THE CURRENT ERA OF CHANGE

Demands on corporate executives, members of boards, regulators, and financial markets for reform and greater accountability continue to grow in the wake of legislative, regulatory, and investor actions. Significant changes are occurring in audit practice, corporate disclosure, financial reporting, financial analysis and research, and individual and institutional accountabilities. This column examines the ongoing revolution in corporate governance as the second anniversary of the spectacular Enron collapse approaches.

It was reported in 1781 that when the siege of Yorktown was lifted and the British troops surrendered to the American Revolutionary forces, they were marched out to their awaiting ships with regimental colors cased, while the tune the pipers and drummers played was an old British march with the appropriate title, "The World Turned Upside Down." For the expanding British Empire, this was, at that moment, a true statement!

The old tune could be an appropriate theme song for financial executives in the current era, given the tumultuous events of the past few years that continue to roil the capital markets, corporate suites, and boardrooms. At least some parts of the world we inhabit may have indeed seemed to have "turned upside down" since the Enron accounting problems surfaced in autumn of 2001.

As has been noted several times recently in this column, the United States clearly entered a new era of accountability for corporate management and boards, financial regulators, financial market professionals, and investment managers. It is an era with a still uncertain—or at least unpredictable—future, given all of the powerful forces now driving "reform."

There is not yet an appropriate sobriquet for the early, uncertain, years of the twenty-first century. What is certain is that there is a real revolution going on in corporate governance, with growing investor and public sector demand for more individual and institutional accountability as well as greater demonstration of corporate social responsibility. (As an example of what may come, the demand for greater environmental protection by companies has already segued neatly into a global"sustainability" movement in which both corporations and nongovernmental organizations [NGOs] collaborate. This was more evolutionary than revolutionary.)

The past three years: defined by tumult

Corporate finance officers are often at the center of many recent dramatic events, with their colleagues, the CEOs, and members of their boards. In this section is a brief review of some of the more dramatic events of the first years of the new century, some of which seem to portray a world turned upside down for those involved.

As we approached the start of the new millennium, in March 2000, the longest run in economic expansion (120 months in duration) was beginning to weaken and a brief recession was about to begin. The great bull market of the 1990s, characterized by waves of initial public offerings (IPOs), the overvaluing of tech and dot com stocks, a legion of aggressive investment bankers chasing deals, the influx of an enormous amount of cash into the market of savings and earnings of ever more affluent baby boomers, and the spectacular productivity gains by U.S. companies, would not have a soft landing.

Investor pain was deep and broad: In the space of a few months, or a year at most, an estimated $7 trillion in shareholder "wealth" evaporated and the major indexes headed straight south. The events that followed included those mentioned in the following paragraphs.

In March 2000, the "bubble market" abruptly collapsed; some called this the tech wreck, and the NASDAQ exchange index, which rose to well above 5,000, crashed in 2000 to a point where three-quarters of its value vanished, representing the worst

HANK BOERNER is managing director of the New York office of Rowan & Blewitt, an issues management consulting organization. He specializes in corporate governance, institutional social responsibility, corporate accountability, and related societal issues and trends. He is former head of communications for the New York Stock Exchange. The views expressed here are his own. Hank Boerner can be reached at hank@pb.net.

THE PUBLIC ACCOUNTING FIRMS WILL BE REQUIRED TO APPLY FOR LICENSING TO CONDUCT AUDITS OF PUBLIC COMPANIES AND INFRACTIONS COULD MEAN A LOSS OF LICENSE.

investor *percentage* loss since the 1929 stock market crash.

Corporate failures began soon after that, with significant public attention focused in late 2001 on the collapse of Enron *(Fortune's* seventh largest firm on the 500 roster), which was soon followed by WorldCom, and other companies.

President George Bush, in his January 2002 State of the Union address, called for major reforms in corporate governance and his administration developed a list of 10 action steps for corporate governance reform.

Among the proposals was a requirement (soon followed by an Securities and Exchange Commission [SEC] rule) that all CEOs and CFOs personally attest to the accuracy of their current financial reports as of June 30, 2002 (for the August 2002 filings) and the full prior year's financials (as previously filed). Tensions mounted in many corporate finance offices.

Of the almost 1,000 firms required to file by mid-August 2002 (with the media reporting daily on the tally), all but five companies met the deadline and certified both current and past filings as accurate. (The five firms announced restatements of prior results and then filed; a few companies in turmoil, such as Enron, could not meet filing deadlines and were not expected to.) Soon after, however, literally a parade of corporate accounting restatements followed, and some were quite dramatic. Investor confidence continued to erode because of the restatements.

A package of reform legislation moving slowly through both houses of Congress suddenly picked up momentum after WorldCom collapsed. (The WorldCom debacle affected many voters in hundreds of Congressional districts and became a hometown crisis for some lawmakers.) The Sarbanes-Oxley (SOX) package of 11 titles of legislation was rushed to the White House and signed into law by President Bush on July 31, 2002. (Its chief sponsors were Senator Paul Sarbanes, a Democrat from Maryland, and Representative Michael Oxley, a Republican from Ohio).

This investor protection legislation was recognized as the most comprehensive since the adoption of the 1933 and 1934 securities acts (which some SOX titles update and strengthen). So popular was this measure that some provisions became law upon the President's ceremonial signing at the White House, including tougher penalties for those CEOs and CFOs meeting the August 2002 deadline for filing.

SOX designates just two bodies for future accounting rulemaking: SEC and the Financial Accounting Standards Board (FASB); both organizations are also assured of more reliable funding and less political interference. (The FASB has relied on the generosity of the accounting profession since its founding in 1972.)

A Public Company Accounting Oversight Board (PCAOB) is created by SOX, to oversee accounting and auditing practices. The public accounting firms will be required to apply for licensing to conduct audits of public companies and infractions could mean a loss of license.

After a rocky start, the PCAOB was headed by former New York Federal Reserve Bank Chairman William McDonough, known as a no-nonsense administrator. (It was he who swiftly assured banks and brokers that money would be available from the New York Federal Reserve to help them remain liquid on September 11, 2001, since Chairman Alan Greenspan was traveling.) In late 2003, the PCAOB is busy building staff and writing rules for auditors.

In New York State, Attorney General Eliot Spitzer has been conducting an aggressive campaign against Wall Street's "name" brokerage and investment banking houses—some aspects of the probe continue at this writing—and has achieved a major settlement: $1.4 billion to be paid by 10 major houses, with almost $500 million to be used for independent and objective financial analysis and research for customers.

The focus of the investigation was on sell-side research reports that misled investors. Merrill Lynch was first to settle. Mr. Spitzer has since moved on to focus on mutual fund behavior. As his new investigation began, the SEC had just approved a new rule (instigated by socially responsible investor Amy Domini of the Domini Funds) to require funds to inform investors of their corporate governance policies, and each year, to report their proxy votes for each company in which they have invested.

Other state attorneys general are following the Spitzer model and bringing actions against securities industry firms in their respective states (Massachusetts is one example).

Shareholders aroused and acting

Against the background of these events and actions, individual and institutional investors in the 2003 proxy season successfully brought more than 1,000 shareholder-sponsored resolutions.

A number of these resolutions won majority or near-majority votes in the spring 2003 annual meetings. Emboldened, and soon to be armed with new SEC rules regarding shareholder proxy filings for the 2004 proxy season, union pension funds, public employee pension funds, faith-based investors, and others with an agenda to advance reforms in corporate governance or corporate social responsibility declared victory and promised to be even more aggressive. Ballot-box democracy came to the corporate world, some activists proclaimed.

Shareholder activists focus on aligning corporate interests with their own; some groups focus on traditional corporate governance topics, such as board process; others, on achieving social or economic justice through changed corporate behavior. Often, the interests of these two streams of thought intersect and groups join forces to attempt to bring about change in the boardroom and executive suite.

At the same time, mainstream organizations representing the corporate sector are also busy working on reform measures; these include the Business Roundtable, the Conference Board, National Association of Corporate Directors, National Investor Relations Institute, and the Financial Executives Institute.

SROs respond to public pressure

Early in 2002, while monitoring the dramatic events unfolding, the boards of self regulating organizations (SROs), the New York Stock Exchange (NYSE), and NASDAQ exchange took action and created sweeping packages of corporate governance reform measures that were submitted to the SEC for approval.

At this writing in late 2003, some of the proposed rules have been adopted (e.g., requiring shareholder approval of NYSE-traded companies' employee options plans) and others are still awaiting SEC review and final approval. The final rules will be announced in the *Federal Register,* as the law requires. Listed companies' contracts with the two exchanges will be amended to reflect the strengthened standards and rules for listed companies. (Corporate executives should carefully review the specifics of these rules for their respective exchange and note the deadlines for implementation. Some are as soon as six months after publication.)

The NYSE rules carefully define director independence, requiring that shareholders approve employee option plans, and address many aspects of board behavior, organization, and operations. Three committees (nominating, compensation, auditing) must be created by boards if they don't already exist and members of these must meet independence definitions.

Taken together (with other events not highlighted here), it is clear that a revolution in corporate governance is well underway. For many companies, the world is turning upside down, at least in terms of what the rules of the road were for the past quarter century. At this time (in late 2003), the effect of many of these actions on individual companies is impossible to predict or project.

THREE COMMITTEES (NOMINATING, COMPENSATION. AND AUDITING) MUST BE CREATED BY BOARDS IF THEY DON'T ALREADY EXIST AND MEMBERS OF THESE MUST MEET INDEPENDENCE DEFINITIONS.

The era needs a name

In modern times in America, politicians and the media have defined these dramatic types of social reforms as new movements or the start of new eras with clever titles—some of them accidental. This has been especially effective for our presidents as they marshaled public (voter) support for at least 100 years.

It was in 1903, as the powerful (and untouchable) corporate trusts became populist targets that President Theodore Roosevelt proclaimed a "new era" for American voters. No more would railroad, oil, steel, and other monopolies and trusts dominate the nation's public policy or political economics; government would have to intervene. The populist press—and especially the fabled muckrakers—created a frenzy for reform.

President Roosevelt greatly expanded the power of the office of the presidency, proclaiming that he was passionate about controlling corporations, and not the other way around. During his time in the White House, the first major regulatory legislation was adopted into law (the first Pure Food and Drug Act, for example).

Individual states began adopting investor protection laws; it is 1920s law that New York's attorney general Mr. Spitzer is enforcing (The Martin Act).

After the collapse of the stock market in October 1929, a Great Depression followed; the unemployment rate was 25 percent. In accepting the presidential nomination of the Democratic Party in Chicago in 1932, New York Governor Franklin Roosevelt promised working Americans "a New Deal," a title that resonated throughout the country. (This had been the title of a book spelling out reforms by a left-leaning author, Stuart Chase.) Among his first acts of the new administration (and the new Congress elected in 1932) was the creation of what we know as the 1933 investor securities protection laws, followed by the 1934 Exchange Act. (There were so many reforms necessary, it was said, that it took two years to get everything through the Congress.)

The bulk of New Deal securities regulations are still with us; some additional reforms came about during President Harry Truman's Fair Deal administration.

President John Kennedy saw a New Frontier for America in the height of the cold war. President Lyndon Johnson saw a Great Society emerging from historic civil rights and other legislation in the 1960s.

Each of these presidents forged important new social contracts for the nation. At the heart of many their actions were reforms for the corporate sector, and still more consumer protection regulation for Wall Street and banks. Throughout the twentieth century, each crisis in the corporate sector, on Wall Street, and in banking, brought about some measure of increased oversight, more regulations and compliance measures, and greater accountability on the part of corporate managers and boards.

Banks, it is said, are governed by regulations that are "Sarbanes-Oxley multiplied many times."

Exactly 100 years after President Teddy Roosevelt created the modern compact for governing the relationships between the White House, Congress, the corporate world, and investors, another Republican in the White House is being tested by events occurring in the economic, financial, monetary, and business sectors. President George Bush also has a powerful "bully pulpit" (a name coined by Teddy Roosevelt), and a Republican-controlled House and Senate that would like to maintain control in 2004. Could more investor protection reforms be in store?

Perhaps from his speeches or a clever headline writer's keyboard the appropriate sobriquet will emerge. For now, the New Era of Corporate Accountability might work for some corporate finance officers wrestling to define the enormity of changes underway and still to come.

Uncertain future

The passage of time will finally reveal to us just how sweeping the reforms set in motion will be. If all of the measures in SOX's 11 titles are vigorously applied, if the new NYSE and NASDAQ rules for listed companies are rigorously applied, and if aroused shareholder advocates and social responsibility activists remain engaged in capital market affairs, then corporate finance executives will surely find themselves operating in a much different environment than, say, in the 1980s or 1990s, when many were beginning their corporate careers.

One could ask hypothetically, would our nation's capital markets have been as successful [as they were in the 1990s bull market] without the reforms of 1933 and 1934 to guide the markets, as well as the many measures adopted since (such as the 1940 Investment Company Act to regulate mutual funds).

Perhaps the current reforms and those to come will work as anticipated. If the measures highlighted here (and others) in the end restore and/or strengthen investor confidence in the capital markets, and wealth is again allocated to worthy investment vehicles, there could one day be the magical " 15,000 Dow" predicted by Prudential's well-known analyst, Ralph Acampora. (Recently, Mr. Acampora said that his prediction was still firm; as investors return to the market, it will begin to gain strength once again.)

And there is this to keep in mind: Yes, the world had turned upside down on that October morning in 1781. But the greatest days were still ahead for both the British Empire and the new American nation. Everyone involved in the corporate governance revolution will be hoping for the same for corporate board and management, the capital market organizations, and for institutional and individual investors. •