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Certified Corporate Governance Professional Sample Material

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V-Skills

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1. CORPORATE GOVERNANCE

Corporate governance refers to the system by which corporations are directed and controlled. The governance structure specifies the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, auditors, regulators, and other stakeholders) and specifies the rules and procedures for making decisions in corporate affairs. Governance provides the structure through which corporations set and pursue their objectives, while reflecting the context of the social, regulatory and market environment. Governance is a mechanism for monitoring the actions, policies and decisions of corporations. Governance involves the alignment of interests among the stakeholders.

There has been renewed interest in the corporate governance practices of modern corporations, particularly in relation to accountability, since the high-profile collapses of a number of large corporations during 2001–2002, most of which involved accounting fraud. Corporate scandals of various forms have maintained public and political interest in the regulation of corporate governance. In the U.S., these include Enron Corporation and MCI Inc. (formerly WorldCom). Their demise is associated with the U.S. federal government passing the Sarbanes-Oxley Act in 2002, intending to restore public confidence in corporate governance. Comparable failures in Australia are associated with the eventual passage of the CLERP 9 reforms. Similar corporate failures in other countries stimulated increased regulatory interest (e.g., Parmalat in Italy).

1.1. Other Definitions

Corporate governance has also been defined as "a system of law and sound approaches by which corporations are directed and controlled focusing on the internal and external corporate structures with the intention of monitoring the actions of management and directors and thereby mitigating agency risks which may stem from the misdeeds of corporate officers."

- ✓ In contemporary business corporations, the main external stakeholder groups are shareholders, debt holders, trade crops., suppliers, customers and communities affected by the corporation's activities. Internal stakeholders are the board of directors, executives, and other employees.

Much of the contemporary interest in corporate governance is concerned with mitigation of the conflicts of interests between stakeholders. Ways of mitigating or preventing these conflicts of interests include the processes, customs, policies, laws, and institutions which have an impact on the way a company is controlled. An important theme of governance is the nature and extent of corporate accountability.

A related but separate thread of discussions focuses on the impact of a corporate governance system on economic efficiency, with a strong emphasis on shareholders' welfare. In large firms where there is a separation of ownership and management and no controlling shareholder, the principal–agent issue arises between upper-management (the "agent") which may have very different interests, and by definition considerably more information, than shareholders (the "principals"). The danger arises that rather than overseeing management on behalf of shareholders, the board of directors may become insulated from shareholders and beholden to management. This aspect is particularly present in contemporary public debates and developments in regulatory policy.(see regulation and policy regulation).

Economic analysis has resulted in a literature on the subject. One source defines corporate governance as "the set of conditions that shapes the ex post bargaining over the quasi-rents generated by a firm." The firm itself is modeled as a governance structure acting through the mechanisms of contract. Here corporate governance may include its relation to corporate finance.

1.2. Principles of Corporate Governance

Contemporary discussions of corporate governance tend to refer to principles raised in three documents released since 1990: The Cadbury Report (UK, 1992), the Principles of Corporate Governance (OECD, 1998 and 2004), the Sarbanes-Oxley Act of 2002 (US, 2002). The Cadbury and OECD reports present general principles around which businesses are expected to operate to assure proper governance. The Sarbanes-Oxley Act, informally referred to as Sarbox or Sox, is an attempt by the federal government in the United States to legislate several of the principles recommended in the Cadbury and OECD reports.

- ✓ Rights and equitable treatment of shareholders: Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by openly and effectively communicating information and by encouraging shareholders to participate in general meetings.

- ✓ Interests of other stakeholders: Organizations should recognize that they have legal, contractual, social, and market driven obligations to non-shareholder stakeholders, including employees, investors, corps, suppliers, local communities, customers, and policy makers.

- ✓ Role and responsibilities of the board: The board needs sufficient relevant skills and understanding to review and challenge management performance. It also needs adequate size and appropriate levels of independence and commitment.

- ✓ Integrity and ethical behavior: Integrity should be a fundamental requirement in choosing corporate officers and board members. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making.

- ✓ Disclosure and transparency: Organizations should clarify and make publicly known the roles and responsibilities of board and management to provide stakeholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

1.3. Corporate Governance Models Around The World

There are many different models of corporate governance around the world. These differ according to the variety of capitalism in which they are embedded. The Anglo-American "model" tends to emphasize the interests of shareholders. The coordinated or Multi stakeholder Model associated with Continental Europe and Japan also recognizes the interests of workers, managers, suppliers, customers, and the community. A related distinction is between market-orientated and network-orientated models of corporate governance.

Continental Europe

Some continental European countries, including Germany and the Netherlands, require a two-tiered Board of Directors as a means of improving corporate governance. In the two-tiered board, the Executive Board, made up of company executives, generally runs day-to-day operations while the supervisory board, made up entirely of non-executive directors who represent shareholders and employees, hires and fires the members of the executive board, determines their compensation, and reviews major business decisions.

India

India's SEBI Committee on Corporate Governance defines corporate governance as the "acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal & corporate funds in the management of a company." It has been suggested that the Indian approach is drawn from the Gandhian principle of trusteeship and the Directive Principles of the Indian Constitution, but this conceptualization of corporate objectives is also prevalent in Anglo-American and most other jurisdictions.

United States, United Kingdom

The so-called "Anglo-American model" of corporate governance emphasizes the interests of shareholders. It relies on a single-tiered Board of Directors that is normally dominated by non-executive directors elected by shareholders. Because of this, it is also known as "the unitary system". Within this system, many boards include some executives from the company (who are ex officio members of the board). Non-executive directors are expected to outnumber executive directors and hold key posts, including audit and compensation committees. The United States and the United Kingdom differ in one critical respect with regard to corporate governance: In the United Kingdom, the CEO generally does not also serve as Chairman of the Board, whereas in the US having the dual role is the norm, despite major misgivings regarding the impact on corporate governance.

In the United States, corporations are directly governed by state laws, while the exchange (offering and trading) of securities in corporations (including shares) is governed by federal legislation. Many US states have adopted the Model Business Corporation Act, but the dominant state law for publicly traded corporations is Delaware, which continues to be the place of incorporation for the majority of publicly traded corporations. Individual rules for corporations are based upon the corporate charter and, less authoritatively, the corporate bylaws. Shareholders cannot initiate changes in the corporate charter although they can initiate changes to the corporate bylaws.

Regulation

Legal environment – General

Corporations are created as legal persons by the laws and regulations of a particular jurisdiction. These may vary in many respects between countries, but a corporation's legal person status is fundamental to all jurisdictions and is conferred by statute. This allows the entity to hold property in its own right without reference to any particular real person. It also results in the perpetual existence that characterizes the modern corporation. The statutory granting of corporate existence may arise from general purpose legislation (which is the general case) or from a statute to create a specific corporation, which was the only method prior to the 19th century.

In addition to the statutory laws of the relevant jurisdiction, corporations are subject to common law in some countries, and various laws and regulations affecting business practices. In most jurisdictions, corporations also have a constitution that provides individual rules that govern the corporation and authorize or constrain its decision-makers. This constitution is identified by a variety of terms; in English-speaking jurisdictions, it is usually known as the Corporate Charter or the [Memorandum] and Articles of Association. The capacity of shareholders to modify the constitution of their corporation can vary substantially

The U.S. passed the Foreign Corrupt Practices Act (FCPA) in 1977, with subsequent modifications. This law made it illegal to bribe government officials and required corporations to maintain adequate accounting controls. It is enforced by the U.S. Department of Justice and the Securities and Exchange Commission (SEC). Substantial civil and criminal penalties have been levied on corporations and executives convicted of bribery.

The UK passed the Bribery Act in 2010. This law made it illegal to bribe either government or private citizens or make facilitating payments (i.e., payment to a government official to perform their routine duties more quickly). It also required corporations to establish controls to prevent bribery.

1.4. Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 was enacted in the wake of a series of high profile corporate scandals. It established a series of requirements that affect corporate governance in the U.S. and influenced similar laws in many other countries. The law required, along with many other elements, that:

- ✓ The Public Company Accounting Oversight Board (PCAOB) be established to regulate the auditing profession, which had been self-regulated prior to the law. Auditors are responsible for reviewing the financial statements of corporations and issuing an opinion as to their reliability.

- ✓ The Chief Executive Officer (CEO) and Chief Financial Officer (CFO) attest to the financial statements. Prior to the law, CEO's had claimed in court they hadn't reviewed the information as part of their defense.

- ✓ Board audit committees have members that are independent and disclose whether or not at least one is a financial expert, or reasons why no such expert is on the audit committee.

- ✓ External audit firms cannot provide certain types of consulting services and must rotate their lead partner every 5 years. Further, an audit firm cannot audit a company if those in specified senior management roles worked for the auditor in the past year. Prior to the law, there was the real or perceived conflict of interest between providing an independent opinion on the accuracy and reliability of financial statements when the same firm was also providing lucrative consulting services.

Codes and guidelines

Corporate governance principles and codes have been developed in different countries and issued from stock exchanges, corporations, institutional investors, or associations (institutes) of directors and managers with the support of governments and international organizations. As a rule, compliance with these governance recommendations is not mandated by law, although the codes linked to stock exchange listing requirements may have a coercive effect.

OECD principles

One of the most influential guidelines has been the OECD Principles of Corporate Governance—published in 1999 and revised in 2004. The OECD guidelines are often referenced by countries developing local codes or guidelines. Building on the work of the OECD, other international organizations, private sector associations and more than 20 national corporate governance codes formed the United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) to produce their Guidance on Good Practices in Corporate Governance Disclosure. This internationally agreed benchmark consists of more than fifty distinct disclosure items across five broad categories:

- ✓ Auditing
- ✓ Board and management structure and process
- ✓ Corporate responsibility and compliance
- ✓ Financial transparency and information disclosure
- ✓ Ownership structure and exercise of control rights

1.5. Stock Exchange Listing Standards

Companies listed on the New York Stock Exchange (NYSE) and other stock exchanges are required to meet certain governance standards. For example, the NYSE Listed Company Manual requires, among many other elements:

- ✓ Independent directors: "Listed companies must have a majority of independent directors...Effective boards of directors exercise independent judgment in carrying out their responsibilities. Requiring a majority of independent directors will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest." (Section 303A.01) An independent director is not part of management and has no "material financial relationship" with the company.

- ✓ Board meetings that exclude management: "To empower non-management directors to serve as a more effective check on management, the non-management directors of each listed company must meet at regularly scheduled executive sessions without management." (Section 303A.03)

- ✓ Boards organize their members into committees with specific responsibilities per defined charters. "Listed companies must have a nominating/corporate governance committee composed entirely of independent directors." This committee is responsible for nominating new members for the board of directors. Compensation and Audit Committees are also specified, with the latter subject to a variety of listing standards as well as outside regulations. (Section 303A.04 and others)