How to Apply the Concept of Independence in the University Board Governance Context

by Cheryl Foy

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What is Independence in a Board Context?

It is broadly accepted in corporate governance circles that boards entrusted with overseeing corporate entities must be largely comprised of independent members. Anyone in a material relationship with an organization is not independent. KPMG advises that a ""material relationship" is a relationship that could, in the view of the board, be reasonably expected to interfere with the exercise of a member's independent judgement" [1]. In the unique context of university boards, on which stakeholders such as faculty, staff and students serve, the application of the concept of independence requires careful thought. This paper seeks to demonstrate that principles of independence can be fully respected and can co-exist with university principles of shared governance and collegiality.

Why Is Independence Important in Governance?

Independence is important because it is assumed that being independent or having no material relationship with an organization is necessary for board members to have the objectivity and distance to oversee the organization. This intuitively makes sense. We know that relationship impairs objectivity. When I've made this point in the past, I've been assailed by social scientists who assert that no one is objective. I agree. But some, by virtue of their relationships with the university, are less objective than others who are unrelated. Those without relationships of employment or study have fewer barriers to objectivity and fewer barriers to a focus on the best interests of the institution as opposed to the best interests of any single interested party. Indeed, many internally elected members report feeling a sense of obligation to represent those who elected them whereas their role is to bring the perspective of that group and then consider all of those with an interest when coming to a decision about what is in the best interests of the university.

Under the ISO37000 *Governance of organizations – Guidance*, the relationship between independence and good decision-making is reinforced: governing bodies are advised that in the course of "mak[ing] decisions of requisite quality and ensur[ing] that its decision making is appropriately informed …the governing body should: … consider its level of independence and the effect this has on its decision-making, including financial interests, position, associations, relationships, bias and alliances" (p.29).

[1] https://assets.kpmg.com/content/dam/kpmg/ca/pdf/2021/11/kpmg-audit-committee-guide-canadian-edition.pdf, p. 6

The Council of Ontario Universities makes a similar connection between decision-making and independence in its *Leading Practices* paper: "The majority of board members are external to the university and are able to exercise independent and impartial judgment (e.g., no personal or financial relationships, continuing conflicts of interest)"[2].

Finally, KPMG describes the "willingness to challenge management" as the "essence of independence"[3]. In the university context, I'm not sure that this assertion holds as I've seen faculty members, in particular, very interested in challenging management. But the point here is that those employed by an organization either may be interested in challenging management to advance a specific party's agenda or may be intimidated from challenging management because their continued employment, a promotion, or other benefit may be threatened. In the private sector, similar concerns are raised when board members remain in place too long. For example, in the United Kingdom[4], the corporate governance code for public companies demands justification for board members to remain on boards for longer than nine years. The presumption is that board members become too close to management and lose their independence as too much time passes.

The gist of all this is that board and board member independence is seen as fundamental to good decision-making.

Independence, Financial Literacy, and Audit Committees

Committees with audit responsibility are a particular focus for independence, along with financial literacy. Why is this the case? Overseeing the financial integrity of an entity through the audit function is seen as one of most important roles of a board and independence from the organization is seen as essential to the effectiveness of that oversight. For non-profit boards (which includes universities), Grant Thornton describes accountability and independence as the two key principles guiding audit committees.

Financial literacy is commonly understood to be the ability to read and understand financial statements of the complexity of the applicable organization. I would add that it includes the ability to ask probing questions about those statements. The COU *Leading Practices* document indicates that all audit committee members should be "external members and [there must be] a sufficient number who are financially literate"[5] . The better practice is to ensure that all audit committee members are both financially literate and independent. It is noteworthy that in a

[2] https://ontariosuniversities.ca/wp-content/uploads/2022/11/Leading-Practices-in-University-Board-Governance-COU.pdf, p.3
[3] https://assets.kpmg.com/content/dam/kpmg/ca/pdf/2021/11/kpmg-audit-committee-guide-canadian-edition.pdf, p. 6
[4] https://board-excellence.com/blog/2019/06/16/long-serving-board-directors-challenges-dilemmas-opportunities-best-practices/
[5] https://ontariosuniversities.ca/wp-content/uploads/2022/11/Leading-Practices-in-University-Board-Governance-COU.pdf, p.4

2022 Value for Money Audit, the Auditor General of Ontario sees financially literacy as a requirement for the board as a whole. She noted that more than a third of one university's board was not financially literate and that "near-to-all members of a board should be competent in this area".[6]

Who is Not Independent on a University Board?

In the private sector, the focus is on ensuring that the organization recruits and selects board members that are unrelated to the corporate entity (meaning that they don't have personal or financial relationships with the entity or key personnel). It is common for private sector boards, like university boards, to include the president and CEO as a member. The president and CEO is is not considered independent. University boards in Canada differ because from most other boards because in addition to including the president, they also (typically because their statute prescribes this) include members of faculty, staff, and students. Faculty and staff in an employment relationship or those in a student relationship with the university are in material relationships with the university and thus not independent. This lack of independence extends to *ex officio* board members like the university president, principal, or rector.

How Does Independence Co-Exist with Shared Governance and Collegial Principles?

Shared Governance: The concept of shared governance is complex and is not the focus of this paper. Suffice it to say that shared governance seeks to ensure the role of faculty in the governance of the university. The idea is that those with academic knowledge and expertise will provide informed perspectives respecting decisions of an academic nature. Shared governance gives rise to academic governing bodies like university senates who are delegated power and authority to decide and/or advise on academic matters. Shared governance is also the reason that faculty members sit on university boards. Shared governance has been extended to include students and staff on university boards.

Collegiality: Collegiality is an approach to decision-making that has been described as "the bedrock of university governance practice … [and is] a tradition that revolves around conferring, collaborating, and gaining consensus. It is also a collective process for decision-making in which academics play an integral role"[7]. Like shared governance, collegiality prescribes a special role for faculty in university decision-making.

University Boards: By virtue of their legislation, university boards in Canada are almost universally composed of a majority of external or independent board members. Having a majority of external or independent board members is a feature of university governance

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[6] https://www.auditor.on.ca/en/content/annualreports/arreports/en22/AR_FinancialMgmtUniversities_en22.pdf, p.8

[7] I. Austin & G. Jones, *Governance of Higher Education – Global Perspectives, Theories and Practices* (New York: Routledge, 2016), p. 125

designed to ensure that universities serve the public interest. And while university boards cannot assert the level of independence of some private boards, the fact that university boards have a majority of external board members supports the assertion that the boards are independent from a governance perspective. The fact that most university board composition includes faculty, staff, and students, means that at the board level principles of independence, shared governance and the aspect of collegiality that supports faculty inclusion in decision-making, are all respected.

University Board Committees: Some worry that excluding internal university board members from committees such as audit or human resources committees creates two classes of university board members and furthermore that it is inconsistent with university practices based in collegiality and principles of shared governance. I disagree. Shared governance and collegiality seek to involve key stakeholders in decision-making but that goal can be achieved in multiple ways. It does not, for example, mean in governance that all stakeholders must sit on all committees. More on this below.

Does the Concept of Independence Create Two Classes of Board Member? It is a fact that internal and external board members will constitute two board groups with distinct features. This fact, however, does not automatically lead to generalized preferential treatment for external members. A lack of independence is not an attribute that renders that member "lesser than" any more than an external board member who brings great strategic skill but no knowledge of universities should be seen as "lesser than". Ideally, all board members are valued for the skills, experience, and perspective they bring. Having two adverse groups on a board is a sign of more general board dysfunction unrelated to concepts of independence. Board leadership should be striving to create a functional board on which all board members understand and strive to fulfil their legal duties to act in the best interests of the university. When assigning board members to committees, it should be a practice to consider the attributes and skills of the different board members against the committee requirements. Independence is one attribute that will make a board member unsuitable for a committee like audit but will not be a requirement for other board committees.

Good Governance can Co-Exist with Principles of Shared Governance and Collegiality: The principles of good governance can co-exist with a strong commitment to shared governance and collegial principles. Universities are expected to follow good governance practices and indeed, Ontario universities have publicly committed to do so through the COU *Leading Practices* document cited above. Independence is a fundamental principle of good governance and ensuring independence and financial literacy on audit committees is fundamental to good governance. Independence is also appropriate on committees responsible for human resources matters and in particular those charged with final decisions about the performance of the president. Two things should give internal members comfort that independence and shared governance/collegialism can co-exist: 1) there are multiple board committees on which internal members can sit and make a meaningful contribution without compromising good governance by sitting on committees which require independent members, and; with the exception of highly confidential matters delegated fully to a committee, committee work and decisions are transparent to and overseen by the full board. All members of the board have the opportunity to see and ask questions about the work done by board committees. Internal members are still included in decision-making but at the board level, rather than the committee level. Principles of good governance, shared governance, and collegiality are all respected in this approach.

Conclusion: As universities strive to ensure effective governance within their unique contexts, it is important not to simply overlay corporate governance principles onto universities. Where corporate governance standards or principles jar or don't seem to fit, it is appropriate to take a step back to consider the underlying reason for the lack of alignment. It is important to analyze the sources of friction and look at what may seem to be competing principles. In the final analysis, my advice is to take an approach that realizes and respects the essence of all applicable principles.