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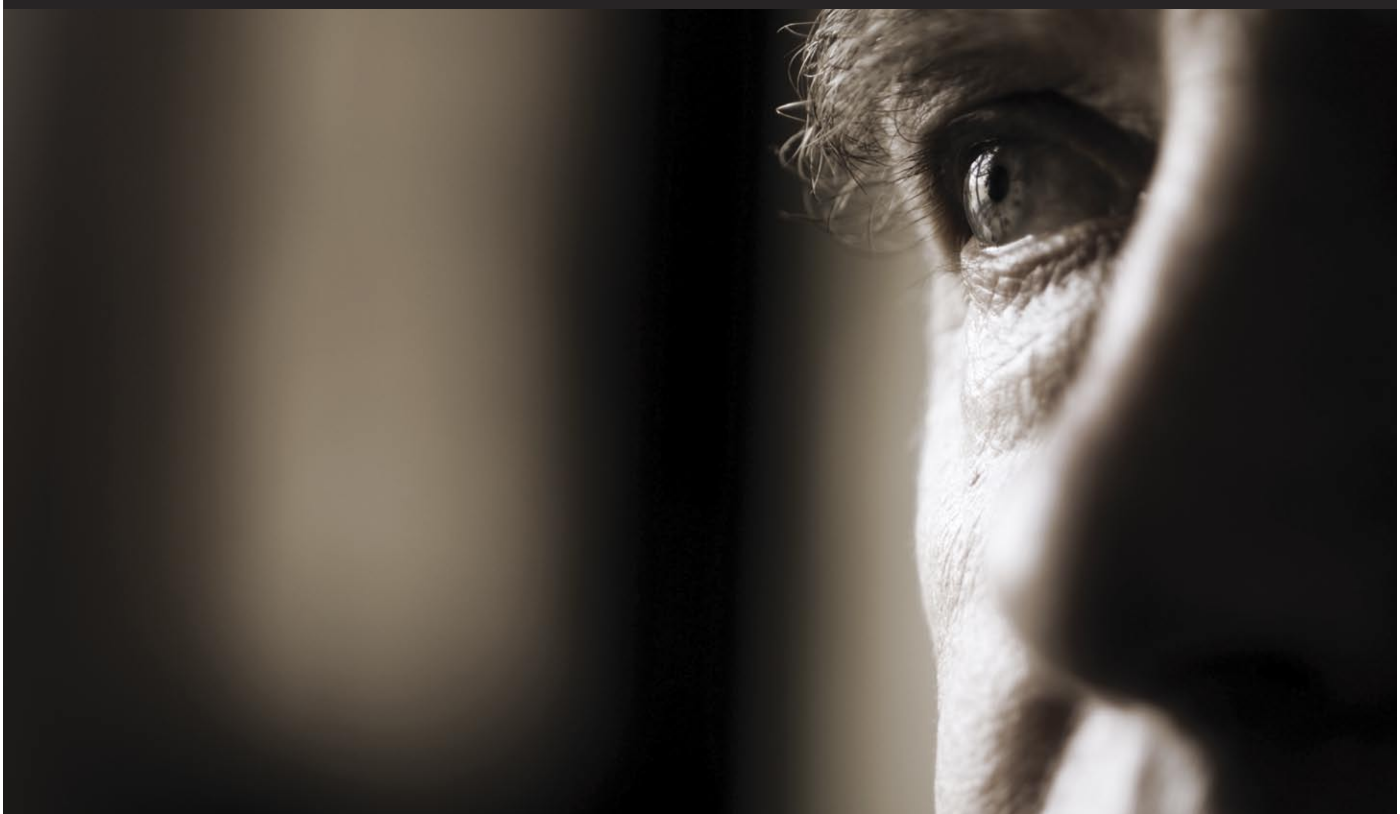
ROUNDTABLE



INTERNATIONAL CORPORATE GOVERNANCE ROUNDTABLE

Companies have expanded their corporate governance frameworks in recent years to improve transparency and minimise the risk of internal fraud. The emphasis on disclosure and independency has added pressure to corporate boards along with audit and compensation committees. No one expects scrutiny from shareholders, regulators and the media to lapse in the near future. But companies are learning that certain corporate governance measures, particularly those intended to improve risk management, can actually strengthen a company's operations rather than smother existing resources.

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THE PANELLISTS

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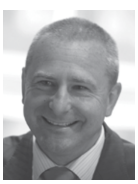

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What effect do you believe the changing functions and characteristics of internal audit and audit committees has had on the corporate governance frameworks of today's companies?

Amitrano: In recent years, the role of internal audit has become broader and more aligned to business and strategic risk, whereas historically it focused on detailed financial checks. That shift is largely due to the increased expectations and responsibilities placed on non-executive directors and audit committees. As a result, corporate governance frameworks have become broader and not just about financial reporting risk. For example, the UK's Turnbull report covered operational, compliance and enterprise-wide risk in addition to financial risk. Similarly, the COSO framework is about much more than financial reporting risk and control.

Keevan: Internal audit departments are generally better staffed and held in higher regard today than they were prior to the adoption of the Sarbanes-Oxley Act. Because they are able to perform more effectively, they have a greater influence on corporate governance decisions than ever before. Similarly, audit committees are generally working harder to understand the business, its internal controls and the key accounting principles, estimates and judgements underlying the financial statements. They are also asking tougher questions of management and, along with the rest of the board, are more carefully evaluating the leadership qualities of senior management and the values they convey to the rest of the organisation.

Custance: The effect has been generally positive as it has led to increased transparency and minimised the risks of internal malpractice remaining undetected. Internal audit has therefore improved corporate governance frameworks and compliance. However, it has also increased internal bureaucracy with a consequent drain on management time. Senior management therefore need to keep it in check and ensure that it is utilised and viewed internally as a constructive tool designed to safeguard and improve the company's business.

Wardell: Audit committees are keen that the controls and internal audit elements necessary to comply with Sarbanes-Oxley were not so demanding of their time. It was obvious from the beginning that the impact of Sarbanes and the governance rules on the audit committee would be a significant change in the audit committee's power and its role on the board. In the US, most boards have taken to including all board members in audit committee meetings, then when the audit committee need to address an issue that requires independent action, the people who are not on the audit committee leave the room. This seems to be best practice. What companies quickly found was that so much work had been assigned to the audit committee that their meetings were getting longer and board items were being pre-digested. So a parallel path has developed in the US where the audit committee winds up considering many of the most important board issues, and does so with all of the board members in attendance.

Nestor: The foremost effect is a more robust and more formalised system of authority distribution and internal control within large organisations – which is directly linked to increased transparency of internal control to the board. Another key change is the availability of an independent 'pair of ears' for the external auditors to raise issues. A note of caution, though. In our experience we have found that audit committees tried too hard to directly oversee the finance and accounting functions and ended up sacrificing independence for 'proximity' – audit committee members almost turned into controllers.

> **The role of the non-executive directors and in particular their independence has played a key part in strengthening companies' corporate governance frameworks.**
>
> DAVID ROBBINS

Robbins: The role of the audit committee and internal audit function has been evolving for many years, however the past four years has seen the speed of this evolution increase tremendously. The role of internal audit and its independence from management have become key issues for businesses and this has strengthened the governance frameworks of many companies. With respect to the audit committee, the role of the non-executive directors and in particular their independence has played a key part in strengthening companies' corporate governance frameworks.

Swinford: The audit committee's increased responsibility has led to greater board scrutiny of management's recommendations and conclusions in all areas. That includes business strategy first and foremost, assessment of risk, compensation recommendations – the full gamut of those areas which boards oversee. As a result of the experience of the audit committee with external auditors, there is a greater focus on the use of outside advisers in other board activities, including compensation advisers and outside counsel.

Scarr: By and large, internal audit has become more risk focused, which has added to the governance framework. There has, however, been a gap between the abilities of internal audit and risk management and the understanding of these abilities by the audit committees. Often, there is a lack of understanding in the audit committee of the drivers of internal audit and the benefits that can be obtained by the business by having a properly constituted risk and audit function.

In the wake of the credit crunch, regulators and shareholders will be keeping a close eye on financial reporting processes. Will this put additional pressure on audit committees and auditors in 2008?

Amitrano: Since the markets have dried up, it has become harder to value assets and instruments which are subject to market convention. Certain judgements and assumptions have to be made which make the process problematic. It is not only financial services companies that face this challenge; any company that holds financial instruments will need to value interest rate caps, foreign currency mechanisms and so on. Given that backdrop, the audit profession will apply more scrutiny. When the people carrying out valuations face a tougher job, there is a higher chance that they will make mistakes, such as undervaluing their exposure. An audit does not involve a thorough check of every transaction and every assertion in the company's financial statements; it focuses on risk, and the credit crunch has caused certain aspects to be a higher risk than they were a year ago. The most pressurised situations will occur where difficulties obtaining finance call into question whether a company remains a going concern.

Robbins: In December the FRC highlighted that under the present economic condition companies, and in particular audit committees, needed to pay particular attention to their financial reporting processes. At the same time they stressed the importance of companies keeping their risk management processes up to date and relevant. Although in theory both of these areas have always been of importance to audit committees and auditors alike, I believe that they will have more scrutiny in the coming year, particularly from the non executive audit committee members.

Scarr: The problems caused by the credit crunch will be far reaching and will affect many companies. One of the problems for generalist internal auditors will be understanding the potential risks and where exposure to these risks will be occurring within the business. A secondary problem may be ensuring that the audit committee understands the importance of assessing the risk and includes this within the internal audit calendar for the year.

Nestor: Bank audit committees and auditors will probably have to look closer at improving reporting of off-balance sheet risks. We will probably also see regulatory action in this area in the wake of the crisis. I think that the pressure will be more on risk committees of financial institutions and it will focus on improved stress testing and controls on liquidity risk. The work of audit committees in corporates will be less affected by the crunch – although corporate strategies in certain sectors will certainly be affected. But they are discussed and endorsed at full board level.

Custance: There will almost certainly be additional pressure as a result of the credit crunch. Underlying the credit crunch has been a failure to properly evaluate the assets on various institutions' balance sheets, or alternatively an element of 'head in the sand' or, worse, 'turning a blind eye'. So shareholders and regulators will be looking to auditors to ask a lot more questions and dig much deeper. That means either a more extensive – and therefore expensive – audit process or that auditors' reports will contain far more caveats and qualifications in order to cover themselves, if not both. I expect an upturn in claims against external auditors.

Poor risk management decisions contributed significantly to the credit crunch. These decisions would likely have been avoided, or their effects at least mitigated, had appropriate business policies, practices and controls been in place and operating effectively.

WILLIAM T. KEEVAN

Keevan: Uncertainty has increased both the business risks companies face in the marketplace and the risks inherent in the accounting estimates and judgements required to be made in preparing financial statements. For example, valuing complex financial instruments, determining whether impairment writedowns are required with respect to those assets, or other non-financial assets for that matter, overseeing the processes by which management makes such determinations, and evaluating the appropriateness of the related accounting will be more difficult and therefore, will be the principal cause of increased pressure on management, audit committees and auditors.

To what extent do you believe the recent credit crunch is linked to poor corporate governance? What affect do you believe the subsequent litigation will have on conflicts of interest and other corporate governance practices going forward?

Custance: Poor corporate governance has been a major factor. The initial subprime exposure was due to abysmal lending criteria, and was then passed on because institutions did not take a thorough enough look at the risks attached to the assets they were buying. One of the areas which the ensuing litigation is likely to highlight is the conflict of interest inherent in financial institutions which underwrite and then syndicate debt instruments. If the institution has any concern as to the underlying value of the debt, then it is obviously not in its interests to disclose that concern to potential syndicate members. More generally, regulators, shareholders and investors will expect institutions to exercise much more rigorous controls over their investment strategy and implementation.

Keevan: The recent credit crunch is linked in large measure to poor corporate governance. This is reflected most vividly in the recent departures of the chief executives at large financial services firms such as Citigroup, Merrill Lynch and Bear Stearns, to name a few. Poor risk management decisions contributed significantly to the credit crunch. These decisions would likely have been avoided, or their effects at least mitigated, had appropriate business policies, practices and controls been in place and operating effectively.

Robbins: Whether the credit crunch can be directly linked to poor corporate governance is hard to say. What is clear is that a number of the companies which are now facing difficulties, and in particular those with problems which can be directly attributed to the subprime mortgage market, failed to either identify some significant risks or failed to prepare suitable mitigation plans. Today's market conditions have highlighted that companies risk management frameworks should be continuously updated and monitored. Furthermore, they have added to the argument for even greater transparency within the disclosures made in the annual accounts.

Amitrano: Arguably, mortgage originators in the US made irresponsible lending decisions and the secondary investors who bought the products made ill-informed investment decisions. With the benefit of hindsight we might say there were cases of poor management and therefore poor corporate governance. But it is important to distinguish between corporate governance failures and decisions that are simply wrong. In the case of subprime lending, it may be that management knew the risks and were prepared to take them – that just happened to be the wrong decision.

When an entire industry is caught out, which seems to have happened here, it suggests that the crisis was systemic and that no single organisation could have been expected to guard against it. The threat of litigation will undoubtedly cause companies to reflect on governance and to consider tightening up their processes.

Scarr: The credit crunch is more relevant to a breakdown in risk management than a wholesale breakdown in corporate governance frameworks. There are two interesting and often forgotten conflicts of interest that have applied here. The first is the reporting route for risk management and internal audit – often they report internally to the finance director and therefore they may not be able to report independently on credit crunch related issues. The second is the number of non executive directors sitting on a large number of boards – when a company is suing another due to the credit crunch, there may be a risk of conflicts when companies have non executive directors in common.

Wardell: I don't think there is any linkage between the credit crunch and poor corporate governance, except for those financial services companies which invested in subprime. In these cases there are some serious questions about what the investment committees were thinking. We probably will see another round of litigation and it will hit insiders who were withholding obvious knowledge. Greater attention will be paid to conflicts of interest.

Swinford: I think the credit crunch is more the result of undue risk-taking than poor corporate governance. We saw this with the internet boom in the 90s. There is a strong tendency for people to pursue current successful strategies with unbridled enthusiasm. That is actually one of the reasons we are seeing a much greater emphasis on risk management and risk assessment than we have seen in the past, because people tend to pursue growth strategies at the expense of minimising risk and sound, conservative financial judgement.

How can companies balance disclosure requirements with the need to protect competitive advantages, such as trade secrets and business plans?

Wardell: The need to maintain a balance has not really changed. In the US at least, confidential treatment is available. There are strategies to make sure that what a company discloses is redacted in a certain way, or omitted altogether. Discussions are continuing over the issue of compensation and performance targets which the SEC has asked for; that is, companies are able to avoid complying with a request for performance targets if the company will end up disclosing competitive plans. There is more pressure for greater disclosure. And some of it comes close to what is considered trade secrets and confidential information, but there are fairly adequate protections available.

Scarr: In the UK, the new Companies Act brought particular fears of this – especially due to the derivative actions that are now possible, leaving directors open to a greater degree than they were before. There is still, however, no need for companies to encounter these problems as long as sufficient planning and advice is taken in time to ensure the disclosure is appropriate. It remains to be seen how much additional information will, in fact, be brought to the attention of the public.

Amitrano: Stakeholders do need to have some understanding of business strategies and risk appetites and companies can go a very long way before they actually endanger their competitive advantage through disclosures. Regulators are in the process of increasing and broadening disclosures. While there is a risk of pushing organisations into the realms of sensitive and confidential information, companies need to exercise judgement. Disclosure committees are often put in place to establish a balance between meeting the stakeholders' requirements for understanding the business and protecting the company's own interests.

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MARCO AMITRANO

Keevan: Disclosure requirements are intended to protect the interests of shareholders. Disclosures that undermine a company's competitive advantages run counter to that objective and, presumably, would negatively affect shareholder value. Accordingly, I do not believe that disclosures that would have such an affect are required. This does not mean, however, that the decision of what and how much to disclose is always clear cut. Certain disclosures can be made without undermining competitive advantages if management and the audit committee give the relevant issues sufficient thought, realistically define what disclosures would undermine a competitive advantage, seek legal advice when appropriate and are prepared effectively to defend their decision if challenged. Also, adopting a policy of not providing guidance to 'the street' minimises the risk that management will be in a position in which it feels compelled to disclose or, conversely, feels compelled to decline to disclose specific information.

Robbins: There is a fine balance between providing sufficient information to shareholders so that they have confidence in the capital markets and giving away trade secrets that help to provide competitive advantage. The question companies need to ask themselves when deciding whether to disclose information is "would failure to provide this information impact on shareholders decisions?" If the answer to this question is yes, then the relevant information should be made available.

Nestor: They can balance this requirement by going private, to begin with. The availability of cheap credit and growing regulatory pressure on reporting and controls resulted in a large number of companies exiting public markets in the last few years. But credit is cheap no more and I believe that regulators will show forbearance rather than toughness as a result of the crunch. I do not personally believe that truly effective disclosure creates competitive disadvantages. Companies such as Pfizer and Barclays are both market leaders and champions of good disclosure. It is rather the double whammy of ever more detailed, as opposed to principles-based, regulation and a climate of over-litigation – both emanating from the US – that creates friction between the legitimate goal of protecting a company's competitive positioning and investor thirst for information. The UK is a shining light in this respect, with regulation being principles based, companies being called to explain their policies to investors rather than blindly comply and hurdles to private litigation being considerably higher.

How has the role of the compensation committee evolved over time? What would you say are its defining objectives in today's business world?

Swinford: The committee role is moving from reactive to a substantially proactive involvement. Committees are still relying on the chief executive to establish strategy and to identify the key measures of success, but the committees are taking a stronger and more independent role. Committees recognise the need to assure shareholders that there is appropriate oversight of the compensation process to prevent executive self-dealing. Compensation has a strange characteristic in that the managers making the recommendations are being paid under the programme. So there needs to be significant oversight to ensure the process is objective and conducted at arm's length.

Robbins: I would say that the compensation committee's main objective is to try to align the rewards of the executives with the goals of shareholders. In particular, the committee needs to try to ensure that the structure of executive compensation packages does not encourage short termism. At the same time, the compensation committee needs to ensure that the rewards are of a sufficient level to attract and retain the type of executive needed for the business. In recent years, many compensation committees have been better informed and had the benefit of greater transparency with regards to publicly available information about comparative positions, which has afforded them the opportunity to be more rigorous in their challenge to remuneration packages. Furthermore, investors are now more likely to voice their concerns if they believe that the levels of compensation being paid are too high.

Custance: The compensation committee has become increasingly important and high profile. Retaining talent and ensuring that remuneration is seen to be transparent and fair have put the spotlight on executive pay and benefits, and hence on the role of the compensation committee. It needs to be meritocratic and reward results to avoid the 'fat cat' syndrome, without being too short-termist; if executives feel under too much pressure to produce results, that increases the risk of decisions being made which are not in the best interests of the business or, worse, of malpractice.

Nestor: The obsession with executive compensation is something that is particular to the UK and US institutional investors, mainly driven by large pension funds. In continental Europe and most emerging markets , compensation is less of an issue; strong owners make sure that management is not overpaid. There, and I would submit everywhere else, the primary objective of the comp committee should be to assess talent in the company and ensure that it is attracted and retained.

Scarr: Directors emoluments have never been more contentious or subject to public scrutiny. What more condemnation could there be for the current effectiveness of remuneration committees? It is a tough market and reward for success needs to be available. The current scrutiny stems from an apparent reward for failure that is not in the interests of shareholders.

Wardell: The compensation committee has evolved considerably. In the US, it really started as a committee that was necessary to sanitise stock options, because both the SEC and the Treasury had particular requirements about non-employee directors being part of the compensation committee that granted options. But today it is an active committee made up of independent directors, and its first job is to set compensation policy. Second is to make sure that compensation is appropriate for the jobs of senior management, and to stay in touch with the comparable compensation of others similarly placed companies in the industry. Finally, it needs to evaluate and hold accountable the chief executive, and establish his or her performance targets.

How important is succession planning in the context of corporate governance? Who should take responsibility for this task and what actions can they take to achieve it?

Scarr: Succession planning and business continuity are clearly linked, and many businesses struggle with them. Until this receives attention at board level, there will be little ability within the business to increase its effectiveness. Succession planning at board level is a risk that must be managed. How much time does a board really devote to this issue, and is it reasonable to think that if little time is spent on it, there will be good results? It can be argued from the world of football that it costs more money to bring in a good replacement if it is done without being planned.

Nestor: Succession planning is a fundamental governance task. When it comes to executive committee or ex-board members and probably one level below, it should be the job of the comp committee to ensure that the chief executive is promoting the right people to the right jobs – and to support him in this task without second guessing him. In industries that are more talent-intensive, such as finance, IT and many others, the board should regularly review HR strategy. When it comes to succession planning for the chief executive himself, this is clearly the chairman's job with the help of the Nomination Committee. In a 2006 amendment, the UK Combined Code accepted as good practice the chairman chairing the nomination committee. This is a very welcome change.

Swinford: Succession planning is critical to effective governance for two reasons. First is ensuring that the company has the right people to fill higher-level positions if they become vacant,

The primary objective of the comp committee should be to assess talent in the company and ensure that it is attracted and retained.

STILPON NESTOR

to ensure the continuity of the organisation's culture, its strategic plan and its distinctive knowledge compared to other companies. Second, a good succession plan allows the board to more effectively oversee executive decisions. The board is always more in control of the company when it promotes executives from lower ranks within the organisation, rather than recruiting a high-powered executive from outside. From a process perspective, the board must have the opportunity to get to know the key people on the succession chart because members need to learn who these people are, how they think and how they operate.

Keevan: Succession planning is unquestionably one of the most important corporate governance responsibilities of the board of directors. It goes directly to the board's ultimate responsibility for maximising long-term shareholder value. Moreover, this responsibility is not borne solely by the board. The current chief executive also has an important role, although not a determinative one, in succession planning. He or she must identify potential candidates internally or hire potential candidates from the outside and work with the board to ensure that a successor to the current chief executive is readily available when required. The recent firings of the chief executives of Citigroup and Merrill Lynch are two high-profile examples of the respective boards and chief executives not meeting their succession planning responsibilities.

Custance: Succession planning is very important. It should be the responsibility of the board as a whole, rather than individuals nominating their own successors where egos and other personality issues can mean that successors are not put in place early enough or the wrong people are chosen. It is also crucial that successors are in place and prepared to take over at any time – the recent unexpected departures of chief executives from Citigroup, Merrill Lynch and Bear Stearns, because of subprime losses, shows why this is so important.

Robbins: Succession planning is a key element in the good governance of a company and should be kept under review. Both executive and non executive management have a role to play in ensuring that the company has people with the right skills in the right positions at the right time. In many companies succession is a key risk and is therefore included within the risk review.

Wardell: Succession planning is important at all levels. It is a question for boards and critical for chief executives. Usually, the governance committee or the compensation committee leads that function. A succession plan needs to be continuously reviewed and revised as necessary.

Amitrano: The loss of key executives is a huge risk for any organisation and succession planning is therefore vital. Responsibility lies with the current board and management. Shareholders expect implicitly that the proper succession planning is taking place at the board and management level. Succession planning must take account of knowledge and culture, which are vital components of corporate governance.

Has shareholder activism led to a situation where these stakeholders exert too much influence over board composition, or is this a positive development?

Robbins: Shareholder activism has increased exponentially in the last five years and has been welcomed by many. A number of reports suggest that companies that have been the subject of change due to shareholder activism have seen short term improvements in share values. Therefore, from this perspective, it will be viewed as a positive thing. However, if boards are too heavily focused on short term objectives in order to deliver short term increases in shareholder value, there is a concern for the longer term prospects. If shareholder activism leads to an increase in the value of a business both in the short and long term then it would be viewed as a good. But active investors always need to be aware that shareholder activism can be a distraction to management which could, if not handled correctly, lead to value reduction in both the short and long term.

Overall, shareholder activism is positive – especially from heavy institutional shareholders, such as mutual funds or the large pensions plans. They really know what they are doing.

TOM WARDELL

Keevan: For a board to be effective, its members must be independent, objective, knowledgeable of the business and act with integrity in everything they do. The board also has to act as a cohesive unit despite individual differences of opinion. This cohesiveness cannot be achieved absent mutual respect among the board members. Most boards have a process for identifying and evaluating potential director candidates. Admittedly, some processes are better than others, but nearly all of them consider a candidate's ability to make a positive contribution to the success of the company by displaying independent judgement and integrity while also giving objective consideration and respect to the views of other board members. Unfortunately, this is much less likely to be the case if otherwise effective director selection processes are circumvented and persons with specific activist's agendas become directors.

Custance: Shareholder activism depends on the type of shareholder. Public activism by shareholders who are ordinary members of the public has helped to highlight some important issues in the management and practices of certain companies, but in reality tends to have minimal impact on board composition. It is the major institutional shareholders who increasingly have the real influence here. That is not necessarily a positive development because it is subject to the particular agenda of the shareholder, which may be focusing on a short term realisation of its investment – such as a private equity house – rather than the best interests of the company.

Wardell: In my opinion, the jury is still out on shareholder activism. Overall, shareholder activism is positive – especially from heavy institutional shareholders, such as mutual funds or the large pensions plans. They really know what they are doing. But some groups have lost a little bit – or a lot – of perspective. Some groups seem to be confused about the purpose of a corporation and the proper focus of corporate governance. I will cite, most particularly, the people who want global warming plans. Some of the proposals are the most histrionic, ill-considered ideas I have seen in a long time. They appear based on a theory that corporations are obliged to inculcate the interests of public interest groups, rather than those of shareholders, into strategic plans. These groups seek to avoid the legislative process and to warp the regulatory process or end-run it altogether.

Amitrano: It is difficult to generalise on the issue of shareholder activism. In simple terms, if the board is poor it might be the right thing to do, but if the board is good, then it might be disruptive. Looking at the bigger picture, there is better engagement with shareholders and this has to be positive overall, but whether the cost outweighs the benefit has to be considered on a case by case basis.

Swinford: I don't think there is too much shareholder activism about board composition. That said, there are some questions about whether the activism is on the part of shareholders or on the part of shareholder advisers. Sometimes shareholder advisers have agendas that seem to be based on their own beliefs or business interests. But the board does have constituencies and it is appropriate for outsiders to weigh in on the composition of the board and how it should carry out its activities. It is difficult to argue that the board should be able to operate in total isolation.

Nestor: Influence over board composition by shareholders is a good thing. In fact, the main problem with US governance is that shareholders have little say on board composition and boards are self-perpetuating. Where shareholder activism may be overstepping its mark is in attempting to set strategy for companies from the outside. Strategic and governance improvement suggestions might be productive as long as they are discussed in a climate of quiet cooperation. But strategic change by megaphone and activist strong-arming undermines the fundamental role of the board, that of governing. Boards – and I insist on 'boards' – should be willing and able to explain and discuss their strategic choices with shareholders but firm in retaining their prerogative in this respect.

When it comes to M&A, do companies need to enhance their corporate governance practices in areas such as due diligence, fairness opinions and duty to shareholders?

Nestor: As regards bidders, I have strongly argued on the failed Deutche Borse bid for LSE that once a bid is in the offing, the board should be on independence alert to manage the risk of conflicts between outside investors on one hand and management or controlling shareholders on the other. This is because laws impose few obligations on bidders when they launch a major takeover. Independence alert means first of all talking directly to shareholders – not via management as Deutche Borse did. When it comes to targets, the practices are well established in most jurisdictions and regulators are in general much more alert. Having said this, shareholder approval is the norm only in the UK.

The compensation programmes of target companies often say a lot about the company's culture, which is an important part of the due diligence process.

DAVID SWINFORD

Wardell: Enhancing M&A corporate governance is already underway. It really means making sure that the boards and committees of boards in charge of acquisitions and dispositions make sure that their operating people are conducting their activities according to established standards. There is an increasing amount of attention being paid to it, largely because so many mergers have fallen short of people's expectations. There is a need for regular review and deliberation on M&A matters, and the board should be part of this every step of the way. They need to ensure that the transaction represents an opportunity to deliver shareholders value and benefit under the current business plan.

Amitrano: Over the last five years, companies have enhanced their corporate governance practices around M&A for a couple of reasons. Firstly, as a response to the increasing regulatory financial reporting environment. In the US, Sarbanes-Oxley 404 has arguably pushed companies to focus on the financial reporting impact of deals. Not only do they need to report on the numbers and the earnings impact of a transaction, but if the target company has deficient controls this fact will emerge within the first two years. Second is the change in accounting rules, which makes it harder to hide a bad transaction. Previously, goodwill could be put on the balance sheet and amortised over 20 years, but following changes to both US GAAP and IFRS, goodwill is held and assessed for impairment annually. Once a company begins writing off huge amounts of goodwill, the deal starts to look less convincing. Many argue that the accounting rules are unfair and paint the wrong picture, but they reveal when one company has overpaid for another.

Custance: If the relevant rules and procedures applicable to M&A are followed, then any corporate governance issues should be covered. Because the new Companies Act increases to some extent directors' duties, this may mean that companies need to have more of an eye on corporate governance practices in the M&A field.

Keevan: All companies should periodically review and evaluate their M&A-related corporate governance practices and make enhancements when appropriate. All M&A transactions should be made with a view toward increasing long-term shareholder value. Achieving this objective requires that appropriate processes and controls be in place and operating effectively to support any decision to move forward with or abandon the transaction. The adequacy of the due diligence process is a critical consideration in this regard.

Swinford: When it comes to mergers and acquisitions, the compensation programmes of target companies often say a lot about the company's culture, which is an important part of the due diligence process. Hewlett Packard and Compaq Computer, for example, did not have compatible cultures. It was extremely difficult to bring those people together because they thought radically differently. Sometimes cultural compatibility does not get sufficient attention.

Scarr: There is significant concern that directors, especially non executives, are not being made aware of their duties to shareholders in M&A situations, particularly when private equity is involved. In these situations it is particularly important that the directors do not find themselves subject to derivative shareholder action under the new Companies Act and therefore that they take advantage of the Combined Code principle to obtain adequate independent advice for all directors. Historically, most due diligence procedures focus on the company's financial position rather than looking at the internal control and risk management frameworks that are operating, which can prove to be of equal importance. This is perhaps less the case now when US listed entities are involved, as these are increasingly aware of internal control issues at the highest level.

It is important that appropriate resources are provided for embedding corporate control frameworks on a global basis.

CRAIG SCARR

Given that regulators are more actively enforcing the Foreign Corrupt Practices Act, what must companies do to ensure compliance on a global basis?

Keevan: Every company committed to ensuring compliance with the FCPA must carry out a number of tasks. First, develop formal written policies which clearly explain the requirements of the FCPA and state the company's commitment to compliance and to take appropriate action against employees and agents who violate the Act or the company's policies. Second, communicate those policies to company personnel, agents and others as appropriate in all markets, and require that they formally acknowledge having read the policies. Third, develop and provide training in the interpretation and application of the policies. Fourth, ensure that employees and others are aware of who they can speak with to obtain guidance, ask questions and report concerns and suspected violations anonymously if they wish. Finally, enforce the policies consistently regardless of the level of employee involvement.

Scarr: The FCPA has really brought into focus the need for an integrated approach to risk management across territorial borders. Companies that grow quickly or through a process of M&A can find it difficult to ensure the control culture in all subsidiaries matches those in the parent company. It is important that appropriate resources are provided for embedding corporate control frameworks on a global basis.

Wardell: They key here is training, training, training. FCPA is tough because it cuts across customary business practices in so many countries and increasing globalisation means companies need to set up controls to capture it. They need to have a good compliance programme and a good compliance audit – but many companies do not. Training is clearly the core. People in the companies need to understand what FCPA is and that they cannot breach it. They need training on transactions which might trigger FCPA, often a collateral transaction such as one which involves a payment to someone who turns out to be the brother-in-law of a government official. These issues surface in many circuitous ways, but the underlying questions are always "are we really getting any value for this additional payment, and if so, what does that value look like?"

Amitrano: First of all it is worth pointing out that the FCPA comes with some quite severe penalties and so once understood it really does focus the minds of companies in terms of how they are going to respond to it. Companies should evaluate the comprehensiveness and effectiveness of their compliance programme to assess any gaps in policies and procedures. They also need to ensure that employees have an understanding of the relevant regulations and requirements; it is not enough to assume a policy has been implemented just because an email has been distributed. People really have to buy into it. Another mistake companies make is they lack proper monitoring mechanisms. Specific anti-corruption compliance reviews bring management attention to particular high-risk areas.

Robbins: In order to achieve global compliance with the FCPA, companies need to ensure that the requirements are communicated to staff in all locations and in particular they need to pay attention to local custom and practice. Furthermore, they need a monitoring process to review if the act is being complied with including regular compliance statements from senior management.

Nestor: Companies must ensure that all their subsidiaries have developed processes and procedures to implement group level principles, usually contained in a group Code of Ethics. The specific assignment of responsibility for ethics enforcement at all levels within the group is key in this respect, and so is a specific audit focus on compliance processes, especially when companies operate across a wide range of jurisdictions.

If a company does face a government inquiry or investigation linked to a corporate governance issue, what steps should it take?

Amitrano: The first step is to understand the root causes of why the investigation has occurred to enable the board to form their own view of the facts and circumstances. The second step is to establish a positive, constructive dialogue with the regulator. The third step is to embed the right controls within the organisation. That means imposing a culture of compliance throughout the organisation, underpinned by a clear tone at the top. Good control is all about people and culture. A compliance programme should also be pragmatic and effective to avoid causing organisational inertia. The fourth step is to have the regular and reliable management information, with assurance provided either by an internal compliance function or an external assurance provider.

Swinford: The entire board needs to be involved, and it needs to take any government inquiry or investigation very seriously. A problem with letting management handle the issue is that key figures within the management team may actually be under investigation. So the board should quickly determine whether or not it requires an independent committee to deal with the issue, and that independent committee needs to determine whether or not it needs independent counsel. The board should get involved immediately and do a triage to determine how serious the situation is and the potential consequences.

Nestor: A company's board should order an independent review by governance professionals. It is important to shape the mandate in a way that goes beyond a simple investigation of legal failures, extending to the identification of organisational weaknesses and disincentives that might have caused or enabled the breach under investigation.

Custance: Companies should instruct specialist legal advisers as soon as possible. A company will need to know precisely what information the government or other regulatory body is entitled to and what powers it has. The rules and procedures involved are complex. There are likely to be issues in particular to do with which documents and records are privileged. Ensure that all potentially relevant records and documents, both hard copy and electronic, are collected together and retained. Also instruct a good PR consultant to handle any media interest and advise on internal and shareholder communications.

Scarr: Even the most robust risk management and risk management frameworks can find themselves open to this form of attack. But just because a question is raised by regulators it does not mean that the company is at fault. Often, independent specialist advice, taken early on, can alleviate the risk of continued regulatory action.

Wardell: In these situations, the company needs to make sure there is somebody in charge of the problem and an internal group to deal with it. Sometimes the investigation can be handled entirely internally, but usually external resources are required, such as lawyers for whom forensic accountants are engaged, because that gives the company privilege protection. The company also needs to draw a line around those who may be a part of the problem and get them out of the way, which does not necessarily mean firing them. There is also a need to make sure the right procedures are in place, such as sending out a document retention memo so that people do not destroy information. It is important to have a focal point of communication so communications are under control and any internal or external questions are answered by a very small group of people in charge of the problem. Someone should also act as an interface for the government agency. It could be general counsel, a member of management or a representative from outside the company. These are all general features that should form part of any investigation process, but it is difficult to be any more specific as cases vary widely.

The challenge going forward will be to demonstrate a genuine contribution, for example, actually reducing your carbon footprint rather than just offsetting it.

TOM CUSTANCE

Keevan: The first step the company should take is to engage experienced outside legal counsel to conduct a thorough independent investigation and to represent the company in its dealings with the government. Outside counsel should report directly to the board, typically represented by the audit committee or a special committee of the board established specifically for this purpose. Further, outside counsel should be empowered to engage forensic accountants and other experts as it deems necessary to ensure the integrity and completeness of the investigation. The board or designated committee should meet regularly with counsel to be updated on developments and consider additional steps to be taken. The forensic accountants and other experts should attend those meetings as requested by the board or committee and considered appropriate by counsel. Since the board is ultimately responsible for the decisions that are made, it must make sure it understands the underlying facts and circumstances of the case and the bases of counsel's advice on how best to proceed.

Will corporate social responsibility and sustainability continue to climb the boardroom agenda in the future? How can companies establish themselves as good corporate citizens, and what are the penalties for failing to do so?

Custance: Corporate social responsibility is climbing the boardroom agenda, but not necessarily for the right reasons. This is often a reaction to the fact that many clients or customers, particularly in the public sector, now require organisations to have social responsibility and sustainability programmes as a condition of buying their services and products. So not having this on the boardroom agenda is likely to mean losing business to competitors. But there is plenty of scope for 'window dressing' with very little substance behind it. The challenge going forward will be to demonstrate a genuine contribution, for example, actually reducing your carbon footprint rather than just offsetting it.

Wardell: I guess it will continue to be on the boardroom agenda, but 'sustainability' is a new buzz word and companies that have undertaken it have found it very expensive for questionable benefit. Companies need ask whether they are exposed for litigation and liability based on assumptions that turn out to be unreliable in their sustainability review. This takes us back to the global warming issue; do people really expect that oil refineries can produce a plan for what they will look like 35 years from now? Ultimately, companies can continue to be responsive and attentive to the legal requirements and the market requirements that are upon them. That is really what sustainability is about. But I am not sure that there is much to do beyond that.

Nestor: These issues probably will climb the agenda. But I am a bit of a heretic in this respect – at least if the true faith is the one preached by public pension funds, SRI investors and the CSR cottage industry. In my view, a company's primary responsibility is the creation of value. Our societies have devised other institutions to deal with the production of public goods and the redress of market failures. As long as social or environmental action is value-enhancing in the long term then it should be undertaken – this includes the obvious and quite common case where clients expect such action and reward it by their loyalty or by paying more. Good corporate citizenship is therefore good business, not good governance.

Swinford: Although companies are increasingly concerned about how they are perceived in the outside world, I am not sure this translates directly into corporate social responsibility being higher on the board agenda. Certainly, the concept of sustainability has grown in importance, and this is part of the overall risk management framework. But financial markets are so focused on short and mid-term value creation that some of the social responsibility and sustainability issues are more prominent in the UK and Europe than they are in the US. There are clearly concerns about environmental issues and labour practices in certain countries. But unless a company becomes the target of an attempted boycott or a public relations campaign, there has not been much reaction in the past.

Robbins: While there has been a lot of press about corporate social responsibility, it will only continue to climb the boardroom agenda if boards believe that either investors or regulators continue to increase their interest in this area. Most businesses now understand that they have corporate social responsibilities, but the fact still remains that the main goal for many is to increase shareholder value. If operating in a socially responsible manner helps to do this, or there is increased regulatory focus, then it will move up the board agenda. A further factor to consider is the increase in specialist investment funds which will only invest in those businesses which are seen to be socially responsible. If this trend continues, it will add further pressure to boards.

Amitrano: There is unprecedented political, media and business interest in corporate responsibility and sustainable development issues. An increasing number of business and government leaders are indicating that it is a top priority. Inevitably, the wave of rising concern has led to some comments that corporate responsibility is just a short-term fad or a politically acceptable front for cost reduction measures. But it is here to stay. Companies face a tighter regulatory framework in areas such as the environment, health and safety, labour standards, business ethics and so on. Regulations relating to corporate responsibility do not only involve the traditional areas of waste management, air emissions and safety standards, for example, but also ethical requirements on company directors. The tax and other economic sanctions which have been brought to bear are pushing this issue further up the agenda. In terms of the bigger picture, companies are beginning to realise that their customers are starting to care about the sustainability of the products and services they purchase.

Scarr: Ethical behaviour continues to be important. Increasingly, people do not notice if you are leaders in corporate social responsibility, but it will gain column inches if you are not. It is important for companies to understand whether or not it is integral to their brand image for them to follow the CSR agenda. If following CSR principles is or will be important, then it must be followed legitimately, rather than the company appearing to undertake more CSR than is actually the case. Often, a poorly thought out CSR strategy can cause more harm than good. A typical example of this is when a company does not fully understand the processes and procedures operating throughout its many divisions, departments and jurisdictions.

Keevan: Most companies give corporate social responsibility and sustainability sufficient attention to comply with applicable laws and regulations and to maintain a favourable corporate image in the marketplace. Companies that are doing a respectable job in this regard today are not likely to devote additional time to those matters. Conversely, other companies will devote additional time and effort to such issues if they perceive an incremental benefit to shareholders from doing so.

Do you believe the risk management demands placed on corporate boards and committees have gone too far in some respects?

Wardell: I do think that risk management may have gone too far in some respects, but we need to define what that means. Moving risk management from the position it occupied as recently as three or four years ago – which was "our insurance group takes care of that" – to something which involves identifying the strategic risks that a company faces in its business plan, and then evaluating those and staying in touch with them, is extremely valuable. But when you get into what is often called the 'ERM Rubik's Cube' method of risk management, issues can become so ethereal that people overlook or misconceive the methods by which business people solve problems all the time. Boards today have a fairly good understanding of this pitfall, and are more concerned with having scoped the risks well and with the quality of their compliance programme.

Scarr: Generally, the rule 'what you put in you get out' applies to risk management as much as any other field of life. For many companies which historically exercised good risk management, today's more prescriptive approach has felt, at times, a little like a straight jacket. Identifying with management how a robust risk management framework will assist them in delivering on targets and then exceeding these expectations is fundamental to establishing risk management within businesses. When this is achieved, it is not perceived as a restriction but as an augmentation of business practice. It is only poor and 'tick box' risk management that is overly demanding on corporate boards and committees.

Amitrano: Boards have traditionally taken a reactive approach to risk and regulation issues in individual areas. But this is changing. More and more, they are taking a proactive and integrated approach to risk management and compliance, which can enhance their company's brand. This can simplify business processes and improve the quality of products and services. So the most sophisticated, forward-looking and agile companies convert the regulatory and compliance burden into an opportunity. A player that is able to turn these issues into something positive will potentially start to lead within their market. Risk and regulation will always be a burden; the question is, how can it be addressed in a way that drives business performance?

Keevan: Clearly the board, and especially the audit and governance committees, need to have a sound understanding of the risks the company faces and the controls in place to manage those risks. On the other hand, with some possible exceptions, boards and committees that feel compelled in today's environment to spend substantial amounts of time during each meeting on the intricacies of their company's enterprise wide risk management systems or the details of every 'needs improvement' finding in the reports prepared by their internal auditors are likely not to be spending sufficient time on other important strategic and governance matters.

Swinford: I do not believe risk management has gone too far. It is still developing as a discipline, and over time certain aspects under review will become less important than others. But this is an evolving area that is absolutely critical to running large enterprises over the long-term.

Robbins: Given the recent turmoil caused by the credit crunch it would be hard to say that risk management per se has gone too far. Management, regulators, shareholders and other stakeholders need to have confidence that management understand the risks facing their company, understand the risk appetite of the company and that they understand the impact on the company should a risk turn into a reality. Furthermore, this needs to be clearly communicated to investors so that they can make informed decisions. The danger of too much legislation is that it introduces too much red tape, to some extent this can be avoided by a responsible approach by boards and management.

Nestor: The discussion and approval of risk appetite – a strategic task – and the oversight of risk management should be one of the primary tasks of the board, especially the board of a financial institution. Many banking boards we have worked with had some way to go in fully understanding the risks faced by the organisation and were not yet fully competent to make risk appetite choices looking forward. I also believe, contrary to some other commentators, that entrepreneurship is not the core job of the board. It is the job of management – under the strategic validation of the board. However, if by risk management we are talking about compliance box-ticking then the answer is yes, we've gone too far. Boards should be tasked with holding management accountable for compliance, they should not bear responsibility for it.

Custance: It is certainly true that there are more areas of risk management for which corporate boards are responsible than there used to be, largely due to a combination of increased regulation and a compensation culture. Whether that has gone too far is in a sense irrelevant because it's there and boards need to cope with it. The 'demands' on boards and committees can be minimised if they ensure that they have effective risk management procedures and systems in place throughout their organisations.

What challenges exist for companies attempting to integrate effective internal governance mechanisms, and how can they be overcome?

Swinford: There are a number of challenges. First, many organisations focus their pay, evaluation and promotion systems on exceeding current annual goals which are primarily financial in nature, with a strong performance requirement. It is very easy for executives to downplay a governance risk or a potential problem in the name of making today's numbers. People who succeed in making today's numbers are often given a pass if they infringe a minor company rule. But when a company no longer requires its key people to comply with the rules all the time, it creates exceptions which demonstrate that current performance is more important than doing things the right way. It then becomes hard to establish good internal governance because even if the rules are in place, people know they do not have to follow them. When that culture develops, and people continue to be promoted, by the time they reach the top they have their own personal rule system. For corporate governance to take hold, boards need to ask not only "what were the financial results?" but also "how were they achieved?" and "How did the company deal with any difficult issues along the way?"

Nestor: The biggest challenge is rapid growth and change. More and more often, companies see their geographic and/or business footprint change significantly, whether by M&A or otherwise. In striving for integration and unity of purpose, some companies find a significant value in adopting a Group Governance Policy. In addition to being an important element of internal control, the GGP is also a sort of a governance 'dashboard' for the board and top management as well as a communication tool. It is a single document that would typically contain high-level principles regarding group organisation, establishment and closure of group entities, and the coordinating role of the corporate centre; a description of the way business lines and functions develop their activities across legal entities and their reporting lines; description of group legal entity controls and the role of legal entity boards of directors and chief executives.

Robbins: For global companies with operations in many countries, and in particular the emerging economies, a key challenge is how they achieve a global governance standard with business units and economies at varying stages of maturity. The often competing demands for good governance and increased performance when operating in emerging economies are difficult to balance. Clear policies and procedures combined with strong management controls and an effective monitoring process are key to ensuring effective corporate governance across the globe.

Wardell: This is largely a cultural issue. Training and follow-through are critical. Internal mechanisms must also be practical and fit into the company's own business. The principle of not engaging in anything that will violate the FCPA will be very different for a company that exports all its goods from the United States compared to a company that actually manufactures in other countries. Those experiences need to be thought through and executed practically so it makes sense to people in the context of the company they work for.

Keevan: The biggest challenge facing such companies is managing the change process and the biggest challenge in implementing the change process is overcoming the internal functional 'silos' that have developed over time and, if allowed to continue in existence, will impede the integration process. The impetus for change has to come from the top of the organisation, and all levels and functions within the company have to get on board and be fully engaged. Typically, a steering committee comprised of key management personnel representing the various functional activities of the company should be established to develop a plan and timetable for accomplishing the objectives to be achieved. The progress of this steering committee must be monitored by the highest levels of management and the board. Particular attention must be given to ensuring that the silo mentality noted above is not reflected in the functioning of the steering committee. Obviously, if the steering committee cannot divest itself of that mentality, the integration process is doomed to failure.

Amitrano: Most companies historically handled risk and compliance issues in silos, which results in many ways of assessing and measuring risk. This leads to different pieces of infrastructure and different technology platforms; it becomes duplicative. The opportunity to link and report key pieces of information on organisational risk and performance is lost. So companies need to move risk and compliance up to the boardroom. This creates a risk management reporting mechanism that gives the board comfort that new risks and changing risks are dealt with in a consistent way. It also ensures that new regulations are addressed in line with the company's risk appetite and culture. Some industries have given more impetus to the centralisation process. Financial services and pharmaceuticals, for example, are under a heavy regulatory burden which has encouraged them to integrate risk and compliance functions. Other industries are starting to see the benefits of this and are trying to move in the same direction. ■