

ISSUES IN CANADIAN BOARD TRANSPARENCY

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Abstract

Transparency is considered one of the principles of good corporate governance. But what does it mean – in practice – especially when it comes to Board transparency – i.e. the ability of shareholders to gain knowledge about an organization's corporate governance practices in order to make an informed assessment of Directors' individual and collective roles and performance. In a preliminary investigation of Board transparency practices in Canadian listed firms (using data from 2003-2004), it was found that there were wide variations in the nature and quantity of corporate governance practices disclosed. The reasons for these variations are discussed and a number of recommendations for improved disclosure are presented.

Keywords: transparency, disclosure, corporate governance, boards, performance

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As corporate governance issues continue to take a spotlight in the media, defining 'good governance practices' and whether firms are achieving them is of considerable interest to many academics, investors/shareholders, regulators/legislators and other stakeholders. One particular issue that is gaining increasing attention concerns the principle of 'transparency' – especially the transparency between the board and 'firm outsiders'. Interestingly, when discussing transparency, most automatically think about the way in which a company and its management is transparent to its investors and other stakeholders. Yet, the transparency of management has been increasing over the years with a variety of new public filings, and disclosures (e.g. Management Discussion and Analysis).

Unfortunately, the same cannot necessarily be said about board transparency. Indeed, there is very little published information available on the topic. And the results publicly available are discouraging. For instance, Bujaki and McConomy (2002) conducted a study in which they reported on the comprehensiveness of voluntary corporate governance disclosures in the annual reports and management information circulars of Toronto Stock Exchange (TSE) firms. Their analysis indicated that "only a very few firms disclosed that they had fully implemented the TSE guidelines, and that the extent of disclosure of corporate governance practices implemented varies widely among the firms" (p. 105). As a result, the lack of appropriate board transparency and accountability to shareholders has

been called “the missing link” in corporate governance (Montgomery and Kaufman, 2003).

Given the topic’s infancy, it is also not surprising that there is no uniformly accepted definition of the term. In fact, formal studies of board transparency are virtually non-existent. Accordingly, for the purposes of this paper, board transparency is defined as *the ability of shareholders to gain knowledge about an organization’s corporate governance practices in order to make an informed assessment of Directors’ individual and collective roles and performance.*

Until recently, though, there was actually very little incentive or requirement on the part of boards to report directly to shareholders – unlike management – on their own activities or performance. There seemed to be almost a tacit understanding that when firm performance was “good”, the board tucked itself under management’s wing and shared the spotlight with them. Yet, the same could not be said to occur when firm performance was “bad”. In this latter situation, boards would conveniently forget the role they may have had to play in “creating the mess” and typically sought to distance themselves from management – perhaps even firing the CEO and other officers. The directors would then pat themselves on the back for having acted in the shareholders’ best interests.

Fortunately, with increased requirements for board transparency, directors are under greater scrutiny and under greater pressure for disclosure. In Canada, this first occurred with the 14 TSX (Toronto Stock Exchange Group) corporate governance disclosure guidelines and has been further supplemented with the 2005 Canadian Securities Administrators National Policy Instrument 51-201.

Nevertheless, much work still remains to be done. A recent survey in corporate governance practices conducted by Ipsos-Reid (conducted via online interviews with Canadian investor relations officers, corporate directors and those responsible for corporate governance and disclosure within their companies) revealed that only 38% of the interviewees thought their companies had a formal policy regulating the relationship between the shareholders and the board. When asked whether they agreed that the board of directors has adequate communication/contact with shareholders, only 20% of the interviewees chose “completely agree”, 56% said they were “neutral” and 17% said they “completely disagree”.

Clearly, these results suggest that board transparency is a fairly major problem that lies with the quality and quantity of information exchanged by the board to shareholders.

The Research Question

An exploratory empirical research study was launched in 2005 to determine the state of practice with respect to board transparency. The primary

questions which the research sought to answer were as follows:

1. What are the areas of board transparency to which Canadian companies are responding?
2. What areas of board transparency are in most need of attention?
3. What recommendations, if any, might flow from the observations made?

The purpose of this paper is to report on the results related to these questions.

How the Research was Conducted

Sample selection & size. The study is based on a convenience sample of 50 firms drawn from the 276 firms making up the TSX/S&P composite index.

Unfortunately, both the method of sample selection and the sample size restrict any claims that might be made about the representativeness of the findings. Nevertheless, the findings from this sample are intended only to report initial (though speculative) findings that will be further explored as the sample size grows. However, given the thirst for data on effective governance practices, the author believes that these findings may provide tentative guidance to those boards of directors looking for direction and spur other researchers to enter the arena.

Data collection. All of the information was gathered from reviewing the Proxy Information Circulars for 2003-2004 which each firm in the sample was required to prepare and submit on an annual basis to its shareholders as well as the regulators.

Board Transparency was measured by adopting (and modifying) the seven disclosure criteria used by the Globe and Mail Newspaper’s “Report on Business” ranking of corporate governance practices, namely:

- Does the company have a statement of corporate governance practices indicating where it is compliant (or not) with regulator requirements?
- If the company is non-compliant, does it provide an explanation why it is not?
- Does the company fully name which of its directors are related and explain why?
- Does the company disclose how much it paid its auditor for consulting and other work?
- Does the company disclose full biographies of its board members?
- Does the company list the other boards on which its directors sit?
- Does the company disclose attendance records of its directors at board and committee meetings?

In addition, it was decided to add five other disclosure criteria based on the principles and criteria of good governance as articulated by the OECD, the Canadian Coalition for Good Governance and

National Policy Instrument 51-201. These extra five criteria were:

- Does the board state that it evaluates its own performance?
- Are the board evaluation results available to shareholders?
- Does the board publish meeting minutes and make them available to shareholders?
- Are shareholder proposals made available in the Annual Proxy Information Circular?
- Does the board publish the compensation given to individual directors?

The answer to each question for each of the 50 firms in the sample was registered as either “yes” (=1) or “no” (=0).

Data analysis. Descriptive statistics and frequencies were calculated for each item measured. The nature and the degree of the relationships among the variables measured was then determined using Spearman Rank correlation analysis. A one tail analysis was used to determine significance as we hypothesized in advance only positive relationships among our variables of interest.

Findings

Board Transparency Performance. Table 1 shows the frequencies for each of our 12 measures of board transparency. Based on these results, it is clear that the most popular areas for disclosure (i.e. disclosure greater than 70%) were related to: stating corporate governance practices (100%; Rank = 1); disclosing and explaining which directors are related (90%; Rank = 2); disclosing board biographies (84%; Rank = 3); disclosing fees paid to auditors (78%; Rank = 4); and listing other boards on which members sit (74%; Rank = 5). The areas not generating the same high levels of voluntary disclosure included: making board evaluation results available (0%; Rank = 12); making minutes available (2%; Rank = 11); including shareholder proposals in the proxy (12%; Rank = 10); disclosing the compensation of individual directors (14%; Rank = 9); and explaining non-compliance (37.5%; Rank = 8).

Discussion & Conclusions

With a very small sample size, it would be misleading and irresponsible to generalize from the current set of observations. Consequently, there will be no extensive commentary on the findings until they are supported by a larger and broader spectrum of respondents.

Nevertheless, the preliminary findings presented in this paper tempt some brief and tentative observations – which readers are cautioned to use more as speculations and musings. As additional data is obtained, it is hoped that they may eventually become more authoritative statements.

1. Notwithstanding the high level of disclosure for the top rated board transparency criterion, there appears to still be much room for improvement. It seems to be almost inexplicable as to why there was significant resistance on the part of some firms in terms of disclosing what might be considered as routine, ordinary information. For example, with respect to board members biographies, 16% of the firms surveyed refused to supply this information and 26% resisted revealing the ‘other boards’ on which their members sit. One can only speculate as to why this should occur – obstinacy? embarrassment? However, it shows the degree to which transparency – and its concomitant disclosure requirements – need to be placed higher on the corporate governance reform agenda if there is to be progress made in this area. Greater pressure seems especially warranted for those firms who have resisted explaining why they are not in compliance with regulators’ disclosure guidelines or those who have difficulty reporting even the attendance records of individual board members. It is probably because of these practices that recent changes in corporate governance reporting standards – primarily through National Policy Instrument 51-201 – has made the disclosure of these activities mandatory for qualifying issuers.
2. Given the difficulty that the firms in our sample had with the “low hanging disclosure fruit” such as board bios and attendance records, it was not surprising to find extraordinary levels of non-disclosure when it came to such items as making board evaluations and minutes available (0% and 2% disclosure levels respectively). Yet, shareholders need to know what their boards are doing once the board room door is closed. What do they talk about? Who does what and just how good are the men and women elected to simultaneously represent the shareholders and to also act in the best interests of the corporation? One of the major problems in corporate governance comes from the essential unobservability of critical board room behaviours, practices and processes. Without being in the room, it is virtually impossible for shareholders to know what boards are doing or if they are doing their jobs properly. Yet, gaining access to the kinds of information that boards collect (or should be collecting) if they are to function effectively (e.g. minutes and self/peer evaluations), may be just the ticket that shareholders need to fulfill the promise of transparency (i.e. *to gain knowledge about an organization’s corporate governance practices in order to make an informed assessment of Directors’ individual and collective roles and performance*).
3. It is interesting to note that although the companies in this sample claimed to follow most

- if not all – of the disclosure guidelines promoted by the TSX, their interpretations were often quite different. It was especially noted that many firms did not quote the TSX guidelines precisely when reporting compliance against them. As a result, it was sometimes not clear (or the firms may have been given the benefit of the doubt – or not) as to which disclosure criteria they were adhering. This only serves to highlight how there can be wide discrepancies between disclosure of corporate governance practices and the written dialogue which attempts to explain the decisions taken or describe the judgment calls made (Bart, 2006).
4. Firms in our sample often professed to be devotees of good governance and the principles which various organizations have articulated and espoused (e.g. The Canadian Coalition for Good Governance), but our results show that most were limiting their disclosure to what is only required by the regulator's (or media's evaluation) guidelines. This can be especially seen from the comparison of disclosure results for the seven Globe and Mail board transparency criteria versus the five that we added to the analysis. The four lowest ranking disclosure items all came from our additional criteria. This suggests therefore that at the time these disclosures were made, Canadian firms were not being proactive in disclosing information to shareholders but simply reactive to either bad press or the introduction of regulator driven guidelines.
 5. A review of the disclosure discussion related to board evaluations showed that there was a remarkable inconsistency in the way that the firms in our sample relayed how they conducted their assessments. The discussions vacillated between survey questionnaires, peer reviews, self assessments, meetings with the chair, assessments by management and/or the governance and nominating committee and the use of outside consultants. While it is not anticipated that board evaluations will be publicly disclosed (at least for the near term), it is recommended that the evaluation process needs to be more tightly controlled and that, at a minimum, shareholders should be made aware of the process used in detail. Companies should also consider disclosing what questions have been asked. Thus, even without knowing the answers to the questions, shareholders will be given the opportunity to gain reasonable assurance that the evaluation process is reasonably thorough and constructive. And for those firms brave enough, actual results could be published and balanced by publishing the board's 'work plan' for making the improvements that need to be made by individuals (whose names have been disguised, as Director A, B, C etc.) or the board as a whole. This would truly allow shareholders to monitor their board's performance and discourage board members from becoming complacent.
 6. Since National Policy Instrument 51-201 came into force in 2005, the matter of disclosing board attendance is no longer an issue. The policy explicitly recommends the: "disclosure of attendance record of each director for all board meetings held since the beginning of the issuer's most recently completed financial year". It is a sad commentary however, on the state of mind of Canadian Boards that it took a national regulation to force directors to disclose what should be considered routine information.
 7. It was interesting to observe that none of the firms studied mentioned how much directors were paid for expenses. Yet, shareholders would probably be interested in knowing how much money directors – either collectively or individually – spend on consulting fees, travel, education and business dinners. The compensation amount – when it is disclosed – does not mean much unless other expenses for which board members are reimbursed accompany it.
 8. Given the slow pace at which board transparency is advancing, it would be unreasonable to recommend disclosure of detailed summaries of each board meeting. Instead it is suggested that boards make overall meeting summaries available to shareholders. These summaries could include board attendance, the agenda covered (appropriately purged of sensitive items), and the length of the meeting. Doing so, would give shareholders some sense of the board's actual work.

Some Final Conclusions

Board transparency is increasing in importance. And recent changes in Canadian regulations have heightened the need for continuing reforms in the disclosure arena. For instance, National Policy Instrument 51-201 sets a new landscape for board transparency issues. Also organizations such as the Canadian Coalition for Good Governance are getting higher levels of attention from public companies. And the notion of greater involvement by shareholders in corporate governance is being accepted more and more. As a result, increasing numbers of boards of public companies are coming to terms with the new reality that they must begin to communicate more proactively with their shareholders. If they don't, then the board – which has been described as the darkest corner of the governance black box – is going to get an ever increasingly bright spotlight shone upon it. In other words, to coin an old phrase, 'they can run, but they can't hide!'

Appendices

Table 1. Board Transparency Frequency Analysis

BOARD TRANSPARENCY CRITERIA	QUANTITY (N=50)		PERCENTAGE	
	YES	NO	YES (RANK)	NO
Statement of corporate governance practices	50	0	100% (1)	0%
Explains non-compliance * (N=16)	6	10	37.5% (8)	62.5%
Discloses and explains which directors are related	45	5	90% (2)	10%
Discloses fees paid to the auditor for consulting and other work	39	11	78 % (4)	22%
Discloses board biographies	42	8	84% (3)	16%
Lists other boards on which members sit	37	13	74% (5)	26%
Discloses attendance records	26	24	52% (7)	48%
States that board evaluations are done	31	19	62% (6)	38%
Makes board evaluation results available	0	50	0% (12)	100%
Makes minutes available	1	49	2% (11)	98%
Includes shareholder proposals in proxy	6	44	12% (10)	88%
Discloses compensation of individual directors	7	43	14% (9)	86%

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