

1-7-2007

The legitimising power of regulation for Australian banks: an institutional approach

H. Deo

University of Wollongong, deo@uow.edu.au

Hemant J. Irvine

University of Wollongong, hirvine@uow.edu.au

A. Abraham

University of Wollongong, aabraham@uow.edu.au

Follow this and additional works at: <https://ro.uow.edu.au/commpapers>



Part of the [Business Commons](#), and the [Social and Behavioral Sciences Commons](#)

Recommended Citation

Deo, H.; Irvine, Hemant J.; and Abraham, A.: The legitimising power of regulation for Australian banks: an institutional approach 2007.
<https://ro.uow.edu.au/commpapers/331>

The legitimising power of regulation for Australian banks: an institutional approach

Abstract

The history of the Australian banking system has been one of a striving for legitimacy, against a cycle of boom, bust and public antagonism. Despite a series of banking inquiries and ensuing regulatory reform, banks continue to announce unexpected results. Over the past 15 years, each of the four major Australian banks, while complying with the increasingly stringent requirements of regulatory bodies, reported at least one major financial blunder. An institutional perspective demonstrates that rules and regulations play a powerful legitimising role in assisting banks to maintain their public image in the face of such disasters.

Keywords

Banking, legitimacy, institutional theory, regulation, compliance

Disciplines

Business | Social and Behavioral Sciences

Publication Details

This paper was originally published as: Deo, H, Irvine, HJ & Abraham, A, The legitimising power of regulation for Australian banks: an institutional approach, Accounting & Finance Association of Australia and New Zealand Conference, Gold Coast, Queensland, Australia, July 1-3 2007.

The legitimising power of regulation for Australian banks: an institutional approach

by

Hemant Deo*

Helen Irvine*

Anne Abraham*

* Senior Lecturer, School of Accounting & Finance, University of Wollongong

Keywords: Banking, legitimacy, institutional theory, regulation, compliance

Corresponding author:

Dr Anne Abraham

Email: aabraham@uow.edu.au

Address: School of Accounting & Finance
University of Wollongong
Northfields Avenue Wollongong NSW Australia 2522

Telephone: +61 2 42213738

Fax: +61 2 42214297

The legitimising power of regulation for Australian banks: an institutional approach

Abstract

The history of the Australian banking system has been one of a striving for legitimacy, against a cycle of boom, bust and public antagonism. Despite a series of banking inquiries and ensuing regulatory reform, banks continue to announce unexpected results. Over the past 15 years, each of the four major Australian banks, while complying with the increasingly stringent requirements of regulatory bodies, reported at least one major financial blunder. An institutional perspective demonstrates that rules and regulations play a powerful legitimising role in assisting banks to maintain their public image in the face of such disasters.

1. Introduction

Against a history of boom and bust, and resulting “public antagonism” (Crane, *et al.*, 2001, p. 64), the Australian banking industry has struggled to create and maintain an image of legitimacy and success. Not one of Australia’s four biggest banks has been immune from financial controversy in the last fifteen years. In this period there have been announcements of unexpected losses or disasters by each of Australia’s four major banks, Australia and New Zealand Banking Corporation Ltd (ANZ), Commonwealth Bank of Australia (CBA), National Australia Banking Corporation (NAB) and Westpac Banking Corporation (WBC), culminating in the NAB’s unexpected announcement in January 2004, that it had incurred hundreds of millions of dollars in foreign currency trading losses. These surprise announcements have been made despite a history of government enquiries and the development of more stringent regulatory systems since the deregulation of the Australian banking system in 1979.

Such events illustrate the banks’ propensity to experience crises, undergo investigations, and re-form their corporate image before another crisis eventuates. They also raise questions about the purpose of regulation, disclosure, corporate governance and the financial reporting practices of Australia’s major banks. Because banking is a significant, competitive, high-profile industry, its major players must maintain their credibility in the marketplace in spite of occasional revelations of unethical or illegal practices and a lack of accountability. This paper asserts that institutionalised regulatory systems have a legitimising effect on Australian banks, assisting them to promote an image of strength and success in spite of recurrent failures.

The paper first provides an overview of some unexpected announcements made by the four major Australian banks since 1992, and then provides a framework for the interpretation of these events, based on institutional theory. It next provides a brief history of Australian banking enquiries and an overview of corporate regulatory structures, including the recent introduction of Australian Stock Exchange (ASX) corporate governance rules. Following this, the banks' responses to their respective crises and new regulatory requirements are explored. Conclusions are then drawn about the role and significance for banks, of Australia's regulatory framework, and possibilities for future research are outlined.

2. Unexpected announcements

In the twelve years immediately preceding NAB's shock announcement of January 2004, each of the four major Australian banks announced unexpected losses or expenses. Table 1 below highlights selected examples.

[Insert Table 1]

The unexpected announcements of the early 1990s related to property devaluations and the failure of the banks to recognize that they were grossly underprovided in respect of bad debts. NAB's unexpected announcement of 2002 related to its Homeside mortgage division, and the 2004 announcement related to the foreign currency trading losses already mentioned. In each of these cases, announcements of losses were followed by annual reports whose profit figures were dramatically affected. The figures in Table 1 are taken from the banks' annual reports rather than from earlier announcements of the extent of losses, underprovisions or writedowns.

In the early 1990s, all of Australia's big four banks experienced problems with bad and doubtful debt provisions, particularly ANZ, CBA and WBC. ANZ reported a

profit of \$267m in 1991 after a charge for bad and doubtful debts of \$1,037m. The following year, in 1992, ANZ reported a loss of \$579m (ANZ, 1992, p. 34; Lloyd, 1992, p. 37; Kaye, 1992, p. 28), due to massive bad and doubtful debt provisions of \$1,600m. In the 1992 Report to Shareholders, the provisioning charge was attributed to the “worst recession since the 1930s” in Australia (ANZ, 1992, p. 15), resulting in a devaluation of properties, particularly in Victoria, which was severely affected (ANZ, 1992, pp. 9 and 10). This charge was expected to be reduced in the years ahead, assisting the bank to return to profitability (ANZ, 1992, p. 8).

In 1991, CBA (1995, p. 34) declared a profit of \$883m, after a provision for bad and doubtful debts of \$1,026m. The following year, in 1992, the bank’s bad debt problems were not over (Willmer, 1992), with the bad and doubtful debts charge remaining high at \$843m. In 1992, the profit of \$409m was less than half that of 1991 (CBA, 1995, p. 34). 1992 was described in CBA’s annual report as a “difficult year during which economic activity remained weak” (CBA, 1992, p. 40).

WBC also struggled at that time with its bad and doubtful debt provisions. A profit of \$476m in 1991 was earned after making provisions of \$1,119m, and in 1992 the situation worsened, with a bad and doubtful debt provision of \$2,802m, resulting in a loss of \$1,562. (WBC, 1992, p. 38). The 1992 expense included new specific provisions relating to “diminutions in value of property development projects” (WBC, 1992, p. 55), brought about by changing valuation policy to current market value (WBC, 1992, p. 42) because of a disastrous fall in the property market. This led to a WBC write-down of property by 34% (Kavanagh, 1992, p. 18, WBC, 1992, p. 12).

NAB’s 2001 annual report reflected the result of the collapse of its United States subsidiary, HomeSide, as a result of what was “arguably Australia’s biggest corporate blunder” of that year (Durie, 2002, p. 72). The bank’s group net profit (after tax)

attributable to members of the company was \$2,083m after “writedowns of mortgage servicing rights and goodwill” in HomeSide Lending, Inc., after tax, of \$3,617m had been taken into account (NAB, 2001, p. 10). Despite the unexpectedness of the HomeSide announcements of July and September 2001, and the size of the loss, NAB was not punished by the market, with its share price increasing 47% by June 2002 (Durie, 2002, p. 72).

In December 2003 the NAB group reported a profit after tax of \$3,955m (NAB, 2003, p. 82), and the next month, unexpectedly, it announced estimated foreign currency trading losses of \$180m, which eventually grew to a staggering \$360m. They were incurred as a result of the illegal practices of several “rogue” foreign currency traders who, since 2001, had been taking advantage of the banks’ lack of internal controls (PricewaterhouseCoopers 2004, p. 7; APRA, 2004). Rather than being revealed through the bank’s own internal control systems, these revelations came about as a result of information about “suspicious behaviour” provided by one NAB “whistle-blower” (ABC, 2004; Hepworth, 2004, p. 4).

In an economy where the banking sector is dominated by its major banks to the extent of 70% of Australian banking business, these unexpected revelations had a significant effect on public perceptions about the image of NAB and other banks. However, such is the trust of the Australian public in the big banks as investment vehicles, and in the regulatory system’s ability to respond to crises, that invariably, they survive revelations of an unexpected nature, even if these revelations are massive in size and effect.

Immediately following NAB’s shock announcement, several inquiries were launched. In 2001, the Australia Prudential Regulatory Authority (APRA) had identified Australia as non-compliant with effective banking supervision requirements, and its

inquiry into NAB's foreign currency trading losses represented not just an investigation into the bank's practices, but also an attempt to safeguard its own reputation as the watchdog of the Australian financial industry. It required NAB to implement changes to its control systems (APRA, 2004, pp. 78–79; Murray 2004b, p. 27; Anonymous, 2004, p. 78), further damaging its reputation and integrity (Cornell, 2004, p. 55).

NAB conducted its own investigation in order to determine how the losses occurred, their extent, and also to re-establish its image, which had been considerably tarnished. Criticism of its board was harsh, with “an unsuspected degree of sloppiness in the bank's risk management” being uncovered (Sykes, 2004, p. 9), deficiencies in governance, an aggressive risk-taking culture (APRA, 2004, p. 72, Hewson, 2004, p. 82) and a poor level of transparency (PriceWaterhouseCoopers, 2004, p. 32). NAB responded with the resignation of several directors, including the Managing Director and CEO, Frank Cicutto, who had survived NAB's 2002 HomeSide crisis. In addition, auditing systems, found to be seriously deficient (Durie, 2004, p. 84) were reviewed, control procedures were strengthened, and several individuals were dismissed (NAB Group, 2004). NAB's foreign currency crisis and its aftermath highlighted the foreign currency trading culture of all major Australian banks (Baker, 2004, p. 55), and challenged them to review their governance systems (Whyte and Boyd, 2004, p. 64).

These five unanticipated banking announcements can be viewed as part of a cycle of boom and bust, but they should also be set into their regulatory context. The next section explores this from an institutional perspective.

3. An institutional regulatory framework

Financial reports are presented as objectively constructed images of reality, but in many cases, these images are shown subsequently to have been flawed, and extremely subjective. Corporate crises raise the issue of what trust can be placed in financial reports, and how they are to be interpreted. Clarke *et al.* (2003, p. 241) asserted that financial reports prepared in compliance with accounting standards are unreliable and extremely subjective, failing to provide any “real world manifestation”. Entities, however, do not prepare financial reports according to their own rules, but within the context of an institutional framework, which includes a system of financial reporting rules. Recognising these institutional dynamics, neo-institutional theory (DiMaggio and Powell, 1983) suggests that organizations, eager to appear legitimate, are subject to three kinds of institutional pressures, from regulatory authorities (“regulatory” pressure), from the taken-for-granted (“normative”) expectations of society, and from the pressure of copying successful organizations (“mimetic” pressure).

In the creation of financial reports within the boundaries of regulations, Hines (1988, p. 257) observed that financial reports, rather than merely “*communicating*” reality, actually *construct* it, i.e. that financial reporting is not a technical activity but rather a manifestation of the power of financial statements to create a subjective reality. This is consistent with Clarke *et al.*’s (2003) belief, already highlighted, that there is no correspondence between financial reports and the events or financial positions they portray. Accountants are not usually perceived to be creative, imaginative people who wrestle with ontological issues, such as what constitutes reality and consequent epistemological issues such as how knowledge can be apprehended. However, the conflicting beliefs about financial statements that have been outlined indicate that people have different understandings about what reality is, and how knowledge is

defined and communicated. While financial statements are portrayed as factual, objective and irrefutable, beneath those statements lie deeply held philosophical assumptions and ideologies.

Rejecting the notion that financial statements actually “construct” reality, Mouck (2004) drew on Searle’s (1995) theory of institutional reality. He likened the establishment of acceptable forms of financial regulation, including financial reporting, to the rules of a game, which, once set in place, become the framework by which the game is governed. The “game” of financial reporting, therefore, is played by companies, which apply these rules to their own financial operations, and produce reports which portray a particular view of “reality”. These reports, while they are “epistemologically objective with respect to those rules”, are the product of a system which in itself has no objective basis (Mouck, 2004, p. 540). This can be described, as shown in Table 2, as a three-tiered system: an institutional framework exists which is realist and objective, consisting of taken-for-granted societal expectations. Within that framework, a system of financial reporting rules and regulations is subjectively created, with which entities must comply. As entities apply the rules and regulations, their financial reports, while reflecting the necessity of measuring up favourably against those of their competitors, are nevertheless perceived to be objectively constructed. Somewhere in the process, however, reality has been re-defined and what lies beneath the figures has been submerged.

[Insert Table 2]

The next section sets the institutional context in which Australian banks operate by providing an historical overview of three banking inquiries, and a broad overview of Australian financial reporting rules and regulations. These institutionalised systems

assist the banks in their pursuit of legitimacy as they are able to demonstrate conformity with societal expectations.

4. Historical background

4.1 Banking Inquiries

Three major government inquiries into banking were conducted in Australia between 1981 and 1996. They provided legitimacy for both the governments and the banks; for governments because the very institution of an inquiry demonstrated a commitment to accountability and public interest issues, and for the banks because the regulations that followed provided them with an opportunity for improved financial reporting.

4.1.1 Campbell Report.

The establishment of the Napier Royal Commission by the Commonwealth Government in 1935, to inquire into Australia's monetary and banking system, reflected a realization, after the experience of the Great Depression of the early 1930s, that development in financial markets could severely affect general economic conditions (Australian Government, 1997, p. 575). Between the Napier Royal Commission into the Monetary and Banking System in 1937, and the institution of the Reserve Bank of Australia in 1960¹, changes to Australian banking arrangements were incremental, reflecting response to consumer demand.

In establishing a Committee of Inquiry into the Australian Financial System (the Campbell Committee, chaired by Sir Keith Campbell) in 1979, the then Federal Treasurer, John Howard, recognized that since the Royal Commission there had been “massive change in both the domestic and international financial environment”, and furthermore, that it was essential that the structure and operations of the Australian

¹ This occurred as a result of the Banking Act of 1959, when the new Reserve Bank of Australia (RBA) took over the central bank responsibility previously held by the Commonwealth Bank of Australia.

financial system should “adequately meet the current and future needs of the Australian economy”. The purpose was not more regulation, but an assessment of the current levels of regulation and government involvement (De Lucia and Peters, 1998, p. 3).

The overriding theme of the Campbell Report, published in 1981, was that “the community would be best served by a deregulated financial system”, i.e. one “subject to the discipline of the market with a minimum of government intervention and regulation” (De Lucia and Peters, 1993, p. 3). While the report was concerned with financial stability and the need for prudential oversight, it was the theme of deregulation which attracted the most attention and provided the impetus for later changes in Australia’s financial systems (Weerasooria, 2000, p. 12). The report’s findings included:

- market oriented intervention by the authorities is preferable on efficiency grounds to direct controls because it influences demand, supply and the cost of credit across the entire spectrum of the financial system;
- regulations imposed on the financial system should not be concentrated on particular types of institutions, but rather should apply equally to all institutions;
- there should be no legislative or administrative barriers to entry into the various forms of financial intermediation, and
- governments have a responsibility to ensure the stability and confidence of the financial system through the use of prudential

guidelines on the operations of financial institutions (De Lucia and Peters, 1993, p. 3).

4.1.2 Martin Report

With the change of government in 1983, the Australian banking system experienced another series of profound changes. At a time when the world economy was unstable, inflation was high and having an adverse effect on investments, and financial markets were competing globally with the advent of new technology, Australian monetary authorities adopted more liberal marketing policies and the Commonwealth Government made the decision to “float” the Australian dollar (De Lucia and Peters, 2003, p. 1). This action was taken as a result of the report of the Martin Committee, whose appointment was announced on the election of a new Labor Government in 1983, by the Federal Treasurer, Mr. Paul Keating. Its purpose was to “report on the financial system ... (with) regard to the Campbell Committee recommendations and (taking) account of the Government’s economic and social objectives as well as of the need to improve the efficiency of the financial system” (De Lucia and Peters, 2003, p. 4).

In the tradition of the Campbell Report, the Martin Report recommended continued deregulation and the introduction of more “market oriented” policies, including the introduction of international banks into the Australian market, and the floating of the Australian dollar, already mentioned (De Lucia and Peters, 2003, p. 4). The Report also recommended the introduction of prudential provisions to ensure “stability of the financial system” (De Lucia and Peters, 1998, p. 5) and the “maintenance of community confidence” (Moore *et al.*, 1992, p. 172). These recommendations were taken up with the Government’s introduction of prudential guidelines for banks.

There was thus a recognition that a sound institutional system was necessary for the effective functioning of Australia's financial industry.

4.1.3 Wallis report

In the wake of the Martin Report, the increased competition within the banking sector, together with technological advances and innovative product design and distribution modes, led to the "increasing commoditisation of financial products" (De Lucia and Peters, 1998, p. 9). In June 1996, the Federal Treasurer, Mr Peter Costello, announced a new Financial System inquiry whose terms of reference were:

... providing a stocktake of the results arising from deregulation of the Australian financial system since the early 1980s. The forces driving further change will be analysed, in particular, technological development. Recommendations will be made on the nature of the regulatory arrangements that will best ensure an efficient, responsible, competitive and flexible financial system to underpin stronger economic performance, consistent with financial stability, prudence, integrity and fairness (Crane *et al.*, 2001, pp. 102 – 103).

Specifically, the inquiry, to be chaired by Mr Stan Wallis, was to report on the results of deregulation that followed the Campbell Report, identify factors that would contribute to future change and make recommendations on Australia's financial regulatory structures (De Lucia and Peters, 1998, pp. 3–4). While the inquiry was not a response to a specific financial crisis, it lent credibility to the government's image as good economic managers, concerned with what Australian's financial system would look like in 2010, and how it could operate as "a world's best financial system" (De Lucia and Peters, 2003, p. 7). In attempting to predict what Australia's financial

system would look like in 2010, two extremities of views were identified: one that change would be “gradual and incremental” and at the other extreme, that the financial system was experiencing a “paradigm shift”. The Inquiry predicted “considerable change” would occur over the medium term (Australian Government, 1997, pp. 11–12).

The findings of the Wallis Inquiry were released in April, 1997, and included 115 recommendations. They reflected the necessity of balancing prudential regulatory requirements against the need for the financial system to be capable of responding in a flexible and efficient manner to increased competition, both domestic and international. There were four primary areas of investigation, competition and efficiency, conduct and disclosure, financial safety, and systemic stability and payments, all of which relate to the broad institutional framework as portrayed in Table 2.

Integrity was identified as a core value of financial markets, together with the need for adequate disclosure to protect consumers and enable informed judgements to be made. To this end, the Report recommended a regulatory structure consisting of three distinct regulators, each with specific areas of responsibility and accountability, in order to foster competition and growth within financial system markets, while at the same time ensuring safety and protection for consumers. Thus, from broad notions relating to the institutional framework, actual mechanisms were suggested, as reflected in the second level of Table 2.

A Payments System Board (PSB) was to be established as part of the RBA, with oversight responsibility of the Australian payments system. This would allow the main board of the RBA to attend to monetary policy and issues of economic stability. The Australian Prudential Regulation Commission (APRC) was to be established as a

single prudential regulator, combining the existing regulatory responsibility of the RBA, the Financial Institutions Scheme and the Investments and Securities Commission (ISC). By separating the functions of the RBA and the APRC, each regulator would be able to focus on their main areas of responsibility within their portfolio, and clearer lines of accountability would further encourage competition and ensure safety. The Corporations and Financial Services Commission (CFSC) was proposed to take over the responsibilities of the Australian Consumer and Competition Commission (ACCC), regulating conduct and disclosure that would benefit the consumer within the financial system markets. However, not all the recommendations were incorporated into formal rules and regulations as had been proposed in the Wallis Report.

4.2 Financial accounting rules and regulations

The regulatory system in which Australia banks produce financial statements has developed against the backdrop of these banking inquiries and the broad institutional structures that have been socially constructed as a result (Mouck, 2004). Once these systems and regulatory bodies are in place, the rules and regulations they develop and enforce appear objective, with entities' compliance judged against them. Regulations emanating from the *Corporations Act 2001* (2001), and from various regulatory bodies formed as a result of legislation, such as the Australian Accounting Standards Board, the Australian Securities and Investments Commission (ASIC), APRA and the Australian Stock Exchange (ASX), have been tightened in recent years. More demanding rules in relation to corporate disclosure (Kavanagh, 2003, p. 12) and governance have been stimulated by institutional pressures from the public for corporate boards to demonstrate greater accountability for their operating systems. By complying with these expectations, banks are able to present a legitimate image, both

in matters of governance and profit-making. In the face of crises, banks and all companies invariably rely on promoting themselves in a positive light.

5. Bank responses

Competition between the four major banks is intense, and banks must conform to societal expectations by producing financial reports that comply with regulatory requirements and thus present a favourable image. The unexpected announcements already highlighted illustrate that adherence to financial reporting regulations is not sufficient to ensure good results. According to Table 2, while the quantification of accounting rules and regulations seems objective, it occurs within a system that is epistemically subjectively created. The institutional framework, while accepted as a “given”, cannot be taken as objective, and consequently, if users of annual reports are to have confidence in them, more information is required than that demanded by accounting standards and Corporations Law. Users need to have confidence in the broad institutional framework, and in the process through which reports are prepared. In recent years there has been an increasing emphasis on good corporate governance, i.e. the development of good institutional systems from which rules and regulations emanate.

In March 2003, the ASX Corporate Governance Council released its “Principles of Good Corporate Governance and Best Practice Recommendations” (ASX 2003), in which it outlined ten principles and 28 recommendations, intended to provide a guide for listed companies. In relation to financial reporting and the management of risk, these recommendations include adherence to accounting standards, the establishment of an audit committee, and the development and implementation of an official policy to recognise and manage risk (ASX, 2003). Compliance with these principles is not

mandatory, but companies are required to disclose the extent to which they have adopted the ASX's corporate governance recommendations (ASX 2005).

As a result of these recommendations, annual reports now contain more than financial information, and all Australian listed companies are aware of the importance of compliance with corporate governance expectations in presenting a reliable, successful image. NAB's foreign currency loss disclosures of 2004 would appear to have had an impact on all major banks, particularly NAB and CBA. A study of the annual reports of all four major banks for 2003 and 2004 reveals changes, some significant, in the extent to which banks complied with ASX corporate governance recommendations.

The 2003 ANZ report (ANZ, 2003, p. 39) stated full compliance with ASX Corporate Governance recommendations, as did its 2004 report (ANZ, 2004, p. 45). WBC's report changed slightly between 2003 and 2004. In 2003, it noted a failure to comply with the ASX recommendation relating to shareholder approval of equity-based executive remuneration (WBC, 2003, pp. 66–67), while in 2004, this was presented as “qualified compliance” (WBC, 2004, pp. 68–69). The 2003 CBA report did not mention the ASX principles of good corporate governance (CBA, 2003), while in 2004, it stated that it had fully complied with all recommendations (CBA, 2004, p. 39).

NAB's 2003 report also did not mention the ASX corporate governance guidelines, but after the events of 2004, its annual report identified five instances of non-compliance (NAB, 2004, p. 78). The 2004 report placed greater emphasis on the Directors' report, the Financial Review and Corporate Governance sections. These all portrayed a company shocked by the foreign currency revelations, and working to rectify the systems that allowed the losses to occur. NAB's 2004 Directors' Report

included the statement that “no further matter, item, transaction or event of a material and unusual nature has arisen in the interval between end of financial year and date of report that in the opinion of the directors has significantly affected or may significantly affect the operations of the group, the results of those operations or the state of affairs of the group in future financial years” (NAB, 2004, p. 87). The Directors’ Report (NAB, 2004, pp. 84-85), under the heading “significant changes in the state of affairs”, also included a lengthy discussion of the foreign exchange trading losses of \$360m, citing the PricewaterhouseCoopers Report of March 12, 2004: “the losses arising from the foreign currency options trading increased significantly between September 2003 and January 2004”, with four traders exploiting “loopholes and weaknesses in systems and processes to hide trading losses and protect bonuses”.

Further, the company admitted that “warning signals, both inside the Company and from the regulators and other market participants, were not properly acted upon” (NAB, 2004, p. 64), in spite of the fact that the Board had “overall responsibility for corporate governance, including safeguarding stakeholder interests and reviewing and monitoring risk management and compliance” (NAB, 2004, p. 85). The company indicated changes it had made in its board, management, risk and control frameworks, and culture, including information on the company’s “whistleblower protection program” (NAB, 2004, p. 79), which, significantly, was also included in the 2003 report (NAB, 2003, p. 69).

The response by the banks indicated a desire to present themselves as institutionally acceptable. Given the competition between the four major banks, it is hardly surprising that they would present an image of conformity with regulatory requirements. It would be expected that all the banks, not just NAB, would have conducted substantial internal reviews of the policies and procedures regarding risk

management and ethical behaviour as a result of all financial controversies, particularly after that of January 2004, given the scope of the APRA investigation², which focused on the foreign exchange options trading practices of all the major banks. While APRA uncovered some risk management control issues, there were none of the “same magnitude” of those at NAB (Murray 2004a, p. 47; AAP, 2004). There is no doubt that risk management moved “up the agenda” of boards, but a survey³ suggested this was because of increased regulatory requirements rather than self-assessment (Murray 2004a, p. 47). For whatever the reason the profile of risk management increased internally, it is hardly surprising that the banks’ desire to present themselves as sound in these areas would be reflected in their 2004 annual reports.

By reporting on their compliance with the ASX corporate governance recommendations, the banks demonstrated the reliability of their systems. From an institutional viewpoint, both the regulatory authorities (ASIC, ASX, APRA) and the regulated (the banks), by promulgating and adhering to rules and regulations, demonstrate their legitimacy. The speed and effectiveness of the reactions of regulators and law enforcement agencies are scrutinised in an institutional environment where there are greatly increased “political, public, industry and business expectations” that misconduct on the part of companies will be prevented, minimised, and punished (Lucy, 2004, p. 6).

² When it announced in March 2004 that it had completed its investigation of NAB, APRA also announced that it was in the process of reviewing the “risk management practices” of other authorised deposit taking institutions, asking them “to satisfy themselves and APRA that they could not face similar problem” (APRA, 2004).

³ PricewaterhouseCoopers and the Economist Intelligence Unit surveyed 130 executives of “global financial institutions”, with regulatory pressure being identified by almost three-quarters of them as an “extremely significant” or “major” driver of changes in risk management priorities over the last two years (Murray 2004a: 47).

6. Conclusions

This paper has presented an institutional perspective of the “boom and bust” cycles of Australian banking, with particular focus on unexpected financial losses announced by the four major banks over the past fifteen years. These losses were unexpected, with no hint being given in earlier reports that there was any trouble looming. Financial reporting rules and regulations, while they are portrayed as being objective, are only objective if the institutional context in which they are applied is taken as given. The institutional systems which underlie these rules and regulations are, however, subjectively determined. Three major banking inquiries were all subjectively and politically motivated, but the recommendations for regulatory reform were not implemented completely. Within this context, the controversies examined in this paper were unable to be prevented. Thus, rather than being objective, financial reporting rules and regulations ultimately operate within a broader institutional context, which is subjectively determined. Increasingly, there is a need for banks to provide evidence that they have sound corporate governance practices underlying the reports they produce if they are to maintain an image of legitimacy. In the light of banking revelations over the last fifteen years, this boom and bust history, users of financial reports are demanding even greater disclosure, and require more assurance that they can rely on the reality behind the figures.

This paper has focused on the revelations of four banks, over a fifteen year period. A longer period of study, or a wider focus that included other banks and financial institutions, may provide further evidence, not only of the cyclical nature of financial crises and consequent recovery, but also of the integrity of an institutional approach, which focuses on the legitimising power of regulatory systems. While institutional

theory does offer particular insights, it also dictates the focus, and, as with the employment of any theory, thereby determines the interpretation of data.

Given the banks' history of financial crises, there seems no doubt that, paradoxically, further unexpected announcements may be expected. When each new crisis unfolds the public will demand increased assurance that they can rely on the banks' financial reports. As in the past, it is expected that the regulatory authorities, by providing an acceptable institutional framework, will assist the banks in repairing their image and re-establishing their legitimacy.

References

Anonymous, 2004, APRA has a lot to learn, *Australian Financial Review*, 25 March: 78.

Australia and New Zealand Banking Corporation (ANZ), 1992, *ANZ Annual Report 1992* (Australia and New Zealand Banking Corporation).

Australia and New Zealand Banking Corporation (ANZ), 2003, *ANZ Annual Report 2003* (Australia and New Zealand Banking Corporation).

Australia and New Zealand Banking Corporation (ANZ), 2004, *ANZ Annual Report 2004* (Australia and New Zealand Banking Corporation).

Australian Associated Press (AAP), 2004, APRA gives tick to other banks after NAB currency scandal. *Australian Associated Press Financial News Wire*, 1 June.

Australian Broadcasting Corporation (ABC), 2004, NAB in damage control over rogue traders, *7:30 Report Transcript*, 14 January. Available: <http://www.abc.net.au/7.30/content/2004/s1025640.htm> [Accessed 27 August 2005].

Australian Government, 1997, *Financial System Inquiry Final Report* (Australian Government Publishing Service, Canberra).

Australian Prudential Regulation Authority (APRA), 2004, *Report into irregular currency options trading at the National Australia Bank*, 23 March. Available: http://www.nabgroup.com/vgnmedia/downld/APRAreport_24march04.pdf [Accessed 27 August 2005].

Australian Stock Exchange (ASX) Corporate Governance Council, 2003, *Principles of good corporate governance and best practice recommendations*, March. Available: <http://www.shareholder.com/visitors/dynamicdoc/document.cfm?documentid=364&companyid=ASX> [Accessed 27 August 2005].

Australian Stock Exchange (ASX), 2005, *Analysis of corporate governance practices reported in 2004 annual reports*. Available: http://www.asx.com.au/supervision/pdf/Analysis_of_CG_practice_disclosure_May_16_2005.pdf [Accessed 27 August 2005].

Baker, P., 2004, 'Profit is king' at all our banks, *Australian Financial Review* 25 March, 55.

Clarke, F., G. Dean, and K. Oliver, 2003, *Corporate collapse: accounting, regulatory and ethical failure* (Revised Edn, Cambridge University Press, Melbourne).

Commonwealth Bank of Australia (CBA), 1992, *Commonwealth Bank of Australia Annual Report 1992* (Commonwealth Bank of Australia).

Commonwealth Bank of Australia (CBA), 1995, *Commonwealth Bank of Australia Annual Report 1995* (Commonwealth Bank of Australia).

Commonwealth Bank of Australia (CBA), 2003, *Commonwealth Bank of Australia Annual Report 2003* (Commonwealth Bank of Australia).

- Commonwealth Bank of Australia (CBA), 2004, *Commonwealth Bank of Australia Annual Report 2004* (Commonwealth Bank of Australia).
- Cornell, A., 2004, Long-term blow to NAB's integrity, *Australian Financial Review* 25 March, 55.
- Corporations Act 2001*, 2001. Available: <http://www.scaleplus.law.gov.au/cgi-bin/download.pl?/scale/data/pasteact/3/3448> [Accessed 27 August 2005].
- Crane, R., I. Fraser, and T. Martin, 2001, *Financial institutions, markets and instruments* (LBC Information Services, Pyrmont, New South Wales).
- De Lucia, R., and Peters, J., 1993, *Commercial Bank Management: Functions and Objectives*, Australian Institute of Bankers (Hornsby, New South Wales).
- De Lucia, R., and Peters, J., 1998, *Commercial Bank Management*, LBC Information Services (North Ryde, New South Wales).
- De Lucia, R., and Peters, J., 2003, *Commercial Bank and Financial Institutions Management*, Lawbook Co. (Pyrmont, New South Wales).
- DiMaggio, P. J., and W.W. Powell., 1983, The iron cage revisited: institutional isomorphism and collective rationality in organizational fields, *American Sociological Review* 48, 147-160.
- Durie, J., 2002, Banks cartel powering away, *Australian Financial Review*, 18 June, 72.
- Durie, J., 2004, Audit issues bring new woes to NAB, *Australian Financial Review*, 27 February, 84.
- Hepworth, A., 2004, Whistleblowers still out in cold, *Australian Financial Review*, 17 January, 4.
- Hewson, J., 2004, Where NAB went wrong, *Australian Financial Review*, 2 April, 82.

- Hines, R., 1988, Financial Accounting: in communicating reality, we construct reality, *Accounting, Organizations and Society* 13, 251-261.
- Kavanagh, J., 1992, Westpac under siege, *Australian Financial Review*, 4 September, 18.
- Kavanagh, J., 2003, Confrontation, disclosure and shareholder demands, *Australian Financial Review*, 18 December, 12.
- Kaye, T., 1992, \$1bn recovery tipped for ANZ, *Australian Financial Review*, 2 December, 28.
- Lloyd, S., 1992, Banks prepare for a \$60m battle for market share, *Australian Financial Review*, 25 November, 37.
- Lucy, J., 2004, FSR, CLERP 9 and surveillance programs: ASIC priorities over the next 12 months. An address by the Acting Chairman of ASIC to Institute of Chartered Accountants in Australia Queensland 2004 Business Forum, Australian Securities and Investments Commission, 13 March.
- Moore, D., Lyell, D., Crane, R. and Crowley, M., 1992, *Financial Institutions and Markets* (Serendip Publications, Wamberal, New South Wales).
- Mouck, T., 2004, Institutional reality, financial reporting and the rules of the game, *Accounting, Organizations and Society* 29, 525-541.
- Murray, L., 2004a. Banks not taking risk seriously enough, *Australian Financial Review*, 4 August, 47.
- Murray, L., 2004b. ASIC's turn to crack whip at NAB, *The Sydney Morning Herald*, 21 October, 27.

- NAB Group, 2004, ASX Announcement – National’s response to foreign currency options trading losses, 12 March. Available: <http://www.nabgroup.com/0,,44213,00.html> [Accessed 23 June 2004].
- National Australia Bank (NAB), 2001, *National Australia Bank Annual Financial Report 2001* (National Australia Bank).
- National Australia Bank (NAB), 2003, *National Australia Bank Annual Financial Report 2003* (National Australia Bank).
- National Australia Bank (NAB), 2004, *National Australia Bank Annual Financial Report 2004* (National Australia Bank).
- PricewaterhouseCoopers, 2004, *Investigation into foreign exchange losses at the National Australia Bank*, 12 March.
- Searle, J. R., 1995, *The construction of social reality* (The Free Press, New York).
- Sykes, T., 2004, NAB: sack the board and change the culture, *Australian Financial Review*, 3 April, 9.
- Weerasooria, W. S., 2000, *Banking law and the financial system* (5th edn, Butterworths).
- Westpac Banking Corporation (WBC), 1992, *Westpac 175th Year Annual Report 1992* (Westpac Banking Corporation).
- Westpac Banking Corporation (WBC), 2003, *Westpac Annual Financial Report 2003* (Westpac Banking Corporation).
- Westpac Banking Corporation (WBC), 2004, *Westpac Annual Financial Report 2004* (Westpac Banking Corporation).

Whyte, J., and T. Boyd, 2004, Bankers weigh up the business of risk, *Australian Financial Review*, 19 March, 64.

Willmer, T., 1992, “Commonwealth Bank profit seen constrained”, *Reuters News*, 7 September.

Table 1
Selected unexpected banking expenses or losses

Year	Bank	Significant expenses/losses \$m	Net profit for the year (after tax) attributable to shareholders \$m	Nature of significant expense
1991	ANZ	1,037	267	Provision for Bad and Doubtful Debts
1992	ANZ	1,600	(579)	Provision for Bad and Doubtful Debts
1991	CBA	1,026	883	Provision for Bad and Doubtful Debts
1992	CBA	843	409	Provision for Bad and Doubtful Debts
1991	WBC	1,119	476	Provision for Bad and Doubtful Debts

(Sources: ANZ 1992, CBA 1995, NAB 2001, NAB 2004, WBC 1992)

Table 2

An institutional regulatory framework (based on Mouck, 2004)

Operational level	Level of objectivity	Explanation	Institutional Theory	Examples
Institutional framework	Realist, objective if the institutional framework is taken as “given”	“interlocking set of status functions” (p. 533)	Normative (taken-for-granted) institutional pressures	Governments, legal systems, money, corporations, the notion of accountability
Financial accounting rules and regulations	Epistemically subjective (p. 540)	Subjectively constructed, but once set, these “rules of the game” become concrete and objective	Regulatory/coercive institutional pressures	Corporations Law, accounting and auditing standards
Quantification of accounting rules and regulations	Epistemically objective (p. 540)	Many of the elements of financial statements are “epistemologically objective facts”, even though they have an “ontologically subjective mode of existence”	Mimetic institutional pressures (image creation to preserve organizational legitimacy through acceptable results)	Historical costs, market values, aggregations of different measurement models