

# THE CORPORATE GOVERNANCE ALLIANCE DIGEST

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As a service of Eleanor Bloxham and John M. Nash, below are complimentary summaries of up to date news, information and perspectives on issues in value and corporate governance. We hope you find this service useful. If you don't want us to send you this information in the future, please just notify Eleanor Bloxham ([ebloxham@thevaluealliance.com](mailto:ebloxham@thevaluealliance.com)).

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## THE CORPORATE GOVERNANCE ALLIANCE DIGEST

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This edition of the DIGEST has 5 major sections:

- I. BOARDS: NOMINATIONS, SUCCESSION, COMPOSITION, CONFLICTS
- II. COMPENSATION TRENDS & ISSUES
- III. AUDIT COMMITTEE ALERTS
- IV. SHAREHOLDER, EMPLOYEE, AND CUSTOMER RELATIONS
- V. OTHER REGULATORY AND LEGAL UPDATES

### I. BOARDS: NOMINATIONS, SUCCESSION, COMPOSITION, CONFLICTS

Only 1% of Fortune 500 - and 31% of Nasdaq 100 companies - have Asian-Pacific American directors, according to

a recent report by the Committee of 100, a group of Chinese-American leaders in business, academics and the arts. (USA 4/15)

According to a review by Equilar, 88% of fund directors are men. (WSJ 4/28)

Norway now requires that boards of directors must have at least 40% of each gender -- or face legal action. Currently, women directors on boards are at 8.9% for Norwegian publicly traded firms, (CFO 4/28)

According to the Corporate Library, as of March, 377 CEOs in the S&P 500 chair their own boards, compared with 394 last year. Seagate, Landstar Systems and Inland Real Estate are the latest splits. (CFO 5/3)

Some companies eligible for the "controlled company" exemption under NYSE and Nasdaq rules are using it: they don't plan to have a majority of independent directors or an independent nominating or compensation committee. CT and CII asked the SEC to not allow the exemption. Particularly upsetting to investors is the use of this exemption when a controlling interest holds voting powers without holding a large economic stake. Dillard's is an example. Other companies eligible to use the exemption are choosing not to do so. (WSJ 4/28)

The largest fund companies are lobbying the SEC against a requirement for an outside chair. It is believed about 80% of US mutual funds have chairs who are also senior executives of the funds' management companies and would have to be replaced under the new rule. (NYT 5/10)

The Business Roundtable is lobbying the SEC to permit the nominating committee, rather than shareholders, appoint a new director after a majority of

shareholders withheld their votes for one incumbent. (NYT 5/10)

Separately, it is believed Donaldson has already agreed to eliminate a proposal that would have allowed a petition from 1% of shareholders to prompt a vote by all shareholders on whether to conduct a contested election for a limited number of board seats. (NYT 5/10)

Nasdaq disclosed that 7 of its 20 directors missed more than 25% of last year's board and committee meetings. 3 of the 7 are retiring. The other 4 have full time jobs as CEO of WPP group, global head of Morgan Stanley's institutional equity division, president and CEO of Knight Trading and chair and CEO of Thomas Weisel Partners. (WSJ 4/22)

Under an earlier plan of reorganization, several of MCI's key bondholders planned to sit on the board of directors, but changed their minds after court-appointed corporate monitor, Richard C. Breeden, argued that as board members they should be required to disclose stock sales up to 2 weeks before they occur, giving public notice. Breeden remains on as monitor of MCI for probably another 2 years. (WP 4/19, WSJ 4/20)

McDonald's board is being credited with solid succession planning, when hours after the sudden heart attack death of chair and CEO, Jim Cantalupo, directors announced that Charlie Bell, the president and COO, would succeed him. Janet Clarke, a director, points out that boards need to consider several approaches. "If a company has split the job of chairman and CEO and one of these people dies suddenly, the other should be able to take over for a while," she says. (WSJ 4/20)

A year after dismissing founder Richard M. Scruschy as its chair and CEO HealthSouth appointed Jay Grinney as

its new CEO. New governance rules at HealthSouth split the roles of CEO and chair. (WSJ 5/3)

Although not an independent chair, there will be a separate chair and CEO at Siebel. Michael Lawrie becomes CEO; Tom Siebel, remains as chair. (WSJ 5/4)

58% of Boeing shareholders supported a non-binding resolution calling for the annual election of directors and 59% voted to allow resolutions to be adopted with majority approval instead of a three-quarters vote. Boeing has been told to hire a special compliance officer by the Air Force. (CFO 5/6)

Many corporate governance experts say that "independent" directors are no longer so after they have served 10 years. The average length of time served by the 15 non-executives at Coke is more than 12 years. That figure rises if Don Keough, is not counted as a newcomer. (FT 4/19) Coke's board has been accused of "over involvement". The board appointed Neville Isdell to replace Doug Daft as CEO. (WSJ 5/4, NYT, WSJ 5/5) 16% of shareholders withheld support for Warren Buffet's renomination to Coke's board because of business dealings with Coke and because the audit committee of which he is a member engaged the auditor in consulting services. About 25% voted to split the chair and CEO titles. (NYT 4/23, USA 4/23)

US based Steel Partners Strategic Japan Fund is shaking up Japanese boardrooms, taking on board seats, forcing companies to increase their dividends, change strategies. In some cases companies are attempting to institute protective measures to fend off Steel's efforts. (WSJ 4/15)

Robert C. Nakasone, former CEO of Toys "R" Us, who headed Tenet's compensation committee, resigned last month because he opposed: the selection the new CEO, the board's decision to terminate discussions relating to a possible combination of Tenet with a smaller company, and the board's adoption of a 2004 executive-bonus program that could result in large payments -- without requiring any improvement over prior period results. Tenet Chair Ed Kangas and two other

directors say Mr. Nakasone resigned after he was asked to leave and payouts under the new plan only occur if Tenet achieves results that "greatly exceed anticipated results." (WSJ 4/12)

Analysts say that banking regulators will hold directors accountable for how effectively they monitored Riggs's anti-money-laundering practices. Boards are responsible for ensuring there are effective policies and practices and fully documented compliance programs in place. The issue of independence of the directors has been raised. 6 of the bank's 12 board members are company insiders. Outsiders include Jack Valenti, a close friend of the CEO, Joe Albritton, Steven Pfeiffer and Charles Camalier, both lawyers whose firms work for Riggs, and Eddie Williams, president of the Joint Center for Political and Economic Studies, which lists Riggs as a leading corporate donor and has received the assistance of Albritton and his wife in fund raising (NYT 4/15)

The attorney, Martin Lipton's close relationship with Michael Eisner has been questioned in relationship to the board's considerations of Mr. Eisner's position and the Comcast bid. After Mr. Lipton's arrival, several independent Disney directors raised the issue of whether they should be seeking out their own lawyers and bankers to help evaluate the situation separately from Mr. Eisner and management. "The idea was summarily rejected." (NYT 4/18)

Investors are questioning the lack of disclosure by Action Performance, which when it hired its CFO in August 2000 did not disclose that a month earlier he had been put on accounting probation for seven years, had his CPA license restricted and been made to complete extra hours of professional education. (WSJ 4/21)

Computer Associates directors asked CEO Sanjay Kumar to step down. Directors were concerned about the former CEO's personal legal peril and also the possibility that the company itself could be indicted if he remained CEO. Instead, he resigned from the board and will become the company's "chief software architect" The board named Lewis Ranieri, an outside director since 2001, as chair. An interim CEO

will be named "shortly," and that a search for a permanent CEO is under way. The company plans to restate \$2.2b in revenue. (WSJ 4/22, FT, USA 4/23, CFO 4/27)

Safeway will add 3 independent directors in response to calls for greater board independence. (CFO 5/3)

Two independent directors have resigned from Azteca's board. Azteca's chair is under investigation by the SEC: he bought debt of Azteca's cellphone unit, Unefon, at a discount last June and sold it back to the company at full price in October. He and a partner each took in \$109 million from the deal. His role was not disclosed to shareholders of Unefon or TV Azteca at the time. (NYT 5/10)

A draft investigative report prepared for DPL's board by an outside law firm shows no evidence of accounting fraud but does show conflicts of interest and issues of nondisclosure related to compensation and other issues. In addition, certain records were purged from the chair's computer after investigations began. (WSJ 5/12)

Calpers updates in the SHAREHOLDER section.

## II. COMPENSATION TRENDS AND ISSUES

The median realized pay (counting gains on options, restricted stock and long-term incentives in that year) for CEOs at 350 of the largest companies was \$3.6 m in 2003, according to Mercer, 19% higher than the median from 2002 of \$3.02 m. \$6.2 m in expected pay (which includes the estimated value for option grants) is 19% higher than the median CEO pay for 2000 and the highest at any time in the past 10 years, except for 2001. The median white-collar worker made \$46,100 in 2003, up 3.3% from the median in 2002, according to the Bureau of Labor Statistics. CEOs in office at least 2 years had a 7.2% rise in salary and bonus to a median of \$2.1m on top of a 10% rise the year before. 278 of the 350 gave their highest officer options, down from 295 the year before. According to IRRC, in 2003, stockholders voted on a record 201 executive-pay resolutions; this year so far the number is 289. (WSJ 4/12, 4/16)

The average CEO in the U.S. earned 282 times the salary of the average worker in 2002, according to an annual survey by the Institute for Policy Studies, a Washington think tank, and United for a Fair Economy, a Boston nonprofit. In 1982, the ratio was 42 to 1. 10 shareholder proposals requesting set ratios already have been submitted for this year. Wholefoods has a rule preventing any executive from earning an amount in salary and bonus that's more than 14 times what the average worker makes. The current cap: \$409,000. (WSJ 4/12)

According to a study by Management Practice, the median salary of fund directors at the nation's 50 largest complexes rose 13% in 2003, to nearly \$128,000, up from about \$113,000 a year earlier. (WSJ 4/28)

Under scrutiny – corporate practices related to pay when accounting is restated. While Sarbanes-Oxley addresses the concept, it leaves room for executives other than the CEO and CFO to keep ill gotten or just miscalculated gains – and doesn't require forfeiture for CEOs and CFOs unless willful misconduct was involved with their certification. Some compensation committees include a clause in executives' incentive agreements requiring that bonuses be recalculated if they are based on results that have to be restated. (NYT 4/25)

Many changes are afoot in company stock option plans: fewer employees are receiving them, the length of time to expiration is being shortened, exercise prices are being set higher than the price at the time of grant, Plans are being replaced with restricted stock, restricted stock units (shares are issued at a future date), performance shares (stock grants based on other corporate performance measures), and stock appreciation rights (rights to the increase in stock value between time of grant and exercise – paid either in stock or cash) (WSJ 4/28)

At PepsiCo, executives (excluding the top 12) get to choose how they want to receive 100% of their long-term incentive package. 200 top executives (excluding the top 5) at Principal Financial get to choose 25% of theirs. In

both cases the choice is stock options or restricted stock. At Lincoln, executives have seven choices related to 100% of their long term incentives: all options; all performance shares; all cash; one-third of each; half cash and half performance shares; half options and half performance shares; or half cash and half options. Executives choose their mix at the beginning of a three-year cycle. How much they earn depends on how close they come to meeting earnings-per-share growth, return on equity and total shareholder return targets. (WSJ 4/12)

Under SOX, pre-existing loans remain on a company's books as long as the terms aren't changed - now, proxy reports make clear that many loans by design or otherwise will not be repaid. Examples include Home Depot, Mattel, Unocal. (USA 4/14)

### **SPECIFIC PAY PACKAGES**

Glass Lewis is recommending shareholders not approve an option plan developed by Broadcom's board's options committee which met 25x in 2003 and is composed of the CEO, a co-founder, and the president of an investment advisory firm and according to their calculations would equal 12.2% of Broadcom's enterprise value and dilute existing shareholder interests by 3.7% if put in place. The firm calculates the cost if it were in place last year at 75% of the company's revenue. In addition a repricing of options under the plan would cost shareholders \$250m. Broadcom lost almost \$1b in 2003 and its retained earnings totaled a negative \$6.7b at year-end. Glass Lewis is recommending a withhold vote against the four members of the compensation committee and notes directors themselves are paid far above peer averages of \$140k a year plus \$450k a year in options and cash and an additional 100k options granted every 4 years that would be worth about \$2.5 m if awarded today. It is unknown how Alliance, the American Funds and Fidelity, all large shareholders will vote. (NYT 4/18)

Emilio Botin, chair of Banco Santander was ordered to stand trial, and could be sentenced 4 to 6 years in prison related to severance bonuses paid to Santander's former co-chair and former CEO: Mr.

Botin is accused of "using shareholders' money to buy their resignations" (WSJ 4/28)

53%, of shares voted at Delta's shareholder meeting approved a proposal that would require Delta's board to obtain shareholder approval for any "extraordinary retirement benefits" given to senior executives. Gerald Grinstein, Delta's CEO, said the board would abide by the wishes of shareholders. (WSJ 4/26)

Two lawsuits may help Elliot Spitzer decide whether to sue Mr. Grasso over his pay package: Adelphi University where NY State sued the former president and its trustees, alleging that his \$800,000-plus-a-year pay package was excessive, settling for \$4 m with the president and most trustees forfeiting some money and the Disney case pending in Delaware court related to the \$140 m package. Michael Ovitz received after he stepped down as president. (WSJ 4/20)

As part of his separation agreement, Mark Whiston of Janus will receive \$15 million -- in cash, deferred compensation and through accelerated vesting of his Janus stock holdings. (WSJ 4/21)

### **III. AUDIT COMMITTEE ALERTS**

According to a CFO Magazine poll, nearly 1/2 — 47% of 179 finance execs say they still feel pressure from their superiors to use aggressive accounting to make results look better. The potential reasons may be related to their view of the cause of the scandals: Personal greed (79%) weak boards of directors (58%), overbearing CEOs (45%), unrealistic shareholder expectations (34%) and unrealistic budgets (29%). (Only 33% cited poor internal controls.) 20% of those who felt pressure in the past – say they feel more today; only 38% feel less. On the other hand, 77% say SOX has made it easier to resist. As a reflection of the widespread nature of the problem, only 27% say that if they were investing their own money, they would feel "very confident" about the quality and completeness of information available about public companies. (CFO 5/3)

Based on recent cases, "either quit or join the conspiracy", lawyers say. "Employees with knowledge the financial statements are false can't stay." (WSJ 4/21)

More issues in cash flow reporting. (See also article in last digest edition from CFO magazine.) Accounting rules for cash-flow statements give conflicting guidance on what qualifies as operating activities and what should be classified as investing and financing activities. Customer-related cash flows generally are supposed to be presented as part of operating activities, while cash flows related to loans are supposed to be part of investing activities. So what to do with customer-related loans? Many companies lend their customers money to buy their products. Usually, the initial accounting is fairly simple. Revenue is recorded. Customer receivables go up. Inventory goes down. The company's operating cash flow remains unchanged. However, not all companies take the same approach according to a new report by the Georgia Tech Financial Analysis Lab. Ford, GM, and Harley classify loans to dealers as part of their investing activities. The result: Operating cash flow gets a boost before the loan is collected -- and it stays that way, even if the dealer later fails to pay what it owes. In contrast, when Navistar reports consolidated results, operating cash flow does not receive a boost until the cash comes in. "At the end of the day, we define ourselves as a manufacturing company with a finance subsidiary," rather than the other way around, says Mark Oberle, Navistar's director of investor relations. On this basis, for 2003, Dr. Charles Mulford calculates Ford's and Harley's operating cash flows would have been 14% lower; GM's 64% less. (WSJ 4/16)

Revenue recognition and the proper accounting treatment related to internet ads depends on whether the company is merely an "agent" facilitating a deal, or a "principal" that stands to lose money, if, for example, an advertiser fails to pay. Yahoo reports gross revenue and then shows its payment to the web publisher as an expense, labeled as a "traffic acquisition cost" because it is "the primary obligor" to the publishers. Google, reports revenue net of expenses because "we are not the principal to

transactions." Instead, Google says users view the ads on the Web sites of independent publishers, who determine what ads they accept. (WSJ 5/10)

Although there has been more focus on these issues, many security concerns have yet to be addressed in corporate boardrooms. Security concerns cover a broad array of issues including internal and external threats, it, supply chain and corporate governance issues. (FT 5/10)

The SEC requires companies to disclose issues that could affect a company, but there are no specific rules regarding disclosure of executives' health problems. The issue has arisen at Kraft where investors and employees are disturbed by the lack of disclosure concerning the recent hospitalization of CEO Roger Deromedi, (WSJ 4/12)

If the corporate tax burden rises to the level of the 1990s, according to Commerce Department figures, after-tax earnings would be 13% less than they are now. (WSJ 4/13)

Starting in August, UK accountants, bankers and lawyers will have to notify the Inland Revenue in plain English about tax avoidance schemes immediately after they are sold to individuals or companies. (FT 4/13)

Many institutional shareholders across Europe have backed the introduction of the new IASB accounting rules on derivatives and insurance contracts, (FT 4/13)

In the wake of many scandals, the (US) Association for Financial Professionals, (UK) Association of Corporate Treasurers and (FR) Association Francaise des Tresoriers D'Entreprise called for ratings companies to adopt practices that would increase transparency, prevent conflicts of interest and protect confidential company information, including distinguishing between solicited and unsolicited ratings; publicizing methodologies and any changes to those methodologies; and improved communication with the companies that issue debt, including giving issuers the opportunity to review the text of any rating action affecting their securities to ensure the accuracy of reported

information and to remove any nonpublic information erroneously included. (WSJ 4/15)

To book deep water proved reserves in Gulf of Mexico only, the SEC will allow new technology to substitute for test wells. (WSJ 4/15)

## AUDITORS AND AUDIT FEES

Investigators believe D&T's Italian office, which co-coordinated the audit of Parmalat's worldwide operations, ignored and buried evidence of accounting irregularities uncovered by its sister offices in Brazil, Argentina, Mexico, Portugal, the US and Canada and also appear to have successfully lobbied Deloitte's US global headquarters to intervene in Brazil and remove an auditor there who had raised too many questions. (FT 4/12),

Big four firms often act as autonomous units in each country. In response, the European Commission is proposing that the chief auditor bear full responsibility for group accounts and is considering a requirement that auditors use international auditing standards to complement the use of international accounting standards for listed companies. (FT 4/13)

E & Y, may not accept any new audit clients in the US for 6 months and must pay a \$1.7m fine for lack of auditor independence, related to its joint marketing of consulting and tax services with audit client, PeopleSoft. The SEC judge said there was no reason to believe E & Y would not commit future similar acts and was particularly critical of Edmund Coulson, former chief accountant of the SEC, and the Ernst partner who was in charge of independence issues. E & Y must hire an SEC-approved consultant to monitor future compliance efforts. (NYT 4/17, FT, USA, WP, WSJ 4/19)

KPMG and PwC, are both expected to be in the spotlight of the SEC in coming weeks related to their work as Shell's joint auditors (FT 4/23)

A federal judge ruled that KPMG must reveal the names of clients who invested in its tax shelters. (FT 5/5)

## ACCOUNTING AND CONTROL ISSUES

It was announced that Coke's general counsel, Deval Patrick, was resigning due to criticism from some company directors over his handling of government investigations into the company's accounting. But a couple of days later it was announced that he had been asked to stay on at the request of the board and CEO. A former company auditor, Matthew Whitley, made allegations of fraud and before filing suit, expressed his concerns to Messrs. Heyer and Patrick between late January and March 2003. Mr. Heyer has no recollection of seeing Mr. Whitley's emails. Mr. Patrick told Mr. Whitley he was looking into the matter and he advised the board's audit committee. After perceiving a lack of responsiveness from Coke, on May 19, Mr. Whitley took his fraud allegations public in a lawsuit, leading to the current government probes. William Pecoriello, a beverage analyst at Morgan Stanley, says Heyer should be made CEO with a separate chair. (FT, NYT, WSJ 4/12, USA 4/13, FT, WSJ 4/15)

Goodyear will cut \$65m from its net income reported between 1997 and 2003 as a result of a four-month internal inquiry into the company's accounts in Europe and the US. \$10m of the net income restated related to business in the EU, \$20m related to US workers' compensation claims, and the rest to fixed assets, product liability and inventory. (FT 4/12, WSJ 4/13)

The SEC is planning to charge Time Warner for booking more than \$400m in questionable ad revenue following the company's January 2001 merger with AOL and seeking financial sanctions against the company for failing to cooperate with the investigation. The accounting was approved by outside auditor E&Y. In the meantime, the SEC is refusing to approve any new stock offerings by Time Warner or any of its divisions. (WP 4/13)

Quovadx's CEO and CFO resigned as the SEC formalized its investigation into revenue recognition accounting in 2002 for revenues that had not been collected. (WSJ 4/13)

Some members of the non-executive boards of Royal Dutch/Shell have raised concerns about an internal audit committee that puts too much blame for the energy group's reserves scandal on Sir Philip Watts, its former chair, and too little on remaining executives. (FT 4/12).

Walter van de Vijver, the former head of exploration and production for Shell, said that after assuming his position in mid-2001 he discovered that some prior bookings of oil reserves needed to be re-evaluated for compliance purposes and communicated findings to the committee of managing directors without delay. These bookings covered 1997 to 2001 when Sir Phillip Watts was responsible for those reserves. Internal Shell documents show that he sent a memo in February 2002 to the managing directors' panel, saying that one billion barrels of reserves "are no longer fully aligned" with SEC rules and an additional 1.3 billion barrels of reserves were at risk. In July 2002, Mr. van de Vijver sent a memo detailing Shell's reserves problems whose recipients included Jeroen van der Veer, Shell's current chair and Judy Boynton, Shell's CFO, who was reassigned to aid Mr. Van der Veer, with the controller, Tim Morrison becoming acting CFO. Apparently Mr. van de Vijver repeatedly warned Sir Phillip Watts on the matter to no avail. It was not until January of this year that Shell disclosed that it was downgrading its estimate of proven reserves, a widely followed indicator, by 20 percent, or 3.9 billion barrels, a move that stunned investors. The disclosure led to investigations by regulatory authorities in the US and Europe, as well as a criminal inquiry by the Justice Department. For a third time, Shell revised its estimates on April 19. (NYT 4/14, FT, NYT, WSJ 4/19, 4/20)

Pressure on IROs. Karen Chrosniak, former Adelphia director of investor relations, said she inflated subscriber numbers for the company's quarterly press releases several times, starting in May 2000, each time, following the instructions of Timothy Rigas, CFO or former vice president of finance James Brown, she testified. Mr. Brown has pleaded guilty in the case. (WSJ 4/16)

Global Crossing has postponed its annual meeting and first quarter results,

will restate its 2003 financial results, review its 2002 results, and suspend its financial projections for 2004 due to internal controls issues that led it to underestimate its largest expense, the cost of getting access to other companies' phone and data networks. (WSJ 4/28)

Bally's CFO resigned as the SEC launched a probe into its restatement due to accelerated dues recognition. The next day he was hired back as a \$475k per year consultant. (CFO 4/30)

The SEC may bring civil action related to the activities of a non-executive employee at Pepsi and another at Frito-Lay who signed documents prepared by Kmart stating payments of about \$3 m from Pepsi and \$2.8 m from Frito-Lay. Kmart allegedly used these documents to improperly record the timing of revenue from the two divisions. (CFO 5/4)

The SEC has launched an investigation into Citigroup's accounting practices related to investments, business activities and loan loss allowances in its Argentine operations in the 4th quarter of 2001 and 1st quarter of 2002, at the height of the country's fiscal crisis. (CFO 5/7)

OFHEO has ordered Fannie to review its impairment write-downs on its \$8 billion portfolio of securities backed by manufactured-housing loans, as well as \$300 million of securities backed by aircraft leases and gave the company one week to provide the new sum for each quarter since the fourth quarter of 2002. However, the SEC stepped in and said Fannie didn't need to restate; however, it should change its methods going forward. The issue revolves around accounting rule EITF 99-20, which took effect in 2001 and states the conditions under which companies must write down the value of certain types of securities. Fannie didn't use 99-20 and instead used more managerial judgment in determining the amount of write-downs needed (WSJ 5/7, 5/10)

Nortel's CEO, CFO and Controller were "terminated for cause." The 4 CFOs of the major divisions were placed on leave, saying the moves "are about accountability for our financial reporting and are in the best interests of the

company and all of its stakeholders." (WSJ 4/29, 5/7)

Churchill Downs will restate due to inconsistencies in its reporting of simulcast host fee expenses, which were in some cases netted against revenues and in other cases reported as operating expenses. (CFO 5/11)

Warnaco settled with the SEC related to a \$145 m overstatement in inventory that was mischaracterized to investors as a write off of start up costs and would have resulted in a restatement of Warnaco's annual results for 1996, 1997 and 1998. The former CEO, CFO and General Counsel agreed to disgorge portions of bonuses and interest. PWC agreed to pay a \$2.4m penalty. (NYT, WP 5/12)

#### **IV. CUSTOMER, EMPLOYEE, AND SHAREHOLDER RELATIONS**

GAP issued its first CSR report which includes charts that show the distribution and frequency of violations of Gap's Code of Vendor Conduct during 2003 and the process by which suppliers' factories gain Gap's approval. (FT 5/12)

#### **CUSTOMERS**

The USDA has denied Creekstone Farms' permission to test all its cattle for mad-cow disease so the company could restart sales to Japan. The meatpacker has built a testing laboratory at its slaughtering plant in Arkansas City, Kansas. (WSJ 4/12)

#### **EMPLOYEES**

Merrill Lynch was found guilty of gender bias and ordered to pay a former broker \$2.2m. ML has other cases pending as do Morgan Stanley and Bank of America. (WSJ 4/21)

Often the unvarnished truth works best. "Communication breaks down because executives typically speak through loyal managers, who often mischaracterize the message from above and dilute the return message from below. The result is that the top brass is "naïve about the mentality of the work force and not very sophisticated communicators," says Paul Argenti, professor of corporate

communications at the Dartmouth's Tuck School. (WSJ 4/21)

According to a survey of 1,190 workers by Watson Wyatt only 30% of workers believe that their companies' performance-management programs improve performance and only 20% say their company helps poorly performing workers improve. (CFO 4/28)

#### **SHAREHOLDERS**

A year ago, Calpers sent letters to companies putting them on notice that it would withhold votes from directors that hired audit firms that also did consulting work for the company, an arrangement that could encourage auditing firms to approve questionable accounting. This year, Calpers is withholding votes from directors at 2,700 companies (90% of US firms) and almost all of the U.S. corporations in its portfolio, primarily because they hired audit firms with consulting arrangements. (WSJ 4/16)

Calpers will withhold votes in 46 companies including Citigroup, Apple, Coke, Verizon, Merck, Adobe, Alcoa, Popular, Broadcom, Clear Channel, Capital One, Kohl's, Gannett, Echostar, 3M, Colgate-Palmolive, UPS, Zimmer Holdings, Apache, Avon, AT&T, Sears, Ford, Amgen, and Duke Energy. The reasons include lack of auditor independence; failures to implement shareholder approved plans related to: golden parachutes and poison pills, declassification of the board, and expensing of options; conflicts of interest including: investment banking ties, other business, consulting, charity and familial relationships; scandal and compensation related issues. ((FT, WP 4/12, NYT 4/13, FT 4/14, WSJ 4/16, NYT 4/23, CFO 5/5, 5/10)

Researchers have found that Calpers activism can increase stock prices from 1% to 40% over a period of several years. A study published in the Journal of Applied Corporate Finance showed that companies named to its focus list between 1992 and 2001 saw stock gains of about 12% on average over the 3 months after being named to the list, with firms with a large market capitalization reaping bigger gains than small-cap companies. A study conducted by Wilshire Associates in 2002

determined that 95 companies targeted by Calpers between 1987 and 1999 outperformed the S&P 500 index by more than 14% over the 5 years after being targeted. One success story of note is JDS Uniphase. After being placed on the Calpers list, the company began working with the pension fund to address its concerns about performance and credits Calpers with providing input for its new executive-compensation plan. Being named to the Calpers list "motivated us," says JDS Uniphase's chief financial officer, Ronald Foster. Shares of JDS, which were hovering around \$3 a share a year ago, now are slightly above \$4. Other research about the beneficial effects of shareholder activism are less clear. (WSJ 4/20)

AIMR with a membership of 70k is changing its name to CFA Institute, and intends to be more outspoken about corporate integrity and ethics as part of an overhaul. It has appointed a new CEO, Jeffrey Diermeier, who will take over in January and was previously the chief investment officer of UBS Global Asset Management. And will set up the Center for Financial Market Integrity, which will research and promote ethics issues. The organization does not believe the push for corporate governance has gone too far, supporting recent efforts by Calpers. "We do believe that investment professionals should take a role in corporate governance, We are developing a corporate governance task force for this reason." (FT 5/10)

Maine's pension plan has moved 1/3 of its assets into conservative bonds. (NYT 4/23)

According to GMI Canadian companies achieved the highest average governance rating at 7.6 out of 10, followed by U.S. companies at 7.0. Japanese businesses scored the lowest, with a 3.0, an average attributed in large part to poor disclosure. (CFO 5/4)

Citigroup settled a Worldcom class action suit for \$2.65 b over its involvement in touting Worldcom stock as part of wooing investment banking business. The NY Common fund was lead plaintiff. (FT, NYT, WP, WSJ 5/10)

Reversing a trend since 1995, according to the study by Cornerstone Research,

corporations paid \$2.01 b in 2003 to settle class-action suits, down from \$2.53 b in 2002, due to the decrease in the number of additional case filings in 2001 as well as the fact that cases are taking longer to settle – on average 3.5 years. The future may be less bright for companies: the number of securities class-action suits increased by 31% from 2001 to 2002. (WSJ 5/10)

## V. OTHER REGULATORY AND LEGAL UPDATES

The New York attorney general's office has said that the legal profession's role in the fund scandal is being scrutinized and they would go after law firms that were aware of and approved improper behavior. In a letter to hedge fund client Samaritan, a Sidley Austin Brown & Wood LLP memo says "Though market timing might spawn civil lawsuits from other investors, the SEC "gives no indication whatsoever of attempts to prohibit such strategies." (WSJ 4/12)

Beginning December 5, new SEC rules will require funds to provide added disclosure of policies and procedures regarding market timing, any selective release of info about portfolio holdings, and the use of fair value pricing. (NYT, USA, WP, WSJ 4/14)

The SEC is seeking comment on new rules for shell companies (companies with little or no assets or operations) that would require them to supply financial reports when they merge with a private operating company and restrict their ability to issue stock without regulatory review. (WSJ 4/14)

In a break from the past, Oct. 5 the SEC is requiring that funds hire chief compliance officers reporting directly to fund directors (and not to executives of the advisor) to oversee issues from personal trading by portfolio managers and how funds spread their brokerage commissions, to the accuracy of reports to the SEC. Only the fund board can hire, fire and set the pay of the compliance officer. One challenge facing the compliance officer is a requirement to watch over companies providing services to funds. (WSJ 4/16)

SEC is considering changes to make it easier for foreign companies to delist.

About 1,300 non-U.S. companies, mostly from Europe, are listed in the U.S. These issuers account for 10% of all U.S. listed companies. (WSJ 4/22)

The SEC criticized the European Parliament's recent decision not to adopt a recommendation by the European Commission, the EU executive branch, to require companies to provide quarterly earnings reports. (WSJ 4/22)

The OECD issued revised guidelines on corporate governance, highlighting that shareholders have rights but that institutional investors in particular must make informed use of those rights." The principles say investors "should be allowed, and even encouraged, to cooperate and coordinate their actions in nominating and electing board members, placing proposals on the agenda and holding discussions directly with a company in order to improve its corporate governance." (NYT 4/23)

As part of a probe into how insurers compensate brokers for selling their products, Elliot Spitzer has issued subpoenas to Aon, Marsh, Willis, and Hub related to payments received from insurance carriers. (FT 4/23, WSJ 5/7)

For the first time in the fund trading scandal, the chair of a board has been charged – the chair of more than two dozen of Pimco's mutual funds is charged with defrauding investors by allowing a favored client to engage in trading in stock funds that violated the firm's own rules and hurt long-term investors. (WSJ 5/7)

The SEC is examining whether investment banks have been pressuring affiliated mutual funds to buy shares of IPOs and stock in companies with which the bank has a relationship to gain favor with corporate clients by driving up prices. (WSJ 5/12)