

# CORPORATE GOVERNANCE

ONE SIZE DOES NOT FIT ALL



Canadian regulators should be wary of following too closely  
in the steps of their counterparts south of the border



# Consider that foreign listings on the New York stock exchange are down

A DECLINE IN WILLINGNESS OR NEED TO PARTICIPATE IN U.S. MARKETS THAT NYSE CEO JOHN THAIN SAYS IS DUE, AT LEAST IN PART, TO THE TIME, EFFORT, AND RESOURCES REQUIRED TO BE IN COMPLIANCE WITH SARBANES-OXLEY.

While the U.S. is still “the powerful engine of global capitalism, no birthright dictates that we will remain so,” Thain said candidly. “In the 21st Century economy, great forces of competition and technology are accelerating change and the mobility of capital.”

Thain, however, also points to the growing attractiveness of Japan’s recovering markets, the booming economies of China and India, and the European Union’s progress toward becoming a stronger, more sophisticated and cohesive market—markets that have significant governance shortcomings by American standards.

## THE GLOBAL CHALLENGE

When it comes to corporate governance, no single country has a monopoly on best practices, said Deloitte Global CEO William G. Parrett. While that may be true, governance in some of the markets that are attracting capital are far from examples of best practices.

Japan’s corporate culture and informal approach to governance is different on so many levels from Canada, the U.K. and the U.S. Nevertheless, in December 2004, the Tokyo Stock Exchange introduced a Charter of Corporate Behaviour. Even though the document reads as more of a wish list than a firm set of rules or even guidelines, the delisting of scandal tainted Seibu Railway was a rare but promising turn of events.

Corporate scandal and poor corporate governance plagues China’s market, but it hasn’t deterred hundreds of billions of dollars in foreign investments from flowing into the economy. On a positive note, as the 2006 deadline approaches for China to open fully to foreign competition, prison sentences have become much harsher in an effort to deter wrongdoing.

In Europe, meanwhile, securities regulators have agreed to unprecedented co-operation, fearing SOX-like standards might gain a foothold in Europe. Regulators are anxious to ensure that enforcement action on International Financial Reporting Standards is consistent across Europe at a time when the U.S. Securities and Exchange Commission is preparing to scrutinize IFRS accounts.

## NORTH AMERICA—HARDSHIP AND COMPLAINTS

On the domestic front, however, the SEC has been sensitive to the hardship faced by smaller issuers with limited budgets to review and document their controls.

Overwhelmed with complaints about internal control reporting requirements of Section 404 of SOX, the SEC has extended the compliance deadline for smaller public firms yet again.

Canadian regulators are watching closely to better understand the repercussions.

On a per capita basis, Canada is only second to the United States in the number of public companies but, as TSX CEO Richard Nesbitt points out, “Canada’s market is characteristic of small-cap companies”.

“Despite the benefits of harmonization with the U.S., Canadian initiatives should support the Canadian public interest on a stand-alone basis,” Nesbitt wrote in a letter to members of the Canadian Securities Administrators.

## WHEN IT COMES TO CORPORATE GOVERNANCE, NO SINGLE COUNTRY HAS A MONOPOLY ON BEST PRACTICES

## THE CANADIAN EXPERIENCE

With the Canadian timeline for the internal control reporting now extended to at least 2007, the CSA has given itself time to assess the potential impact of current developments in the U.S.

In the meantime, the most important feature of the new rules for all Canadian issuers has clearly been the requirement for CEO and CFO certification of financial statements and internal controls.

“CEO, CFO certification requirements are like an iceberg,” says Urmas Soomet, Dofasco’s corporate secretary and director of legal services, and president of the Canadian Society of Corporate Secretaries. “The certificate is visible to everyone. What is not visible is the enormous amount of staff work that is being done within corporations to allow the CEO and CFO to sign their certifications.”

“Not only is there far greater emphasis on process, documentation about those processes and transparency,” says Ross McKee of Blake Cassels & Graydon LLP, “the emphasis is on independence of boards. It has shifted the power within many companies from the office of the CEO to the Board of Directors and in particular, the Audit Committee.”

Bob Tait, president and CEO of the Canadian Investor Relations Institute, agrees, adding that issuers are being asked to do more in the approvals process but in a shorter period of time.

## CIVIL LIABILITY—ONTARIO’S ADDED CHALLENGE

Tait also noted that Ontario’s new civil liability legislation has put a bit of a chill on companies giving earnings guidance

## GOOD GOVERNANCE

A serious issue for all organizations. It isn't only publicly traded companies that have an interest in the new governance environment. Non-profit organizations, including charities, and all levels of government are all under increasing pressure to implement better governance.

Stakeholder scrutiny has increased beyond the arena of corporate activities. The profile of government auditors has been elevated at municipal, provincial and federal levels thanks to public perceptions of high tax rates and declining public services, scandalous inquiries into spending irregularities, and the general distrust of politicians and government bureaucracy.

Not-for-profit organizations may not have shareholders, but they do have important funding agents that are increasingly interested in knowing that their money is being spent effectively. Faced with declining sources of traditional funding and a fiercely competitive funding environment, not-for-profits have been under ever-increasing pressure to prove their governance competencies.

"Our work with clients in the public sector, supported by recent research across Canada, indicates that one of the greatest challenges we see boards facing is meeting the public's expectations and demands for accountability and transparency without compromising the organization's ability to meet its targeted outcomes," says Ian Smith, a partner at Mercer Delta Consulting. "Boards need to ensure that the proper processes are in place to meet these expectations, starting with defining the appropriate relationship between the Board and the ongoing operations".

The federal government's introduction of the Canada Not-For-Profit Corporations Act, designed to "strengthen and clarify corporate governance rules for federally incorporated not-for-profit organizations," is an indication of these heightened expectations in Canada.

There are strong indications that not-for-profits south of the border are getting the message as well. Grant Thornton's second annual Board Governance Survey for Not-for-Profit



Organizations, indicated that 83 per cent of more than 700 not-for-profit entities say they are "very" or "somewhat" familiar with the act, compared to 56 per cent in 2003, and almost half (48 per cent) of survey respondents have made changes to their corporate governance policies as a result of Sarbanes-Oxley.

While there hasn't been the same feverish push on governance that corporations endured after Enron, there are clear expectations that both government and not-for-profits must improve governance practices, and there are even more obvious advantages to making changes that improve transparency, accountability and effectiveness.

which can imply a promise of performance and are subject to some factors which are beyond control of the company.

Beginning December 31, 2005, Ontario becomes the first Canadian jurisdiction to give secondary market investors the statutory right to sue public companies that operate in Ontario's capital markets for misleading disclosure and failure to make timely disclosure. With 90% of all equity trading in Canada, the secondary market in Canada dwarfs the size of the primary market.

"Public companies will have even stronger incentives to disclose accurate and complete information, and investors will have broader remedies to hold them accountable if that information is false, misleading or untimely," said Tom Allen, former chair of the Toronto Stock Exchange Committee on Corporate Disclosure.

Interestingly, in his explanation of why the U.S. market wasn't as attractive to foreign issuers, NYSE's Thain also blamed the reputation of America as a growing target for anti-business litigation and potential liabilities from class action lawsuits. Time will tell whether Ontario's civil liability laws have the same effect in Canada.

## NEW RULES, REGULATIONS AND GUIDELINES

### IS THE COST WORTH THE BENEFIT?

U.S. studies conclude that SOX implementation costs a lot and the results haven't been obvious.

A New York Stock Exchange survey in August reported that

80 per cent of CEOs are spending more time on regulatory and compliance issues than five years ago. Almost 70 per cent say their most demanding governance task is meeting the terms set out by Section 404 of the act.

According to a July report by professors at the University of Nebraska, audit fees for the Fortune 1,000 increased by an average of \$2.3 million, or 66 percent, between 2003 and 2004. 12 of the 648 companies surveyed rose by more than \$10 million each.

Even without the requirements of Section 404, the demands on resources required for documentation and CEO/CFO certification have significantly increased costs and lowered profits for many Canadian and U.S. companies.

### A THREAT TO COMPETITIVENESS

"My own concern is Canada's international competitiveness," says Urmas Soomet, Dofasco's corporate secretary and director of legal services, and president of the Canadian Society of Corporate Secretaries. "Businesses in Canada and the United States will be somewhat less efficient than their global competitors who do not have the same regulatory burdens to bear."

These burdens go beyond direct cost increases. There's the hidden cost of distracting management from running and managing the business—preoccupying managers with internal control reporting.

"They certainly have the potential to hurt productivity, efficiency, results and ultimately negatively impact share value," says Bob Tait, president and CEO of the Canadian Investor Relations Institute.



David Beatty, managing director of the Canadian Coalition for Good Governance, says that directors are getting tired of always looking in the rear view mirror, preoccupied with formulaic compliance activities rather than looking ahead and leading their business.

### POTENTIAL FOR REAL BENEFITS

“Obviously the first year or two of a new regulation or compliance takes more of the director’s time,” says Ann Mulé, Sunoco’s chief governance officer, assistant general council and corporate secretary. But she believes that “compliance will take a lot less time at the board level,” once directors are more comfortable with the processes.

While most CEOs question the balance between the investment required and the resulting benefits, the NYSE survey indicated that 66 per cent agree that Sarbanes-Oxley and Exchange governance rules help board members become more informed. 72 per cent of the CEOs also believe it makes them better engaged.

“The companies that get the most benefit from this corporate governance process review are those who take it as an opportunity to consider their business processes and reporting functions, and examine whether improvements can be made to either streamline the process or make it more effective,” says Ross McKee of Blake Cassels & Graydon LLP.

### WHAT ABOUT ETHICS?

Of course, the real reason governance rules were enhanced was to restore and ensure investor confidence. Pennsylvania

law school professor David Skeel warns that we’re kidding ourselves if we think we can head off the next round of scandals.

“SOX is about compliance, but good governance isn’t just about compliance,” says Janis Riven, president of the Institute of Chartered Secretaries and Administrators in Canada (ICSA) and lecturer at Concordia’s John Molson School of Business.

“There are limits to the compliance approach.”

“Corporate governance is a hot topic, but we are overly optimistic about what corporate governance can do,” says Wharton legal studies professor Thomas Donaldson. “Simply rearranging the chairs at the higher echelons of a company will not prevent the types of fraud that have occurred over the past several years.”

In his testimony before the U.S. Senate during the Sarbanes-Oxley hearings, Donaldson reminded lawmakers that in all of the recent major corporate scandals, the companies in question had fairly elaborate corporate compliance programs in place.

“We love to pin ethics to governance,” says Riven. “We have to be very careful of that because ethics is a very mushy area, and governance shouldn’t be mushy.”

## BOARD SUPPORT

### WHO’S WALKING THE TALK

As the hours get longer, directors are able to join fewer boards. In 2001, New York-based Pearl Meyer & Partners estimates directors put in an average of 150 hours a year, including 60

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hours of meetings. Today, it is closer to 200 to 250 hours with 80 or 90 hours of meetings.

"Compensation committee meetings used to be 45 minutes to an hour and a half on average. Now they are more like 2 hours and the notebook that goes out beforehand is 50 pages thick," said Edward Archer, Pearl Meyer's managing director. "When they ask who is going to chair the audit committee, everyone bends down pretending to tie their shoes."

"So far it appears that most corporations have been stepping up to the plate with the additional resources needed to cope with these changes," says Ross McKee of Blake Cassels & Graydon LLP.

Bob Tait, president and CEO of the Canadian Investor Relations Institute also observed that Canada's public companies are investing the appropriate time and energy to meet their governance obligations, but adds, "clearly there are a large number of companies that are complaining that the costs are too high and question the effectiveness of these governance rules."

"Some companies have hired additional people to deal with these needs," agrees Urmas Soomet, corporate secretary at Dofasco and president of the Canadian Society of Corporate Secretaries; but, he adds, most have not. "This means that most companies have staff who are working harder than ever, and projects which may have some real business value are being deferred and may never get done at all. This is unfortunate."

#### ARE THEY QUALIFIED TO DO THE JOB?

Corporate secretaries are under increasing pressure to ensure

that boards and committees remain apprised of, compliant with, and adapt to increased demands of new requirements as they take effect. Yet formal recognition of this vital role is not evident in most Canadian organizations.

"The role of the corporate secretary has not generally been well defined in Canada," says Janis Riven, president of the Institute of Chartered Secretaries and Administrators in Canada (ICSA)—which offers the only internationally recognized professional designation for corporate governance professionals. "In larger companies, the role is better defined with explicit duties to support and advise the board. In smaller companies, the role gets parked with general counsel or maybe the head of strategic development, and the assistant ends up keeping the minutes and keeping the records."

Properly established corporate secretaries are in a uniquely independent position within an organization. They know who is driving the agenda and who sets the agenda. They know if the materials that go to the board are appropriate, timely or the right quality.

"It is clearly becoming an important challenge for corporations to have individuals with the right qualifications to do the job," says Lynn Beauregard, executive director of ICSA and the Canadian Society of Corporate Secretaries. "The ICSA designation is the only one that provides this level of assurance."

"Any organization that wants to walk the talk on governance needs a champion of the process," adds Riven. "That would be the corporate secretary." ■

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