THE BUSINESS ROUNDTABLE

Principles of Corporate Governance

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THE BUSINESS ROUNDTABLE
AN ASSOCIATION OF CHIEF EXECUTIVE OFFICERS COMMITTED TO IMPROVING PUBLIC POLICY

Principles of Corporate Governance

A White Paper from THE BUSINESS ROUNDTABLE

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Foreword and Introduction

The Business Roundtable is recognized as an authoritative voice on matters affecting American business corporations and, as such, has a keen interest in corporate governance. The Business Roundtable is an association of chief executive officers of leading corporations with a combined workforce of more than 10 million employees in the United States and $3.5 trillion in revenues. The chief executives are committed to advocating public policies that foster vigorous economic growth, a dynamic global economy, and a well-trained and productive U.S. workforce essential for future competitiveness.

Past publications of The Business Roundtable that have addressed corporate governance include our *Statement on Corporate Governance* (September 1997); *Executive Compensation/Share Ownership* (March 1992); *Corporate Governance and American Competitiveness* (March 1990); *Statement on Corporate Responsibility* (October 1981); and *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation* (January 1978). We are pleased to note that, in the five years since our 1997 *Statement* was published, many of the practices we suggested at that time have become common.

The United States has the best corporate governance, financial reporting, and securities markets systems in the world. These systems work because of the adoption of best practices by public companies within a framework of laws and regulations.

Given the accelerated nature of change, innovation, and progress in the U.S. and global markets, and in light of notable exceptions to a system that has generally worked well, The Business Roundtable believes it is appropriate to restate our guiding principles of corporate governance. These principles, we believe, should help to guide the continual advancement of corporate governance practices, and so advance the ability of U.S. public corporations to compete, create jobs, and generate economic growth.

The Business Roundtable supports the following guiding principles:

First, the paramount duty of the board of directors of a public corporation is to select a chief executive officer and to oversee the CEO and other senior management in the competent and ethical operation of the corporation on a day-to-day basis.

Second, it is the responsibility of management to operate the corporation in an effective and ethical manner in order to produce value for stockholders. Senior management is expected to know how the corporation earns its income and what risks the corporation is undertaking in the course of carrying out its business. Management should never put personal interests ahead of or in conflict with the interests of the corporation.

Third, it is the responsibility of management, under the oversight of the board and its audit committee, to produce financial statements that fairly present the financial condition and results of operations of the corporation, and to make the timely disclosures investors need to permit them to assess the financial and business soundness and risks of the corporation.

Fourth, it is the responsibility of the board and its audit committee to engage an independent accounting firm to audit the financial statements prepared by management and to issue an opinion on those statements based on Generally Accepted Accounting Principles. The board, its audit committee, and management must be vigilant to ensure that no actions are taken by the corporation or its employees that compromise the independence of the outside auditor.

Fifth, it is the responsibility of the independent accounting firm to ensure that it is in fact independent, is without conflicts of interest, employs highly competent staff, and carries out its work in accordance with Generally Accepted Auditing Standards. It is also the responsibility of the independent accounting firm to inform the board, through the audit committee, of any concerns the auditor may have about the appropriateness or quality of significant accounting treatments, business transactions that affect the fair presentation of the corporation's financial condition and results of operations, and weaknesses in internal control systems. The auditor should do so in a forthright manner and on a timely basis, whether or not management has also communicated with the board or the audit committee on these matters.

Sixth, the corporation has a responsibility to deal with its employees in a fair and equitable manner.

These responsibilities, and others, are critical to the functioning of the modern public corporation and the integrity of the public markets. No law or regulation alone can be a substitute for the voluntary adherence to these principles by corporate directors and management and by the accounting firms retained to serve American corporations.

The Business Roundtable continues to believe that the most effective way to enhance corporate governance is through conscientious and forward-looking action by a business community that focuses on generating long-term stockholder value with the highest degree of integrity.

The principles discussed here are intended to assist corporate management and boards of directors in their individual efforts to implement best practices of corporate governance, and also to serve as guideposts for the public dialogue on evolving governance standards.

I. Key Corporate Actors

Effective corporate governance requires a clear understanding of the respective roles of the board and of senior management and their relationships with others in the corporate structure. The relationships of the board and management with stockholders should be characterized by candor; their relationships with employees should be characterized by fairness; their relationships with the communities in which they operate should be characterized by good citizenship; and their relationships with government should be characterized by a commitment to compliance.

Effective corporate governance requires a clear understanding of the respective roles of the board and of senior management and their relationships with others in the corporate structure.

The board of directors has the important role of overseeing management performance on behalf of stockholders. Its primary duties are to select and oversee a well-qualified and ethical chief executive officer who, with senior management, runs the corporation on a daily basis, and to monitor management's performance and adherence to corporate standards. Effective corporate directors are diligent monitors, but not managers, of business operations.

Senior management, led by the CEO, is responsible for running the day-to-day operations of the corporation and properly informing the board of the status of such operations. Management's responsibilities include strategic planning, risk management, and financial reporting.

Stockholders necessarily have little voice in the day-to-day management of corporate operations, but have the right to elect representatives (directors) to look out for their interests and to receive the information they need to make investment and voting decisions.

Effective corporate governance requires a proactive, focused state of mind on the part of directors, the CEO and senior

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management, all of whom must be committed to business success through maintenance of the highest standards of responsibility and ethics. Good corporate governance is far more than a "check-the-box" list of minimum board and management policies and duties. Even the most thoughtful and well-drafted policies and procedures are destined to fail if directors and management are not committed to enforcing them in practice. A good corporate governance structure is a working system for principled goal-setting, effective decision-making, and appropriate monitoring of compliance and performance. Through such a vibrant and responsive structure, the CEO, the management team, and the board of directors can interact effectively and respond quickly to changing circumstances, within a framework of solid corporate values, to provide enduring value to the stockholders who invest in the enterprise.

II. The Roles of the Board of Directors and Management

An effective system of corporate governance provides the framework within which the board and management address their respective responsibilities.

The Board of Directors

- The business of a corporation is managed under the direction of the corporation's board. The board delegates to the CEO, and through him or her to other senior management, the authority and responsibility for managing the everyday affairs of the corporation. Directors monitor management on behalf of the corporation's stockholders.
- The selection, compensation, and evaluation of a well-qualified and ethical CEO is the single most important function of the board. The board also appoints or approves other members of the senior management team.

- Directors bring to the corporation a range of experience, knowledge, and judgment. Directors should not represent the interests of particular constituencies.

- Effective directors maintain an attitude of constructive skepticism; they ask incisive, probing questions and require accurate, honest answers; they act with integrity; and they demonstrate a commitment to the corporation, its business plans, and long-term stockholder value.

- In performing its oversight function, the board is entitled to rely on the advice, reports, and opinions of management, counsel, auditors, and expert advisors. The board should assess the qualifications of those it relies on and hold managers and advisors accountable. The board should ask questions and obtain answers about the processes used by managers and advisors to reach their decisions and recommendations and about the substance of the advice and reports received by the board.

- Given the board's oversight role, stockholders and other constituencies can reasonably expect that directors will exercise vigorous and diligent oversight over a corporation's affairs. However, they should not expect the board to micromanage the corporation's business by performing or duplicating the tasks of the CEO and the senior management team.

- The board's oversight function carries with it a number of specific responsibilities in addition to that of selecting the CEO. These include responsibility for:

    ▲ *Planning for management succession.* The board should plan for CEO and senior management succession and, when appropriate, replace the CEO or other members of senior management.

The board and its audit committee should take reasonable steps to be comfortable that the corporation's financial statements and other disclosures accurately present the corporation's financial condition and results of operations to stockholders, and that they do so in an understandable manner.

- *Understanding, reviewing, and monitoring implementation of the corporation's strategic plans.* The board has responsibility for overseeing and understanding the corporation's strategic plans from their inception through their development and execution by management. Once the board reviews a strategic plan, the board should regularly monitor implementation of the plan to determine whether it is being implemented effectively and whether changes are needed.

- *Understanding and reviewing annual operating plans and budgets.* The board has responsibility for overseeing and understanding the corporation's annual operating plans and for reviewing the annual budgets presented by management. The board should monitor implementation of the annual plans to assess whether they are being implemented effectively and within the limits of approved budgets.

- *Focusing on the integrity and clarity of the corporation's financial statements and financial reporting.* While financial reports are primarily the responsibility of management, the board and its audit committee should take reasonable steps to be comfortable that the corporation's financial statements and other disclosures accurately present the corporation's financial condition and results of operations to stockholders, and that they do so in an understandable manner. In order to do this, the board, through its audit committee, should have a broad understanding of the corporation's financial statements, including why the accounting principles critical to the corporation's business were chosen; what key judgments and estimates were made by management; and how the choice of principles, and the making of such judgments and estimates, impacts the reported financial results of the corporation.

- *Engaging outside auditors and considering independence issues.* The board, through its audit committee, bears responsibility for engaging an outside auditor to audit the corporation's financial statements and for ongoing communications with the outside auditor. The board, through its audit committee, should periodically consider the independence and continued tenure of the auditor.

- *Advising management on significant issues facing the corporation.* Directors can offer management a wealth of experience and a wide range of perspectives. They provide advice and counsel to management in formal board and committee meetings and are available for informal consultation with the CEO and senior management.

- *Reviewing and approving significant corporate actions.* As required by state corporate law, the board reviews and approves specific corporate actions, such as the election of executive officers, declaration of dividends, and appropriate major transactions. The board and senior management should have a clear understanding of what level or types of decisions require specific board approval.

- *Nominating directors and committee members and overseeing effective corporate governance.* It is the responsibility of the board and its corporate governance committee to nominate directors and committee members and to oversee the composition, structure, practices, and evaluation of the board and its committees.

The CEO and Management

The CEO and senior management run the corporation's day-to-day business operations.

- It is the responsibility of the CEO, and of senior management under the CEO's direction, to operate the corporation in an effective and ethical manner.
- The governance model followed by most public corporations in the United States has historically been one of individual, rather than group, leadership. U.S. corporations have traditionally vested responsibility in the CEO as the leader of management rather than diffusing high-level responsibility among several individuals. The Business Roundtable believes that this model has generally served corporations well.
- The CEO should be aware of the major risks and issues that the corporation faces and is responsible for supervising the corporation's financial reporting processes. For example, the CEO is responsible for providing stockholders and others with information that the CEO believes is important to understanding the corporation's business. Of course, the CEO necessarily relies on the expert advice of others on technical questions and legal requirements.
- As part of its operational responsibility, senior management is charged with:
  - ▲ *Operating the corporation.* The CEO and senior management run the corporation's day-to-day business operations. With a thorough understanding of how the corporation operates and earns its income, they carry out the corporation's strategic objectives within the annual operating plans and budgets reviewed by the board.

- *Strategic planning.* The CEO and senior management generally take the lead in strategic planning. They identify and develop strategic plans for the corporation, present those plans to the board, implement the plans once board review is completed, and recommend and carry out changes to the plans as necessary.
- *Annual operating plans and budgets.* With the corporation's overall strategic plans in mind, senior management develops annual operating plans and annual budgets for the corporation, and the CEO presents those plans and budgets to the board. Once board review is completed, the management team implements the annual operating plans and budgets.
- *Selecting qualified management and establishing an effective organizational structure.* Senior management is responsible for selecting qualified management and for implementing an organizational structure that is efficient and appropriate for the corporation's particular circumstances.
- *Identifying and managing risks.* Senior management identifies and manages the risks that the corporation undertakes in the course of carrying out its business. It also manages the corporation's overall risk profile.
- *Good financial reporting.* Senior management is responsible for the integrity of the corporation's financial reporting system. It is senior management's responsibility to put in place and supervise the operation of systems that allow the corporation to produce financial statements that fairly present the corporation's financial condition and thus

permit investors to understand the business and financial soundness and risks of the corporation.

The CEO should be a person of integrity who takes responsibility for the corporation adhering to the highest ethical standards.

- The CEO and senior management are responsible for operating the corporation in an ethical manner. They should never put individual, personal interests before those of the corporation or its stockholders. In carrying out this function, The Business Roundtable believes that corporations should have:
  - ▲ *A CEO of integrity.* The CEO should be a person of integrity who takes responsibility for the corporation adhering to the highest ethical standards.
  - ▲ *A strong, ethical "tone at the top."* Senior management, and particularly the CEO, should set a "tone at the top" that establishes a culture of integrity and legal compliance communicated to personnel at all levels of the corporation.
  - ▲ *Internal controls.* A corporation should have an effective system of internal controls providing reasonable assurance that the corporation's books and records are accurate, that its assets are safeguarded, and that it complies with applicable laws. The internal controls system should be periodically evaluated and updated so that it continues to be effective in a changing environment.
  - ▲ *Codes of conduct.* A corporation should have a code of conduct with effective reporting and enforcement mechanisms. Employees should have a means of alerting management and the board to potential misconduct without fear of retribution, and violations of the code should be addressed promptly and effectively.

III. How the Board Performs Its Oversight Function

Publicly owned corporations employ diverse approaches to board structure and operations, and no one structure is right for every corporation. Nevertheless, The Business Roundtable believes that the corporate governance "best practices" set forth in the following sections provide an effective approach for corporations to follow.

Board Composition and Leadership

- Boards of directors of large, publicly owned corporations vary in size from industry to industry and from corporation to corporation. In determining board size, directors should consider the nature, size, and complexity of the corporation as well as its stage of development. The experience of many Roundtable members suggests that smaller boards are often more cohesive and work more effectively than larger boards.

- The Business Roundtable believes that having directors with relevant business and industry experience is beneficial to the board as a whole. Directors with such backgrounds can provide a useful perspective on significant risks and competitive advantages and an understanding of the challenges facing the business. Because the corporation's need for particular backgrounds and experiences may change over time, the board should monitor the mix of skills and experience of its directors in order to assess, at each stage in the life of the corporation, whether the board has the necessary tools to perform its oversight function effectively.

- The board of a publicly owned corporation should have a substantial degree of independence from management. Board independence depends not only on directors' individual relationships — personal, employment, or business — but also on the board's overall attitude toward management. Providing objective independent judgment is at the core of the board's oversight function, and the board's composition should reflect this principle.

A substantial majority of directors of the board of a publicly owned corporation should be independent of management, in both fact and appearance.

- A substantial majority of directors of the board of a publicly owned corporation should be independent of management, in both fact and appearance, as determined by the board.

  - ▲ *Assessing independence.* An independent director should be free of any relationship with the corporation or its management that may impair, or appear to impair, the director's ability to make independent judgments. The listing standards of the major securities markets relating to audit committees provide useful guidance in determining whether a particular director is "independent." These standards focus primarily on familial, employment, and business relationships. However, boards of directors should also consider whether other kinds of relationships, such as close personal relationships between potential board members and senior management, may affect a director's actual or perceived independence.

  - ▲ *Relationships with not-for-profit organizations.* Some observers have questioned the independence of directors who have relationships with nonaffiliated not-for-profit organizations that receive support from the corporation. The Business Roundtable believes that such relationships and their effect on a director's independence should be assessed by the board or its corporate governance committee on a case-by-case basis, taking into account the size of the corporation's contributions to the not-for-profit organization and the nature of the director's relationship to the organization. Independence issues are most likely to arise where a director is an employee of the not-for-profit organization and where a substantial portion of the organization's funding comes from the corporation. By contrast, where a director merely serves on the board of a not-for-profit organization with broad community representation, there may be no meaningful independence issues.

- Most American corporations are well served by a structure in which the CEO also serves as chairman of the board. The CEO serves as a bridge between management and the board, ensuring that both act with a common purpose. Some corporations have found it useful to separate the roles of CEO and chairman of the board to provide continuity of leadership in times of transition. Each corporation should make its own determination of what leadership structure works best, given its present and anticipated circumstances. The board should have contingency plans to provide for transitional board leadership if questions arise concerning management's conduct, competence, or integrity or if the CEO dies or is incapacitated. An individual director, a small group of directors, or the chairman of a committee may be selected by the board for this purpose.

Most American corporations are well served by a structure in which the CEO also serves as chairman of the board.

Board Organization

- Virtually all boards of directors of large, publicly owned corporations operate using committees to assist them. A committee structure permits the board to address key areas in more depth than may be possible in a full board meeting.

- Decisions about committee membership should be made by the full board, based on recommendations from a committee responsible for corporate governance issues. The board should designate the chairmen of the various committees if this is not done by the committees themselves.

- Committees should apprise the full board of their activities on a regular basis. Processes should be developed and monitored for keeping the board informed through oral and/or written reports.

- The Business Roundtable believes that the functions generally performed by the audit, compensation, and corporate governance committees are central to effective corporate governance. However, The Business Roundtable does not believe that a particular committee structure is essential for all corporations. What is important is that key issues be addressed effectively by the independent members of the board. Thus, the references below to the functions performed by particular committees are not intended to preclude corporations from allocating these functions differently.

- Other committees, such as executive or finance committees, also may be used. Some corporations find it useful to establish additional committees to examine special problems or opportunities in greater depth than would otherwise be feasible.

- The responsibilities of each committee should be clearly defined and understood. A written charter approved by the board, or a board resolution establishing the committee, is appropriate.

Audit Committee

- Every publicly owned corporation should have an audit committee comprised solely of independent directors.

- Audit committees typically consist of three to five members. The listing standards of the major securities markets require audit committees and require that an audit committee have at least three members and that all members of the audit committee qualify as independent under the applicable listing standards, subject to limited exceptions.

- Audit committee members should meet minimum financial literacy standards, and at least one of the committee members should have accounting or financial management expertise, as required by the listing standards of the major securities markets. However, more important than financial expertise is the ability of audit committee members, as with all directors, to understand the corporation's business and risk profile and to apply their business experience and judgment to the issues for which the committee is responsible with an independent and critical eye.

- The audit committee is responsible for oversight of the corporation's financial reporting process. The primary functions of the audit committee are the following:

  ▲ *Risk profile.* The audit committee should understand the corporation's risk profile and oversee the corporation's risk assessment and management practices.

  ▲ *Outside auditor.* The audit committee is responsible for supervising the corporation's relationship with its outside auditor, including recommending to the full board the firm to be engaged as the outside auditor, evaluating the auditor's performance, and considering whether it would be appropriate for the outside auditor periodically to rotate senior audit personnel or for the corporation periodically to

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The selection of an outside auditor should involve an annual due diligence process in which the audit committee reviews the qualifications, work product, independence, and reputation of the proposed outside auditor.

change its outside auditor. The selection of an outside auditor should involve an annual due diligence process in which the audit committee reviews the qualifications, work product, independence, and reputation of the proposed outside auditor. The audit committee should base its decisions about selecting and possibly changing the outside auditor on its assessment of what is likely to lead to more effective audits. Based on its due diligence, the audit committee should make an annual recommendation to the full board about the selection of the outside auditor.

- *Auditor independence.* The audit committee should consider the independence of the outside auditor and should develop policies concerning the provision of nonaudit services by the outside auditor. The provision of some types of audit-related and consulting services by the outside auditor may not be inconsistent with independence or the attestation function. In considering whether the outside auditor should provide certain types of nonaudit services, the audit committee should consider the degree of review and oversight that may be appropriate for new and existing services. When making independence judgments, the audit committee should consider the nature and dollar amount of all services provided by the outside auditor.

- *Critical accounting policies, judgments, and estimates.* The audit committee should review and discuss with management and the outside auditor the corporation's critical accounting policies and the quality of accounting judgments and estimates made by management.

- *Internal controls.* The audit committee should understand and be familiar with the corporation's system of internal controls and on a periodic basis should review with both internal and outside auditors the adequacy of this system.
- *Compliance.* Unless the full board or another committee does so, the audit committee should review the corporation's procedures addressing compliance with the law and important corporate policies, including the corporation's code of ethics or code of conduct.
- *Financial statements.* The audit committee should review and discuss the corporation's annual financial statements with management and the outside auditor and, based on these discussions, recommend that the board approve the financial statements for publication and filing. Most audit committees also find it advisable to implement processes for the committee or its designee to review the corporation's quarterly financial statements prior to release.
- *Internal audit function.* The audit committee should oversee the corporation's internal audit function, including review of reports submitted by the internal audit staff, and should review the appointment and replacement of the senior internal auditing executive.
- *Communication.* The audit committee should provide a channel of communication to the board for the outside auditor and internal auditors and may also meet with and receive reports from finance officers, compliance officers, and the general counsel.

- ▲ *Hiring auditor personnel.* Under audit committee supervision, some corporations have implemented "revolving door" policies covering the hiring of auditor personnel. For example, these policies may impose "cooling off" periods prohibiting the corporation from employing members of the audit engagement team in senior financial management positions for some period of time after their work as auditors for the corporation. The audit committee should consider whether to adopt such a policy. Any policy on the hiring of auditor personnel should be flexible enough to allow exceptions, but only when specifically approved by the audit committee.

Audit committee meetings should be held frequently enough to allow the committee to appropriately monitor the annual and quarterly financial reports.

- Audit committee meetings should be held frequently enough to allow the committee to appropriately monitor the annual and quarterly financial reports. For many corporations, this means four or more meetings a year. Meetings should be scheduled with enough time to permit and encourage active discussions with management and the internal and outside auditors. The audit committee should meet with the internal and outside auditors, without management present, at every meeting and communicate with them between meetings as necessary. Some audit committees may decide that specific functions, such as quarterly review meetings with the outside auditor or management, can be delegated to the audit committee chairman or other members of the audit committee.

Corporate Governance Committee

- Every publicly owned corporation should have a committee that addresses corporate governance issues. A corporate governance committee (often combined with, or referred to as, a nominating committee) is central to the effective functioning of the board. Traditionally, the corporate governance/nominating committee's role was to recommend director nominees to the full board and the corporation's stockholders. Over time, the committee's role has expanded so that, today, it typically provides a leadership role in shaping the corporate governance of a corporation.

A corporate governance committee should be comprised solely of independent directors.

- A corporate governance committee should be comprised solely of independent directors. While the CEO typically works closely with the corporate governance committee, a committee made up exclusively of independent directors reinforces the idea that the governance processes of the corporation are under the control of the board, as representatives of the stockholders.
- A corporate governance committee performs the core function of recommending nominees to the board. The committee also recommends directors for appointment to committees of the board. These responsibilities include establishing criteria for board and committee membership, considering rotation of committee members, reviewing candidates' qualifications and any potential conflicts with the corporation's interests, assessing the contributions of current directors in connection with their renomination, and making recommendations to the full board. The committee also should develop a process for considering stockholder suggestions for board nominees. While it is appropriate for the CEO to meet with potential director nominees, the final responsibility for selecting director nominees rests with the board.
- A corporate governance committee should monitor and safeguard the independence of the board. The Business Roundtable believes that an important function of a corporate governance committee, related to its core

function of recommending nominees to the board, is to ensure that a substantial majority of the directors on the board are, in both fact and appearance, independent of management.

- A corporate governance committee should oversee and review the corporation's processes for providing information to the board. The committee should assess the reporting channels through which the board receives information, and the quality and timeliness of information received, so that the board obtains appropriately detailed information in a timely fashion.

- A corporate governance committee should develop and recommend to the board a set of corporate governance principles applicable to the corporation. These principles should be communicated to the corporation's stockholders and should be readily available to prospective investors and other interested persons.

- A committee comprised of independent directors should oversee the evaluation of the board and management. Specifics concerning the evaluation process are discussed under "Board and Management Evaluation."

Compensation Committee

- Every publicly owned corporation should have a committee comprised solely of independent directors that addresses compensation issues. A compensation committee has two interrelated responsibilities: overseeing the corporation's overall compensation programs and setting CEO and senior management compensation.

- In addition to reviewing and setting compensation for management, a compensation committee should look more broadly at the overall compensation structure of the enterprise to determine that it establishes appropriate incentives for management and employees at all levels. In doing so, the committee should understand that incentives are industry dependent and are different for different categories of people. All incentives should further the corporation's long-term strategic plan and should be consistent with the culture of the corporation and the overall goal of enhancing enduring stockholder value.

- A diverse mix of compensation for the board and management can foster the right incentives and prevent a short-term focus or a narrow emphasis on particular aspects of the corporation's business.

  - *Trend toward equity compensation for directors and management.* In recent years, many corporations have increasingly moved toward compensating directors and management with stock options and other equity compensation geared to the corporation's stock price. While this trend may align director and management interests with stockholder value, equity compensation should be carefully designed to avoid unintended incentives, such as an undue emphasis on short-term market value changes.

  - *Management compensation.* Management compensation practices will necessarily differ for different corporations. Generally, however, an appropriate compensation package for management includes a carefully determined mix of long- and short-term incentives. Management compensation packages should be designed to create a commensurate level of risk and opportunity based on business and individual performance. The structure of management compensation should directly link the inter-

A compensation committee should look . . . at the overall compensation structure of the enterprise to determine that it establishes appropriate incentives for management and employees at all levels.

ests of management, both individually and as a team, to the long-term interests of stockholders.

▲ *Management benefits.* A compensation committee should consider whether the benefits provided to senior management, including post-employment benefits, are proportional to the contributions made by management.

Directors should be incentivized to focus on long-term stockholder value.

Board Operations

- Serving on a board requires significant time and attention on the part of directors. Directors must participate in board meetings, review relevant materials, serve on board committees, and prepare for meetings and for discussions with management. They must spend the time needed and meet as frequently as necessary to properly discharge their responsibilities. The appropriate number of hours to be spent by a director on his or her duties and the frequency and length of board meetings depend largely on the complexity of the corporation and its operations. Longer meetings may permit directors to explore key issues in depth, whereas shorter but more frequent meetings may help directors stay up to date on emerging corporate trends and business and regulatory developments. When arranging a meeting schedule for the board, each corporation should consider the nature and complexity of its operations and transactions, as well as its business and regulatory environment.

- Directors should be incentivized to focus on long-term stockholder value. Including equity as part of directors' compensation helps align the interests of directors with those of the corporation's stockholders. Accordingly, a meaningful portion of a director's compensation should be in the form of long-term equity. Corporations may wish to consider establishing a requirement that, for as long as directors remain on the board, they acquire and hold stock in an amount that is meaningful and appropriate to each director.

- The Business Roundtable does not endorse a specific limitation on the number of directorships an individual may hold. However, service on too many boards can interfere with an individual's ability to perform his or her responsibilities. Before accepting an additional board position, a director should consider whether the acceptance of a new directorship will compromise the ability to perform present responsibilities. It also is good practice for directors to notify each board on which they serve before accepting a seat on the board of another business corporation, in order to avoid potential conflicts. Similarly, the corporation should establish a process to review senior management service on other boards prior to acceptance.
- Independent directors should have the opportunity to meet outside the presence of the CEO and any other management directors.
- Many board responsibilities may be delegated to committees to permit directors to address key areas in more depth. Regardless of whether the board grants plenary power to its committees with respect to particular issues or prefers to take recommendations from its committees, committees should keep the full board informed of their activities. Corporations benefit greatly from the collective wisdom of the entire board acting as a deliberative body, and the interaction between committees and the full board should reflect this principle.

Independent directors should have the opportunity to meet outside the presence of the CEO and any other management directors.

- The board's agenda must be carefully planned, yet flexible enough to accommodate emergencies and unexpected developments. The chairman of the board should be responsive to individual directors' requests to add items to the agenda and open to suggestions for improving the agenda. Importantly, the agenda and meeting schedule must permit adequate time for discussion and a healthy give and take between board members and management.
- Management presentations should be scheduled to allow for question-and-answer sessions and open discussion of key policies and practices. Board members should have full access to senior management. Generally, the CEO should be advised of significant contacts between board members and senior management.
- The board must have accurate, complete information to do its job; the quality of information received by the board directly affects its ability to perform its oversight function effectively. Directors should be provided with, and review, information from a variety of sources, including management, board committees, outside experts, auditor presentations, and analyst and media reports. The board should be provided with information before board and committee meetings with sufficient time to review and reflect on key issues and to request supplemental information as necessary.
- Many corporations provide new directors with materials and briefings to permit them to become familiar with the corporation's business, industry, and corporate governance practices. The Business Roundtable believes that it is appropriate for corporations to provide additional educational opportunities to directors on an ongoing basis to enable them to better perform their duties and to recognize and deal appropriately with issues that arise.

- From time to time, it may be appropriate for boards and board committees to seek advice from outside advisors, independent of management, with respect to matters within their responsibility. For example, there may be technical aspects of the corporation's business — such as risk assessment and risk management — or conflict-of-interest situations for which the board or a committee determines that additional expert advice would be useful. Similarly, a compensation committee may find it useful to engage separate compensation consultants. The Business Roundtable believes that board and committee access to outside advisors in such cases is an important element of an effective corporate governance system.

The board should have an effective mechanism for evaluating performance on a continuing basis.

Board and Management Evaluation

- The board should have an effective mechanism for evaluating performance on a continuing basis. Meaningful board evaluation requires an assessment of the effectiveness of the full board, the operations of board committees, and the contributions of individual directors.

    ▲ *The performance of the full board should be evaluated annually, as should the performance of its committees.* The board should conduct periodic — generally annual — self-evaluations to determine whether it and its committees are following the procedures necessary to function effectively.

    ▲ *The board should have a process for evaluating whether the individuals sitting on the board bring the skills and expertise appropriate for the corporation and how they work as a group.* Board positions should not be regarded as permanent. Directors should serve only so long as they add value to the board, and a director's ability to continue to contribute to the board should be considered each time the director is considered for renomination.

Planning for the departure of directors and the designation of new board members is essential.

- Planning for the departure of directors and the designation of new board members is essential. The board should establish procedures for the retirement or replacement of board members. Such procedures may, for example, include a mandatory retirement age, a term limit, and/or a requirement that directors who change their primary employment tender a board resignation, providing an opportunity for the corporate governance committee to consider the desirability of their continued service on the board.
- Planning for management succession is also critical. The board or its corporate governance committee should identify and periodically update the qualities and characteristics necessary for an effective CEO. With these principles in mind, the board or committee should periodically monitor and review the development and progression of potential internal candidates against these standards. Advance planning for contingencies such as the departure, death, or disability of the CEO or other top executives is also critical so that, in the event of an untimely vacancy, the corporation has in place an emergency succession plan to facilitate the transition to both interim and longer-term leadership.
- Under the oversight of a committee comprised of independent directors, the nonmanagement members of the board should annually review the performance of the CEO and should participate with the CEO in the evaluation of senior management. The results of the CEO's evaluation should be promptly communicated to the CEO by representatives of the nonmanagement directors.

IV. Relationships with Stockholders and Other Constituencies

Corporations are often said to have obligations to stockholders and to other constituencies, including employees, the communities in which they do business, and government, but these obligations are best viewed as part of the paramount duty to optimize long-term stockholder value. The Business Roundtable believes that stockholder value is enhanced when a corporation treats its employees well, serves its customers well, maintains good relationships with suppliers, and has a reputation for civic responsibility and legal compliance.

The goal of stockholder communications should be to help stockholders understand the business, risk profile, financial condition, and operating performance and trends of the corporation.

Stockholders and Investors

- Corporations have a responsibility to communicate effectively and candidly with stockholders. The goal of stockholder communications should be to help stockholders understand the business, risk profile, financial condition, and operating performance and trends of the corporation.
- Corporations communicate with investors and other constituencies not only in proxy statements, annual and other reports, and formal stockholder meetings, but also in many other ways. All of these communications should be consistent, clear, and candid.
- In planning communications with stockholders and investors, corporations should consider:
  - ▲ *Candor*. Directors and management should never mislead or misinform stockholders about the corporation's operations or financial condition.
  - ▲ *Need for timely disclosure.* In an age of instant communication, there is an increasing need for

Corporations should obtain stockholder approval of new stock option and restricted stock plans in which directors or executive officers participate.

corporations to disclose significant information closer to the time when it arises and becomes available. The Business Roundtable supports the beneficial trend toward prompt disclosure of significant developments, while recognizing that a current disclosure regime must allow time to reasonably ensure accuracy and should not be a basis for new liabilities.

▲ *Ultimate goal of stockholder communications.* Whatever the substance of the communication, the corporation's ultimate goal should be to furnish information that is honest, intelligible, meaningful, timely, and broadly disseminated, and that gives investors a realistic picture of the corporation's financial condition and results of operations through the eyes of management.

- Because stockholders have a particular interest in the amount and nature of equity compensation paid to directors and senior management, corporations should obtain stockholder approval of new stock option and restricted stock plans in which directors or executive officers participate.

Employees

- It is in a corporation's best interest to treat employees fairly and equitably.

- Corporations should have in place policies and practices that provide employees with compensation, including benefits, that is appropriate given the nature of the corporation's business and employees' job responsibilities and geographic locations.

- When corporations offer healthcare, insurance, retirement, and other benefit plans, employees should be fully informed of the terms of those plans.
- Corporations should have in place mechanisms for employees to alert management and the board to allegations of misconduct without fear of retribution.
- Corporations should communicate honestly with their employees about corporate operations and financial performance.
- Technology makes communicating with employees quicker, easier, and less expensive. Corporations should take advantage of technological advances to enhance dissemination of information to employees.

Communities

- Corporations have obligations to be good citizens of the local, national, and international communities in which they do business. Failure to meet these obligations can result in damage to the corporation, both in immediate economic terms and in longer-term reputational value.
- A corporation should be a good citizen and contribute to the communities in which it operates by making charitable contributions and by encouraging its directors, managers, and employees to form relationships with those communities. A corporation also should be active in promoting awareness of health, safety, and environmental issues, including any issues that relate to the specific types of business in which the corporation is engaged.

Government

- Corporations, like all citizens, must act within the law. The penalties for serious violations of law can be extremely severe, even life threatening, for corporations.

Compliance is not only appropriate, but also essential. Management should take reasonable steps to develop, implement, and maintain effective legal compliance programs, and the board should periodically review such efforts to gain reasonable assurance that they are effective.

- Corporations have an important perspective to contribute to the public policy dialogue and should be actively involved in discussions about the development, enactment, and revision of the laws and regulations that impact their businesses and that affect the communities in which they operate and their employees reside.

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