

# THE CORPORATE GOVERNANCE ALLIANCE DIGEST

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### Published by:

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Mr. Nash founded the National Association of Corporate Directors, is President Emeritus, and was responsible for launching NACD's highly successful Blue Ribbon Commission Reports on governance.

Women directors and director candidates are invited to the 2005 Colloquium for Women Directors: "Board Diversity: The 21st Century Challenge" to be held at NASDAQ Market Site in New York November 10 and 11th. See additional information at the end of the Digest or go directly to [www.globewomen.com](http://www.globewomen.com) and click on to Corporate Women Directors International for information and registration.

This edition of the DIGEST has 6 major sections:

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

Some investors question potential conflicts of interest involving Alan Levan, who is CEO of Levitt, a home builder, CEO of BankAtlantic Bancorp and a partner in BFC Financial. BFC has a controlling stake in Levitt. Levitt was spun off from BankAtlantic last year. (WSJ 10/3)

While CEOs are still the first choice for boards, some companies that have had regulatory difficulties are nominating former regulators or prosecutors. (WSJ 10/17)

News Corp faces a lawsuit in Delaware over its poison pill provisions, which the board decided to extend without a shareholder vote. (At the annual meeting, 16% of the proxies cast at the annual meeting were withheld from the 4 directors up for re-election - the board is classified though that may be under review) British Sky Broadcasting faces shareholder revolt at its annual meeting next month, with leading investor groups in the UK voicing concern about its share buyback plan, which would increase the stake held by Rupert Murdoch's News Corp. (FT 10/21, 10/22)

Oxford's plan to have university strategy decided by a powerful board of trustees made up entirely of outsiders should be followed by Cambridge said Lord Patten, chancellor of Oxford. (FT 10/22)

Charles Schwab is asking shareholders to vote to declassify its board and have directors face election each year. (AFX Europe 10/28)

A study released by The Forum of Executive Women in Philadelphia indicates that despite the large pool of qualified female talent, most public companies here have stalled in their efforts to place women and women of color on local corporate boards. In fact, the report shows that while 61 board seats opened up last year, only 4 were filled by women, and 2 of those were filled by women of color. The study also reports that Philadelphia companies have made virtually no progress in the number of women in key leadership positions over the past few years. (D & B Oct)

Boards are finding it useful to have directors with international expertise. A 2005 survey by Spencer Stuart found that only 35% of 149 large U.S. businesses have at least 1 non-American director, up from 31% in 1999; about 90% of Europe's largest 99 companies by market cap have 1 or more directors from outside their home country, 49% have at least one American on the board, up from about 35% in 1999 according to an analysis for The Wall Street Journal by search firm Heidrick & Struggles. (WSJ 10/31)

A new study by Sylvia Ann Hewlett and Cornell West of minorities in corporations finds that African Americans, Asians, and others are held back by subtle discrimination based on style (example: too quiet, too loud). Lack of awareness of subtle discrimination can create motivations to be inauthentic which is debilitating. (BW 11/7)

### II. COMPENSATION TRENDS AND ISSUES

Robert Toll, CEO of Toll Brothers, earned \$31.7 m in total comp last year;

KB Home's Bruce Karatz earned \$24 m and Alan Levan earned \$2.4 m as CEO of Levitt, BankAtlantic and partner of BFC. (WSJ 10/3)

Disney's board will expect new CEO Robert Iger to clear a set of performance hurdles in order to receive incentive awards, such as meeting or beating the total shareholder return for the S & P 500 during given periods of time. His 5-year contract could pay him \$17.25m per year including \$2m in base, 7.25m in target bonus and \$8m in equity based comp. (WSJ 10/7)

According to a review by Equilar, some compensation committees are working to address executive pay: Tidewater and MTI technologies have reduced CEO salaries; Staples, Nucor, Nvidia, Connetics, Zhong and Myogen have addressed issues of perks and aim for egalitarian practices; Kimco Realty, Big Lots, NorthBay Bancorp and Standard Parking are working to address executive employee pay gaps; Global Sante Fe is limiting stock grants; IBM, Office Depot, Polaris Industries, SFBC and OM Group use premium options that only vest when a certain share price is achieved; Intermagnetics General uses performance based restricted stock. (NYT 10/9)

Delphi, now in bankruptcy in the US but not elsewhere, "sweetened" its executive package including stock for 600 executives around the world and bigger cash bonuses for top US executives as well as extending severance packages from 12 to 18 months and extending non-competes to 18 months. At the same time, the fate of its pension plan was unknown, although CEO Steve Miller said union workers would need to accept 1/3 of current pay and benefits (a 67% reduction) to retain the plan. He also said he wants greater leeway to hire nonunion temporary and contract workers without union input and to buy materials and parts from nonunion subsuppliers, wants to move large numbers of traditional union jobs outside the union's protection (jobs such as machine repairmen, carpenters and tool builders all would be outsourced to other companies), cut back on the number of elected union officials at each plant representing workers in negotiations and grievances, eliminate union officials who oversee worker

retraining or employee-assistance programs, and eliminate the longstanding requirement that any purchaser of a Delphi plant maintain the union and assume the existing collective bargaining agreement. In the meantime Delphi is expanding overseas and hiring more non-US workers. Following a series of protests, CEO Miller will temporarily reduce his salary to \$1 until the company emerges from bankruptcy, the President will cut his salary by 20% and officers who were at Delphi at the time when Miller joined the company have volunteered to waive 10% of their base pay. (WSJ 10/11, NYT 10/15, USA, WSJ 10/17)

CalPERS is calling on United Health and PacificCare to trim back merger-related bonuses, including \$245 m in accelerated stock options; \$15 m in change-of-control payments; and \$85 m more in cash bonuses and stock if they stay with the merged company. In addition, PacificCare CEO Howard Phantsiel would receive \$130 m in additional retirement payments. (CFO 10/18).

2004 average pay packages for CEOs at big companies came in at \$10 m, up 13% from 2003. (NYT 10/23)

To combat high CEO pay, Edgar Woolard, former CEO of Dupont and chair of the NYSE comp committee, suggests directors should bar compensation consultants from discussing pay with anyone inside the company and base CEO pay at a set premium to their lieutenants. (NYT 10/23)

Analysts are cautioning investors on some proformas that now may not only exclude stock option compensation but also the cost of restricted stock. "Shame on them," said Chuck Mulford, an accounting professor at the Georgia Institute of Technology.. (CFO 10/31)

### III. AUDIT COMMITTEE ALERTS

A July study by NYU found 227 restatements in the 1st 2 quarters of this year, compared with 282 in all of 2004. (WSJ 10/17)

For comment thru year-end, COSO issued guidance to small companies on internal controls processes. "The market

does not readily tolerate inaccurate reporting, regardless of a company's size," the report says. The report recommends that smaller companies broaden their pool of audit-committee members to include CFOs, management accounting experts; accounting professors with detailed knowledge of business, accounting, and auditing; chief audit executives or internal audit directors who have experience in internal control and business strategy from their own businesses; and retired partners from public accounting firms. "Controls do cost, and there is not a real shortcut." noted the chair Professor Rittenberg. The 189-page draft outlines 26 fundamental principles associated with 5 key components of internal control: control environment, risk assessment, control activities, information and communication, and monitoring. (CFO, FT, NYT 10/27)

D&T, URS, Southwest Gas, Williams-Sonoma and the NYC Bar Association's committee on financial reporting have responded to SEC comment requests related to the acceleration of annual report filings from 75 to 60 days for filers with market caps of \$750m or more asking the SEC to delay or eliminate its acceleration plan. (CFO 10/31)

FASB's advisory group (made up of CEOs, CFOs and other business leaders) says FASB should address issues related to revenue recognition (how can investors tell if a company is conservative or aggressive), pension accounting (its complexity and lack of disclosure of economics), simplification of the standard setting process, more field testing and cost/benefit analyses. There was no consensus related to the amount of guidance given by FASB. The idea of separate standards for private firms was "shot down". (CFO 10/31).

### AUDITORS and AUDIT FEES

On the heels of a report criticizing KPMG audits, the PCAOB issued a report that said in the case of Deloitte's some audit deficiencies were "of such significance that it appeared to the inspection team that the firm had not, at the time it issued its audit report, obtained sufficient competent evidential

matter to support its opinion on the issuer's financial statements." In 4 of the cases cited as examples, the issues identified by the board's inspection team led the companies to restate their financial reports to correct accounting errors or disclosure deficiencies. (WSJ 10/7)

The Bond Market Association and the Securities Industry Association have written the SEC asking that the SEC request that the AICPA repudiate an AICPA white paper which they say advises auditors involved in due diligence discussions with offering underwriters to refrain from answering basic questions about a securities issuer's financial statements, including whether or not the auditor suspects fraudulent activity and calls for reduced auditor due diligence and continued exclusion of investors and regulators from the due diligence process. The letter comes after the groups expressed their concerns to the AICPA about the paper and the AICPA subsequently "promoted" it at an October 11 meeting. (CFO 10/13)

One of the tax shelters offered by KPMG, which it used itself and was banned by the IRS, required board involvement. A company's tax year had to be changed to end on a different day than its 401(k) plan's fiscal year'. Then, the company's board would pass a resolution on or before the last day of the tax year -- but at the start of the 401(k) plan's new fiscal year -- fixing the company's minimum 401(k) contribution for the coming year. The company would then record a tax deduction reflecting its past year's contributions and a significant portion of the next year's contribution -- often almost an additional year's worth. By using the strategy in subsequent years, it could keep the extra deduction indefinitely. (WSJ 10/14)

#### **ACCOUNTING, CONTROL, RISK AND DISCLOSURE ISSUES**

The SEC is investigating disclosure omissions between 1996 and 2003 when San Diego sold \$1.2 b of bonds in 16 offerings, but didn't disclose the city's liability to its pension fund (now holding a \$1.1 b deficit) and the fact that it owed the pension fund what amounted to a \$500m one time payment because it had

entered into an agreement to not contribute full amounts over a 10 year period. The city attorney is also investigating and KPMG has refused to approve its 2003 financial statement making future bond issues impossible. Investigation costs have so far totaled \$15m. (WSJ 10/10)

Federal investigators have joined the SEC probe of Toronto holding company Fairfax Financial's use of finite insurance, an area of ongoing review by the SEC. (WSJ 10/10)

Biovail Canada's largest publicly traded pharma, said the Ontario Securities Commission is investigating the company's revenue recognition for 2002 and 2001. (WSJ 10/10)

Dana Corp. will restate net income downward by between \$25 m and \$45 m after tax to correct issues involving customer pricing and transactions with suppliers in Dana's commercial-vehicle business. (CFO 10/20)

Following questioning by Peter F. James, who had been working in the controller's office at Refco less than two months when he noticed something this summer that teams of accountants had apparently missed for years (a larger-than-normal interest payment that had been made to Refco on an outstanding loan made by the company), it was discovered that a \$430 m loan to its CEO had not been reported (as a related party transaction) and been covered up through collusion with hedge fund Liberty Corner, something that was not noticed by the company's auditors or investment bankers (Based on a recent filing Refco is unsure as to who its creditors are.) Grant Thornton is investigating why it did not find the issue in its audits. Refco faces shareholder lawsuits including charges Refco illegally shifted funds. TIAA-CREF and Oppenheimer Funds bought Refco's shares in spite of risk factors detailed in the prospectus including internal auditors report of two significant deficiencies in its internal financial controls: lack of "formalized procedures for closing our books." and deficient in ability to prepare financial statements "that are fully compliant with all SEC reporting guidelines on a timely basis" - and the fact that it was under

investigation by both the US attorney in NY and the SEC. The CFTC is also now investigating Refco. At regulated futures trading firms segregated funds aren't held in individual customer accounts but in a larger pool that holds all segregated funds. In the event of bankruptcy all customers share in trading losses so the group may suffer as a whole despite the "segregated" status. (USA 10/10, USA, WSJ 10/12, USA, NYT 10/13, FT, NYT, WSJ 10/14, NYT, USA 10/16, WSJ 10/17, USA 10/18, NYT 10/19, 10/20, 10/23, FT, NYT 10/24, USA 10/30, 10/31, BW 11/7)

Google has decided to publish pro-forma results alongside GAAP - but will continue to refrain from future earnings estimates or face-to-face meetings with analysts. (CFO 10/14)

Ameritrade may restate related to the manner and timing of their hedging designation for prepaid variable forward contracts. (CFO 10/25)

A Bausch & Lomb audit committee investigation into its Brazilian subsidiary determined that the general manager, the controller (both of whom have been fired), and other employees of BLIO "engaged in improper management and accounting practices." including mischaracterizing roughly \$600k in expenses to fund an unauthorized local pension arrangement, totaling approximately \$1.5 m, for their benefit and the benefit of other local managers; avoiding Brazilian payroll-tax obligations; and misusing company assets for personal benefit. The audit committee also discovered that Brazilian tax authorities have made assessments for unpaid taxes totaling roughly \$5 m, as well as interest of about \$7 m and about \$21 m in penalties and appropriate reserves relating to these assessments were not reflected by its subsidiary. The SEC has opened an informal inquiry. (CFO 10/27)

The SEC has issued subpoenas related to whether GM has understated debt or inflated income in its handling of pensions (possibly relating to the discount rate and discount rate methodology and to its obligations with respect to Delphi's health and pension plans) and some transactions between GM and Delphi (Delphi said it had

improperly accounted for \$237 m paid to GM -- raising questions about GM's accounting because GM did not disclose it and it increased GM's income substantially) and at GMAC related to finite insurance. 6 companies under pension scrutiny are GM, Delphi, Ford, Boeing, Navistar and Northwest. GM had planned to wait until its regular quarterly report to the SEC next month to note the subpoena requests, but it decided to make the special disclosure after DaimlerChrysler's mention of subpoenas in a separate filing. (CFO, NYT 10/27, USA 10/28, FT 10/31)

#### **IV. CORPORATE STRATEGY**

##### **VALUE - INNOVATION, ENTERPRISE RISK AND REWARD**

Professor Allan Eberhart, at Georgetown University examined R&D spending at 8k companies over a 50-year period and found 1% to 2% increased operating profits at companies that increased R&D spending by 5% or more in a single year. Looking at a much shorter time span, a Booz Allen study of 6 years of financial results by 1k publicly traded companies responsible for the bulk of R&D spending globally found the companies that spent proportionately greater sums than their industry peers didn't enjoy greater revenue gains or better profits although the top half of companies as measured by R&D to sales spending had 40% higher gross margins than those in the bottom half and the bottom 10% of R&D spenders performed worse than average or top spenders. How the money was spent seemed as important as how much. Example: Toyota and Ford spend roughly the same % of sales on R&D but Toyota has achieved greater success with hybrid cars. (WSJ 10/11)

According to a Christian & Timbers report of interviews with hundreds of corporate board directors during the last month, top of mind issues include the impact of recent hurricanes and fuel prices on this year's financials, product pricing, hiring plans for next year, business continuity, the effect of the Fed's interest-rate increases on cost of capital and plans for borrowing and the need for global diversity on the board of directors (particularly those with expertise in China). (CFO 10/13)

The chief marketing officer of P&G recently stated, "Marketing is a \$450 b industry, and we are making decisions with less data and discipline than we apply to \$100k decisions in other aspects of our business." According to Harvard Professor Quelch most boards and an increasing % of Fortune 500 CEOs lack marketing expertise. The board of Harrah's, receives regular reports on four metrics: share of customers gaming dollars, % of revenues from customers who play at more than one of the company's casinos, % of loyalty program members advancing to higher status as a result of their higher expenditures and customer satisfaction across the casinos (a measure linked to the CEO's bonus). (WSJ 10/11)

Cash as a percentage of long-term debt stands at just below 40%, close to a record high. Hedge funds want the cash back -- or for CEOs to take more risk. (WSJ 10/12)

Recent research by AXA, a European insurer, found that 46% of small and medium-sized businesses in Britain do not have a business continuity plan. The growth of outsourcing has added to the complexity of risk management related to disruptions in faraway places. Susir Kumar, CEO of Intelenet, an Indian outsourcing firm 50% owned by Barclays Bank, says that Indian firms are more diligent about continuity planning than firms in the West -- partly because disruptions there are more frequent (so they get more practice), and partly because costs are so much lower they can afford to duplicate more facilities. (Economist 10/28)

##### **INTELLECTUAL PROPERTY**

While U.S. and European patent laws preclude anyone from patenting a gene as it exists in the human body, patents may be obtained by claiming a proprietary way of isolating genes or developing a specific sequence/therapeutic use for them or specifying patents of the proteins that each gene instructs cells to produce. A group of MIT professors found that 18.5% of genes/gene sequences were claimed as intellectual property. (This is likely underestimate). Multiple patents exist on single genes. (WSJ 10/14)

#### **M & A**

Shan Industries acquired Accurate Forming from Tyco. Ed Breen, Tyco's CEO, promised publicly at each of the company's last two annual shareholder meetings to push his lieutenants to settle with Shan a suit arising out of environmental liabilities. The purchase agreement stated specifically that the seller (Tyco) would be responsible for any losses arising out of environmental cleanups, fines or penalties. Those have been in the millions. So far Shan has collected less than \$300k. (NYT 10/30)

#### **IV. CUSTOMER, EMPLOYEE, SHAREHOLDER, and COMMUNITY RELATIONS**

##### **CUSTOMERS**

Kraft has labeled some foods as healthier and, in response to childhood obesity under a new policy, any product advertised on a TV show where more than 50% of the audience is under 12 has to meet the nutritional standards set by the company. These rules don't apply to magazines or Web sites. (WSJ 10/31)

##### **EMPLOYEES**

The Home Depot board requires its members to spend at least one full day a year in face-to-face meetings with executives and middle managers in finance, human resources, operations and IT. Home Depot directors gain insights to grasp issues faster, ask smarter questions, get to know rising stars -- and obtain fuller insights into the performance of the CEO. (WSJ 10/10)

As a powerful leadership tool that can provide early warning signals, boost morale, uncover new ideas, and cut through corporate red tape, a survey for The Wall Street Journal conducted by the Business Roundtable found 39 out of 44 companies said their CEOs personally answer staffers' emails. CEOs of Cinergy, Qwest, Sun Microsystems, Pfizer, Raytheon, and Baxter do this and find it valuable. The former CEO of John Hancock questions the time/benefit of such a practice. (WSJ 10/10)

Perhaps the first major corporation to do so, IBM has adopted a policy of not using the results of genetic tests to make

employment decisions. The law in 33 states ban employment discrimination on the basis of genetics and the federal Health Insurance Portability and Accountability Act forbids employers from using genetic information as a basis for denying or limiting health coverage. (WSJ 10/11)

## SHAREHOLDERS

The law firm, Levin, Papantonio, settled about 300 or so investor claims against Merrill Lynch for faulty stock research for approximately 3 cents on the dollar. (WSJ 10/13)

The SEC says that independent research providers can be paid for research by companies not covered by investment banks - but that the independent research providers can only be matched up with new clients using a "blind-pool" model. That is, the purchaser of the research can't request or specify any attributes about the independent research provider it would like assigned to it. (WSJ 10/13)

There is a global competition for capital: "hardly a capital market today that doesn't have at least 25% non-domestic ownership." To compete globally, many countries are improving governance standards. Example- Brazil. More progress in enforcement is expected in Canada where currently time to trial is slow. (WSJ 10/17, 10/27)

A Wall Street Journal Online/Harris Interactive online survey of 1,248 investors -- defined as holders of 401(k)s, IRAs, or individual company stocks or bonds -- found that 2/3 don't believe boards of directors are effective in overseeing the companies they govern. 55% believe corporate governance regulations are too lenient (77% of investors ages 45-54) and only 6% feel the regulations are too strict. (WSJ 10/17)

In line with suggestions by the justice ministry on ways to improve shareholder participation at meetings by providing dividend bonuses, Allianz is considering such a move. Its voting participation is at 35% (lower than most German firms which stand at 46% according to data compiled by DSW, the small shareholders' association). Spanish companies have seen large increases in

participation in shareholder meetings following tiny bonus dividend allocations. (FT 10/21)

## COMMUNITY

As part of a \$500m project to clean up the Hudson River, GE has agreed to pay \$78m, in addition to the \$37m it has already paid, to dredge PCBs it dumped into the river before the government banned the substance (WSJ 10/6)

## VI. OTHER LEGAL/REGULATORY

British, French and Spanish securities regulators, are examining whether the senior GLG hedge fund trader, Philippe Jabre, improperly used nonpublic information on coming convertible-bond deals to trade on behalf of his fund (WSJ 10/26)

The SEC plans to randomly check a sampling of investment advisory firms each year rather than visit each firm once every five years. (WSJ 10/31)

## Announcement

Women directors and director candidates are invited to the 2005 Colloquium for Women Directors: "Board Diversity: The 21st Century Challenge" to be held at NASDAQ Market Site in New York November 10 and 11th. Organized by Corporate Women Directors International, the Colloquium opens with the press launch of a new report on women directors serving on the boards of the largest global and U.S banks and closes with a practical roundtable among seasoned women directors -- Karen Hastie Williams (Chubb, Continental Airlines, Gannett), Jocelyn Cote-O'Hara (Xerox Canada and Manitoba Telecom) and Mary K. Bush (RJR TOB Holdings, Pioneer Funds) on "*Navigating Board Politics*". Included in the program is a luncheon session with SEC Commissioner Cynthia Glassman, who provides insight into the "*Impact of Sarbanes Oxley into Board Composition*", along with NASDAQ EVP Ed Knight. For program and registration information, log on to [www.globewomen.com](http://www.globewomen.com) and click on to Corporate Women Directors International.