Regulatory responses to global corporate scandals

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Introduction

Corporate governance can be described to be a method of controlling the way in which corporate ions act, paying attention to their shareholders, stakeholders and governments.

Recent corporate scandals following the aftermath of corporations such as Enron and WorldCom has influenced changes in the way the corporate law is exercised. This has influenced changes to the way the US and UK deall with the governance of organizations.

“ corporate governance methods are those rules that apply to specific financial markets and organizational forms, and that establish the discretion of parties that possess control rights and the information and mechanisms at their disposal to choose management, propose or confirm major strategic decisions, and to determine the distribution of renumberation and profits”

“ events in the S have encouraged some UK investors to take corporate governance more seriously and have directed the attention of investors globally towards independence in the audit process”

Follwing the US scandals the Sarbanes-Oxley Act 2002 was incorporated to the US. Part of this act provides for the creation of the Public Companies Accounting Oversight Board (PCAOB) to establish auditing standards with approval by the SEC and to oversee the quality of work performed by auditing firms. Thus, the auditing of publicly traded companies is now regulated by the US federal government rather than by the profession itself.

This act applies only to those companies that sell shares in interstate commerce. Although the act does not override any accounting regulatory activity of the states, it substantially expands federal regulation withrespectto SEC registrants. The key elements being that CEO or CFO athorise financial statements, audit commitees to be indepdant bodies, controls are mandatory to prevent future fraud and no loans should be supplied to employees.

Certification by CEOs and CFOs of Fairness of Financial Reporting

One of the most significant reforms to date has been the requirement that CEOs and CFOs of SEC registrants must personally certify the fairness of the financial statements. It is important to note that the US Congress purposely focused on fairness and not compliance with GAAP. This requirement subjects the officers to individual criminal charges and/or civil liability and thus presumably motivates officers, especially the CEO, to become actively involved in financial reporting processes. Also, the act substantially restricts the kind of consulting which an auditor may do for an audit client.

Differences between the US and UK corporate governance structures

Until recently, the US and UK approaches have been quite different. Here, the emphasis over the past few decades has been on building up a voluntary code, and morphing that into the self-declaration approach of ‘ comply-or-explain’. Corporate governance in the UK came to the fore with the publication of the Cadbury report in 1992, which was prompted by the late 1980s collapse of the Maxwell group3. However, perhaps in response to the

increasingly severe scandals in Europe, the UK is now tending to follow the US lead of introducing mandatory and punitive measures.

Jill Treanor, commenting in the Guardian on this change of direction4 stated that UK company directors risked criminal charges in the future if they attempt to hide information from their auditors. Citing comments by Jacqui Smith (then DTI Minister for Industry and the Regions), she elaborated by surmising this is the first step of wider, comprehensive changes to company law, which were planned to be introduced in due course.

Some parallels with SOX can thus be drawn and aspects of recent and current amendments to UK law include:

Company directors will have to state they have not withheld information from auditors

Details of non-audit services provided by their auditors will have to be declared

Immunity for whistleblowers

Greater power to investigators to uncover information on companies – including access to company premises without a warrant

There has also been pressure for change from the EU in Brussels. Accounting directives collectively known as the Modernisation Directive5 have recently been issued which became mandatory in all member states and focuses on harmonising accounting practices.

With corporate governance not yet reaching maturity, many individuals, organisations and even nations are still getting to grips with it; not only what

it is and how to implement it, but also how to measure its success. As an evolving topic that has not yet stabilised, CQI members might wish to keep abreast of European developments. A good way to do this perhaps is to regularly review the portal of European law at the European Union's website.

The Combined Code6 is widely regarded as the definitive corporate governance reference in the UK. Pulling together several related studies, it contains most key governance aspects that have developed over the years, both as a result of, and in anticipation of corporate malfeasance. For example, the recommendations contained in the Higgs report7 on the role and contribution of non-executive directors and the activities of audit committees have been included, as was the issue of internal control.

Various sector-specific examples of self-regulation have emerged recently. As an example, following recent friction between the individual voluntary arrangement sector and the major banks, 27 companies have founded the debt resolution forum to establish best practice in their industry in an attempt to placate both the banks and the financial sector regulator.

However, minor corporate governance compliance issues continue to emerge within the UK. Some examples include:

Alpha Airports was suspended from the stock exchange in 2006 due to corporate governance issues

Healthcare Holding had its floatation cancelled due to the resignation of its nominated advisor (a sector specialist recognised by the stock market, similar to a non-executive director)

HSBC plc received criticism when it planned to appoint its chief executive as

chairman, which runs contrary to one of the basic corporate governance guidelines8

Full SOX compliance in the US is very expensive and a trend has started where US start-up companies prefer to list in London on the alternate investments market (AIM) where regulations are looser and listing costs are much lower. With moremoneynow being raised on initial public offerings in London than in New York for the first time since 2000, it does appear that US organisations not willing or able to meet SOX regulations are taking the easy route and moving to London. One US company that floated here on AIM instead of in the US said it would have taken 18 months longer and cost an extra $1m because of SOX compliance regulations9.

On a positive note, many organisations are now publicly emphasising their commitment to corporate governance issues. For example, Aetna, one of the world's largest insurers, recently announced that it, ' has earned top quartile ratings for its corporate governance practices from Institutional Shareholder Services (ISS), an independent provider of proxy voting and corporate governance services'10.

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