

GOVERNANCE REFORM

Good Corporate Governance Begins in the Hearts and Souls of Directors

Fundamental to having a strong corporate board is having the right people in the right place, asking difficult questions and addressing high-level business strategies—a goal that often is not easy to attain.

In today's rapidly changing regulatory environment, there is no shortage of commentary on the significant impact that legislative and other reforms could have on the corporate governance process and the role of corporate directors. One has only to read the front page of any major newspaper to get a sense for the sea of change that is coming to the boardroom.

Whether the proposed reforms represent positive or negative change depends on who you ask. Proponents of the changes rightly point to large organizations who failed to manage risk properly. Opponents believe the reforms' collective weight could lead to unhealthy instability in the boardroom. Both opinions have merit, and in that light we can probably reach some middle ground. First, though, let's establish some general tenets:

1. Our current financial crisis resulted in part from corporate governance failure, but most companies are well run. Let's not throw the baby out with the bathwater or do something that could weaken effective governance structures.
2. Rewards generally follow properly managed risks, but properly managed risks sometimes lead to failure. Effective corporate governance should be expected to eliminate unmanaged risks that are meaningful to organizational objectives; but if we think we can eliminate all risk, we likely will succeed only in reducing (a) corporate profit and (b) America's competitive advantages in the global marketplace.

3. The heart and soul of effective corporate governance—board members and management with the right skills, adequate information and personal fortitude—cannot be legislated or regulated, but can be improved.

The proposed reforms—whether say-on-pay, proxy access, elimination of staggered boards, majority voting requirements, or segregation of the roles of CEO and Chairman—are focused more on the process than on the participants. If implemented, these reforms would alter corporate compensation and boardroom structure, but may not address the underlying attributes critical to an effective board.

Better corporate governance begins with directors who honor their fiduciary responsibilities to shareholders, strategically oversee management, anticipate potential problems, and steer the company toward growth. Fundamental to having a strong corporate board is having the right people in the right place, asking difficult questions and addressing high-level business strategies—a goal that often is not easy to attain. These five elements of a successful board will help in your quest:

1. **Diverse Knowledge.** Directors should possess a good mix of expertise and skills to support each other. The board's commitment and culture must support asking tough questions and maintaining a healthy skepticism.
2. **Management Strength.** Management must be committed to working with the board in

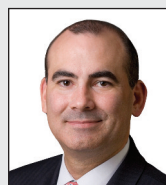
a spirit of cooperation that recognizes the board's primary role as overseers, not friends. Management must inform the board as important issues arise, and present information and strategies for managing problems or capitalizing on opportunities.

3. **Qualified Internal Audit Function.** The board should have access to a qualified internal audit function that has autonomy and the ability to speak frankly. A good internal audit function can be the arms, legs, eyes, and ears of an effective board.

4. **Trusted Advisors.** Effective boards have access to external professionals (like independent auditors or legal counsel) who toe the line, tell boards exactly what they think and, when necessary, entertain difficult conversations.

5. **Access to Information.** Successful boards have access to the relevant, reliable, and timely information they need to provide oversight and guidance. Armed with that information, board members should be resolute in asking difficult questions and driving to acceptable answers.

We learned from the recent financial crisis that greater investor understanding, input, and transparency are important. We do not yet know if any of the proposed reforms will be enacted, but we do know that they are not a panacea. Regardless of what happens in Washington, now is the time for boards to "check under the hood." Board quality and strength are paramount in driving lasting success.



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