from the management board or statements of clear formal roles where those who direct also manage. Without it, confusion can occur over where the power for a decision lies and therefore who can be held accountable for decisions and actions.

All individual members of boards are expected to exercise independence of judgment on all matters. This means acting in the interests of the organisation, not of sectional interests. It also means managing meeting procedures (which are found in the Act and Standing Orders), being prepared, asking the right questions, when appropriate taking a stance and promoting a point of view, and making decisions based on logic and evidence. And, in all this, to operate in a spirit of co-operation, discussion/dialogue and participation.

I should mention here “cabinet solidarity”, that is, maintaining confidentiality of discussion and decisions and supporting in practice and spirit the decisions arrived at by the board.

Board functions

The functions of boards operating in both the private and public sectors are similar. Table 7 shows the function of police boards in Canada and Australia. The major difference is the appointment of the Chief

Constable in Canada where assessment of performance is a function of a governing board while appointments at this level in Australia are not the prerogative of the board but the portfolio Minister. This has a major bearing on the independence of a board.

Table 7.The functions of police boards

Board functions: Canada	**Board functions: Australia**
Appointment of the Chief Constable	Executive board
Provide direction and approve strategic plan/values	Provide forum for collegiate leadership under CEO
Identify performance measures and set targets	
Policy formulation	Plus
Approve budget	Client/customer satisfaction
Monitor control, performance, risk, compliance	Relationships with external stakeholders
Approve hr plan	Internal and external communications
Reporting	Employee relations
Assess performance of the CEO/Chair	Acquisition and divestment strategies
Assess performance of the board and members	Balance short and long term issues

Source: British Columbia Police Board 2004; ANAO 1997

Board Self-assessment

The selection of any method of evaluation depends on the purpose of the evaluation. Board self-assessment is designed to improve the operations of a board; internal auditing monitors issues related to operational accountability, and external auditing often emphasises performance indicators, risk management and compliance.

In the exercise prepared for this session you were invited to complete a board assessment. Using a rating scale board members can see where a board is not meeting best practice criteria.

The results of board performance are rarely benchmarked against external organisations. An exception is a series of studies of large corporate companies in Sweden by Professor Rolf Solli, one of our CICGR Advisory Board members who videod board meetings and subsequently analysed the results to evaluate the performance of the boards and their members..

Table 8. Assessment of board effectiveness: Elements in the CICGR self-assessment checklist

Compliance with terms of reference and board responsibilities
Leadership
Structures and relationships
Performance
Accountability
Compliance with legal requirements and duties

In CICGR we have been working with boards using self-assessment checklists which can be most useful is in assessing performance against world best practice and identifying areas for improvement. It appears that an external facilitator is more successful in facilitating the process than an internal one.

Accountability

Accountability is at the heart of good governance. Experiences over the past few years with the failure of government entities such as the State Bank in SA, and Enron, OneTel, HIH and more recently with AWB in the private sector provide compelling reasons to believe that where there is little or no accountability there is a substantially increased risk of damage to the organisation's performance and reputation. In all cases, the failure of the entities was due to ineffective boards, lack of asking the right questions and lack of control over senior management.

In the case of the SA State Bank, the Auditor-General said (referred to by Henry Bosch, 1995 p.110):

> There is nothing esoteric about asking questions, seeking information, demanding explanations and extracting further details. There is nothing unduly burdensome in expecting each director, to the best of his or her ability, to insist on understanding what was laid before them, even at the risk of becoming unpopular. Both the law, and a basic sense of duty and responsibility, demand it.

Internal accountability of governance is achieved through organisational policies, codes of ethical standards, the cultural ethos, disciplinary regulations, internal audit controls and transparent and accurate reporting. Most police departments have an Audit Committee reporting to their Board to which the internal audit unit may also report; they are audited by the Auditor-General and as stated above, the Chief Commissioners report to their Portfolio Minister and the Minister for Finance. There is also monitoring by the Ombudsman and the Office of Police Integrity. The final arbiter of accountability is the media.

Conclusion

Evaluation against benchmarks describing world best practice can be useful as are board self-assessments. A self-assessment can rate the extent to which individual board members comply with their code of conduct including disclosure of personal interests and potential and actual conflicts of interest.

Have we found the Holy Grail of governance? No. far from it. There are significant gaps in our knowledge of how governance is practiced in the public sector, how governance should be implemented and what benchmarks could exist across police jurisdictions.

Lack of research evident in many areas includes:

- Implementing the change to best practice governance
- Balancing government priorities and police independence
- Extent of transparency and public access to relevant information
- Extent of control across State and National borders
- Indigenous community relationships
- Accountability in outsourcing/partnership arrangements
- Accountability in private policing
- Information sharing, data flows, privacy and accountability
- Community participation/governance
- Benchmarking governance across jurisdictions

In conclusion, governance matters because it contributes to the sustainable long term success of any organisation. It matters because it ensures citizens can have a more transparent and productive relationship with their police force.

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