A ROAD TOO FAR — COMPLIANCE AT THE EXPENSE OF PERFORMANCE?

Guylaine Saucier

While some of the new regulatory and legislative frameworks are welcome improvements to corporate governance, they are no substitute for a culture of governance. Guylaine Saucier, chair of the joint committee of the Chartered Acccountants of Canada and the Toronto Stock Exchange, says we need boards to do the right thing, not just follow the right rules. She points out that many of the most egregious violations in the wave of corporate scandals already constituted illegal behaviour according to law as it then existed. There is no substitute, she writes, for independent boards who have the information they need to make the right decisions. A culture of governance is equally built on the integrity of management and the board.

Certains des nouveaux cadres législatifs et réglementaires en matière de gouvernance d'entreprise représentent à n'en pas douter une amélioration bienvenue, mais rien ne saurait remplacer une véritable culture de gouvernance. Selon Guylaine Saucier, présidente du comité mixte de l'Association canadienne des comptables agréés et de la Bourse de Toronto, les conseils d'administration doivent en effet jouer pleinement leur rôle, au-delà d'une simple conformité aux règlements. Elle rappelle ainsi que les violations les plus flagrantes révélées par la vague de scandales boursiers constituaient déjà des infractions claires aux lois en vigueur. Rien ne remplacera donc des conseils indépendants disposant de toutes les informations leur assurant de prendre de bonnes décisions. Intégrité du conseil et intégrité de la direction sont également indispensables à une réelle culture de gouvernance.

"You can't make people good by Act of Parliament"
A Woman of No Importance, by Oscar Wilde

As new rules are introduced into the capital markets by securities commissions and stock exchanges, investors should welcome the "raising of the bar" in a number of areas of corporate governance. However, it would be a mistake to view these new rules as a panacea for what investors truly seek: improved corporate performance. If only it were so easy as to pass new laws to ensure that companies improve their performance. Acts of Parliament, as Oscar Wilde so aptly stated, are unfortunately ineffective at producing such results.

The concern, though, that many should have with the current rush to new legislation and regulations is that our focus is being shifted away from the real goals to a somewhat artificial construct. Of course we need rules for our capital markets and we need a high level of standards for those who lead our corporations. But as the pendulum continues to swing toward greater legislative requirements, we continue to move down the road of creating a culture of compliance as opposed to a far more productive culture of governance.

Good governance is a means to good performance. It is well understood that the role of the board of directors is to exercise its fiduciary responsibilities in the long-term best interests of the corporation and its shareholders. But good governance is more than merely complying with an ever-growing list of requirements on a variety of topics. Take, for example, the question of director independence. Investors need independent voices at the board and there seems to be a consensus that major suppliers or consultants would face a challenge of perception, if nothing else, in trying to fulfill the role of independent director. But as some start questioning whether directors should even have personal ties to management, it is clear we have gone too far. We need stewards of shareholders' assets who have independence of mind, not just independence according to some prescribed regulations.

A board is supposed to add value. We need to ensure that directors of integrity and competence are elected to serve on boards and then trust that their judgment will help contribute to strong corporations. Rather than determining their social connection to the CEO, let's use the checklist J. Edward Newell, now chairman of Nova Chemicals but at the time CEO, suggested in 1997 following the Bre-X scandal: "When evaluating a company's directors, look for values such as strength of character, an inquiring and independent mind, practical wisdom, mature judgment and relevant international track record. Remember, the primary responsibility of directors is to enhance shareholder value. They're there for competence."

We have to go beyond checklist governance and, to a large extent, take a leap of faith and rely on trust. I do not want to leave the impression that there is no need for reform. On the contrary, I see the need for a great deal of change in the governance of our corporations. But if the only change forthcoming is from legislatures, we will not be raising the bar at all. What took place at some of the high profile "governance" scandals in recent years had nothing to do with the lack of appropriate laws — many of the most egregious actions were blatantly illegal at the time — but rather the lack of integrity of those serving on the boards in question.

There are specific actions we can take to create the governance culture that is necessary if we want to restore investor confidence. For starters, let's ensure there is a nonexecutive board chairman. This person can then take on the leadership role to ensure the proper functioning of the board. This would include such things as:

- Ensuring there is a process to provide an ongoing evaluation of the CEO and the company's strategic plan;
- Ensuring that the right issues are on each agenda. Is the board appropriately addressing the corporation's priorities?
- Ensuring the board receives pertinent information in a timely manner. Too often, management will spend months considering a number of proposals only to send their board arguments supporting one recommended action 24 hours before the meeting convenes;
- Ensuring there are processes in place to renew the board. Directors are rarely removed from their positions. They stay, year after year, regardless of whether the company's strategy or priorities have changed. They stay even if their contributions are minimal. The board needs to impose more stringent expectations on their own performance and contributions.

Establishing a governance culture is not only a board matter — it is a responsibility of the corporation as well. It is, in fact, a process of accountability that ends with the shareholder. It is worthless to have a governance culture only at the board level. The CEO and the top management have to believe that it is worthwhile to the corporation and buy into that culture. Putting a strategic plan before the board that is already printed in colour is not exactly inviting board participation.

Just as the call for greater transparency between companies and their shareholders has led to improved communications, investors need a secure CEO who is transparent with the board. The CEO must provide the board not only with information that supports management's preferred option, but also with the pros and cons of all strategies and issues under consideration. Without that relationship of trust, all the rules and regulations may be observed, but they will not result in the desired effect. If the CEO really does not believe in the role of the board of directors, it is very easy to limit their influence by limiting their access to all pertinent information. I am pleased to report that, as a director myself, I have seen improvements in this area that are encouraging, as are the recent recommendations in the area of governance by the Canadian Council of Chief Executives.

Some of the rule changes are also welcome and can lend weight to improving the governance culture. One such change is the relationship between the auditor, management, the audit committee and shareholders. Auditors must be accountable to shareholders, and the change that now sees them report to the Board through the audit committee was necessary to enhance this reporting structure.

There is a role for all participants in the capital markets to work to improve the governance culture. My concern, though, is that our focus today is not in the right place. Many were hurt by the litany of well-known corporate scandals such as Enron and WorldCom, and so the rush is on to enact new rules designed to prevent any such reoccurrence. Shareholders are demanding more and more from boards and have the right to do so. But we need our boards to do the right thing, not just follow the right rules.

No matter how detailed the legislative requirements, how comprehensive the list of qualifications, and how daunting the rules governing behaviour, the integrity of directors is what will ultimately determine their value on a board. If we are not appointing the right people in the first place, then perhaps a compliance culture is all we can hope for. I, however, believe we can do much better. We do not have to "settle" for following a litany of rules and regulations.

We can put in place the right legislative framework, appoint directors who demonstrate the integrity and values necessary to lead our corporations and provide boards with the information to allow them to add value. In short, we can create a culture of governance that can contribute to stronger corporate performance.

Guylaine Saucier, former chair of the Board of the CBC, was chair of the joint committee of the Chartered Accountants of Canada and the Toronto Stock Exchange. The TSE report, Beyond Compliance: Building a Governance Culture, *is available on-line at www.jointcomgov.com*