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Developing a Framework for the Financing and Governance of Australian Universities

A Report prepared for the
Business Council of Australia by
The **Allen Consulting** Group



Foreword

The Business Council of Australia's aspiration is for Australia to be the best place in the world to live, to learn, to work and to do business. Education and training are key drivers of a higher standard of living.

The Higher Education sector in Australia has played a critical role in the development of the leadership, skills, ingenuity and knowhow of our people. It is critical to position the Higher Education sector to be able to continue this role, successfully and equitably exhibiting and reporting excellence and relevance in teaching and learning and research.

The foundations to support excellence include the financial and governance structures of the sector and individual institutions. The current review of the Higher Education sector provides an ideal opportunity to consider the current financing and governance structures of Australia's universities and ascertain whether they will support the future sustainability, quality, equity and effectiveness of the Higher Education sector.

The Business Council of Australia recognises that the Australian Higher Education sector is currently funded at total levels above the OECD average but it also acknowledges that individual universities are facing increasing funding pressures which have implications for both excellence and equity.

A sustainable and equitable solution to these financial pressures requires more than simply calling for greater public expenditure within existing financial and organisational structures. There is a need to re-examine and reform the financing framework for the sector in order to develop a sustainable system which delivers resources reflecting the value created for individuals and the community by the sector in teaching and learning and research. The financing framework must also ensure our best and brightest are able to access higher education.

Just as the importance of sound governance arrangements in the corporate sector is now being recognised and treated as an issue of fundamental importance for business, governance is also an important ongoing issue for the Higher Education sector as it adapts to a changing operating environment. The last decade has seen many changes in aspects of the governance frameworks of Australian universities. The emerging challenge is to ensure the governance structures of the future support the strategic directions and priorities of universities, as well as the diverse nature of their activities, yet also provide for sound accountability.

If the issues facing many Australian universities are to be successfully addressed, strong, independent and transparent governance processes within each university are needed. This may require changes to the legislative framework and to membership of university councils and senates.

Through this submission, the Business Council of Australia seeks to provide constructive input to the current important debate regarding the future of the Higher Education sector in Australia.

John Schubert

President, Business Council of Australia

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Executive Summary

The role and activities of universities in Australia are changing and the funding environment is becoming more complex. The Business Council of Australia (BCA) believes that governance and financing frameworks within the Higher Education sector will need to be updated to reflect these changes in the operating environment.

This submission to the Nelson Review of Higher Education in Australia, prepared by the Allen Consulting Group on behalf of the BCA, focuses on a number of issues surrounding the financing framework and governance arrangements for the Australian Higher Education sector and makes recommendations for action in these inter-related areas. The key points raised in sections two and three of this submission are summarised below.

Financing framework issues

The current framework for the financing of the Australian Higher Education sector suffers from several fundamental problems. It does not provide strong incentives for institutional excellence in teaching, it does not allow institutions the flexibility they require to respond appropriately to student demand, it drives course offerings based on funding models rather than demand, it limits universities ability to pursue a broader revenue base and it does not appropriately reflect the range of public and private benefits flowing from higher education.

The BCA believes that the development of a sustainable and equitable solution to the funding pressures facing universities will require significant long term changes to the current highly regulated financing framework.

Ideally the financing framework for the Australian Higher Education sector should allow and encourage the sector to be highly responsive to student, community and industry needs and to access funding from a variety of sources.

Fundamental long term principles for the financing framework

The fundamental principles that should underpin the development of an appropriate long term overall financing framework for higher education should include that it:

- provides equity of access, with access based on ability, not ability to pay upfront. However, to the extent that students generate private returns from their education and are (later) able to pay, a fair contribution from individuals should be made;
- is sustainable and that the balance of revenue sources reflects that higher education delivers both public and private benefits;
- allows universities to generate revenues that are sufficient to fund a standard of resourcing commensurate with the value created for the community and individuals;

- includes incentives to institutions for excellence in teaching and research and in their management and administration through strong market feedback mechanisms;
- provides reliability and predictability of base level funding, allowing institutions to plan with confidence. Providing base funding on a triennial basis rather than yearly would be an appropriate way to provide for longer term institutional resource allocation decision making and strategic planning;
- allows institutions to retain the rewards of generating additional revenues themselves; and
- provides flexibility and choice - not a 'one size fits all' system, but one encouraging and allowing institutions to differentiate what they offer, and students to choose what best suits them.

In accordance with the basic principles outlined above, the new financing framework should move away from the current system's focus on central planning (in areas such as the number of student places to be funded for particular courses) and allocation of funding on a historical activity basis. The new financing framework should be based upon a less centralised and significantly more student directed approach to university funding.

The BCA believes that in the long term, the introduction of student entitlements and some level of fee flexibility (while preserving a HECS like deferred payment system to preserve equity of access) and a reduction in central planning of course numbers, but with a process to address specific labour market needs, will best deliver a student and client responsive system, excellence through competition and provide universities with the ability to raise revenues from a variety of sources and flexibly respond to market needs.

However, the BCA recognises that a rapid shift to such a model may present transitional problems for some institutions and pose a threat to the quality of education outcomes. In particular current labour market rigidities may prevent institutions from being able to rapidly respond to changes in market demand. Therefore, in the short term the BCA recommends that as an initial step towards the implementation of a financing framework that accords with the above ideal principles, the system for student fees and the allocation of funded places to particular courses should initially be partially de-regulated.

Such a model will need to be partnered with changes in the HECS system to ensure students are not disadvantaged and the creation tagged Commonwealth funds to support universities in their meeting of community service obligations and regional needs and scholarship funds to assist students from low socio economic backgrounds and rural students.

Key recommended transitional changes

To provide greater certainty of funding and flexibility in terms of responding to student demand, partial deregulation of the fees system should be accompanied by changes in the delivery of the base operating grant. The current operating grant should continue at (at least) current levels but funding should be delivered on a three year cycle and should be far less tied to specific centrally dictated levels of student numbers in particular courses.

Initial recommended reforms to the fees system include:

- while increasing flexibility and providing incentives for excellence are important principles and should be long term goals for the sector, for the time being fee flexibility should be introduced within reasonable limits (say ± 25 per cent, which would translate to between $\pm \$900$ and $\pm \$1,500$ per annum in the HECS charge incurred by students given current HECS bands), rather than full fee deregulation being pursued at this time;
- the premium (or discount) fees offered by particular institutions for particular courses should go directly to the institution, subject only to the normal adjustment from a nominal (deferred payment) to an upfront basis;
- any premium component should be repayable by the student only when the student reaches an income level in excess of average total full time weekly adult earnings (currently $\$906$ p.w.¹) within a single system of percentages of income repayable - under HECS or similar arrangements. It should be noted that this would entail the Commonwealth Government taking on a greater contingent liability than it currently incurs through the current HECS system;
- all current HECS parameters should be reviewed if a move towards a new more flexible fee system is to be pursued. Parameters to be reviewed should include:
 - the standard fee structure, presently divided into three bands. The basis for such banding should be transparent – cost of course delivery, future income potential of graduates and the public benefits associated with the course are all of relevance in determining appropriate course fees;
 - the income thresholds for repayment - which presently cut in at levels of income which are less than half the average full time adult weekly earnings – should be raised to a level of at least 60 per cent of average adult full time weekly earnings. This would see the income thresholds for any HECS repayment rise from an income of $\$23,242$ per annum to $\$28,267$ per annum. HECS debt should continue to be indexed to inflation – real interest rates should not be applied to accumulated HECS debt; and
- consideration should be given to increasing the rate of repayment applying at salaries higher than average weekly earnings.

The immediate partial de-regulation of fees that is proposed would provide a much needed increase in institutional incentives for excellence while not exposing institutions to a destabilising increase in funding pressure.

¹ ABS, 6302.0, *May 2002 Average Weekly Earnings, States and Australia*, released 15/08/02

Any additional Commonwealth funding for the Higher Education sector should be on the basis of funds tagged for specific outcomes and all universities should have the opportunity to bid for these funds.

Immediate consideration should be given to the creation of such tagged funds for community service obligations; addressing regional needs; and scholarships to improve the partition of low socio economic students and rural students.

Section two of this submission also considers the implications of the changing nature of the financial environment for universities (and their increasing involvement in commercial activities) for how universities approach governance and risk management.

Governance issues

The changing and more complex nature of the operating environment for universities makes the adoption of best practice governance arrangements within the sector more important than ever before.

While the process of change in this area is already underway, with significant changes having been implemented at a number of institutions, a continued commitment to achieving best practice governance arrangements is needed.

Fundamental principles for best practice governance

The BCA believes that the following list provides a small number of the key features for best practice governance arrangement in the university context:

- the fundamental objectives of universities should be clearly stated in their enabling Acts;
- the role of the governing body should be clearly articulated, preferably in the governing legislation, as being to act in the interests of the university as a whole for the achievement of its stated core objectives and not to advance particular sectional interests;
- the responsibilities of the governing body should be clearly and publicly stated by each university. The key responsibilities for the governing body should be to guide the strategic direction of the university, manage risk, monitor and report on university performance outcomes, ensure compliance with statutory requirements; appoint and oversee the performance of the vice-chancellor and liase with stakeholders and ensure the achievement of its stated core objectives.;
- while the governing body should be constituted of members with a range of skills (it is, in particular, essential that at least some members have strong skills in the area of risk management), governing bodies should be no larger than is necessary to ensure that such skills are available;
- processes for the appointment of board members should focus on ensuring that the board has the broad range of skills necessary for it to fulfil its role and should not be restricted by the need to fill ‘quotas’ for board members from particular interest groups;
- governing bodies should have strong standing committee structures, and in particular a standing audit committee, which is provided with the resources necessary to secure independent audit advice;

- the academic board, which is responsible for overseeing academic quality and ethical standards, should not operate in isolation from the broader university governance system. The academic board should act in the best interests of the university as a whole and should regularly report to and interact with the governing body; and
- governing bodies should prepare an annual risk management plan and report against this plan each year.

Recommended actions

Bringing current practice into line with all these best practice principles requires a number of actions to be taken at both a system wide and specific institutional level. Such actions include:

- ensuring that the core objectives of universities are clearly defined in their governing Acts;
- ensuring the role of governing bodies is clearly articulated by legislation and each university - including a clear statement that the role of the governing body is to act in the interests of the university as a whole and not advance particular sectional interests and to achieve the stated core objectives;
- board appointment processes should be reviewed and ‘quotas’ for board members from particular interest groups removed;
- the responsibilities of the governing body should be clearly articulated by each university;
- a comprehensive set of university governance best practice guidelines should be developed;
- universities should provide an assessment of their governance arrangements against these best practice guidelines;
- State/Territory and Commonwealth governments should work together, perhaps through the Ministerial Council for Education, Employment, Training and Youth Affairs forum, to harmonise and streamline the legal and accountability requirements for universities and harmonise and streamline the provision of performance data by universities. Good governance is not about submitting input and throughput data to multiple government agencies. The time spent on procedural reporting should not be great and certainly should not take resources away from more strategic governance issues such as risk management. As part of this performance data reporting harmonisation process, more emphasis should be placed on the development of true performance outcome measures in the areas of student learning and research;
- State/Territory and Commonwealth governments should work together to harmonise relevant policies and procedures to ensure universities can effectively operate in a commercial environment to achieve their core objectives. Universities should use relevant risk management strategies;

- more emphasis should be placed on the development of true performance outcome measures in the areas of student learning and research. The resources allocated to procedural reporting of input and throughput data should not be great. If the establishment of one central intermediary body will result in less overall allocation of resources, by both government and universities, to the assembly, submission, analysis of and reporting on procedural data, it may be worthwhile. However, it would be inappropriate to form a new body that simply adds an additional administrative layer to the performance monitoring system;
- consideration should be given to the remuneration of governing body members in recognition of the increasing complexity and importance of the tasks to be undertaken by governing bodies; and
- consideration should be given to significantly reducing the average number of State government/Ministerial appointments to governing bodies.

Section One

The Context

Key Points

The role and activities of universities are changing and the funding environment is becoming more complex.

Governance and financing frameworks need to be updated to reflect the changes in the operating environment.

The financing framework for the Higher Education sector must reflect the reality that universities will increasingly need to generate revenue from a wide range of sources, including Commonwealth and State governments, domestic and international students and the business sector.

The changing roles and activities of universities

As the wide-ranging issues papers released as part of the Nelson Review of Higher Education in Australia have highlighted, the roles and activities of Australian universities have been changing in recent years. Commonwealth public funding has declined as a share of total university revenue with universities increasing their activities in the areas of:

- the provision of fee for service education services, particularly to international students;
- the provision of fee for service consultancy services;
- the management of intellectual property for financial returns; and
- the commercialisation of university research activities.

Reflecting these changes, between 1991 and 2000, non-government sources of income have doubled as a share of university revenue, with non HECS fees and charges now representing 36 per cent of university revenue² and consultancy and research commercialisation 5 per cent of university revenue³.

At the same time as universities have been seeking to expand their commercial activities in response to market demand and to generate new revenue streams, there have also been significant pressures to increase operating efficiency in response to the tight funding climate.

The combination of the need to take on new commercially focused activities and to increase internal operating efficiencies has brought to the forefront a number of important issues regarding what is an appropriate financial framework for higher education and how, given their changing functions, Australian universities should be governed.

² Ministerial Issues Paper, *Higher Education at the Crossroads: An Overview Paper*, April 2002, pg.3

³ Ministerial Issues Paper, *Meeting the Challenges: The Governance and Management of Universities*, August 2002, pg.61. It should be noted that consultancy and contract research revenue, rather than research commercialisation revenue, makes up the vast majority of this revenue classification.

Given that a return to largely Commonwealth government funding of higher education is not likely to occur, it is important that the changing funding environment is examined. The financing framework for the Higher Education sector must reflect the reality that universities will increasingly need to generate revenue from a wide range of sources, including Commonwealth and State governments, domestic and international students and the business sector.

If universities are to successfully navigate this transition to an environment typified by a more diverse and complex set of financial arrangements, it is imperative that the governance structures underpinning the operation of universities promote the appropriate management of commercial risks and the efficient achievement of institutional performance objectives.

The structure of this submission

This submission responds to a number of the major themes and issues within two recent issues papers released as part of the Nelson Review of Higher Education in Australia, namely:

- “Setting Firm foundations: Financing Australian Higher Education”; and
- “Meeting the Challenges: The Governance and Management of Universities”.

Through this submission, the Business Council of Australia (BCA) is not seeking to provide “the answers” to questions of higher education financing or governance. Rather, it wishes to contribute to the debate of these issues by setting out a number of principles that should underpin the development of future financing and governance arrangements within the Australian Higher Education sector.

In particular:

- Section Two of this submission presents a number of fundamental principles that should underpin the development of an appropriate financing framework for higher education in Australia. At the conclusion of this section a discussion of various approaches to the commercialisation of research is included to illustrate how the demands of the new, more commercial, funding environment have important implications for university governance.
- Section Three of this submission sets out a number of core governance principles of relevance in the university context. This section explicitly addresses the fundamental governance issue raised in the Ministerial issues paper, namely: whether the changing nature of university activities requires changes to university governance structures and what best practice university governance arrangements for Australia would entail. This section concludes with a number of recommendations for action to improve governance arrangements within the Australian Higher Education sector.

*Section Two***Developing an Appropriate Financing Framework for Higher Education****Key Points**

The BCA believes that the development of a sustainable and equitable solution to the funding pressures facing universities will require significant long term changes to the current highly regulated financing framework.

Ideally the financing framework for the Australian Higher Education sector should allow and encourage the sector to be highly responsive to student, community and industry needs and access to funding from a variety of sources. The fundamental principles underpinning the overall financing framework for higher education should include that it:

- provides for equity of access, with access based on ability rather than ability to pay up front;
- is sustainable and that the balance of revenue sources reflects that higher education delivers both public and considerable private benefits;
- provides incentives to institutions for excellence in delivery of services and outcomes through introducing greater market feedback mechanisms;
- provides reliability of base level funding; and
- promotes flexibility and choice for both students and institutions.

The BCA believes that in the long term, the introduction of student entitlements and some level of fee flexibility (while preserving a HECS like deferred payment system to preserve equity of access) and a reduction in central planning of course numbers, but with a process to address specific labour market needs, will best deliver a student and client responsive system, excellence through competition and provide universities with the ability to raise revenues from a variety of sources and flexibly respond to market needs.

However, the BCA recognises that a rapid shift to such a model may present transitional problems for some institutions and pose a threat to the quality of education outcomes. Therefore, in the short term the BCA recommends that as an initial step towards the implementation of a financing framework that accords with the above ideal principles, the system for student fees and the allocation of funded places to particular courses should initially be partially de-regulated.

Such a model will need to be partnered with changes in the HECS system to ensure students are not disadvantaged and the creation tagged Commonwealth funds to support universities in their meeting of community service obligations and regional needs and scholarship funds to assist students from low socio economic backgrounds and rural students.

To ensure its long term future, work should begin now to develop and implement a new financing framework for the Higher Education sector. The new financing framework should move away from the current system's focus on central planning towards a less centralised and significantly more student directed approach to university funding.

Section two of this submission also considers the implications of the changing nature of the financial environment for universities (and their increasing involvement in commercial activities) for how universities approach the inter-related areas of governance and risk management.

The university financing context

The BCA recognises that whilst on an internationally comparative basis Australia's Higher Education sector is funded above the average level amongst OECD countries, some institutions within the sector are facing increasing funding pressures. The current mix of funding sources for the sector, in particular a growing reliance on international student fees, also raise some risks for the sector going forward.

Funding pressures within the sector have implications for both excellence and equity within the Australian Higher Education sector. However, the BCA believes that developing a sustainable and equitable solution to these financial pressures requires more than simply calling for more public expenditure to be made within the existing financial and organisational frameworks of the sector. There are a number of complex and important competing calls on limited government financial resources in areas such as health, welfare and community services. Pressure on government finances is likely to increase further in the future due to coming demographic changes.

The BCA believes there is a need to re-examine and reform the higher education financing framework. The current framework for the financing of the Australian Higher Education sector suffers from several fundamental problems. It does not provide strong incentives for institutional excellence in teaching, it does not allow institutions the flexibility they require to respond appropriately to student demand, it drives course offerings based on Government funding rather than demand it limits universities ability to pursue a broader revenue base and it does not appropriately reflect the range of public and private benefits flowing from higher education.

A sustainable funding system is needed which delivers resources from a range of sources that reflects the value created for both individuals and the community by the sector in teaching and learning and research.

The goal must be to develop a financial framework that sustainably and fairly supports a Higher Education sector that can deliver excellence with equity.

Evidence, and implications, of funding pressure

The limited nature of outcomes oriented performance measurement within the Higher Education sector makes it hard to establish whether the current levels of funding within the sector are providing adequate resources to support core university activities such as teaching and student learning. However, some input

indicators do suggest that the Australian Higher Education sector is experiencing, generally although unevenly, a tightening funding situation in relation to the level of funding available to support excellence in undergraduate teaching and learning. This is reflected in:

- a decline in the Commonwealth operating grant relative to cost benchmarks relevant to universities (Burke and Phillips 2001 estimated a 9 per cent or approximately \$500m shortfall in 2001 c.f. the 1995 level indexed to AWE). The impact of this varies between institutions but many universities have limited income from other sources;
- the ongoing low levels of cash on hand for many, although not all, universities.

Implications of this financial pressure include restricted ability to attract and retain talented staff in Australian universities, develop new learning resources and limited ability to redevelop infrastructure.

There will be significant implications also for equity of access, if funding pressure restricts the ability of universities to provide enough affordable places.

However, to put the funding situation in a broader perspective, it should be noted that a tightening of the funding environment does not appear to be unique to Australia. Total funding for higher education in Australia as a percentage of GDP remains above the OECD average⁴.

Also, while the resourcing situation for teaching is clearly tight in some institutions, which is reflected in measures such as the rising student:teacher ratio, the BCA believes that the situation in relation to the funding of higher education research is less clear.

Data from the AVCC indicates that university expenditure on R&D in Australia increased from \$1.1b in 1988 to \$2.6b in 1998. OECD data indicates that Australia spends a considerably higher percentage of GDP on higher education research and development activities than the OECD average and a higher percentage than either the United States or the United Kingdom. Australia also ranks 1st in the OECD in terms of higher education researchers per head of population and 6th in the OECD in terms of publicly funded research as a percentage of total research and development.⁵

The level of university expenditure on R&D is higher than in many other countries. This situation has emerged in all likelihood as a result of the lower levels of business investment in R&D.

It should also be noted that the Government's 2001 package of initiatives to support innovation, *Backing Australia's Ability*, contained substantial new funding to support research within the Higher Education sector.

The outcomes associated with research undertaken within the Higher Education sector are not clear. The BCA would like to see more attention paid to

⁴ The BCA research report released in August 2002, *Higher Education in Australia: Developing a New Data Framework and International Comparisons and Issues*, contains an analysis of a range of data relating to higher education in Australia and internationally. This report is available on BCA's website: www.bca.com.au

⁵ The report, *Higher Education in Australia: Developing a New Data Framework and International Comparisons and Issues*, contains a preliminary analysis of data relating to the resourcing of research, and some of the outcomes of this research, within the Australian higher education sector.

measuring and assessing the social, economic and commercial outcomes from the large and growing commitment of public funds to Higher Education sector⁶.

The BCA believes that the issue of research funding should be addressed within the wider context of the overall innovation system in Australia. In particular, focus is needed on what is causing the relatively low levels of business expenditure on R&D (notwithstanding the increase recorded in the past year) and the limited nature of the current interaction between business and public sector researchers.

Given the already relatively high level (by international standards) of funding for higher education research in Australia and the need to address research issues within a broader context, the BCA has focused the following discussion of the funding framework for higher education on issues that impact particularly upon the levels of funding available to support student learning.

Design principles for a sound funding system

The BCA recognises that Commonwealth funding will remain an important element of the overall higher education financing system. However, it believes that the principles governing the terms on which this funding is provided need to be re-examined. It is also important that the Commonwealth funding is viewed in the context of the broader financing framework. Significant revenue contributions are now being generated from a number of sources, in particular from students (domestic and international), consultancy services and research commercialisation.

The fundamental principles that should underpin the development of an appropriate long term overall financing framework for higher education should include that it:

- provides equity of access, with access based on ability, not ability to pay upfront. However, to the extent that students generate private returns from their education and are (later) able to pay, a fair contribution from individuals should be made;
- is sustainable and that the balance of revenue sources reflects that higher education delivers both public and private benefits;
- allows universities to generate revenues that sufficient to fund a standard of resourcing commensurate with the value created for the community and individuals;
- includes incentives to institutions for excellence in teaching and research and in their management and administration through strong market feedback mechanisms;

⁶ The BCA welcomes recent work in relation to measuring the commercialisation of university research that has been undertaken by Yencken and Gillan at the Australian Graduate School of Entrepreneurship at Swinburne University. The BCA also understands that the Australian Research Council will be releasing a study into University commercialisation activities. These are positive steps towards a much needed focus on measuring outcomes rather than inputs in relation to Higher Education sector research activities.

- provides reliability and predictability of base level funding, allowing institutions to plan with confidence. Providing base funding on a triennial basis rather than yearly would be an appropriate way to provide for longer term institutional resource allocation decision making and strategic planning;
- allows institutions to retain the rewards of generating additional revenues themselves; and
- provides flexibility and choice - not a 'one size fits all' system, but one encouraging and allowing institutions to differentiate what they offer, and students to choose what best suits them.

The overall financing system needs to strike an optimal balance among:

- base funding from the Commonwealth;
- fees paid by students in recognition of the rewards to them, with equity protected by income contingent deferred payment arrangements as per the HECS type of model; and
- a range of other revenue sources, including
 - overseas students;
 - corporate funding for tailored courses;
 - corporate funding of research;
 - State government funding, whether related to State public sector labour force issues (e.g. teaching, nursing) or to State economic development strategies (requiring specific skills or research directions);
 - commercialisation of research; and
 - active fund-raising and philanthropy.

In terms of system design, the central policy focus for the Commonwealth Government is, and should remain, on the first two of the above, i.e. Commonwealth base funding and student fees, the latter coupled with income-contingent deferred payment (loan) arrangements.

In principle, there are great advantages in funding students rather than institutions. Such an approach would provide strong performance incentives to institutions and maximise student choice. However, the present system for base funding and fees is totally institutional - HECS payments go to consolidated revenue, not to the institution. While the BCA acknowledges that there are arguments for retaining some elements of an institutional funding formulae to ensure a stable and predictable base level of funding, the BCA believes that excellence in outcomes (in areas such as student learning) can best be delivered through a funding framework that contains strong market feedback mechanisms⁷.

⁷ Research into educational productivity in the United States suggests that market forces have an important role to play in improving performance outcomes within the education system. For details regarding this research see paper by C.Hoxby, Harvard University and the National Bureau of Economic Research, *Government Intervention in the Provision and Financing of Education*, presented to the OECD meeting of Representatives of National Economic Research Organisations in July 2002. www.oecd.org

The BCA recognises that the Commonwealth block grant system, including the component of the block grant that supports research should continue. It is important that all universities have access to funds to support the development of research infrastructure and to develop the research and broader scholarship of staff. However, there is also a need to ensure these funds are applied in a manner to achieve a set of agreed outcomes in this area.

However, over the longer term the BCA believes that greater focus should be given to developing a financing framework that provides stronger market feedback mechanisms and incentives for excellence.

The student fees system presents a major opportunity to immediately introduce a degree of flexibility to the system which would:

- provide incentives to institutions to more market responsive learning environments, services or courses; and
- offer students more choice and better link their expenditure (on an income-contingent deferred basis) to the services they actually receive.

With regard to other sources of revenue, policy makers should perhaps seek only to ensure that the financing framework does not provide obstacles or disincentives (such as clawing back Commonwealth funding if institutions generate other revenue sources) for institutions to pursue other revenue streams. The terms on which base funding and fees are regulated should leave institutions with maximum opportunity and incentive to pursue a diversity of other sources.

A pathway to a new financing framework

Changes to the fees framework should be undertaken with a view to providing greater incentives for excellence while protecting against a fall in base standards. The student fees system should appropriately reflect that there are both public and private benefits associated with higher education.

The BCA believes that a financing framework that gives greater fee flexibility to universities and ties funding more strongly to students would best allow the Australian Higher Education sector to achieve excellence and equity on a sustainable basis. The strong market feedback mechanisms within such a financing framework would reward universities for providing students with a high quality learning environments and more demand focussed services⁸.

The BCA recognises that a rapid move to a significantly student directed and less centrally regulated financing framework may impose transitional strains upon some institutions. Changes in student numbers, both between institutions and between faculties within institutions, will necessitate changes to levels of infrastructure funding and staffing. Current labour market rigidities may prevent institutions from being able to rapidly respond to changing student demand profiles. For these reasons the BCA is not advocating an immediate move to a largely deregulated and student directed financing framework.

⁸ However, it is important to note that the BCA does not believe that all funding should be student directed. The BCA recognises that it is important that a base level of non student directed funding should continue to be provided to universities to support their community service activities and underpin investment in core institutional infrastructure.

It is important though that transitional changes to the current system are introduced now and that these changes provide incentives that are strong enough to encourage behavioural change. It is important also that as universities are given more flexibility regarding fees that they are also granted greater flexibility in terms of the number of HECS funded places that they can offer for particular courses.

To provide greater certainty of funding and flexibility in terms of responding to student demand, partial deregulation of the fees system should also be accompanied by changes in the delivery of the base operating grant. The current operating grant should continue at (at least) current levels but funding should be delivered on a three year cycle and should be far less tied to specific centrally dictated levels of student numbers in particular courses.

The initial transitional changes to the fees framework for undergraduate studies recommended below attempt to provide a step in the direction of student directed funding without exacerbating the funding pressures that some institutions within the Higher Education sector are already facing.

One useful transitional change to the undergraduate fees system would be to allow universities to charge a premium or discount to base HECS rates for particular courses.

Important features of this variable fees system would be that:

- while increasing flexibility and providing incentives for excellence are important principles and should be long term goals for the sector, for the time being fee flexibility should be introduced within reasonable limits (say ± 25 per cent, which would translate to between $\pm \$900$ and $\pm \$1,500$ per annum in the HECS charge incurred by students given current HECS bands), rather than full fee deregulation being pursued at this time;
- the premium (or discount) fees offered by particular institutions for particular courses should go directly to the institution, subject only to the normal adjustment from a nominal (deferred payment) to an upfront basis;
- any premium component should be repayable by the student only when the student reaches an income in excess of average total full time weekly adult earnings (currently $\$906$ p.w.⁹) within a single system of percentages of income repayable - under HECS or similar arrangements. It should be noted that this would entail the Commonwealth Government taking on a greater contingent liability than it currently incurs through the current HECS system;
- a number of current HECS parameters should be reviewed if a move towards a new more flexible fee system is to be pursued. Parameters to be reviewed should include:
 - the standard fee structure, presently divided into three bands. The basis for such banding should be transparent – cost of course delivery, future income potential of graduates and the public benefits associated with the course are all of relevance in determining appropriate course fees; and
 - the income thresholds for repayment - which presently cut in at levels of income which are less than half the average full time adult weekly

⁹ ABS, 6302.0, *May 2002 Average Weekly Earnings, States and Australia*, released 15/08/02

earnings – should be raised to a level of at least 60 per cent of average adult full time weekly earnings. This would see the income thresholds for any HECS repayment rise from an income of \$23,242 per annum to \$28,267 per annum. HECS debt should continue to be indexed to inflation – real interest rates should not be applied to accumulated HECS debt; and

- consideration should be given to increasing the rate of repayment applying at salaries higher than average weekly earnings.

Any additional Commonwealth funding for the Higher Education sector should be on the basis of funds tagged for specific outcomes and all universities should have the opportunity to bid for these funds.

Immediate consideration should be given to the creation of such tagged funds for community service obligations; addressing regional needs; and scholarships to improve the partition from low socio economic students and rural students.

In addition to a review of HECS parameters, the BCA believes that the current system for student income support may also need to be reviewed. Eligibility criteria and levels of income support (both those available as grants and as loans) should ensure that students are able to participate in higher education if they have the ability and want to and devote appropriate attention to their studies while maintaining an acceptable standard of living.

The above approach towards reforming the fees system is offered as a method of delivering (partial) fee deregulation, and builds on the suggestions within funding model two in the Ministerial issues paper, *Setting Firm Foundations: Financing Australian Higher Education*¹⁰. The above proposed changes to the fees system would have a variety of impacts upon students. Some students would incur a higher total HECS debt while others would experience no change or even, where Universities offer a discount to the base HECS level, a lower level of total HECS debt. All students however would benefit from the raising of the base HECS repayment threshold to at least 60 per cent of average full time adult weekly earnings. Also, students would benefit from improvements in the quality of the learning environment that the changes would encourage.

At the maximum end of the fee scale, a student undertaking a five year HECS band 3 course with the maximum premium being charged would accrue a total HECS debt \$7,500 higher than under the current system. However, unlike under the current system where HECS debt must be repaid once an income of \$23,242 per annum is reached, the student would not have to start repaying any of the debt until their income exceeded \$28,267 per annum and they would not begin to repay any of the \$7,500 ‘premium’ debt until their income exceeded \$47,000 per annum. Given that the ‘premium’ HECS would be paid directly to the university that they attend, it would also be expected that the student would experience a higher quality learning environment than under the current financing system.

The significantly higher proposed income threshold for repayment of any ‘premium’ HECS debt should address equity concerns. The debt only begins to

¹⁰ The BCA does not believe that model one presented in the issues paper would provide enough impetus for longer term change in the system. The BCA believes that models three and four, while clearly based upon a core principles that the BCA would endorse – that funding should be greater linked to student demand and choice – could pose significant transitional problems for institutions given current labour market and infrastructure rigidities.

be repaid once an income above average full time adult weekly earnings is reached.

The BCA believes that the changes outlined above would be a useful transitional move towards establishing a sustainable financing framework that encourages excellence while preserving equity. However, work should begin now to develop and implement a new financing framework for the sector that will ensure long term sustainability, equity and excellence.

In accordance with the basic principles outlined earlier, the new financing framework should move away from the current system's focus on central planning (in areas such as the number of student places to be funded for particular courses) and allocation of funding on a historical activity basis. The new financing framework should be based upon a less centralised and more student directed approach to university funding. The move to such a system will require current labour market rigidities within the Higher Education sector to be addressed.

Diversifying income sources

Among the 'other' sources of income that may be available to universities, the one that stands out as having declined markedly over recent decades is State Government funding. Given the increasing importance of high level skills and applied research for competitiveness in 'new' economic fields, as well as traditional State manpower interests, this is a key area for seeking increased funding. The suggestion here is not that funding burdens should be shifted from the Commonwealth to State/Territory governments, but rather that where particular economic or social benefits are available to a state from certain university activities, there may be good reason for State/Territory governments to provide additional funding for these activities. It is important that the Commonwealth, rather than attempt to clawback additional funding provided by State/Territory governments, presents strong incentives to institutions and State/Territory governments for growing this source of funding.

It is important to note that as universities seek to diversify their income sources and pursue more commercial activities, the capabilities they require in terms of governance structures and risk management capabilities increase considerably.

The discussion below considers in more detail the implications of universities' approaches to commercial activities for the type of governance and institutional risk management capabilities that the universities' need. This case study highlights the link between the changing financial environment, under which universities are increasingly seeking to develop new revenue streams, and the need for universities to examine and possibly strengthen their governance and risk management capabilities and procedures.

Universities' commercial activities and their implications for governance and institutional risk management capabilities

As was noted in Section One of this submission, Commonwealth public funding has declined as a share of total university revenue as universities have increased their activities in the areas of:

- the sale of education services, particularly to international students;

- the sale of consultancy services;
- the management of intellectual property for financial returns; and
- the commercialisation of university research activities.

Revenue from consultancies and contract research now makes up approximately 5 per cent of total university revenue. Revenue from the commercialisation of university intellectual property (IP) however remains at less than 0.2 per cent of total revenue¹¹. While there appears to be some scope for increased revenues from the commercialisation of university IP, it is important to note that international experience suggests that the share of total revenue generated through consultancies, contract research and research commercialisation is unlikely to increase significantly beyond their current combined proportion of total revenue. Certainly, a contribution from consultancy and commercialisation activities of greater than 10 per cent to total revenue seems highly unlikely to occur. Attempts to generate revenues beyond this level would likely require universities to move away from the pursuit of their core objectives in the areas of student learning and the generation of new knowledge.

Notwithstanding the limitations upon commercialisation activities as a source of university revenue, the trend towards greater commercialisation of research that has been seen in recent years does raise a number of issues in relation to how universities understand and manage the risks associated with this activity.

The BCA believes that two fundamental issues need to be addressed prior to discussion of the commercialisation of research and its implications for governance arrangements within universities.

Firstly, it should be clearly understood by university administrators and governing bodies that if universities wish to generate significantly higher revenues from the commercialisation of research it is likely that universities would need to expose themselves to significantly higher levels of risk. As with other commercial activity, the level of return in the area of research commercialisation is linked to the level of risk assumed by the organisation commercialising the research.

At one extreme, universities could take a zero risk/zero return approach to the commercialisation of research by simply not engaging in the commercialisation activities. In this case they would renounce any rights to IP generated through research conducted by the university and allow others – such as researchers, venture capitalists or companies - to take on the commercialisation task if they wished. If universities followed this approach, there would be no need for them to develop strong risk management strategies and competencies relating to research commercialisation at either a management or governing body level.

At the other extreme, universities could seek to take on full responsibility for the commercialisation of research. This high risk/high return approach would see universities' claim and protect the IP generated through university research, fund the further development of the IP into a product with commercial potential and bring the product to market. In essence the university would be acting as inventor, seed funder, venture capitalist and company operator. Obviously, to fill these roles would require universities to develop a wide range of skills,

¹¹ Ministerial Discussion Paper, *Meeting the Challenges: The Governance and Management of Universities*, August 2002, pg.61

provide significant pools of funding and take on full commercial risks. Adoption of this approach would require universities to develop very significant risk management processes and capabilities at both a management and governing body level.

The BCA would not advocate that universities pursue either of these extreme approaches. Rather, universities should most likely seek to pursue a moderate risk/moderate return approach to the commercialisation of their research. Details of what such an approach may entail in terms of processes and risk management capabilities is discussed further below.

Secondly, universities need to be aware that from the perspective of either venture capitalists or companies interested in participating in the commercialisation of research, one key feature in the approach taken by universities to research commercialisation will be a major determinant of whether it is viable for them to deal with the university to pursue commercialisation opportunities. It is imperative that the ownership of the IP should be clear – unless a venture capitalist or company can clearly identify who has ownership of the IP they wish to commercialise they cannot commence the commercialisation process. It is also highly desirable from the perspective of potential commercial partners that ownership of the IP is vested in one legal entity. The way that universities allocate the benefits that may flow from IP between the researchers, particular faculties or the wider university is of relatively minor concern to potential commercial partners. Potential commercialisation partners simply require that the IP is appropriately protected and is owned by a clearly identifiable legal entity.

Before considering how Australian universities may wish to approach the commercialisation of research, and the implications of this approach for appropriate governance arrangements, the approaches to research commercialisation adopted by three recognised leading international institutions are very briefly considered in Box 1.

Box 1

BEST PRACTICE APPROACHES TO COMMERCIALISATION OF RESEARCH

Stanford University and the Massachusetts Institute of Technology in the United States and Cambridge University in the United Kingdom have been widely acknowledged as leading performers in terms of the successful commercialisation of research undertaken at these institutions.

There are some important common features evident in the approach taken to commercialisation of research by these institutions.

The three institutions each have one body – the Office of Technology Licensing at Stanford, the Technology Licensing Office at MIT and the Technology Transfer Office at Cambridge – with clear responsibility for the management of IP generated at the institutions. Each of these offices takes a flexible approach to how to best commercialise research.

These offices do not seek to undertake the commercialisation of the IP “in house” but rather look to either licence or sell the IP to companies or venture capital providers or help the investors establish spin out companies. Their focus is to see the IP successfully developed and commercialised in a timely manner in a way that benefits all stakeholders, not to try to extract maximum financial returns for the university from the IP.

The approach adopted by each of these institutions can be seen as a moderate risk/moderate return approach.

Sources: Stanford OTL, MIT TLO and Cambridge TTO websites

A moderate risk/moderate return approach for the commercialisation of research by Australian universities

The adoption of a moderate risk/moderate return approach to research commercialisation by Australian universities would see each university have appropriate structures and resources in place that allow it to identify, protect, market, licence or sell and distribute returns from IP generated at the university. A complicating factor in the Australian environment is that much of the most commercially oriented research is conducted within research centres (such as CRCs) that include participants from a number of different institutions. In the case of multi-institutional research projects it is important that it is clearly identified at the outset of the research project what body will be responsible for the management of IP generated through the research program.

Implications of a moderate risk/moderate return approach for risk management capabilities and governance arrangements

The adoption of a moderate risk/moderate return approach to research commercialisation has a number of implications for the governance and risk management arrangements that should be in place within universities.

In particular the governing body will need to ensure its members have the range of skills, and access to expert advice, necessary to:

- oversee the development of clear institutional policies towards IP and risk management;
- oversee the establishment (where such a body has not already been established) and appropriate resourcing (the TLO at MIT spent over US\$7 million in 2001 on patent fees alone) of a single commercialisation office with responsibility for management of university IP;

- provide appropriate oversight of the activities of the commercialisation office. This will likely involve regular internal reports on the operation of this office being provided to the governing body. It will also likely require an annual independent assessment of this office to be conducted and the results provided to the governing body. The governing body should have either a committee or particular members charged specifically with oversight of the activities of this commercialisation office.

If universities wish to adopt a higher risk/higher return approach to the commercialisation of research, which some universities appear to be doing (through vehicles such as the UniSeed fund), the oversight procedures and risk management capabilities of governing boards will need to be developed even further.

Section Three

Developing Best Practice Governance Arrangements

Key Points

The changing and more complex nature of the operating environment for universities makes the adoption of best practice governance arrangements within the sector more important than ever before.

The process of change in this area is already underway. There is a need to continue the process of ongoing improvements to achieve best practice governance arrangements.

The BCA believe that a number of further actions should be taken to ensure that best practice governance arrangements are in place within the Australian Higher Education sector. Such actions include:

- ensuring that the core objectives of universities are clearly defined in their governing Acts;
- ensuring the role of governing bodies is clearly articulated by legislation and each university - including a clear statement that the role of the governing body is to act in the interests of the university as a whole and not to advance particular sectional interests and to achieve the stated core objectives;
- board appointment processes should be reviewed and ‘quotas’ for board members from particular interest groups removed;
- the responsibilities of the governing body should be clearly articulated by each university;
- a comprehensive set of university governance best practice guidelines should be developed;
- universities should provide an assessment of their governance arrangements against these best practice guidelines;
- State/Territory and Commonwealth governments should work together to harmonise and streamline the legal, accountability and performance data requirements for universities;
- State/Territory and Commonwealth governments should work together to harmonise relevant policies and procedures to ensure universities can effectively operate in a commercial environment to achieve their core objectives. Universities should use relevant risk management strategies.
- more emphasis should be placed on the development of true performance outcome measures in the areas of student learning and research. The resources allocated to procedural reporting of input and throughput data should not be great;

- consideration should be given to the remuneration of governing body members in recognition of the increasing complexity and importance of the tasks to be undertaken by governing bodies; and
- consideration should be given to significantly reducing the average number of State government/Ministerial appointments to governing bodies.

Overview of key issues

The recent Ministerial issues paper, *Meeting the Challenges: The Governance and Management of Universities*, raises a wide range of issues in relation to the governance of universities in Australia. Issues discussed range from the appropriate definition of what “governance” refers to, through to more specific questions relating to how the current system of university governance in Australia could be altered.

Areas of potential change highlighted include (but are not limited to) whether:

- university governing Acts should be amended to clarify the role of governing bodies;
- provisions for Parliamentary, Ministerial and Governor-in-Council appointments should be removed;
- the size of governing bodies should be reduced;
- a good practice manual for university governance should be developed;
- governing board members should be remunerated; and
- the legal and accountability requirements of the State/Territory and Commonwealth governments should be harmonised and streamlined.

Each of these suggestions, along with several other suggestions for change set out in the issues paper, are all worthy of consideration in the context of trying to achieve best practice in university governance in Australia. At the conclusion of this submission the BCA has made a number of specific recommendations for action in the area of governance.

However, before commenting on particular suggestions for change, the BCA feels that it is important to first address some of the core issues that should underpin consideration of any specific potential changes, namely:

- what are the fundamental principles of good governance for universities;
- what new governance challenges are associated with the changing roles of universities; and
- how well do current governance arrangements cope with the challenges presented by the changing role of universities.

The BCA believes that consideration of these questions is necessary if we are to understand what, given the changing roles and activities of universities in Australia, would constitute the key features of best practice university governance arrangements in Australia.

Once the key features of best practice governance arrangements are agreed, specific proposals for change in current arrangements can be assessed in terms of whether they will support the movement towards best practice arrangements.

Fundamental principles of good governance for universities

The importance of good corporate governance has received a great deal of attention recently in response to a number of high profile corporate collapses both in Australia and overseas. While the mechanisms for achieving good governance in the corporate sector are not all applicable in the context of university governance, many of the fundamental principles of what good governance entails are highly relevant. Principles relating to transparency, accountability, efficiency, equity and risk management are all relevant to the governance of universities.

A number of studies into governance, in Australia and overseas, have been conducted in recent years. Of particular interest, when attempting to formulate principles for university governance, are:

- the 1995 Higher Education Management Review (the “Hoare Report”);
- the OECD Principles of Corporate Governance released in April 1999;
- the discussion paper, *Principles and Better Practices: Corporate Governance in Commonwealth Authorities and Companies*, released by the Australian National Audit Office in May 1999;
- a number of papers and speeches delivered over the past two years by the Australian Auditor General that deal in particular with issues surrounding risk management and performance information best practice;
- the performance report into *Corporate Governance Principles and Practices* released by the New South Wales Audit Office; and
- the 2002 Review of University Governance conducted by the Victorian Government.

The fundamental governance principles that have emerged from these studies are of considerable interest in terms of establishing principles for university governance arrangements. Also of interest is the dominant governance model in the United States, that be described as according with the “corporate” model of governance. The governing body within most American universities takes on roles and responsibilities analogous to those of boards of directors in corporations¹².

Reflecting the differences in the operations and objectives of private sector corporations, public sector companies and universities, the details of the principles for good governance that emerge from these studies differ somewhat. However, a number of common fundamental principles applicable to good governance for universities do emerge, namely:

¹² Harvard University for instance has a seven member board of the Harvard Corporation that meets frequently and is responsible for the operations of the University. This board is in turn responsible to a much wider Board of Overseers that meets infrequently and is available to provide advice regarding the direction of the University. See B.Hermalin, University of California Berkeley, *Boards of Trustees in Higher Education: A Research Program*, paper presented at the June 2002 Cornell Higher Education Research Institute Conference: Governing Higher Education for further discussion of the governance paradigm in the USA. www.ilr.cornell.edu/cheri.

Articulation of objectives, roles and responsibilities

- the universities objectives should be clearly articulated (likely in its governing legislation) and the universities governance system should be designed to best support the achievement of these objectives;
- the functions of the governing body should be clearly articulated and the governing body be imbued (by legislation where necessary) with sufficient authority to fulfil its stated role; and
- the responsibilities of members of the governing body should be clearly articulated and members provided with appropriate resources to allow them to fulfil their roles.

Responsibilities of the governing body

- the governing body should act on a fully informed basis, in good faith, with due diligence and care, fulfilling professional obligations and in the best interests of the university;
- the governance framework should ensure that the governing body: is capable of providing strategic guidance of the university (which may require members of the governing body to, on aggregate, possess a wide range of skill sets); effectively monitors the performance of management; manages institutional risk (which may entail the provision of resources to allow for access to independent advise, the establishment of audit, remuneration and other committees without management representation on them, and so on); and is accountable to the university and its stakeholders.

Disclosure and transparency

- the university's governance framework should ensure that timely and accurate disclosure is made of all material matters relating to the university's operations, including its financial performance and its performance against the university's stated objectives; and
- clear and transparent mechanisms for the appointment of governing body members and the oversight of governing bodies activities should be in place.

Efficiency

- the governing body should be constituted so as to discharge its responsibilities in an efficient manner (issues of governing body size, frequency of meetings, possible remuneration of members, the adequacy of systems for distribution of information to members and so on will all impact upon the efficiency of the governing body).
- governance and reporting arrangements should not involve duplication of effort and excesses in administrative burdens (this clearly has implications for the roles currently played by State/Territory and the Commonwealth government). National protocols for reporting and governance arrangement could potentially be developed through the Ministerial Council for Education, Employment, Training and Youth Affairs forum.

Such seemingly common sense broad fundamental principles would appear to be widely acceptable and the BCA strongly endorses each of these fundamental principles. However, there does appear to be some dispute within the sector regarding some of these principles.

For instance the fundamental principle that a university's governance system should be designed to best support the achievement of the university's core objectives is by no means universally accepted within the sector. The issue of whether the members of university governing bodies should be seen as "custodians" of the university or as "delegates" representing the sectional interests of particular stakeholder groups still appears to be the subject of considerable debate¹³.

On this particular issue, the BCA strongly endorses the view, expressed in the Hoare report, that the members of a university governing body should recognise that their overriding responsibility is to further the objectives of the university rather than to advance particular sectional interests. Unless the goals of a university's governing body are aligned with the core objectives of the university, the governance system will act as a hindrance, rather than a spur, towards the achievement of the objectives of the university.

The need to collect and disclose information relating to university performance in core areas such as teaching and learning outcomes also does not appear to widely accepted within the higher education sector.

A recent research report¹⁴ commissioned by the BCA highlighted the lack of consistent, broadly-applied outcomes assessment processes at the higher education level in relation to core performance areas such as student learning. For instance it is not possible to establish whether graduates from Australian universities are better today than they were a decade ago, or how they compare with higher education graduates from overseas. If resources are to be efficiently applied within the sector in the future it is essential that the outcomes associated with different practices can be measured and assessed.

The BCA believes that the introduction of systemic measurement of student learning outcomes should not only be a public policy priority, but also a priority for universities themselves. Universities need to properly assess things such as student learning outcomes if they are to be able to adequately measure their own performance against their core objectives. The ability to assess institutional performance against institutional goals is obviously of central importance for effective institutional governance.

New governance challenges associated with the changing roles of universities

The process of change in the area of governance is already underway within the Australian Higher Education sector, with significant changes having been implemented at a number of institutions. For instance, the University of Sydney has recently resolved to implement a new Senate committee structure, establishing committees and task forces to deal with matters such as audit, finance and executive remuneration. However, despite progress made in recent years, a continued commitment to achieving best practice governance arrangements within the sector is needed.

¹³ a paper by Meredith Edwards, Director of the National Institute for Governance at the University of Canberra, *University Governance: A Mapping and Some Issues*, delivered to the LifeLong Learning Network National Conference sets out some detail regarding this debate.

¹⁴ The report, *Higher Education in Australia: Developing a New Data Framework and International Comparisons and Issues*, is available on the BCA website.

Accepting and acting in accordance with the fundamental principles for good governance outlined above can perhaps best be seen as a necessary step to ensure good university governance. However, the increasingly complex and challenging environment within which universities operate means that the way these principles are enacted may be very different to the arrangements that were acceptable in the past.

For instance, the principle that the governing body should be so constituted as to be able to effectively monitor the performance of management and manage institutional risk may require governing bodies to have different membership profiles and resourcing arrangements to those that would have been sufficient to fulfil these functions ten years ago.

The trend towards universities undertaking a more complex range of commercial activities has significant implications for the level of risk management capabilities required of university governing boards.

The need for universities to generate greater non-government revenues means not only that management has to be empowered and capable to do this but also that the governing body of the university is empowered and capable of overseeing these activities.

The Australian Auditor General has identified risk management as a central issue for good governance in public sector and has made risk management a particular area of focus of the Australian National Audit Office's performance audit program¹⁵.

The issue of risk management by universities is not restricted to Australia. In the United Kingdom for example, the HEFCE has produced briefing on risk management for governors and senior managers and a guide for good practice in risk management¹⁶.

How current governance arrangements are coping with the challenges presented by the changing role of universities

It is incumbent upon higher education institutions to appropriately use the financial resources provided to them, whether they be by Government, industry, fee-paying students or private benefactors. Governance frameworks are largely set through State Government legislation. At present there are both governance obligations linked to the entire operation of institutions and governance obligations linked specifically to how public resources are used by institutions.

The BCA believes that the governance systems of institutions should be evaluated in terms of whether:

- the objectives, roles and responsibilities of the university, governing body and governing body members are clearly articulated;
- the governing body is fulfilling its key responsibilities in the areas of strategic guidance, risk management, oversight of management and accountability to stakeholders;

¹⁵ See for example the address by the Auditor General, *Risk Management in the Australian Public Service Today and Tomorrow*, delivered at the launch of the Australasian Risk Management Unit, Monash University, February 2001

¹⁶ For discussion of these initiatives see page 84 of the *2002 Review of University Governance* conducted by the Victorian Government

- the governing body has transparent operating procedures and whether the universities disclosure obligations are being met; and
- the governing body is discharging its responsibilities in an efficient manner and whether the governance arrangements avoid duplication of effort and excesses administrative burdens.

The 1995 Higher Education Management Report (the Hoare Report) considered in detail the performance of existing university governance structures from the perspective of how they were impacting upon the effective functioning of universities. The report examined a number of aspects of governance including:

- the role of the governing body;
- the role of the Chancellor and Vice Chancellor;
- the size and composition of the governing body; and
- the relationship between the governing body, the academic board or senate and the Vice Chancellor.

The review made a number of recommendations designed to improve the performance of university governance structure, in particular to improve the clarity of the role of governing bodies.

While there has not been a comprehensive national review of university governance practices in Australia since the Hoare Report, there have been a number of studies completed in recent years that shed some light on current governance arrangements within the sector. These studies include:

- the 2001 Phillips Fox Lawyers review, *The Regulatory Environment Applying to Universities*;
- the performance report into Corporate Governance Principles and Practices released by the New South Wales Audit Office;
- the 2002 Review of University Governance conducted by the Victorian Government; and
- a paper by Meredith Edwards, Director of the National Institute for Governance at the University of Canberra, *University Governance: A Mapping and Some Issues*, delivered to the LifeLong Learning Network National Conference

The Phillips Fox study, which explores the legal underpinnings of university governance in Australia, highlights that due to most universities being founded under State legislation there are some important differences between universities in terms of:

- restrictions on the establishment of companies by universities;
- rules governing investments and borrowings;
- land use, acquisition and disposal rules; and
- the treatment of intellectual property and the commercialisation of research

However, it would appear that a number of States have recently or are currently reviewing university governing legislation with a view to amending legislation

to better reflect the changing university operating environment. While the BCA support's such moves, it notes that it is somewhat incongruous that the States/Territory Governments play this major role in the governance of universities while playing a much more limited role in either providing funding for universities or in monitoring universities' performance.

The performance report into Corporate Governance Principles and Practices released by the New South Wales Audit Office surveyed a wide range of public sector organisations in New South Wales to establish their current governance practices. This study included a survey of a group of 32 universities and subsidiaries in New South Wales. The key findings of this survey can be summarised as:

- members of university and subsidiaries governing bodies perceived resource management to be their primary role, followed by corporate strategy, communicating objectives, overseeing management's performance and ensuring compliance with legal requirements;
- in 47% of the governing bodies members were assigned specific roles;
- 38% of governing bodies had no board committees (such as audit, finance, remuneration) which was a high percentage compared to other types of public sector organisations. Only 34% of the bodies had an audit committee;
- the governing bodies tend to draw their experience evenly from the public and private sectors;
- the governing bodies tended to meet once every two months (38%) or less frequently (34%);
- approximately half of the governing bodies had identified their own key performance indicators to monitor management's performance; and
- 53% of the governing bodies had internal systems for supplying information to the body that are independently and regularly reviewed by internal audit (a low proportion compared to other types of public sector organisations).

What these results indicate is that while some governing bodies have some features of best practice governance practices in place, performance is quite variable across the sector in New South Wales.

The 2002 Review of University Governance conducted by the Victorian Government examined a number of aspects of university governance in Victoria and made a range of recommendations for change. While noting that some of the system wide standards recommended are already in place at some universities, the review does highlight that, as in New South Wales, governance arrangements and practices are quite variable across different universities in Victoria. Some of the review's key recommendations for change, that very much accord with the fundamental principles for good governance discussed above, include:

- (R1) that all universities have objects specified in their Acts;

- (R3) that the primary functions of the governing body include: appointing and monitoring the performance of the vice chancellor; identifying the mission and setting the strategic direction of the university, ensuring appropriate accountability to stakeholders; performance monitoring; and risk management;
- (R5) that universities' Acts state explicitly that council members' duty is to act solely in the interests of the university taken as a whole having regards to its objects;
- (R22) that universities be required to include in their annual report on operations their progress in handling risk; and
- (R24) that university councils establish effective oversight of controlled entities that incur substantial risk.

The BCA recommends this review as providing a very worthwhile contribution to the debate surrounding university governance. Indeed, this document, in combination with other inputs such as the Hoare Report, could provide a solid basis upon which a best practice guide to university governance could be developed.

Meredith Edwards, in her paper, *University Governance: A Mapping and Some Issues*, attempts to assess how university governance structures have changed in Australia since the 1995 Hoare Report. While her study only represents an initial examination of the topic, a number of the findings suggest that while some progress towards better governance has been made since the Hoare Report, such progress is not evident uniformly across the sector and there is clearly still room for further improvements in governance arrangements.

In particular, the paper indicates that:

- while the average size of governing bodies has reduced from 27 in 1990, to 26 in 1995 and to 22 in 2000. This is still significantly higher than the recommended size of 10-15 put forward in the Hoare Report. (Interestingly, research in the area of corporate governance has demonstrated that firm profitability is negatively related to the number of director's on the firm's board¹⁷. It is not clear, however, whether a similarly strong negative correlation between governing body size and institutional performance exists in the university sector.)
- in terms of board composition, there has been a decline since 1995 in the average number of academic staff members and parliamentary members on governing bodies. There has consequently been a rise in the proportion of governing body members subject to Government/Ministerial appointment (the average number of which has remained stable at six since 1990); and
- there is "a remarkable lack of information on roles and responsibilities of councils at the majority of universities" and a "great deal of uncertainty about what they actually do", with a clear public indication of what the role of the governing body is being found for only 12 of the 35 universities studied.

Summary of conclusions

¹⁷ See for example D.Yermack, *Higher Valuation of Companies With a Small Board of Directors*, *Journal of Financial Economics*, 40, 1996

From the above briefly described reports and reviews, a general picture of the current status of university governance emerges. Key features of the current situation can perhaps be summarised as:

- while there are numerous examples of good practice in relation to particular governance issues and in particular institutions, performance across the sector tends to vary considerably on an institution by institution and issue by issue basis;
- the issue of ensuring sound risk management capabilities and practices is seen to be of increasing importance for the Higher Education sector; and
- while there is certainly not evidence of a crisis in governance there is room to raise governance standards across the sector.

Key features of best practice university governance arrangements

Drawing on the above assessment of the fundamental principles for good governance, the challenges posed by the changing nature of universities activities and a review of the current governance situation in the Australian Higher Education sector, it is possible to set out a preliminary list of the key features of what best practice university governance arrangements entails.

The BCA believes that the following list provides a small number of the key features for best practice governance arrangement in the university context:

- the fundamental objectives of universities should be clearly stated in their enabling Acts;
- the role of the governing body should be clearly articulated, preferably in the governing legislation, as being to act in the interests of the university as a whole for the achievement of its stated core objectives and not advance particular sectional interests;
- the responsibilities of the governing body should be clearly and publicly stated by each university. The key responsibilities for the governing body should be to guide the strategic direction of the university, manage risk, monitor and report on university performance outcomes, ensure compliance with statutory requirements; appoint and oversee the performance of the vice-chancellor and liase with stakeholders and ensure the achievement of its stated core objectives;
- while the governing body should be constituted of members with a range of skills (it is in particular essential that at least some members have strong skills in the area of risk management), governing bodies should be no larger than is necessary to ensure that such skills are available;
- processes for the appointment of board members should focus on ensuring that the board has the broad range of skills necessary for it to fulfil its role and should not be restricted by the need to fill ‘quotas’ for board members from particular interest groups;
- governing bodies should establish strong standing committee structures, and in particular a standing audit committee, which is provided with the resources necessary to secure independent audit advice;

- the academic board, which is responsible for overseeing academic quality and ethical standards, should not operate in isolation from the broader university governance system. The academic board should act in the best interests of the university as a whole and should regularly report to and interact with the governing body; and
- governing bodies should prepare an annual risk management plan and report against this plan each year.

While this list is preliminary and far from comprehensive, it does provide guidance on where changes to current governance arrangements may be warranted. The BCA believes it would be worthwhile for the Commonwealth Government to take the lead in the development of a comprehensive set of best practice guidelines for university governance in Australia.

The recent governance changes undertaken by the University of South Australia, were pointed to in the Ministerial issues paper on governance as an example of good practice within the Australian Higher Education sector. The discussion below, of the changes implemented at the University of South Australia and their impacts, highlights how better governance practices can be practically implemented.

Governance arrangement changes at the University of South Australia

The University of South Australia was profiled in *Meeting the Challenges: the Governance and Management of Universities*, as an organisation that had reviewed governance structures and processes consistent with the Hoare Report recommendations. Their primary motivation for changing governance arrangements was achieving the level of transparency, accountability and risk management required in an increasingly commercial environment. Balanced by processes to sustain the collegial culture of university work, their governance combines a focus on high-level strategy with operational clarity. Box 2 sets out some of the important lessons learnt by the University during this change process.

Box 2

LESSONS LEARNED BY THE UNIVERSITY OF SOUTH AUSTRALIA

Change is occurring rapidly in the sector. The University of South Australia believes that the legislative and accountability framework in South Australia supports the achievement of our mission. Good governance practices are proving to be a core requirement for making the right adjustments in the new environment. Each governing Council should be continually evolving and improving in response to the particular needs of the community and relevant stakeholders. We strongly support the suggestion that the Government encourage governing bodies to review their own performance regularly.

Establishing a strong standing committee structure (eg Academic Board, Finance committee, Audit committee) has enabled the University of South Australia Council to focus on strategic and corporate planning and has provided greater clarity in the functions of those committees. Establishing an expert Finance Committee to provide the governing body with advice and to monitor the institution's financial performance has been a crucial change in enabling forward planning, to ensure confidence in financial decisions and longer term financial viability.

The size of the Council is adequate at twenty-one members, given its composition. A reduction would inhibit the execution of the duties expected of Council members, particularly the support received from the external members, and good governance requires that they are greater in number than internal members. Staff and student members are valued and contribute to the effective functioning of the Council.

The tension between 'delegate' or 'trustee' conceptions of the roles of Council members has not been an impediment to progressing good governance at the University of South Australia because of the understanding of Council's primary responsibilities to serve the objectives of the university has been made explicit through induction and review and continuously reinforced through the Council leadership.

Source: Discussions with senior administrative staff at the University of South Australia

The University has also identified a number of further steps to continue the process of improving governance arrangements. These include:

- achieving greater confidence by State and Commonwealth government in the governance and accountability of Universities is seen as an important goal; and
- alignment of State and Commonwealth accountability frameworks through a national agreement is desirable. It is important that if the Commonwealth Government increases university autonomy the States should not counter this by restricting autonomy.

Recommended actions to improve university governance arrangements

Bringing current practice into line with all these best practice principles requires a number of actions to be taken at both a system wide and specific institutional level. Based on an assessment of the state of university governance arrangements and practices in Australia against a number of key principles for governance best practice, the BCA recommends that the following initial actions:

- ensuring that the core objectives of universities are clearly defined in their governing Acts;
- ensuring the role of governing bodies is clearly articulated by legislation and each university - including a clear statement that the role of the governing body is to act in the interests of the university as a whole and not to advance particular sectional interests and achieve the stated core objectives;
- board appointment processes should be reviewed and 'quotas' for board members from particular interest groups removed. Processes for the appointment of board members should focus on ensuring that the board has the broad range of skills necessary for it to fulfil its role;
- the responsibilities of the governing body should be clearly articulated by each university;
- a comprehensive set of university governance best practice guidelines should be developed;
- universities should provide an assessment of their governance arrangements against these best practice guidelines;

- State/Territory and Commonwealth governments should work together to harmonise relevant policies and procedures to ensure universities can effectively operate in a commercial environment to achieve their objectives. Universities should use relevant risk management strategies.
- State/Territory and Commonwealth governments should work together, perhaps through the Ministerial Council for Education, Employment, Training and Youth Affairs forum, to harmonise and streamline the legal and accountability requirements for universities and harmonise and streamline the provision of performance data by universities. Good governance is not about submitting input and throughput data to multiple government agencies. The time spent on procedural reporting should not be great and certainly should not take resources away from more strategic governance issues such as risk management. As part of this performance data reporting harmonisation process, more emphasis should be placed on the development of true performance outcome measures in the areas of student learning and research;
- more emphasis should be placed on the development of true performance outcome measures in the areas of student learning and research. The resources allocated to procedural reporting of input and throughput data should not be great. If the establishment of one central intermediary body will result in less overall allocation of resources, by both government and universities, to the assembly, submission, analysis of and reporting on procedural data, it may be worthwhile. However, it would be inappropriate to form a new body that simply adds an additional administrative layer to the performance monitoring system;
- consideration should be given to the remuneration of governing body members in recognition of the increasing complexity and importance of the tasks to be undertaken by governing bodies; and
- consideration should be given to significantly reducing the average number of government/Ministerial appointments to governing bodies.