

Appendix

Codes of Governance: Some Examples *

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1. Introduction

In a volume published at the end of 1996, Sergio Siglienti acutely observes that in Italy the issue of corporate governance has been dealt with by the supervisory authorities and in academic discussion, but has not yet “been fully perceived by the political sphere or by public opinion” (Siglienti 1996, p. 98). In Britain and North America, and also in France, by contrast, a lively debate on corporate systems of direction and control is being conducted within the financial and industrial community. Conclusive evidence of a practical, operational interest in the matter is offered by the publication in recent years of numerous analytical reports and the proclamation of codes of best practices. This short article sets forth the contents of these codes.

2. The Cadbury Report

The need for systematic reflection on corporate governance came to maturity within the British financial community at the turn of the Nineties. Attention was focused by the concerns touched off by such episodes as the BCCI and Maxwell failures and by recurrent polemics on the poor transparency of corporate accounts and directors' compensation.

□ Banca Nazionale del Lavoro, Studi e Relazioni Esterne, Roma.

* While remaining solely responsible for any errors, the author thanks Silvia Silvagni of Coopers & Lybrand for her kind collaboration in obtaining the source documentation.

In May 1991, at the independent initiative of the London Stock Exchange, the Financial Reporting Council and representatives of businesses and professional organizations, a committee of twelve eminent financiers and industrialists was formed, chaired by Sir Adrian Cadbury. In eighteen months the Cadbury Committee surveyed more than 200 firms and produced a report on "the financial aspects of corporate governance" and a "code of best practices".¹

Both the report and the code centred on the structure and the functions of a corporation's board of directors.

The underlying concern is to design an organ that ensures sufficient balance in the direction and control of the firm and prevent any individual from wielding unlimited powers of decision.² The Cadbury Report expressly suggests that if the same person holds the positions of chairman of the board and executive director, this must necessarily be balanced by the presence of a strong and independent member of the board who can foster adequate dialogue in practical governance of the corporation. The Report also places special emphasis on the role of non-executive directors.

The non-executive directors have the function of formulating "independent judgments" on strategy, results, resources. They also have the delicate task of forming and managing a special committee to fix the structure and amount of the executive directors' compensation.³ Finally, their role is enhanced by the Report's recommendation to constitute an audit committee within every corporation comprising at least three non-executive directors.⁴ In carrying out its mandate from the board of directors, the audit committee must form and maintain direct *liaison* with the internal inspection and external audit functions.

3. The Toronto Stock Exchange guidelines

Like the Cadbury Report, the code devised in 1994 by the Toronto Stock Exchange focuses on the structure and functions of the

¹ See Committee on the Financial Aspects of Corporate Governance (1992, p. 6).

² *Ibid.*, p. 11.

³ *Ibid.*, p. 16.

⁴ *Ibid.*, p. 20.

board of directors.⁵ The reasons for the work and its development also follow the British pattern.

The motivations are summed up succinctly enough in the Report's title, *Where Were the Directors?*, with its unmistakable allusion to the problems of corporate governance that were behind the crises that struck so many large Canadian companies as the Eighties gave way to the Nineties. Like the Cadbury Report, the Canadian work was based on the voluntary participation of some 150 financial and industrial enterprises.

The Toronto guidelines envisage five areas for which every board of directors should be responsible: definition and updating of corporate strategy; assessment and management of the main risks; selection and monitoring of top management; communications and image; checking the integrity of internal control and information systems.⁶

To pursue the corporate purpose and the interest of the community effectively and efficiently, the board of directors should guarantee that decisions are sufficiently independent of the interests of any significant shareholders. Accordingly, the Report suggests that the majority of the board should consist of "unrelated directors", i.e. members who are "free from any interest and any business or other relationship which could, or could reasonably, be perceived to, materially interfere with the director's ability to act with a view to the best interest of the corporation".⁷

The Toronto Report also stresses the question of the board's independence from corporate executives, envisaging the formation of a special directors' committee to handle relations with top management.⁸ Finally, the guidelines call for revising the rules on directors' legal liabilities in order to curb the spread of an already substantial amount of litigation before Canadian courts and prevent excessive restriction of the freedom of action of corporate organs of direction and control.

⁵ See The Toronto Stock Exchange Committee on Corporate Governance in Canada (1994).

⁶ *Ibid.*, p. 4.

⁷ *Ibid.*, p. 4.

⁸ *Ibid.*, p. 5.

4. The Viénot Committee Report

Under the stimulus of the Anglosaxon example, in 1995 France produced continental Europe's first report on corporate governance. Like the British and Canadian reports, the French initiative was taken independently by the financial and business community. The Conseil National du Patronat Français and the Association Française des Entreprises Privées appointed a 14-member committee led by Marc Viénot, Chairman of Société Générale, to draft a report of the make-up, powers, and operating procedures of boards of directors of listed companies.⁹

Unlike the Cadbury Report, the Viénot Committee does not premise worry over the pernicious consequences (corporate failure and financial scandal) of defective corporate governance. Rather, the Viénot Report proposes expressly to help bring about greater transparency in the interests of small investors and to ensure the success of major privatizations.¹⁰ In the overriding interest of transparency, the Committee recommends that every board of directors produce a regular, formal report to all the shareholders on its activities, organization and membership.

As to the potential problems of agency between owners and the 'technostructure', the Viénot Report endorses the British and Canadian reports' recommendations for what it refers to as "independent directors" (at least two on the boards of listed companies) and for committees to check the conformity of management's action with the law and the corporate by-laws and to select top executives and set their compensation.

Considerations of efficiency and transparency counsel curbing the extent of interlocking directorates between companies within a group and limiting the number of directorships one person may hold. Within a given board, however, separation of functions is not considered indispensable. Contending that separation of functions is not a panacea, the Report observes that the appointment of the same

⁹ Conseil National du Patronat Français and Association Française des Entreprises Privées (1995).

¹⁰ The Viénot Report (p. 1) begins with the statement that "privatizations and the opening of the Paris market to foreign investors have favoured the rapid development of a new body of shareholders who are often unfamiliar with the rules and operating practices of the boards of directors of listed companies and who naturally tend to ask for clarification".

person as chairman and chief executive officer, which is quite common in France, is very often conducive to corporate goals. That is, it is up to the each board of directors to devise an appropriate form of functional separation, given that in most cases such separation is not the "necessary condition for good overall direction or efficacious control of management" (p. 9).

5. The CoSO Report

Last but not most assuredly not least in our brief survey of codes of corporate governance comes the CoSO Report from the United States.¹¹

Issued almost simultaneously with the Cadbury Report, the 1992 Report by Coopers & Lybrand follows a different logic from the other works on corporate governance. It takes a bottom-up rather than a top-down approach and as a consequence does not focus exclusively on the board of directors. Unlike the contents, the working method of the American Report is substantially similar to that followed in devising the other codes. It was based on the participation of a substantial group of significant members of the financial and business community: 26 board chairmen and members, 34 chief executive officers, 108 financial directors, 81 academics, 60 representatives of legislative and regulatory bodies.

The CoSO Report centres on internal controls within a corporation, considering control as a process designed and implemented in order to facilitate (but certainly not to guarantee) the achievement of three distinct but related objectives: the efficacy and efficiency of operations, the reliability of balance-sheet data, compliance with law and regulations. The fundamental assumption is that within an organization the entire staff is responsible for internal control.¹²

¹¹ The acronym stands for "Committee of Sponsoring Organizations of the Treadway Commission"; the five organizations that joined to promote the Commission and its Report are the American Institute of Certified Public Accountants, the American Accounting Association, the Institute of Internal Auditors, the Institute of Management Accountants, and the Financial Executives Institute.

¹² The philosophy underlying the remarks of Mario Sarcinelli in his essay in this *Issue* (Section 3.3) is in harmony with this approach.

The Report divides the internal control system into five fundamental areas: the control environment, consisting in the degree of integrity, the ethics and the competence of the staff, the management's style and the levels of authority and responsibility; risk assessment and risk management; control activities to check that directives are actually applied; information and communication to enable all those involved to perform their respective tasks; and monitoring, i.e. dynamic assessment of the efficacy of corporate governance.

Combining the three groups of objectives with these five structural areas, the CoSO Report derives a series of recommendations for enhancing the effectiveness of internal controls. The Report suggests that at the top level the CEO should program regular self-evaluation by the internal control structure. The idea is that continuous monitoring and periodic check-ups of the control system should be provided for in the same way that one schedules regular plant maintenance to safeguard quality over time and guarantee satisfactory cost-benefit performance.¹³

This activity of sensitization and self-diagnosis promoted by the CEO should flow successively down to involve the board of directors, the internal auditors, managers, and the entire staff. In any case, the Report concludes, the only worthwhile gauge of success in corporate governance is vigorous, efficacious feedback from bottom to top.

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¹³ See Coopers & Lybrand (1996).

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