NON-EXECUTIVE REPORTING REQUIREMENTS FOR PUBLIC COMPANIES

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The time has come to put an end to corporate scandals; to end excessive compensation for executives; to stabilize capital markets; and, to rebuild public confidence in Corporate America.

As Marianne Jennings, Professor of Legal and Ethical Studies at Arizona State University pointed out at the Institute of Management Accountants' (IMA) 90th Annual Conference & Exposition in Denver, Colorado in June 2009, "For the second time in a decade we find ourselves in the middle of another financial crisis, with investors losing trust in the financial markets and business. Stable economic systems demand trust, and at the heart of trust lies ethics."

To rebuild public confidence in Corporate America, members of the U.S. Senate and U.S. House of Representatives must direct the Securities & Exchange Commission (SEC) to take immediate action to enact a set of principle-based standards for Non-Executive Reporting for all publicly traded companies.

Non-Executive Reporting Requirements should empower non-executive staff of publicly traded companies with a structured process to communicate value-added information directly with analysts, investors and regulators on a recurring basis without fear of reprisal or reprimand.

Registered public accounting firms should audit these periodic reports prior to release and the Public Company Accounting Oversight Board (PCAOB) should oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

Recent corporate scandals have raised serious questions about the effectiveness of boards of directors in exercising their fiduciary duties. Corporate governance requires that the board be a check and balance on the CEO and the executive team. The obvious question is whether directors of public companies properly oversee management and ensure management's actions are in the best interests of shareholders?

Recent Headlines

"The Madoff Fraud: How Culpable Were the Auditors" – Time

"Billionaire Stanford Indicted on fraud charges" – MSNBC.com

"Scrushy ordered to pay investors $2.9 billion" – The Associated Press

"Corporate Fraud" Why Employee Confidential, Anonymous Reporting Mechanisms Are Necessary" – Carolina Newswire

"Ex-CEO of Broadcom Pleads Not Guilty on 21 Charges" – Time

"Ebbers to begin 25-year sentence" – CNN Money

"Ex-Tyco CEO Kozlowski found guilty" – CNN Money

Could the recent financial crisis and ensuing economic meltdown been prevented if the interests of shareholders and the general public were considered as banks aggressively sought incentives to grant mortgage loans of any quality so long as they could be securitized with a high credit rating and sold to unsuspecting investors; loans that did not show up on the banks' balance sheets? Could the recent Ponzi schemes orchestrated by Bernie Madoff and others been prevented?

	(Rouge) Executives, Officers & Directors	(Staff) Non-Executives
E	Ego	Empowerment (of Staff)
T	Take (as much as you can, when you can)	Trust
H	Hide (all our mistakes)	Honesty
I	Individual ("I" come first)	Integrity
C	Compensation	Communication
S	Self-Interests	Success

Figure 1. Opposing perceptions of ethics

Employees have the highest success rate for uncovering fraud, according to the latest research by Alexander Dyck, Adair Morse, & Luigi Zingales (Financial Economics, Feb 2007, "Who Blows the Whistle on Corporate Fraud").

According to a 2008 KPMG Survey:

- 75% of employees observed a high level of illegal or unethical conduct at work
- 50% of employees observed misconduct that, if revealed, would cause their firms to "significantly loose public trust"

In testimony to Congress in March 2009, Scott M. Polakoff of the Treasury Department's Office of Thrift Supervision (OTS) conceded that his agency "did not foresee the risk concentration and the profound systematic impact" caused by AIG's $65 billion in credit default swaps. Credit default swaps and other types of financial derivative contracts became a blockbuster industry that helped fuel the bust when many legendary Wall Street firms were unable to meet their obligations. The extent of company losses came largely as a surprise to stock and bond holders as well as regulators charged with monitoring their performance.

In the recently published article "Rules would stop short of CEO pay caps," SEC Chair Mary Schapiro was quoted, "Our role (at the SEC) is to protect investors by ensuring that they have the information needed to make sound investment decisions."

A key component of Billionaire Warren Buffet's investment strategy is to invest in companies run by honest and competent people. Unfortunately, "… it's hard to write rules to prevent excesses. It's in human nature to go to excess."

Public companies use financial statements to communicate with investors. Financial statements give investors a clear picture of the past – a look in the rear view mirror, and are governed by US GAAP/IFRS, Securities & Exchange Commission (SEC) rules and regulations, and the Sarbanes-Oxley Act of 2002 (SOX). But investors are also interested in where the company is going – a look out the windshield.

There is a wealth of information missing from current public filings that is vitally important to analysts, investors and regulators; information about the ethics and competence of the executive management team.

A continued flow of willing investors is seen as a critical component to the economy's recovery. The only viable alternative to provide increased visibility into public companies and financial institutions to prevent another crisis is to enact a set of principle-based standards for Non-Executive Reporting for all publicly traded companies.

NON-EXECUTIVE REPORTING REQUIREMENTS

Public interests would be best served by a set of principle-based standards that provide a system of checks and balances against the financial reporting standards governed by US GAAP/IFRS, SEC rules and regulations, and SOX; a set of standards that allow non-executive staff to communicate value-added information with analysts, investors and regulators on a recurring basis without fear of reprisal or reprimand.

Non-Executive Reporting standards for public companies should include, but not be limited to:

1. **Ethics**
   Assess ethics at all levels of the organization; horizontally and vertically.
2. **Communication**
   Assess how well the organization communicates.
3. **Strategic planning**
   Assess the effectiveness of strategic planning and how well the organization executes its strategic plan
4. **Management**
   Assess how well the management team works together; whether management is being held accountable for the decisions that impact revenue, earnings, free cash flow, etc.; to assess the competence and character of management; and, to assess the consistency of management decisions made for the benefit of the organization
5. **Organization**
   Assess internal strengths and weaknesses and make it possible to detect organizational stresses that may threaten the future earnings and/or survivability of the company
6. **Risk**
   Assess whether executives are putting company assets at risk for the sake of personal gain

7. **Empowerment**
   Assess whether staff are empowered to perform their duties without fear of reprisal or reprimand
8. **Auditing, Quality Control**
   Provide a structured approach to implement corrective actions and ensure compliance

These standards should be based on the principles of continuous improvement – data driven strategies that define a level of excellence within the organization, and provide a mechanism for continuous improvement.

A board-level committee made up of non-executive staff members who work as a team, with all members having equal representation, should certify a comprehensive report for release on a periodic basis, and issue special announcements containing time-sensitive information that have a significant impact on company performance or behavior. Members of the committee should be elected by a majority of non-executive staff on an annual basis, with voting restrictions based on minimum length of employment, etc.

SARBANES-OXLEY ACT OF 2002

A key component of Billionaire Warren Buffet's investment strategy: invest in companies run by honest and competent people. There is a wealth of information missing from current public filings that is vitally important to analysts, investors and regulators; information that is essential to determine whether the company is run by honest and competent people.

Accounting & finance professionals are burdened by a number of reporting requirements, including US Generally Accepted Accounting Principles (US GAAP), International Financial Reporting Standards (IFRS), Securities & Exchange Commission (SEC) rules and regulations; and, the Sarbanes-Oxley Act of 2002 (SOX).

Yet, accounting & finance professionals lack a structured process that empowers them with the tools to report corporate scandals without fear of reprisal or reprimand; to report value-added information regarding the performance, financial condition, and prospects of a publicly traded company; and, to report information regarding the ethics and competence of leadership.

The certification requirements of SOX make it vitally important that financial disclosures adequately represent the performance, financial condition, and prospects of a publicly traded company. However, even well-designed disclosure requirements may not suffice.

Even in this age of SOX, are investors adequately informed about the true performance, risks and opportunities of public companies? Executives can still make decisions that allow them to reap enormous personal gain to the detriment of long-term shareholder value. What's missing from SOX is transparency into the measure of risk as well as legality of such decisions.

The Economics staff with the Economist stated in a recent article "transparency can work. When information is relevant, standardized and public, it fosters intelligent decision-making.

The SEC must take immediate action to implement Non-Executive Reporting Requirements that allow non-executive staff to report corporate scandals as they occur; to curb excessive compensation by exposing misrepresentations that enable executives, officers and directors to reap enormous personal gains at the expense of the long-term health and viability of the organization; and; to report value-added information regarding the performance, financial condition, and prospects of a publicly traded company on a recurring basis.

These standards should be designed to work in unison with US GAAP/IFRS, SEC rules and regulations and SOX to provide a stronger framework for investor protection, to provide a check and balance with information currently provided in public filings; and, provide a level of transparency into the organization that currently doesn't exist.

Loosely applying Vilfredo Pareto's rule would suggest that with just 20% more effort SOX could produce 80% more value toward protecting the interests of investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws.

Registered public accounting firms should audit the periodic reports prior to release and the Public Company Accounting Oversight Board (PCAOB) should oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

BENEFITS

The time has come to put an end to corporate scandals; to end excessive compensation for executives; to stabilize capital markets; and, to rebuild public confidence in Corporate America.

Navigating our way towards higher ethics in the workplace will not come easy. There will be winners and loser. The winners, obviously, will be the analysts, investors and the public. The losers, of course, will be over-compensated executives who make decisions based on personal gains at the expense of long-term shareholder value.

The primary objectives for implementing non-executive reporting requirements should include, but not be limited to:

- Restore public confidence in Corporate America
- Reign in excessive compensation
- Higher returns for investors
- Better informed investors
- Higher savings rates
- Lower interest rates
- Milder recessions
- Healthier capital markets
- Fewer jobs lost during economic downturns

The obvious question is whether the benefits outweigh the cost of implementing non-executive reporting requirements? The benefits are certainly significant, and the cost is not trivial. Although the cost of implementing these new reporting requirements may not place a significant financial burden on public companies, they most certainly will have a significant impact on culture in Corporate America. And change always comes at a price. Many will embrace change, while others will resist change with all their might.

The cost of not implementing non-executive reporting requirements could be astronomical, even catastrophic to a fragile economy.

Analysts, investors and the public will be able to garner value-added information from non-executive staff to substantiate the information presented in financial statements and disclosures in public filings without having to rely solely on the representations made by executives, officers & directors; will have a level of visibility into the health of the organization that currently doesn't exist; and, will have confidence in the future earnings expectations of the company?

CONCLUSION

In conclusion, non-executive reporting requirements will compliment US GAAP/IFRS, SEC rules and regulations and SOX to provide a stronger framework for investor protection, to provide a check and balance with information currently provided in public filings; and, provide a level of transparency into the organization that currently doesn't exist.

The benefits certainly outweigh the cost for protecting the interests of investors and the public by improving the accuracy, reliability and content of corporate disclosures made pursuant to the securities laws:

- Restore public confidence in Corporate America
- Reign in excessive compensation
- Higher returns for investors
- Better informed investors
- Higher savings rates
- Lower interest rates
- Milder recessions
- Healthier capital markets
- Fewer jobs lost during economic downturns

These comprehensive reporting requirements will empower non-executive staff with a structured process to disclose value-added information regarding the performance, financial condition and prospects of a publicly traded company; information that investors need to make informed decisions. Registered public accounting firms can audit the periodic reports prior to release and the Public Company Accounting Oversight Board (PCAOB) can oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

Evaluate the business in its entirety

Billionaire William Buffett's investment strategy evaluates a business in its entirety:

- "We select our marketable equity securities in much the way we would evaluate a business for acquisition in its entirety."
- "We want businesses to be one

(a) that we can understand;

(b) with favorable long-term prospects;

(c) operated by honest and competent people..."

Non-Executive Reporting Requirements will empower non-executive staff with a structured process to disclose information about the competence and integrity of leadership in publicly traded companies. Imagine a world where the public could access a wealth of information that they could actually rely on to make informed decisions about investing their 401k and IRA; a world based on honesty, loyalty, mutual trust and respect for Corporate America.

[i] Catalyst is, in its own words, the leading non-profit corporate membership research and advisory organization working globally with businesses and the professions to build inclusive environments and expand opportunities for women and business (www.catalystwomen.org). The press release of the study appeared on October 1, 2007.
[ii] Unintended: if a company predicted a long period of losses in its IPO-prospectus, it was excluded from the sample (Crucell N.V.).