

# 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 do not want us to send you this information in the future, please just notify Eleanor Bloxham ([ebloxham@thevaluealliance.com](mailto:ebloxham@thevaluealliance.com)).

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

The handling of corporate-board minutes, payment of arbitration awards and pricing of municipal bonds are three examples where common practices persist that can mean losses to investors. While lawyers may recommend companies protect themselves with sparse board minutes, when these records are altered or incomplete (as is often the case), it is much more difficult for investigators to understand the circumstances. The result: "It is harder for investors to recoup losses and less likely that misbehavior will be deterred

in the future." Charles Niemeier, a member of PCAOB says: "The attitude is that it's OK to lie by omission in board minutes. It's the way it gets done, and the problem is that we have become accepting of this." (WSJ 2/6)

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

In a case that begins Feb 18 and will address minority shareholder rights, Judge Strine will rule on whether to grant the Hollinger board's request for a preliminary injunction preventing Conrad Black from selling his controlling stake in Hollinger International to the Barclay brothers, the legality of a poison pill plan proposed by the board as a defense against the Barclays' bid, and the legality of a last-minute change in Hollinger International's corporate bylaws by Black. It is also anticipated that the judge may review board allegations of Black's wrongdoing, contentions of misleading statements by the board related to his conduct, the board's own approval of 16 separate transactions since 2000 "that benefited management to the detriment of the company's shareholders" (which were revealed in another case), and the audit committee's investigation "of its own conduct" in approving millions in fees to executives. Black has filed a \$644m libel suit against a special committee that investigated \$200m in noncompete payments received by Black and others. (FT 2/10,2/13, 2/14 NYTimes 2/14)

William Gray III, president and chief executive of The College Fund/UNCF, will resign from the board of EDS before a shareholders meeting May 25 to eliminate "any appearance of a lack of independence" because EDS chair and CEO Michael Jordan is chair of UNCF's board and serves on UNCF's

compensation committee. (WashPost 2/2)

## II. COMPENSATION TRENDS AND ISSUES

According to a report in the Portland (Oregon) Tribune, Enron will put the proceeds of its \$2.3bn sale of Portland GE into an interest-bearing account to address the underfunding of its liabilities for the pension plan it is terminating. The amount of underfunding is estimated at around \$700m. (CFO 2/10)

The disclosure of pay can be inadequate for shareholders to fully understand it. Rather than simply meeting requirements, Jesse Brill, chair of the National Association of Stock Plan Professionals, is urging full disclosure (for details: [www.naspp.org](http://www.naspp.org)). (NYTimes 2/8)

According to IRRC's Board Practices/Board Pay 2004 report, lead directors receive 1/2 the additional pay received by non-CEO board chairs. (20% of boards now have lead directors. 30% of boards do not have the CEO in the chair's seat. 9% of boards have independent board chairs.) 80% of companies now pay more to audit and compensation committee members. Total pay for directors decreased 4% to \$102,000 due to the reduced value of stock option grants. The average retainer (paid by 93% of companies) is \$32,000. (Directorship February)

## III. AUDIT COMMITTEE ALERTS

In a separation of duties and a break from tradition, when United Technologies CFO retires in two months, he will be replaced by a VP of Finance and a VP of Accounting and Control reporting to Chair and CEO George David. (WSJ 2/4)

Internal audit should report to the audit committee (and administratively to the CEO) and audit committees should “look to the internal auditors for assurance that applicable policies, rules, and regulations have been complied with, and that the corporate culture includes effectively operating and open communications provisions” says the Institute of Internal Auditors. (Tone at the Top 2/6)

According to accountingweb.com, in line with IASB, FASB is considering a definition of “current liability” that would require companies to use the balance-sheet date — not the date they issue their financial statements — as the date for determining whether a liability is current or long-term. (CFO 2/10)

Citigroup and JP Morgan have implemented internal policies designed to weed out proposed deals that carry legal or reputation risk. However, even if the client’s accounting is OK, it does not mean that the deal is immune to these risks – and making the determination can be difficult. (WSJ 2/2)

Parmalat received about \$5 billion of loans from 40 Italian banks and from Citigroup last year by allegedly double-billing 33 distributors and hundreds of Italian supermarkets for the same goods. (CFO 2/4)

## AUDITORS AND AUDIT FEES

All listed companies in the European Union would either have to rotate their audit firm every seven years or change the senior partner in charge of the audit every five years under new rules being considered by the European Commission in response to the Parmalat scandal in Italy. The UK and Sweden already have a rule requiring partner rotation. The “big 4” audit firms oppose rules that require audit firm rotation as it might provide a competitive opening for smaller audit firms. The EU is also considering a requirement that non-EU auditors register with national authorities if they work for companies listed in the 15-nation bloc - a response to similar measures in the US Sarbanes-Oxley laws. (FT 2/3)

More than 1,460 companies changed auditors or had auditors leave them last year as did nearly 1/3 of Russell 3000

companies (98% of the market value of U.S. stocks). In 70% of the cases no reasons were given and in 10% of the cases auditors left because a company had “internal control problems, disagreed over accounting rules or couldn’t be trusted.” The trend is expected to continue. (USAToday 2/9)

According to Auditor-Trak, in 2003, each of the big 4 lost more public-company audit clients than they gained. While 45% of firms changing chose other big 4 firms, 55% chose other firms as replacements: 34% chose a regional or local firm, and 21% chose a smaller national firm such as Grant Thornton, BDO Seidman, and McGladrey & Pullen (CFO 2/11)

As the deadline draws near, audit committees may want to consider the signal sent to shareholders when they purchase Section 404 software from external auditors. “An auditor firm is very involved in [a] 404 process, then it sells you a software tool, then it comes in and audits over this,” says Steve Barth, a partner at Foley & Lardner “You can just see the cases coming up, can’t you?” (CFO 2/3)

An FEI survey of 321 companies shows that businesses with more than \$5 billion in revenue expect to spend an average of \$4.7 million implementing rule 404 rule this year, and expect those fees to be \$1.5 million annually going forward. (WSJ2/10)

Citing audit fee increases related to corporate executive certification and outside auditor concurrence that internal financial controls are adequate (with which US listed foreign companies must comply by 2005) and the ban on company loans to executives, 11 organizations representing 100,000 European companies, including more than 100 whose securities are traded in the United States, asked the SEC to consider changes that would make it easier for them to stop being registered with the SEC proposed that European concerns be able to drop their registration if they delist and show that less than 5% of their total share volume is in the United States. (Although hundreds of thousands of shares of Deutsche Telecom are traded each day on the NYSE, this is not 5% of its total

share volume.) Currently, a company that no longer wants a US listing can easily delist from an exchange; however, it remains subject to US securities laws unless it can show that it has fewer than 300 American investors. (FT, NYTimes 2/12)

## ACCOUNTING ISSUES

Three months after going public, Quality Distribution, which went public in a November IPO offering with lead managers CSFB and Bear Stearns, has announced that it will restate its results going back to 2001. A former manager, had been terminated in October before the IPO launched, and the company said the employee had failed to renew certain insurance policies for customers yet continued to collect premiums in violation of insurance laws, recorded improper receivables and deposits from third parties and failed to set up adequate reserves for claims during the periods that its customers were not insured by third parties. (CFO 2/6)

The SEC has initiated an informal inquiry into Agco’s policies for revenue recognition, sales returns and allowances, plant and facility closing costs and reserves, and personal use of corporate aircraft. Agco said that in some instances it recognizes revenue when equipment remains on its premises at the dealer’s request after having been invoiced to the dealer. (CFO 2/6)

El Paso warned that it expects to follow Royal Dutch/Shell and significantly revise down its estimates of proved reserves. (WSJ 2/2, FT 2/3)

General Mills received a Wells notice from the SEC about the company’s accounting practices. A former employee accuses the firm of inflating quarterly shipments to meet sales goals (USAToday2/4, WSJ 2/5)

Lancer, a supplier to Coke, under investigation by the SEC and federal prosecutors after a former Coke employee alleged Coke and Lancer used false transactions and improper accounting to boost sales of a dispenser called iFountain, said its auditor, KPMG, has resigned after finding “likely illegal acts” which it said Lancer has failed to correct in a timely fashion and which

could have a material impact on its financial statements. The resignation follows by one business day a statement by Lancer's audit committee that an independent investigation by Baker Botts and PWC didn't find sufficient evidence of intentional misconduct or accounting irregularities. Lancer's 3-person audit-committee is chaired by a past chair of the AICPA and staffed by a former Coke bottling executive. Lancer's president and chief operating officer said the audit committee's investigation was "exhaustive." KPMG intends to withdraw its audit opinions on the company's financial results for 2000-2002. (WSJ 2/4, 2/5)

PepsiCo will restate and increase its earnings for 2002 and 2003 due to an error in computing the cost of its stock options. (WSJ 2/9)

Flowserve will restate and lower its earnings in 2000 – 2003 due to inventory reconciliation issues at a local site that were not in accord with internal control procedures. The SEC has launched an informal inquiry. (CFO 2/10)

Moore Wallace has suspended its CFO, and one of his staff, with pay, for creating/having created a document last week labeled "May 2003," that purported to represent documentation for restructuring charges as part of a tail end of an investigation by PWC ordered by the audit committee in response to a whistleblower complaint. Prior to this incident, PWC had found no basis to support the whistle blower contention of misuse of acquisition-related restructuring charges and other accounting-related actions. (CFO 2/10)

The SEC has formalized its investigation of Goodyear, allowing the SEC to now subpoena documents and statements from people outside Goodyear, including former employees. Goodyear said it was expanding its own investigation of overseas accounting, which will likely delay filing of its 2003 annual report. This could cause the company to violate covenants in its loan agreements and raises questions about Goodyear's ability to negotiate a new \$650 million term loan. (WSJ 2/12)

The SEC has joined the U.S. Attorney for the District of South Carolina in

investigating WebMD, according to the company. The probe stems from the company's financial reporting for Medical Manager Corp., a predecessor of WebMD, and its Medical Manager Health Systems subsidiary, and was triggered by a restatement of its 1999 earnings and information from two terminated employees sued by WebMD for taking improper kickbacks. (CFO2/11)

Under scrutiny for its accounting, investigators are questioning Computer Associates' alleged requirement that all emails be deleted after 30 days and that no back ups are made of its email server. CA makes software it sells to customers to enable regular back ups. (Newsday 2/10, CFO 2/14)

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

### **TRENDS AND SURVEYS**

A study of 353 of the 500 largest US companies from 1996 to 2000, by BMO Financial Group and Catalyst, shows that companies in the top quartile in terms of having the most women executives showed a return on equity of 17.7% and a total return to shareholders of 127.7% compared to 13.1% and 95.3% for the bottom quartile, those with the lowest percentage of women among their top officers. (BusWeek 1/26)

Half of 120 Cs rank managing intangible assets and intellectual capital among the three most important issues and 13% as the most important issue according to an Accenture and Economist survey. 49% consider intangibles to be the primary source of long-term shareholder wealth creation. 95% do not have a robust system in place to measure the performance of intangible assets, and 33% don't have any system at all. (CFO 2/2)

In an opinion poll conducted by Brunswick, ½ of those interviewed felt that a "no comment" answer to the press was tantamount to an admission of guilt and 2/3 of shareholders would not buy shares in a company accused in a lawsuit of wrongdoing. Such publicity, says a study by the Law School at the University of Chicago, is directly

associated with a decline in stock values. Winning the case, says Brunswick, will do little to reverse the damage to reputation. (FT 2/16)

From 1996 to 2002, companies in the technology sector settled 121 lawsuits alleging fraudulent increases in share price — more such settlements than for any other sector, according to a study by Cornerstone Research. In contrast, retail/wholesale companies reported 42 such settlements; telecoms, 36; financial companies, 32; and health-care organizations, 28. Securities lawsuits against tech companies are more frequent, but less costly. The median settlement in stock-manipulation cases against tech companies was \$5 million — lower than in any other industry. At the other end of the spectrum, financial companies paid out a median of \$9.8 million. Premiums for directors' and officers' (D&O) liability insurance rose an average 33 percent, on top of a 29 percent increase in 2002, according to a survey by actuarial consulting firm Tillinghast-Towers Perrin. (CFO 2/3, 2/4)

### **SPECIFIC CASES**

U.S. Department of Labor Administrative Law Judge Stephen Purcell ordered the Bank of Floyd (Virginia) and its holding company Cardinal Bankshares to rehire, with back pay, former CFO David Welch who was fired after he raised concerns about its financial reporting, alleged insider trading, and internal accounting controls, according to the Roanoke Times. The court decision is said to be the first related to Sarbanes-Oxley whistleblower protections. (CFO 2/5)

Judge Holwell overturned a temporary restraining order ruling that dissenting shareholders could distribute a proxy ballot card to other shareholders in order to influence their vote against MONY's proposed merger with AXA. The Judge said that to bar sending out proxy materials "can be seen as frustrating the animating spirit that lies at the core of the SEC rule in question, which is intended to make it easier for shareholders to communicate without having to mount expensive battles in which they mail out their own proxy ballots." ISS recommends shareholders

oppose the merger saying the \$31 price is unreasonably low and criticizing the size of payments that would be made to top executives at MONY. (FT, NYTimes 2/12)

## **V. OTHER REGULATORY AND LEGAL UPDATES**

### **MAJOR INITIATIVES**

Led by the SEC and Consob, Italy's regulator, a task force of 8 to 10 chairs of member organizations of Madrid-based IOSCO, the International Organisation of Securities Commissions will review lessons from, and co-ordinate the global response of regulators to, the Parmalat scandal. The task force plans to focus on lack of transparency in the bond market and unregulated strategies for concealing business operations. During the past two years, IOSCO's technical committee has issued a series of statements and principles to improve practices among auditors, financial analysts and credit rating agencies and in 2002, adopted a multilateral memorandum of understanding on regulatory co-operation and information sharing to boost the ability of securities regulators to investigate securities fraud across national borders. (FT 2/8)

The SEC has finalized rules that require mutual funds to improve transparency by reporting portfolio holdings on a quarterly basis and investors' expenses in semi-annual reports and has proposed rules that ban directed brokerage commissions paid to brokers that promote certain funds and inform shareholders of how and why they picked the investment manager responsible for a fund's performance. Under consideration is a ban on 12b1 fees, which cover funds' marketing and distribution costs. (FT, USAToday, WashPost 2/12)

On Feb. 24, the SEC is expected to consider a package of market-structure issues including banning the quoting of stocks in increments beyond one penny, capping the fees that electronic markets charge for access to stock quotes, and adjusting the formula used for distributing the money that markets collect based on how many trades they report. (WSJ 2/12)

The SEC is considering changes to be made public in March in the way exchanges operate including the way in which shares are traded (best price versus quickest execution), the use of electronic versus traditional exchanges, how payments for market data are calculated, and the quotation of prices in increments of less than 1 cent (FT 2/2, WSJ 2/3)

The first draft of the Corporate Governance Code for Lithuanian Listed Companies was presented at a conference of the National Stock Exchange of Lithuania (NSEL) in co-operation with the Partners for Financial Stability Program (PFS). The opinions heard will be used for improving the draft before the adoption of its final version in spring 2004.

### **INVESTIGATIONS AND REVIEWS**

Taking a firm approach to corporate crime, the Italian police arrested Sergio Cragnotti, the former chair of the bankrupt canned-food producer Cirio, his son and son-in-law for fraudulent bankruptcy, banned his daughter from owning or running a business, placed a director under house arrest, notified another director that he was under investigation, and named 25 bankers in their investigation. The Italians have arrested 11 people in the Parmalat case and placed more than 30 people under investigation. (NYTimes 2/14)

The SEC is requesting information from brokerage firms such as Goldman, Morgan Stanley and Bear Stearns concerning introductions they make of investors in their existing hedge-fund clients to managers of new funds and the compensation they receive in terms of trading business. (WSJ 2/2)

The SEC launched an investigation into two aspects of index funds: (1) the wide range of fees and (2) soft-dollar arrangements to determine what the funds may be buying with soft dollars since research is not needed. (USAToday 2/4, BusWeek 2/15)

A probe by the NYSE and SEC into trading practices of specialist firms is expected to result in a total of at least \$150m in fines and restitution to investors by all specialist firms. The

firms are expected to settle without admitting or denying the allegations. The SEC has estimated that specialists earned up to \$155m in profits as a result of the alleged violations. (WSJ 2/12, FT 2/13)

The SEC and the NASD jointly charged 7 firms with failing to disclose that the prices customers paid for funds didn't reflect discounts they were entitled to. The firms will pay fines equal to the amount of overcharges and reimburse customers. 7 firms will each pay penalties that range from \$4.8 million to \$725,000. Separately, the NASD has charged 8 other firms. Their penalties range from \$280,000 to \$31,000. (NYTimes, USAToday 2/13)

Upholding an Oct. 10 subpoena issued by OFHEO, a federal judge ordered Freddie Mac's former chief executive, Leland Brendsel, to testify about the company's accounting problems. (USAToday, WSJ 2/4)

MFS paid the second largest fine: \$225 million; more than 20 companies in the mutual fund industry are under investigation. (NYTimes 2/6)