Sarbanes-Oxley and the Board of Directors

Techniques and Best Practices for Corporate Governance

SCOTT GREEN

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John Wiley & Sons, Inc.

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In memory of my grandfather who instilled in me the notion that we owe it to the next generation to leave the world better than when we entered it. I also dedicate this book to Nicholas and Christina, who sustain me and represent that bright and better future.

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Preface

Nearly three years ago, as the Sarbanes-Oxley Act became law, I recognized that there would be a need for accessible but detailed guidance to help managers implement certain sections of the Act. Additionally, it was clear that related social systems must also be addressed if the time and money spent on internal controls was to be effective. These beliefs motivated me to write *Manager's Guide to the Sarbanes-Oxley Act* (John Wiley & Sons, 2004) for medium and small public companies as an aid to compliance. (The guide has since then found an audience in large organizations as well.) The procedural aspects of Sarbanes-Oxley have indeed been burdensome, particularly on smaller companies. As I sat down to write *Manager's Guide*, I was tempted to expand the scope of the book to include other audiences. After its publication, my focus on the needs of our nation's corporate managers was validated by the book's acceptance in the marketplace. Nevertheless, other stakeholders were still left without a text that enables quick, easy assimilation of the important compliance criteria emanating from Sarbanes-Oxley. One such group encompasses the thousands of directors who sit on the boards of every corporation and those who support their activities.

I was constantly reminded of this need. At conferences at which I was invited to participate—and radio, television, and online "webinar" appearances relating to *Manager's Guide to the Sarbanes-Oxley Act*—questions frequently moved beyond purely management concerns to the broader role of the Act and governance in the U.S. business model. Over time, I have tried to address many of these questions through my academic and professional writings.* These

*These include "The Limitations of the Sarbanes-Oxley Act," *USA Today Magazine,* (March 2005); "Abolish the Imperial CEO," *Journal of Corporate Accounting and Finance* (September 2004); "The Ripple Effect," *Internal Auditor Magazine* (February 2005); "The Causes, Impact and Future of the Sarbanes-Oxley Act," *Journal of International Business and Law* (Spring 2004); and "Take Seven Key Actions Before You Certify," *Journal of Corporate Accounting and Finance* (May 2004).

articles dispensed useful advice to the nation's directors and gatekeepers. However, each by nature is narrowly focused and cannot independently quench the incredible thirst for knowledge on the subject. Therefore, I have written a book in which much of this advice has been excerpted and included together with the other important issues of our day.

There is little doubt that the risks from sitting on a board, including not-for-profits, has risen exponentially, leaving directors and related stakeholders searching for answers. This necessitates a clearly written book that helps new or potential directors understand how boards operate, detail the special risks of board committees, identify best practices, and recognize the red flags of board governance. Such a book is also useful to sitting directors for understanding governance trends, evaluating their own practices, and understanding what needs to be done if things go wrong. This type of analysis helps directors to properly represent the company's shareholders and limit their own liability.

The problem with many books on corporate governance is that they are narrowly focused, addressing a segment of governance such as director liability, board independence, culture, risk assessment, and so on, or are written at a highly theoretical level that lacks practical guidance on application. I have set out to provide a book that assists potential, new, and sitting directors in understanding and meeting the word and spirit of the Sarbanes-Oxley Act and beyond. This is accomplished not only by citing the requirements of the Sarbanes-Oxley Act, but also by exploring best practices found around the world. These practices are then packaged into five discrete governance factors to help directors think about governance as a process, one that can be followed, the results analyzed, and the implications of conclusions determined. Numerous real world examples, vignettes, case studies, surveys, and other data are presented to bring context to the discussion.

My beliefs regarding board operations is similar to the one that I hold for company management—that is, simply implementing procedural rules will not be effective if social issues are ignored. The boards of Enron and WorldCom met the checklist criteria for acceptable governance practices of their day, and yet the companies melted down on their watch. The culture of the company and social interaction of the board make a difference, and a workable framework

weaves this important concept into the new procedural changes required by legislation, regulators, and even best practice.

Once you have completed this book, you will:

- Understand how current governance practices developed
- Appreciate your potential liability as a director
- Recognize the red flags of governance
- Be conversant in issues surrounding director selection and evaluation
- Understand the strengths and weaknesses of certain board structures
- Grasp the additional responsibilities associated with committee assignments
- Know what steps to take when a potential crisis threatens the company

You will also have the tools to implement best governance practices even when there are few serious threats to the company. The complexity of a directorship requires supervisory ability, emotional intelligence, and attention to procedural details. These skills are important not only for the health of the company and its stockholders. They also protect a director's reputation and financial well-being. Risks to a serving director are real and must be managed. Those who sit idle as events unfold around them will be held accountable. The best way to protect yourself is to be aware of the risks, remain engaged, and actively work for the stockholders of the company.