

***Ethics,  
Corporate Governance,  
and SOX 406***

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*Ethics, Corporate Governance, and SOX 406*

What are the *advantages* of the corporate form of organization, *vis-a-vis* the alternative structures of sole proprietorships or partnerships?

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*Ethics, Corporate Governance, and SOX 406*

What is the corporation?

A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of creation confers upon it, either expressly, or as incidental to its very existence.

Chief Justice Marshall, Dartmouth vs Woodward (1819)

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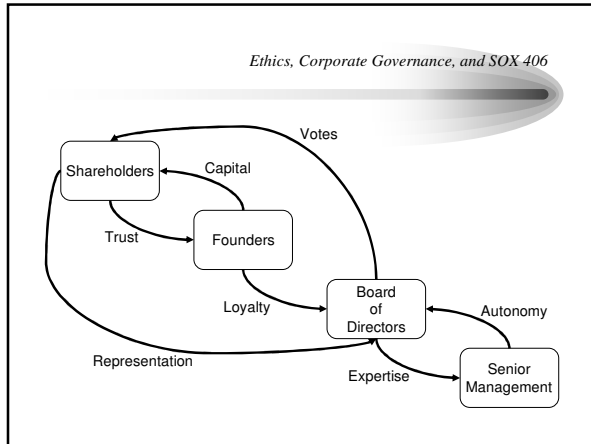
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*Ethics, Corporate Governance, and SOX 406*

- Definitions
  - Corporate governance, the nuts-and-bolts of how a public company meets its responsibilities to investors and other stakeholders...

Ending the Wall Street Walk:

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*Ethics, Corporate Governance, and SOX 406*

- Definitions
  - Stated broadly, the principal responsibility of a corporate director is to promote the best interests of the corporation and its shareholders in directing the corporation's business and affairs.

Corporate Director's Guidebook

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*Ethics, Corporate Governance, and SOX 406*

• Definitions

– In so doing, the director should give primary consideration to long-term economic objectives. However, a director should also be concerned that the corporation conducts its affairs with due appreciation of public expectations, taking into account the law and ethical standards.

Corporate Director's Guidebook

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*Ethics, Corporate Governance, and SOX 406*

• Definitions

– Furthermore, pursuit of the corporation's economic objectives may include consideration of the effect of corporate policies and operations upon the corporation's employees, the public, and the environment.

Corporate Director's Guidebook

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*Ethics, Corporate Governance, and SOX 406*

• Duty of Care:

– Responsibility to exercise appropriate diligence in making decisions and taking other action

- Time commitment and regular attendance
- The need to be informed
- The right to rely on others
- Inquiry

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*Ethics, Corporate Governance, and SOX 406*

- Duty of Loyalty:
  - Exercise powers in good faith in the best interests of the corporation and not in the director’s own interest
  
- Conflicts of interest
- Corporate opportunity
- Fairness, Documentation and Policies

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*Ethics, Corporate Governance, and SOX 406*

- The Patterson Report: Research into Corporate Governance Effectiveness
  - The number of new studies is expanding rapidly
  - Everyone is struggling to define performance
    - Shareholder wealth (market measures)
    - Profitability (accounting measures)
  - “Boards and Directors” is a big category
  - Shareholder proposals haven’t slacked off
  - Institutions make a difference

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*Ethics, Corporate Governance, and SOX 406*

- The Patterson Report:  
Discrete tasks of the Board
  - CEO replacement
  - Response to takeover bid
  - Acquiring another company
  - Takeover defenses
  - Executive compensation
  - Firm failure
  - Financial fraud and reporting
  - Diversification
  - Research & development

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*Ethics, Corporate Governance, and SOX 406*

- The Patterson Report:  
Discrete tasks of the Board
  - Changes in board composition
  - Majority-independent boards and firms without such boards
  - The role of share ownership
  - Appointment of new directors
  - Board size
  - Composition of board committees
  - International evidence

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*Ethics, Corporate Governance, and SOX 406*

- Board self and peer evaluation (CalPERS)
  1. Regularly attend Board and committee meetings and workshops
  2. Prepare in advance for Board and committee meetings and workshops
  3. Familiar with issues facing public pension funds in California, nationally, and internationally

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*Ethics, Corporate Governance, and SOX 406*

- Board self and peer evaluation (CalPERS)
  4. Familiar with laws, regulations and policies that govern CalPERS
  5. Actively participate in discussions at Board and committee meetings and workshops
  6. Make objective decisions using relevant information (including considering other Board members' and staff's viewpoints)

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*Ethics, Corporate Governance, and SOX 406*

- Board self and peer evaluation (CalPERS)
  7. Knowledgeable about the divisions/functions which make up the System
  8. Familiar with and uphold the following Board policies:

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*Ethics, Corporate Governance, and SOX 406*

- TIAA-CREF Policy Statement on Corporate Governance
  - The primary responsibility of the board of directors is to foster the long-term success of the corporation consistent with its fiduciary responsibility to the shareholders.

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*Ethics, Corporate Governance, and SOX 406*

- TIAA-CREF Policy Statement on Corporate Governance (Board of Directors)
  - The board should be composed of a substantial majority of independent directors
  - The board should establish a fixed retirement policy for directors, and a requirement that all directors have a direct and material cash investment in common shares of the company
  - The board should be composed of qualified individuals and should reflect diversity of experience, gender, race and age

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*Ethics, Corporate Governance, and SOX 406*

- TIAA-CREF Policy Statement on Corporate Governance (Board of Directors)
  - The board should have mechanisms to evaluate and improve its performance
  - The board should hold periodic executive sessions at which management, including the CEO, is not present

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*Ethics, Corporate Governance, and SOX 406*

- TIAA-CREF Policy Statement on Corporate Governance (Fiduciary Oversight)
  - Assure a corporate environment of strong internal controls, fiscal accountability, high ethical standards, and compliance with all applicable laws and regulations
  - Develop appropriate procedures to ensure the board is advised of alleged or suspected violations of corporate standards...

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*Ethics, Corporate Governance, and SOX 406*

- TIAA-CREF Policy Statement on Corporate Governance (Fiduciary Oversight)
  - Appoint an audit committee of at least three independent directors, all of whom are financially literate...
  - Install a mechanism to review corporate operating and expense reimbursement policies and practices...to ensure proper use of corporate resources

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*Ethics, Corporate Governance, and SOX 406*

• Board self and peer evaluation (CalPERS)

- Governance Principles
  - Monitor staff performance, and regularly compare results to CalPERS' Mission, Strategic Plan, Annual Plan, and Performance Measures
  - Refrain from becoming involved in operational issues, except as requested by CEO
  - Achieve a governing style that emphasizes strategic leadership and partnership with management
  - Conduct self at all times in a collegial manner

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*Ethics, Corporate Governance, and SOX 406*

• Board self and peer evaluation (CalPERS)

- Core Values
  - Quality - Strive to meet internal and external customer's needs through innovation, competence, and teamwork. Seek to "do it right" the first time.
  - Respect - Sensitive to the needs of others, both within and outside the organization. Courteous, considerate, responsive, and professional.
  - Integrity - In all endeavors, act in an ethical, honest, and professional manner

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*Ethics, Corporate Governance, and SOX 406*

• Board self and peer evaluation (CalPERS)

- Core Values
  - Openness - Willing to listen to, and share information with, others. Receptive to new ideas. Trusting.
  - Accountability - Take ownership and responsibility for actions and their results. Accept both risks and rewards, trusting that good faith risks will not be punished.

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*Ethics, Corporate Governance, and SOX 406*

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*Ethics, Corporate Governance, and SOX 406*

- Board self and peer evaluation (CalPERS)
  1. Regularly attend Board and committee meetings and workshops
  2. Prepare in advance for Board and committee meetings and workshops
  3. Familiar with issues facing IT organizations in California, nationally, and internationally

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*Ethics, Corporate Governance, and SOX 406*

- Board self and peer evaluation (CalPERS)
  4. Familiar with laws, regulations and policies that govern KPBB
  5. Actively participate in discussions at Board and committee meetings and workshops
  6. Make objective decisions using relevant information (including considering other Board members' and staff's viewpoints)

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*Ethics, Corporate Governance, and SOX 406*

- Board self and peer evaluation (CalPERS)
  7. Knowledgeable about the divisions/functions which make up the organization
  8. Familiar with and uphold Board policies:

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*Ethics, Corporate Governance, and SOX 406*

- Board Meetings:
  - Brown Act
  - Parliamentary Procedures
  - Setting the agenda
  - Distribution of Board materials
  - Executive session
  - Electronic meetings
  - Minutes

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*Ethics, Corporate Governance, and SOX 406*

- THE SARBANES-OXLEY ACT:
  - Quarterly CEO/CFO certification of periodic reports and internal controls
  - Audit Committee
    - Independence
    - Financial expertise
    - Oversight of audit firm
    - Complaint/whistleblowing procedures
    - Independent advisors authorized

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*Ethics, Corporate Governance, and SOX 406*

- **THE SARBANES-OXLEY ACT:**
  - CEO/CFO disgorgement of bonuses and stock profits upon restatement
  - Loans to directors/officers prohibited
  - New crimes and enhanced penalties
  - Federal regulation of auditing firms
  - Code of ethics for senior financial officers

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*Ethics, Corporate Governance, and SOX 406*

- SEC implementation regulations
- NYSE Final Rules
- Nasdaq Final Rules
- Latest date for compliance: 31 October 2004
- Codes apply to ‘employees’

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*Ethics, Corporate Governance, and SOX 406*

- Requires public companies to disclose whether they have codes of ethics and also to disclose any waivers of those codes for certain members of senior management
  - The Commission adopted specific rules implementing these requirements in January 2003

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*Ethics, Corporate Governance, and SOX 406*

- Individuals covered include
  - principal executive officer
  - principal financial officer
  - principal accounting officer or controller
  - persons performing similar functions

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*Sarbanes-Oxley Section 406(b)*

- A code of ethics comprises standards reasonably necessary to promote
  - honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships

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*Sarbanes-Oxley Section 406(b)*

- A code of ethics comprises standards reasonably necessary to promote
  - full, fair, accurate, timely, and understandable disclosure in the periodic reports to be filed by the issuer

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*Sarbanes-Oxley Section 406(b)*

- A code of ethics comprises standards reasonably necessary to promote
  - compliance with the applicable governmental rules and regulations

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*Sarbanes-Oxley Section 406(b)*

- A code of ethics comprises standards reasonably necessary to promote
  - the prompt internal reporting of code violations to an “appropriate person or persons” identified in the code

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*Sarbanes-Oxley Section 406(b)*

- A code of ethics comprises standards reasonably necessary to promote
  - accountability for adherence to the code

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*Sarbanes-Oxley Section 406(c)*

- A company is required to make its code of ethics available to the public in one of three ways
  - by filing a copy of the code as an exhibit to its annual report on Form 10-K or 10-KSB

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*Sarbanes-Oxley Section 406(c)*

- A company is required to make its code of ethics available to the public in one of three ways
  - by posting the text of the code on its website and disclosing, in its annual report, its website address and the fact that it has posted the code on its website

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*Sarbanes-Oxley Section 406(c)*

- A company is required to make its code of ethics available to the public in one of three ways
  - by undertaking in its annual report to provide to any person without charge, upon request, a copy of the code, and explaining the manner in which the request must be made

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*Sarbanes-Oxley Section 406*

- A company is required to disclose any amendments to or waivers of the specified code of ethics provisions
  - the term ‘waiver’ is defined as the company’s approval of a “material departure from a provision of the code of ethics”

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*Sarbanes-Oxley Section 406*

- A company is required to disclose any amendments to or waivers of the specified code of ethics provisions
  - the term ‘implicit waiver’ is defined as the company’s “failure to take action within a reasonable period of time regarding a material departure from a provision of the code of ethics”

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*Sarbanes-Oxley Section 406*

- A company is required to disclose any amendments to or waivers of the specified code of ethics provisions on Form 8-K or the company’s website within five days after the amendment or waiver
  - information must remain on the company’s website for at least 12 months after posting

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*Sarbanes-Oxley Section 406*

- Other provisions relevant to codes of conduct
  - Section 301 requires audit committees to establish procedures for handling complaints about accounting and auditing matters and for the “confidential, anonymous submissions by employees” of concerns regarding such matters

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*Sarbanes-Oxley Section 406*

- Other provisions relevant to codes of conduct
  - Section 806 prohibits a company and its agents from retaliating against employee “whistleblowers” who provide information or assist in a government or supervisory investigation

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*Sarbanes-Oxley Section 406*

- Other provisions relevant to codes of conduct
  - Section 1107 imposes criminal sanctions for retaliation against whistleblowers

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*Ethics, Corporate Governance, and SOX 406*

- NYSE requires more than a code...
  - ...mandates “compliance standards and *procedures* that will facilitate effective operation of the code.”

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*Ethics, Corporate Governance, and SOX 406*

- Federal Sentencing Guidelines require more than a code...
  - ...mandate adopting comprehensive ethics and compliance programs, *and* to train everyone in the fundamental components of those programs.

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