

# Corporate governance in the wake of contemporary corporate collapses: some agenda items for evaluators

The number and scope of corporate collapses in recent times clearly illustrate that corporate accountability practices are failing to match the rhetoric of managers responsible for business probity. The malaise has continued even though regulatory enforcement is empowered by federal and state law and enforced by criminal penalties and civil sanctions. Research is now revealing that regulatory creativity may offer considerable potential for bringing about good corporate governance. New regulatory options are thus becoming increasingly sought after, especially given the inefficiencies of the current legal frameworks and the inadequacies of the traditional official line which suggests that the best response to malfeasance is (simply) more law. This paper reviews some current research agendas and evaluative findings. It sets out some evaluative questions that now need to be explored.

## Introduction

Many commentaries have emerged from the corporate collapses of the past three years, both in the daily press and in the academic literature. Commentators have drawn upon a number of popular causal theories, among them poor management (Bosch 2002), inadequate training (Bergman 2000), greed and deliberate fraud (Sykes 1996), conflicts of interest (Robinson 1996), inattentive auditing (Vinten 1992), poor ethical frameworks (UNDP 2000), inadequate legal and accounting rules (Baxt 2002) and misguided regulatory oversight (Davis 2001). Policy-makers are currently drawing upon these commentaries in an attempt to find the appropriate environment in which companies are more likely to be 'sustainable' well into the future, that is, they are less likely to suffer financial catastrophes along with the attendant financial and other social consequences (Sharma & Starick 2002). Policy-makers are thus keen to find evidence of 'what works' in the practice of encouraging 'sustainability'. Corporations and other business entities, too, have an interest in the evaluative work being commissioned and carried out, given the literature that links internal evaluation to organisational performance on

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matters such as change management, risk assessment and service delivery (e.g. Love 1991).

This creates a dilemma for evaluators. Any attempt to interpret cause and effect for the purpose of advising policy-makers is fraught with difficulty (Sarre 1991), and this is especially so in relation to effective 'sustainability' strategies. Corporations fail for a multitude of reasons, only some of which relate to inadequate corporate legal frameworks, poor management structures and under-resourced mechanisms of governance. Given the diverse array of often contradictory macro and micro responses that need evaluation, in which directions should evaluators turn their gaze? This paper explores these dilemmas by setting out some of the evaluative groundwork that has been laid, and the possible policy options that require further evaluative work.

### Existing legal requirements

There is one conclusion that can safely be drawn in considering even the most notorious of corporate collapses: they were not for want of legal regulatory structures. It is worth reviewing, in this context, the sorts of compliance requirements, in law and in financial practice, currently in place in Australia that purport to prevent corporate negligence and to thwart business malfeasance.

To begin with, the *Corporations Act 2001* (Cwlth) makes it clear that directors are accountable to the law with severe penalties in the event of misconduct and even inadvertence.

Directors have, by virtue of sections 180–183 of the Act (and, indeed, under the common law, see *ASIC v Adler* (No. 3) (2002) 20 ACLC 576 at 651–653 per Santow J), a duty to act honestly (which is more than a duty not to act dishonestly), to exercise care and diligence, not to make improper use of their position and not to make improper use of information to which they may be privy. Similarly, directors remain under the scrutiny of the Australian Securities and Investments Commission (ASIC) whose officers check for any contravention of the *Corporations Act*, such as the prohibition against trading while insolvent (section 588G), false trading and market rigging (section 998), and 'insider' trading (section 1013). Moreover, section 324 prohibits auditors having listed connections to the companies that they are auditing, section 208 restricts the circumstances in which a company can give financial benefit to a related party, and section 260A circumscribes the manner in which a company can assist a person to acquire shares (Blake Dawson Waldron 2002). Each of these proscribed activities is reinforced by legal sanctions.

The *Trade Practices Act 1975* (Cwlth) Part IV provides substantial fines for any company that engages in a number of other proscribed behaviours. The Australian Competition and Consumer

Commission (ACCC) monitors compliance with the Act and pursues allegations of unlawful or inappropriate activity such as price fixing and agreements that may have an anti-competitive effect. There are also considerable resources of other regulatory agencies whose task it is to ensure compliance with other specific laws and regulatory requirements, for example the Australian Tax Office (ATO), the Australian Transaction Reports and Analysis Centre (AUSTRAC) and the Australian Crime Commission (ACC), formed in 2002 by the combination of the former Australian Bureau of Criminal Intelligence and the National Crime Authority. Nor should one forget the substantial resources of State and federal Directors of Public Prosecutions whose task it is to prosecute those companies and their directors who fail to abide by the criminal law. These prosecutions can proceed with or without the consent of the agencies responsible for general superintendence of the corporate sector.

There are also, for publicly listed companies, the compliance rules of the Australian Stock Exchange (ASX), such as the 'governance disclosure' requirements of ASX listing rule 4.10.3 which requires companies to include a corporate

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governance statement explaining the main practices, control mechanisms and governance processes employed by the company during the reporting period (Sarre, Doig & Fiedler 2001). Indeed, since 1 January 2003 there are now a number of new 'enhanced disclosure' rules designed to increase corporate accountability and transparency, along with a new periodic reporting regime that began on 1 July 2003 (ASX 2002). Finally, one cannot overlook the resources of the Australian Prudential Regulation Authority (APRA), empowered by the *APRA Act 1998* (Cwlth), insofar as the specific practices of banks, insurance companies, friendly societies and superannuation funds are concerned.

All of these bodies and agencies, along with legislated legal prohibitions, mandates, penalties and requirements, however, were securely in place while the high-profile corporate collapses in 2001 and 2002 across Australia (such as One.Tel and HIH) continued apace. North American experiences provide a similar tale. The American corporate giants WorldCom and Enron collapsed despite an extensive raft of US governance rules, and, indeed, Enron had appeared, not long before its collapse, in *Fortune* magazine's 'All star list of most admired companies' (Banerjee 2002, p. 4). In other words, regulatory requirements, compliance monitors and

their enforcement of laws are not preventing failure, nor are they allaying stakeholders' concerns that some companies continue to operate with inadequate management practices in place.

What is more than a little frustrating for some commentators is that the *official* responses to the collapses that have occurred tend to focus upon 'more of the same' mandates, penalties and requirements, reinforced each time, it appears, with a bigger 'stick'. For example, even though the Corporate Law Economic Reform Program (CLERP) proposed, in September 2002, a broad new range of regulatory options including greater auditor independence, harmonisation of accounting standards and enhancement of disclosure (Horrihan 2002), by far the greatest media attention during that period was given to two other announcements. The first was the public statement by Professor Allan Fels, then head of the ACCC, detailing a key plank of its submission to the Dawson Inquiry (Dawson 2003): that offenders should face lengthy terms of imprisonment if they engage in 'hard-core' corporate collusion (Fels 2002). The second was the government's introduction into federal parliament by the Treasurer, Mr Peter Costello, on 16 October 2002, of the Corporations Amendment (Repayment of Directors' Bonuses) Bill, allowing liquidators to claw back payments made to directors, or their associates, in the four years prior to a winding-up order if a court deemed that the benefits were 'unreasonable'. While both of these ideas have a popular ring to them, one could argue that they will do little to change the underlying malaise that has permeated many corporate boardrooms. Neither clawing back a bonus now and then, nor threatening directors with a prison term for serious collusion, addresses broader regulatory issues.

The argument presented in this paper is that regulatory processes can be better conceived and executed if they embrace some alternative themes and ideas, specifically: the development of corporate reputation and fear of shame as a deterrent, the refining of concepts such as the 'regulatory pyramid' and 'corporate obligation', the exploration of the notions of 'corporate social responsibility' and 'corporate culture', the latter (or its absence) as a precursor to a new category of 'corporate criminal culpability'. Not all of these are entirely new approaches, but their modern manifestations require good evaluative data to enable policy-making to progress productively.

Each of these ideas is discussed briefly below. In them one finds a mixture of management themes, options for a preferred regulatory 'mix', and reporting initiatives. There is no common conceptual framework that links them together; each of them arises largely independently of the others. In addition, there are some suggestions for legal reforms in the paragraphs that follow. That is, it should not be implied that the law is irrelevant to the process of good governance. It is simply that the role of the law should be placed in its proper perspective.

## Ideas around 'shame' and 'reputation'

The emotion of shame following an act of legal turpitude, contrasted with pride in being law-abiding, featured heavily in criminologist John Braithwaite's seminal work *Crime, Shame and Reintegration* (1989). Braithwaite's hypothesis, explored and expanded by others such as Grabosky (1995) and Sparrow (2000), is that fear of shame is a significant social force for preventing criminality. Shame and a poor reputation go hand in hand. Thus, so the thinking goes, criminal justice responses that avoid shaming individuals deny themselves a deterrent effect that carries great weight. Penalties that shame corporations and, by implication, attack their reputation may be a more powerful deterrent than traditional criminal penalties such as fines, which can simply be passed on to consumers.

Reputation is increasingly becoming recognised as a factor that influences investor and consumer decisions and this is especially important given the growing mobility within capital and product markets in Australia. Thus, it may be argued, there is an increased vulnerability of the modern corporation to its reputation. Consider the following research finding from Debra King and Alison Mackinnon. Having sent a wide-ranging survey to 2200 households that tested consumer decision-making based upon an inventory of 40 corporate citizenship practices, they found good evidence to suggest that purchasers do discriminate on the basis of what they have heard about certain providers.

[T]he research provides clear evidence that the community certainly does care about corporate behaviour and has shown that it is willing to punish and reward corporations on this basis. (King & Mackinnon 2001, p. 52)

It is arguable that regulators have opportunities to shame malefactors, but with few exceptions do not. Reconceptualising regulation around threatening corporate reputation and shaming is a strong theoretical development. Further evaluative work considering this option and its effects upon corporate regulation is needed. For example, what actually shames business people? Are there those who are beyond shame? Do business operators distinguish between honest practices and 'sharp' practices if there is money to be made? If so, on what basis do they make this distinction?

## The regulatory enforcement 'pyramid' and regulatory 'pluralism'

The idea of the enforcement 'pyramid' was first conceptualised over a decade ago (Ayres & Braithwaite 1992). Regulation and compliance, on this model, are best understood if depicted as a three-sided 'pyramid'. The width of the base of the

pyramid is designed to illustrate that most regulatory matters are dealt with informally, for example by cautions, stern warnings and the like. Higher up the pyramid (as it becomes narrower), that is, as conduct becomes more serious, so too do the penalties, for example civil sanctions and monetary fines. There are fewer of these matters than the ones dealt with informally. Higher up still are prosecutions for more serious malfeasance, and, at the top of the pyramid (the pinnacle), severe penalties that are very few in number. Regulation, in this respect, is perceived:

... within a dynamic enforcement game where enforcers try to get commitment from corporations to comply with the law and can back up their negotiations with credible threats about the dangers faced by defendants if they choose to go down the path of non-compliance. (Fisse & Braithwaite 1993, p. 143)

There has been an extensive application of this model in Australia, for example through the ATO's Compliance Model. Indeed, survey and interview data collected from over 1500 taxpayers accused of tax avoidance found that the use of threat and coercion produced the *opposite* behaviour from that sought and advocated (Murphy 2002). In contrast, strategies designed to reduce levels of distrust proved preferable in gaining voluntary compliance with the taxation rules.

The 'pyramid' notion also depicts well the principle of 'regulatory pluralism' (Ayres & Braithwaite 1992). Under this notion, regulation should not be conceived as something that can be 'pigeonholed' but as part of a broader 'mosaic'. Simply stated, the value of a pluralistic approach is that one can place many outcome 'eggs' in a variety of regulatory 'baskets'. The preferred 'mix' for certain corporate conduct is a matter that requires continual evaluative development. Which sanctions will have the most appropriate deterrent effect for a particular industry? Which providers (public and private) will be challenged towards 'best practice' models by what combination of penalties or threat of penalties? How does one best regulate the process of regulatory strategies themselves? Evaluation of these different approaches and mixes is necessary to understand and better appreciate their efficacy.

### **Corporate obligation and the 'licence to operate'**

The notion of appealing to a corporation's 'obligations' to society has been finding its way into the recent academic literature (e.g. Hinkley 2000a, 2000b; Richter 2001), and there is a need for further evaluative work that can explore its potential as a regulatory tool. The argument is that corporations are obliged to give something in return for society granting them the legal protection of limited liability and according them the social permission to operate freely in the marketplace. That is, it is premised upon the idea that

corporations should earn a 'social licence to operate' (Sarre & Doig 2000). Those that cannot show their ability to be responsible with their operations should, arguably, lose their 'licence', and the 'privilege' of limited liability. This idea has been primarily associated with the views of Robert Hinkley. He is of the opinion that there should be, by legislative amendment, an expansion of the duties of directors under corporations law to ensure that their primary profit-making enterprise for shareholders is not:

at the expense of the environment, human rights, the public safety, the communities in which the corporation conducts its operations or the dignity of its employees ... This balancing factor should be implanted in corporations in a manner that tempers – but does not destroy – their drive to achieve profits. (Hinkley 2000a, p. 33)

It is Hinkley's view that the corporate legal system does little to encourage corporations to exercise social responsibility or to contribute, cooperate or sacrifice for the common good, a view mirrored by the Australian Conservation Foundation in a

recent public statement (ACF 2002). The notion of governments legislating to entrench the obligation, however, requires further evaluative

work before it will be taken seriously by legislators. At the moment, corporations law in Australia still requires that directors have shareholders' concerns uppermost in their minds. They are not expected to give priority to the concerns of the broader community in which the company operates. One might predict that the law will forestall any attempt to break open this legal axiom, if the precedent provided by *Parke v Daily News* (1962) Ch. 927 is anything to go by. In that case, bonus payments to ex-employees of *Daily News* (as compensation for their losing their jobs) were challenged by shareholders who maintained that the bonuses were not in the shareholders' interests. The court agreed, and cancelled the bonuses. There is little evidence of any desire of lawmakers to shift away from this precedent. By way of example, the idea has not been challenged in either of the two 'opposition' platforms that have recently tackled corporate reform, the Democrats' Corporate Code of Conduct Bill 2000 nor Labor's Corporations Amendment (Improving Corporate Governance) Bill 2002.

'Obligation' research could explore why

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‘traditional’ positions are so entrenched in both legal precedent and popular parlance.

Large transnational corporations responsible for major environmental disasters and negative social impacts in the Third World (Union Carbide, Nike, Exxon, Shell to name a few) rather than lose their licence to operate have actually become stronger and more powerful whether through mergers, restructures or relentless public relations campaigns. (Banerjee 2002, p. 3)

Researchers may wish to explore areas where licences to operate are required (for example in the environmental field in some jurisdictions), and to evaluate the effect of licensing and its potential to improve governance. Moreover, what are the ramifications of adding to directors’ responsibilities broader considerations beyond the share price? What would be the effect of a reform of the *Corporations Act* to make it legal for directors to act in the best interests of *future* shareholders? If there were to be law reform initiatives to shift directors’ responsibilities further than simply shareholder value, how would the law need to be amended to protect directors from legal suit in the event that a broader focus may have a direct causal effect on share price (and hence shareholder prosperity)? In other words, the effect of implementing broader obligations upon companies and their directors requires further exploration.

### **Corporate social responsibility (‘CSR’)**

Not unlike the concept of corporate obligation, there is a view that stakeholders should be challenging companies to build some social responsibility into their corporate ethos. Broadly, this has been described as the movement towards *corporate social responsibility* or ‘CSR’. Some evaluative work suggests that these sorts of initiatives may bring about greater overall business performance and thus a better return for shareholders (Sarre 2001).

Broadly speaking, the concept of CSR requires corporations not only to abide by the law, to be good corporate citizens and to abide by government and professional compliance codes and requirements, but to do more – to display an

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elevated level of quality in their overall corporate ‘culture’ (Sarre, Doig & Fiedler 2001). This includes an organisational commitment to ensure that one’s company not only *conforms* to the law and regulatory obligations, but also *performs* to a higher standard than that which is required by the law. In

other words, it recognises that merely prescribing minimum standards and enforcing them by law is an inadequate form of regulation. Minimum standards have been known to become maximum standards (Bergman 2000). CSR calls upon corporations to publicise their responsibilities and explain to stakeholders how they are allaying concerns. The more obvious examples are the way in which the Shell Corporation (in the face of massive criticism concerning its practices in the 1980s) and the Nike Corporation (amidst growing disquiet concerning allegations of ‘Third World’ sweatshop practices) met their critics with worldwide publicity campaigns. However, an Ernst & Young global survey (cited in James & Gettler 2002, p. 16) found that not all companies are comfortable with the term CSR, and its ramifications with many companies paying only lip service to CSR. For example, 71% of those surveyed said they had strategies to advance it, but only 9% said that they understood how it was relevant to their business.

The best-known manifestations of CSR are the reporting initiatives: codes of conduct (which have been growing in popularity over the past decade) and ‘triple bottom line’ reporting, which has a shorter but no less significant history. Both of these are now discussed below.

### **Codes of conduct**

The popularity of codes of conduct has waned somewhat since the heady days two decades ago when they were touted as the harbinger of a new (and effective) ‘soft-touch’ approach to corporate governance.

The ‘Caux Principles’ are perhaps the best-known (and surviving) example of a general corporate code of good conduct. They were produced by a group of international executives based in Caux, Switzerland, in conjunction with the Minnesota Center for Corporate Responsibility in 1992 (Minnesota Center for Corporate Responsibility 1992). As stated in the preamble to the document, ‘Laws and market forces are necessary but insufficient guides for conduct’. It would be an excellent research exercise to investigate the existence and effectiveness of such codes in an Australian setting, for example determining how many companies have such statements (if not the same Caux Principles), and whether they perceive them to be of any value either to corporate practice or stakeholder value. In addition, a survey of clients, customers and the public in general could reveal much about the effect of such pronouncements on corporate reputation. Governments and regulatory agencies would then be in a position to evaluate the effectiveness of codes in bringing about improved corporate conduct.

Recently, Justice Austin of the NSW Supreme Court was somewhat disdainful of such codes in writing his judgement in a case involving three executive directors and a former non-executive chairman of One.Tel, although he did not dismiss them out of hand. In discussing corporate

governance principles, he noted that much of the literature was:

... in the form of exhortations and voluntary codes of conduct, not suitable to constitute legal duties. It is sometimes vague and less than compelling and must always be used with caution. Nevertheless, in my opinion *this literature is relevant to the ascertainment of the responsibilities to which [the chairman] was subject ...*. (ASIC v Rich and others (2003) 21 ACLC 450 at 466) (emphasis added)

### **‘Triple Bottom Line’ reporting**

The triple bottom line (TBL) concept is designed to highlight the view that a company’s consideration of only one measurement of success – the financial ‘bottom line’ – is inadequate in a number of respects (Elkington 1997). The TBL approach includes two other aspects of doing business today that require equal consideration and active managerial attention – the social impacts (for example health, welfare and safety of employees, consumers and immediate neighbours), and the environmental impacts that a company’s activities may be having locally and more generally. Advocates of triple bottom line reporting argue that the idea of three reporting considerations instead of one is also necessary for, indeed irretrievably linked to, the financial bottom line and hence becomes another method of discouraging financial irresponsibility. In other words, financial success itself is reliant upon not only economic sustainability but also social and environmental sustainability. A company that can meet the needs of the present in terms of social and environmental impact, without compromising the needs of the future, is, so the thinking goes, more likely to appeal to investors and customers alike, and thus be financially successful.

Companies that incorporate this approach in their strategies can, it is claimed, generate substantial competitive advantages (Ecos Corporation 2003). According to some commentators, however, these claims cannot all be adequately verified by the data (Magretta 1997). Nor can one safely assume that those companies that report to the triple bottom line are ones that suffer no public opprobrium.

The literature on corporate social responsibility easily identifies ‘bad’ corporate citizens: tobacco companies, weapons manufacturers, environmental polluters. However, the fact that these companies regularly publish corporate citizenship and social performance reports tends to muddy the waters more than a little. (Banerjee 2002, p. 3)

There is a wealth of information in the literature on TBL that needs further evaluative work. Are the companies that are doing TBL reporting more ‘sustainable’ than their competitors? Indeed, are

there differences in measuring ‘sustainable’ as corporate continuity and ‘sustainable’ in terms of global development? Do sustainable entities need less regulatory attention? Can governments encourage TBL by offering incentives, and, if so, what type? The opportunities for evaluators are boundless.

### **Corporate ‘culture’ and corporate criminal liability**

There is a final issue about the relationship of criminal liability to corporate culture. The *Criminal Code Act 1995* (Cwlth) Part 5 contains an innovative legislative attempt to give a ‘cultural’ emphasis to the specific (and limited) notion of corporate criminal liability. The Code explicitly states that harm caused by employees acting within the scope of their employment is considered to be harm *caused* by the body corporate. Moreover, the Code introduces the crucial concept of ‘corporate culture’, defined in Section 12.3(6) of the Code as an ‘attitude, policy, rule, course of conduct or practice existing within the body corporate generally or in the part of the body corporate in which the relevant activities take place’. A company with a poor corporate culture may be considered as criminally culpable under this legislation as individual directors or senior managers (Woolf 1997). The change was

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designed, according to section 12(3)(2)(d), to catch situations where, despite the existence of documentation appearing to require compliance, the reality was that non-compliance was expected.

There is, however, an important constitutional limitation to the Code. It is designed primarily as a model code for States and Territories to follow and develop uniformity. If the Commonwealth does not have a criminal law applicable to the activity under question, then the Code cannot apply. As it happens, there is no Commonwealth law that deals with corporate manslaughter, for example. It therefore falls to each of the States and Territories to adopt similar provisions to the Commonwealth Code in its criminal code or (in the case of common law States) key criminal legislation. Part 5 has not been adopted in any of the States (Sarre & Richards 2003), although the ACT and Victorian parliaments are both toying with the idea. Should these provisions come to fruition, their effects upon dangerous corporate practices (and the workability of the term ‘corporate culture’ in deterring specific conduct) would be a lively area for evaluative work. For example, what are the ramifications of this type of reform for managers who do not have total

control over employees, such as those who are encouraged to act autonomously? To what extent can we ever measure conduct that may have been deterred?

**Conclusion**

No-one argues against the need for public and private initiatives that promote honest, safe, clean, economically sustainable and employee-aware corporations, through a regulatory environment that is affordable, effective and respected. The debate over the preferred path to getting there, however, fuels much disagreement. Some say that, in order to prevent corporate collapse and forestall corporate irresponsibility, the state must reinforce legal and administrative regulation and finance it appropriately. Others say it should be left to the market, that is, the good will prevail and the poor will fall. It is conceivable that neither of those paths is generally effective. This paper has argued that what is required in order to thwart corporate collapses and to enhance corporate sustainability is a broader regulatory ‘mix’.

There have emerged in the literature a number of regulatory ‘carrots’, and other alternatives to legally based deterrence and punitive policies. If one were to believe their proponents, these ‘carrots’ are likely to be more effective than regulatory ‘sticks’ (Sarre 2002). What is needed is ongoing evaluative work that tests these alternatives in practice. The challenge is for evaluators to investigate each of the possible options for their potential to effect the desired outcome, that is, corporations that exhibit ‘sustainability’ by delivering the outcomes which they promise.

**Note**

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## DRUG EDUCATION IN GOVERNMENT SCHOOLS

In 1996 the Victorian Government launched a comprehensive drug reform strategy called *Turning the Tide* that addressed drug education, legislative reform, and treatment and rehabilitation.

The overall objective of the Turning the Tide in Schools initiative was to enhance and sustain drug education in Victorian schools to contribute to the minimisation of the harm associated with drug use by young people.

In March 2003 the Victorian Auditor-General released a performance audit report on drug education in government schools. The audit found that Turning the Tide in Schools has resulted in almost all government schools and many non-government schools establishing school drug education strategies, providing teachers with professional development in drug education, the development of curriculum materials, and providing information and education programs for parents.

This audit also found that Turning The Tide in Schools has successfully increased the amount and quality of drug education provided, particularly in government schools. The program has also facilitated the development of a range of student wellbeing initiatives.

As drug education moves from being a discrete initiative to a mainstream activity, the Department of Education & Training will need to ensure that drug education continues in schools, remains consistent and relevant to students and local communities, and is evaluated to improve its efficiency and effectiveness.

The audit makes 11 recommendations. These seek improvements in the implementation of individual school drug education strategies, the quality of drug education in schools, and the monitoring and evaluation activities undertaken by the Department and individual schools.

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A copy of the report can also be accessed on the Auditor-General's website:<[www.audit.vic.gov.au](http://www.audit.vic.gov.au)>.

drug education