

**CORPORATE GOVERNANCE IN THE PUBLIC SECTOR
FROM THEORY TO PRACTICE**

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***Governance in the Public Sector:
Lessons from the Research***

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Some Perceptions on Appointment Processes to Public Sector Bodies in Australia

1. CONTEXT AND CAVEATS

Several key current and emerging issues around public sector boards have been revealed in the ARC empirical study on corporate governance practices in the Australian public sector. One particular issue that arose more often than we expected concerned appointment processes to boards and the consequent perceptions this has on the efficient functioning and good governance processes of boards.

My outline is as follows. The next section, Section 2, provides relevant background on what is widely regarded as better practice in public sector appointment processes. It deals with necessary stages in selection and appointments to public sector boards if appointment of people with relevant expertise is to be achieved. It also outlines some sources of better practice. Section 3 identifies and discusses the perceptions of interviewees on appointment processes to government boards – mainly Commonwealth Authorities and Companies (CACs). The focus is on how board members and the CEO are appointed and, specifically, the role of the Minister in this process. The presentation concludes by drawing some tentative inferences from the findings so far.

A few qualifications need to be kept in mind in what follows. First, more CAC interviews are yet to be undertaken. It is therefore too early to come to definitive conclusions. As a result, it would be premature to disaggregate the data and undertake rigorous quantitative analysis of survey material. In addition, there was much change in government policy during the period that the interviews were conducted arising, principally from the Uhrig Review (2003). One consequence, for example, has been increased relative power bestowed on portfolio secretaries compared with chairs of boards and this was reflected in some of the more recent interviews. Nevertheless, what follows is expected to be revealing about the attitude of major players on whom we depend for effective governance of public sector bodies.

2. BETTER PRACTICES IN APPOINTMENT PROCESSES

(a) Stages in Selection and Appointment

Different jurisdictions and commentators have identified a variety of ways for the selection and appointment to public sector boards. However, essentially there is widespread acknowledgement of four main stages in selecting and appointing to a public sector board if better practice is to be followed.

(i) *Preparation: developing a vacancy profile.* An audit is first required of a board's current skills and expertise to see where the gaps are that need to be filled. The audit considers required expertise in line with main current and emerging priorities of the board. It also considers personal qualities needed by all board members. Following this process, selection criteria for specific vacancies are drawn up in line with criteria for board membership as a whole.

(ii) *Selecting and locating suitable candidates.* All suitable candidates who match the position profile (or selection criteria) are located – this often includes public advertisement of the vacancy.

(iii) *Assessing and vetting potential candidates.* Potential candidates are then assessed against the selection criteria. Their qualifications and prior experience need to be verified and an understanding gained of the extent of the candidate’s commitment to fulfilling responsibilities of the position (probity check). In this process, the extent of potential conflicts of interest is assessed.

(iv) *Final selection and appointment.* Whatever processes are used to short list and then finally appoint, they should be in line with pre-determined, merit-based procedures.

A “good” process would cover all these stages in such a way that not only makes merit prominent, explicitly acknowledges the role of the minister, Parliament and/or any independent bodies, but also is transparent throughout.

(b) Better Practice Guidance

In the United Kingdom and Canada, governments have recently felt the need to enhance public confidence in the integrity of the political process around public sector appointments. They have done so by paying attention to a more transparent process with a higher degree of independence and, particularly in the United Kingdom, with attention to merit-based appointment processes. In Australia, as we will see, Australia appears to lag well behind in the way in which members of public sector boards are selected and appointed.

In the UK and Canada there have been particular triggers for making improvements in appointment processes. In the United Kingdom, the move to reduce cronyism in appointment processes was driven by a desire to reduce public cynicism in the mid 1990s. It now has a most sophisticated and comprehensive appointment system based around the oversight and monitoring of the Office of the Commissioner for Public Appointments (OCPA). More recently in Canada, action was a response to a crisis arising from a major sponsorship scandal and an adverse Auditor General’s report in which the governance of six Crown Corporations came under scrutiny (Treasury Board Secretariat, 2005: 4). A greater role for Parliamentary scrutiny is now being put in place.

The ANAO offers some better practice guidance for incremental improvements. The 2003 *Guidance Paper No. 2, Potential Conflicts in the Governance of CAC Bodies*, suggests procedures for managing tensions in the CAC board framework including “Develop with the Minister an agreed procedure to enable board members to have input to the appointment of new members, chair and organisation head” (2003: 5). The ANAO *Guidance Paper No. 3, CAC Boards*, provides a checklist on good board practices, including appointment protocols (2003: 4):

- regular audit to identify skills and personal qualities of chair/members (or directors) needed by the board, as well as current and projected skill gaps
- procedures for identifying potential candidates and a transparently merit-based selection procedure. Appropriate balance of independent members
- comprehensive and detailed director’s letter of appointment

- re-appointment subject to review of performance.

Following the Uhrig Review, the Australian government is presently placing some emphasis, especially through the leadership activities of the Department of Finance and Administration (Finance), on good governance of public sector bodies. Uhrig noted how significant appropriate board appointments can be:

In order to get the best from the board, and the entity itself, it is important to ensure the board has the necessary skills and experience to carry out its responsibilities. The ability of a board to provide effective governance will be placed in jeopardy if its members are inexperienced or inappropriately skilled or the board as a whole is dysfunctional. To ensure this does not occur, Ministers need to be well supported in terms of advice in the appointment process. (97-98)

Uhrig went on to offer some guidance on how Ministers could be supported in the appointment process by both the chair and the department, to ensure the necessary experience and skills relevant for any particular appointment (2003: 98). Unfortunately he fell short of actually including a recommendation on this issue.

Recent literature, especially from the private sector, has thrown a spotlight on the key role that relevant experience and skills of board members can have on the performance of an organisation (Edwards and Clough 2005). Leblanc and Gillies (2005), based on surveys inside of boardrooms, indicate that it is not so much structural factors but board processes and membership that matter, including the competencies of directors (138).

A recent report written for the UK Treasury on *Building Effective Boards* (2004) in the public sector makes a similar point about the strong relationship between skills and experience of board members and organisational performance and the importance of ensuring as wide a pool as possible for possible selection:

Recruitment and retention of able board members is critical to success...recruitment should relate to the board's skills, knowledge and aptitude requirements. Recruitment should be about maximizing the pool from which board members can be recruited to provide the widest possible choice of candidates. (2004: 2)

High profile corporate collapses have recently reinforced a sense that stewardship of all large organisations is a difficult and risky business, requiring skilled and competent people. These fiascos have underlined the fundamental importance of transparency, accountability and probity in organisational governance in the public as well as private sector. Citizens as well as shareholders need the assurances that only the highest standards of governance will prevail.

3. PERCEPTIONS AND ISSUES

Specific questions were asked of interviewees about their experience with, and views of, board appointment processes, including: how they bring skills, competencies and an external perspective to their board; the role board members play in the director appointment process; who appoints the CEO; and the extent to which that method of appointment facilitates effective corporate governance in their organisation.

What was surprising was the frequency with which appointment-related issues were raised during questions which were not specifically related to appointments. Examples include the questions asking respondents to identify any constraints to the implementation of effective corporate governance in their organisation and to nominate two or three major emerging governance issues facing their organisation.

Less surprising was the wide range of views, reflecting in part differences in the nature of CAC bodies and partly the behavioural dynamics operating between the board members and the Minister or government. Many of the CAC bodies had legislation which specified who was to be on the board as well as how they were to be appointed. Others had no such guidance and relied on setting up their own processes to advise the Minister and/or were reliant on ministerial selection and decision.

Several key and closely related issues relevant to a discussion of appointments to public sector bodies were reflected in the survey responses. This paper focuses on how board members and the CEO are appointed and, specifically, on the role of the Minister plays.

Board Appointment Processes

(a) Directors

One major finding of our empirical work was the diversity of approaches in appointing board directors. Some of the practices include:

- Quite detailed specification in the legislation
 - for example, research and development bodies which come under the Primary Industries and Energy Research and Development (PIERD) Act have the composition of their board and appointment processes specified in their enabling legislation.
- Advice from the chair/board to the Minister with or without a nominating committee
- Advice from portfolio departmental heads to the Minister which may not include taking advice from the board or its chair.

A few responses showed a systematic process by which the board identified skill gaps and informed the Minister of what was needed. For example:

We nominate the chair and commercial directors. There is a process to identify skills and a process to identify candidates (including using a consultant to help). We approach nominees to test their interest before going to the Minister. The Minister ultimately decides. (CEO)

In another case, there was a formal process but it was not always effective:

We have a board nomination and remuneration committee that advises the chair on skills needed and nominees. However, it doesn't necessarily work as ultimately the Minister decides. We went through the process but then a different member was nominated. Well, you'll be familiar with the Prime Minister's approach to board appointments... (CEO)

And

The board has processes under GBE Guidelines. The nominations committee has regard to the skill mix on the board. Rarely does the government take notice and appoint their mates. (Chair)

In yet another example, which illustrates the diversity theme, the Minister selects a presiding member to set up a Selection committee. The respondent said:

I feel the chair could play a useful role here. The presiding member can choose whether or not to consult the chair. So the deficiency is in not formally involving the chair. (Chair)

Fewer respondents than we expected noted use of formal processes by which boards provide the Minister with a list of desired skills and names of possible appointees. More common was advice to come informally from the chair and/or the departmental secretary. One chair claimed 100 per cent success with nominations and another claimed 100 per cent failure. Quite a degree of dissatisfaction with board appointment processes was observed for one board, with a member saying:

All individual members of the board have criticized the appointment process...but all are card carrying members of the government of the day! (CEO)

And another

Now more than ever there is less opportunity to have input in the selection of the board. Previously we were able to make recommendations and put up lists. (CEO)

However, this CEO now works through the chair and Minister's office and says, that so far the experience is working out.

The interviews showed many tensions arising from these processes, particularly as boards and departments competed to have the ear of the Minister.

We give formal advice directly to the Minister which is against the arrangements that (the secretary) put in place. He wanted all advice for board appointments to come directly from the department. (CEO)

Despite the direct selection and appointment of directors by the Minister, a degree of independence was observed:

The Minister is responsible for all appointments to...but despite this, the Minister has no influence. (Chair)

And

We are totally independent. We are absolutely independent despite the fact that board members are all mates with the PM. (Chair)

(b) Stakeholders and Government Representatives

There are several issues around the fact that CAC boards frequently include stakeholders in one form or another, experts or government representatives. This is a topic which will be examined in later work by the ARC team. Lack of clarity about the role of a board director, can occur for members of boards who have some representative role eg for a (state) government, industry or organisation.

The Uhrig Review discouraged (but fell short of making a specific recommendation) any representational appointments to boards because they “can fail to produce independent and objective views”. However, it is worth noting that this pure principle is difficult to practice in the public sector where expertise as well as representative views (eg of state governments) are required – sometimes specifically stated in the enabling legislation.

Many of those interviewed could see advantages in stakeholders being represented on boards and it was in this area that there was some broad agreement in responses. Some responses were clear:

You do need some people who understand the business. (Chair)

And some saw the need for balance: although directors came with industry background, they have to:

...tread a very fine line between letting us understand the issues but not acting for their own interests. (CEO)

Respondents seemed to be generally quite aware of the importance of managing the conflicts of interest and many had apparently good processes in place to do that:

There were more differences in view as to whether a departmental representative should be on the board. Uhrig was opposed to departmental representatives being on boards but kept the door open: “Membership of the board by the departmental secretary is unwise unless there are specific circumstances which require it” (2003: 99). Some survey respondents were troubled by potential conflicts, especially when budget proposals were being considered and funding was being sought from the department. Others thought there were significant advantages: these representatives can bring awareness of government thinking and priorities to board discussion. Much depends on the quality and capacity of particular public servants with dual roles.

The potential for conflict of interest is multiple. One departmental secretary saw three aspects to the role: acting in the interest of the body; as portfolio secretary acting for the portfolio as a whole (“*because I carry the can*”); and keeping a watch on things for the Ministers (“*shit management*”). Another portfolio head was quite clear about the priority role:

I’m portfolio secretary and I know that informally the Minister and Prime Minister would expect me to keep an eye on them even though they have a CEO.

Now that the Uhrig recommendations are coming into force and the relative power of the portfolio secretary vis a vis the board chair has been enhanced, the case for a departmental representative on the board could, arguably, be said to be reduced.

(c) Chair

Chairs of CAC bodies were mostly appointed by the Minister, rather than the board itself. A few chairs referred to a phone call from the Minister inviting them to the position. What we were not able to find out was what happened prior to that call: to what extent the search for a chair involved others outside the Minister’s office. This is as yet unexplored territory and an obvious issue of lack of transparency. It is an important topic for, as Leblanc and Gillies have

observed: "... it is the selection of chair that matters most to board process, not the separation (of the chair and CEO) (2004: 12).

One CAC CEO considered that:

The more I think about it, the more I realise that the Minister's appointment of the chair is the biggest issue. There is ambiguity around the respective roles of the chair and the executive director. The chair doesn't respect the line between governance and management. I think our boards decided to live with this and manage it as best as possible. I think they've decided that it's in the interests of the (board) to do this, rather than creating tension between the chair and the board.

Concerns expressed included: "getting the appointment wrong"; compromise on independence of the board; and possible conflict of interest for the chair, being appointed by the Minister.

Appointment of a chair with the right skills is critical to good business but ultimately the Minister has the say. This could be an issue. We need the right skills – not has-beens. (CEO)

However, others explicitly commented that, although the chair had been personally selected by the Minister, the chair operated quite independently.

The issue of how the chair was appointed was not raised as often as appointment processes around the CEO.

(d) CEO

The Uhrig Review was quite categorical about the importance of the CEO of a CAC type body being appointed by the board and not by the Minister, although stopped short of making that a specific recommendation. Practices are indeed inconsistent with some bodies having the capacity to select their own CEOs, some make recommendations that go to cabinet and some have no capacity to choose at all.

Board members displayed quite divergent views about what works best. Several CEOs were content, for example:

The Minister has the power to appoint/remove the CEO. I think it's a reasonable process. For my appointment, the referee checks, advertising etc. were all done by the board. It does not make sense to appoint someone the Minister doesn't have faith in. Uhrig takes a technical, purist approach. I think this is not quite right or disingenuous – even in the private sector. I don't think the Minister would sack me without support of the board or vice versa. (CEO)

And

The process is good. The board recommends and interviews and selects the CEO. This goes to the Minister and to cabinet/government. Been very professionally handled in my opinion. (Chair)

However, representative of the alternative view is the following:

The board appoints the CEO but it must first go thorough the Governor General and cabinet. Government definitely has to be consulted. I think it should operate

more like the private sector because the board is ultimately legally accountable. Under Uhrig, the board should speak to government before it appoints. I think if the board takes responsibility the board should be able to appoint. (CEO)

Tension can exist where there are provisions in the legislation for the board to select the CEO, but, where there is the added requirement to have the potential CEO (as a director) approved by the Minister and Cabinet before finalisation. In one of these cases, we were informed of the importance of a compromise candidate being selected, where necessary.

The CEO is appointed by the board but the Minister needs to find the person nominated acceptable, otherwise a compromise candidate is found. There is ambiguity over the Minister's role in the appointment process. This needs to be addressed. (CEO)

Role of Minister

In line with democratic principles, it is generally considered that it is the right of Ministers to exercise ultimate responsibility for appointments – in terms of final decisions. This is certainly the case in Australia.

Again, many practices emerged from interviews. In the more rigorous process, the enabling legislation was quite specific about the Minister's role. Under the PIERD Act, for example, the specified six non-executive directors are nominated by an independent selection committee appointed by the Minister, and the Minister also appoints the chair and a government director. In others, the process is more opaque and drew several and often unsolicited comments from our respondents because of that.

A seasoned board member had observed “political appointments” and saw jobs for the boys as a constraint – but his recent experience was that if these appointments had sufficient skills, this can protect their board's independence.

One CAC CEO reflected on a Minister who had personally selected more than just a few mates to chair boards who, according to this interviewee, did not necessarily have the most relevant skills. At least one of these chairs admitted to being a “close chum” of the Minister. And from a CEO:

Our chair quite cheerfully admits (being) the Minister's chum. The chair appointment process is totally opaque.

Some respondents were not very positive about the ministerial selection process.

What inhibits good governance in the public sector is the perception that directors (who are appointed by the Minister) are doing what the Minister wants rather than what is good governance.

However, several expressed the view that despite being a mate of the Minister, once selected, members operated in a most professional way.

One CEO took a most pragmatic position which could be seen as support for “merit-cronyism” (term borrowed from Prasser, 2005)

I'm a pragmatist – what you need on a board is someone who your Minister trusts and not only skills expertise and talent. So I'm not supportive of an appointment process at such an arm's length as a purist approach. It has great practical advantage to have the trust of the Minister. (CEO)

There is insufficient information and transparency at the Australian government level to understand the various ways in which Ministers affect appointment processes and many questions arise. However, the consequence of having informal ministerial influence as indicated here raises issues about how consistent that is with transparent and accountable governance. A real issue occurs where all members of a board as well as the CEO of the organisation are appointed by the Minister without any formal processes around that. It can make it difficult for members to fulfill their role as a board and to exercise the independent judgment called for (see Edwards et al 2003:40).

A seasoned private sector player, Henry Bosch, past head of the National Companies and Securities Commission, has been a member of ten or so public sector boards. He is of the view that:

... the quality of directors on government boards is almost universally lower than is the case on equivalent private sector boards. And that is because I think ministers get involved in the selection. (2005)

4. TENTATIVE CONCLUSIONS

There is very little known about appointment processes to Australian public sector boards. Our empirical work to date suggests that there is a variety of practices. At one extreme was the use of most systematic processes, going through the generally accepted stages for good appointment processes : audit, advertisement, merit-based selection with eventual cabinet approval. The practice of appointing “mates” with little due process, was at the other end of the spectrum. It is a process highly focused around Ministers. While some good appointment practices are occurring, these practices are by no means common in our sample, and overall could not be described as comprehensive or systematic. Of concern is a serious lack of transparency and accountability and hence integrity in the process.

The analysis of survey material so far suggests a couple of major themes apart from the obvious lack of transparency. One is that of diversity and inconsistency in perceptions and practices. It will be interesting to disaggregate the larger data set to see if there are any commonalities by type or function of organisation and the extent to which enabling legislation plays a role. A key emerging finding from the interviews, which is consistent with earlier work (see Edwards et al 2003), is a set of tensions which arise out of appointment processes. Tensions can emerge:

- among board members, particularly between ministerial appointments, on the one hand, and those seen to have a conflict of role, as government or industry “representatives”
- between the chair and CEO, whether one or both are appointed by the Minister
- between the CEO, board and the portfolio department in attempting to gain the ear of the Minister
- Between the board and the Minister where selection processes around the CEO leave some ambiguity.

The Uhrig Review has attempted to deal with some of these issues but its approach does raise a basic question to ponder. Is it appropriate for the public sector to move toward the private sector concept of a board or is it more appropriate to accept some of the above tensions and put into place robust ways of managing them well?

Until recently (with the resignation of an appointment to the board of the Reserve Bank of Australia) there has not been much pressure on the government to make the current board appointment process more transparent and accountable. There has been no major crisis forcing reform. It can only be a matter of time before a political appointment to a high profile board in Australia backfires enough to dent public integrity in its key institutions.

Can we expect improved standards of governance around appointment processes in the Australian public sector in the near term? Failing a crisis, major reform appears out of the question at the moment. But is it realistic to expect, in the interests of well-performing organisations, more systematic practices which lead to greater transparency and a greater input of merit into the selection process?

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