The new world of corporate governance

Nancy A. Williams

Nancy A. Williams is a principal with Mercer Investment Consulting and a consultant to public pension funds. Prior to joining Mercer in 1994, she served nearly ten years as deputy executive director and general counsel to the Public Employees Retirement Association of Colorado. Prior to that, she was general counsel to the State Teachers Retirement System of Ohio. An article she coauthored "A New Compact for Owners and Directors," which addresses the governance responsibilities of corporate boards, appeared in the Harvard Business Review. She holds a Bachelor of Science degree in business administration from Ohio State University and a law degree from Capital University.

The fall of Enron and its ilk has turned out to be the kind of cataclysmic event that forces change, said Nancy Williams in her address to the Global Executive Forum. As a result of what Williams calls "corporate shenanigans," new rules now prevail in America's boardrooms and directors and CEOs must learn how to function in a dramatically different environment that demands increased responsibility and accountability of all concerned.

"Shareholders, the SEC, Congress, and the stock exchanges are all aligned. And they're saying boards should be more empowered and more independent, and management should be more accountable.

"In the short run this is going to cause a lot of confusion and friction and concern among directors and CEOs. But in the long run it will help the directors do the job they were always supposed to be doing, and that is protecting the shareholders."

Change brings with it "threats and opportunities and challenges."

Sarbanes-Oxley Act

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act which imposes strict disclosure and corporate governance mandates for all U.S. and non-U.S. public companies filing periodic reports with the U.S. Securities and Exchange Commission. The Act applies to company auditors as well. A few of its many provisions:

- Certification. Chief executive officers and chief financial officers must certify in writing the accuracy of their financial statements on a quarterly and annual basis and "to report on the effectiveness of their internal controls," said Williams.
- Violations. Company lawyers now have "a duty to squeal when they spot securities violations. This provision supersedes the historical lawyer-client relationship and affects all attorneys. You're not going to be able to get away with your securities violations just by switching attorneys."
- Oversight. The Act establishes a new five-member governing body for the accounting profession, the Public Company Accounting Oversight Board. All accounting firms, including non-U.S. firms, must be registered with the Oversight Board before auditing the financials of a public company.

"Consequences for lapsed oversight are severe," said Williams, including the inevitable shareholder suits and congressional investigations. "Suits will be brought by state attorneys general, not only because it is the right thing to do but also because a high-profile case can be a career boost. United States Attorneys are no longer timid about bringing criminal charges against corporate executives. And what works for a U.S. Attorney in one jurisdiction will be quickly copied in other jurisdictions."
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The SEC has weighed in with new rules for board audit committees, requiring them to have at least three members who are independent of company management and knowledgeable about financial issues. At least one member needs to be an expert in accounting or finance.

Higher risks

Given the skepticism and scrutiny that's now focused on the executive suite and boardroom, "the CEO's job is evermore demanding and the risks are even higher." Finding competent people who are willing to serve on corporate boards under the new regulations is becoming difficult.

The NASDAQ and New York Stock Exchange, independent of one another, have published their list of good governance principles and made them part of the requirements to be listed.

"Basically, both exchanges have stressed greater independence of boards and they define what independence, in this context, means. It's no longer let-your-conscience-be-your-guide on whether or not you're independent. Consequently, boards are becoming more aware of their increasing responsibilities. They are understanding more about their accountability. They're grasping the concept of fiduciary responsibility and realizing they might be able to delegate, but they can't abdicate that responsibility."

The scope and quantity of work that boards must do have expanded, and the skills necessary to fulfill board obligations are more complex.

"It's important now more than ever that boards function as teams, because they actually have a lot of work to do."

Empowered boards

Said Williams: "The independent, empowered board presents both a potential opportunity and a potential threat."

On the positive side, the empowered board can be a sounding board for the CEO, bringing wisdom and perspective to the table and creating a solid front to the outside in times of crisis to minimize risk.

Additionally, the board can help to influence critical outside constituencies and provide a support system for the CEO. "A lot of good can come out of having an empowered board," said Williams.

On the other end of the spectrum are the potential negative impacts, which are causing concern for chief executive officers.

"The number one concern of CEOs is that these independent, empowered boards are going to be micromanaging. They're worried that a power struggle could develop relating to the company's direction, because the directors will not understand their role vis-a-vis the CEO's role."

There's also the possibility that "overly independent, empowered board members might take up a lot of the CEO's time and even undercut the CEO's credibility outside the company. And the CEOs worst fear: Their compensation and job might be called into question."

Threats can be minimized if "boards are guided by the principle of NIFO: noses in, fingers out. They have to know what to smell around for, but they have to stay away from micromanagement."
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Also, the board needs to take stock of itself.

"I'm a firm believer that boards need to go behind closed doors at least once a year and do a very serious self-evaluation. Because they are becoming more powerful and more accountable, they need to ask themselves: Will this corporation move forward because of us or in spite of us? That needs to be done in a very comfortable setting, and the directors need to be honest with each other."

The CEO's challenge

Williams referred to a recent survey of CEOs and directors who were asked to identify the biggest problem with their board. Over-engagement, said the CEOs. Under-engagement, said the directors.

"So you have a disconnect there and it's going to have to be sorted out. These are tense times; it's going to be hard to do that."

Degrees of board engagement vary among companies and there's no single answer that's appropriate for all. "But when boards start feeling pressure from shareholder suits, from newspaper articles, from other pressure points, they could react by becoming either under-engaged or over-engaged," said Williams.

"The CEO's challenge is to figure out the degree of board engagement that's best for a company and then to build the kind of engagement that adds value. Boards have different roles at different times in the life of a corporation. Is this an early start-up company? Are these troubled times? Are these times to maintain?"

CEOs need to know their board's level of satisfaction with how the company is being run at all times. "Because what they don't know can hurt them."

In the new world of corporate governance, "getting the right board members is important; putting the governance processes and structure in place is important. New director orientation is very important so people understand their role. And somebody needs to create an atmosphere where there's cooperation, collaboration and active participation on the part of the board."