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## SESSION II: DEVELOPING EFFICIENT BOARD PRACTICES

### BOARD EFFICIENCY: THE AGENDA SETTING ROLE AND INFORMATION NEEDS OF THE BOARD OF DIRECTORS

Presentation by

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#### <sup>1</sup>[SLIDE 1]

- We've heard a lot today about the need for corporate governance improvement in Russia and the significant impediments to such improvement. We've heard from numerous participants, to paraphrase, that in Russia, "*The absence of rules is the rule.*"
- But, putting the theory of corporate governance into practice is not wholly dependent on rules and enforcement; there is much that can be accomplished by voluntary private conduct.
- And so, before I go on with my presentation, I'd like to pose a question for the Russian private sector to ponder:
- *Who among you are the corporate leaders who will come forward and put aside self interest and make reform happen, company by company, because it is in the interests of the companies, the interests of the shareholders, and the interests of Russia?*

#### [SLIDE 2]

- We have heard a number of speakers talk about the governance challenge boards face in providing strategic guidance while monitoring management to hold them accountable.

#### [SLIDE 3]

- I will focus on the key elements of board efficiency -- board agenda, board information flow and board evaluation.
  - Appropriate board composition and committee structure position the board *as a body* to form an objective and informed judgment and take action on that judgment.
  - Attention to the board's agenda helps ensure that the board is focused on the relevant issues.
  - But the board also needs access to relevant, accurate and timely information about corporate performance and potential risks. (I was interested to hear of Mr. Federov's experiences in this regard.)
  - And, from time-to-time, a review by the board of its own performance assists the board to maintain effectiveness and efficiency.
- The goal is to create a culture in which an informed, involved and objective supervisory board actively engages with management in strategic planning, while monitoring the performance of management and watching out for any potential problems.

#### [SLIDE 4]

#### Board Agenda:

- The board's agenda is driven by its role and responsibilities, as set forth in law, regulations, listing rules, and the corporate charter. I am not an expert in Russian Corporate Governance, and therefore will speak from experience in the U.S.

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<sup>1</sup> The views expressed in this paper are those of the author and do not necessarily represent the opinions of the OECD or its member countries. This paper is subject to further revision.

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- Here is a fairly typical list of the board’s responsibilities in the U.S. It is quite similar to the list presented by Stilpon Nestor and is consistent with OECD Principles:
  - The board selects, monitors, evaluates, compensates and, when necessary, replaces senior executives;
  - It reviews and approves major policies and strategic plans, and material capital expenditures and transactions not in the ordinary course of business;
  - It ensures the integrity of the corporation’s financial control and reporting system;
  - It reviews the adequacy of compliance with applicable laws and regulations;
  - and the board organizes its own governance processes.
- This list indicates the delicate balance between the role of the board and the role of management. Boards don’t run the corporation; that is a job for the CEO and the management team. Boards provide guidance and oversight.
- In the U.S. these responsibilities help guide the agenda setting process. Of course, every corporation will have their own unique priorities.
- But the key point is that the board itself must determine its agenda and ensure that the directors have access to the information they require to govern.
- Otherwise, there is a danger that the board will function like this board.

**[SLIDE 5]**

**Information:**

**[SLIDE 6]**

- “Relevant and timely information is an essential predicate for satisfaction of the board’s supervisory and monitoring role.”
- Information needs vary from board to board and from time to time, and are driven largely by the board’s agenda and corporate strategy.
- So board involvement in agenda setting, strategy and in determining information needs are all linked. I emphasize -- to be effective the board must take an active role in ensuring that it has access to the information it requires.

**[SLIDE 7]**

- Common information needs include:
  - Routine data and other information to assist in comparing company performance to business plan, competition, and previous performance periods. This includes:
    - operating statements, balance sheets, and statements of cash flow that compare current period and year-to-date numbers with the corporate plan and the previous year
    - management briefs that explain variations of the above from plan, including revised forecasts
    - market share figures
    - minutes of management committee meetings in which key reports were presented or capital expenditure actions were taken
    - important news articles about the company and its competition
    - reports from financial analysts about the company and its competition
    - forward looking information and projections
  - Directors also require information to prepare for important discussions that require a thorough review of various courses of action, such as --
    - management memos that define the problem, present the alternatives, and analyze the probable financial and intangible consequences of pursuing each alternative.
- And directors require information about related party transactions and potential conflicts of interests involving controlling shareholders and senior managers. (All such transactions -- sales, rentals,

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purchases of assets, loans, guarantees -- should raise red flags for directors, and a lot of attention should be given to getting independent information about fair value.)

- In the U.S., it is common practice for the board to discuss with managers the information directors want. It is also common for there to be a set policy concerning how far in advance of a meeting directors receive such information. Time at the meeting is reserved for discussion rather than education of directors, and this leads to efficiency. But individual directors don't seek information directly from management.

- **Related Practices:**

[SLIDE 8]

- In addition to determining the kind of information it seeks, a board should ensure that a corporate information and reporting system exists to provide high quality information -- both for the board and for public reporting purposes.
- And this has two broad components: Financial reporting, and compliance and risk assessment.
- Since it is through audit and accounting that basic information about corporate financial performance is verified, the audit and accounting function is central to a board's ability to detect potential problems in corporate financial performance.
- Another issue related to the information needs of the board is the plan for management and board interaction in times of crisis.

[SLIDE 9]

- Does management understand when to inform the board of a potential problem? (avoid surprises)
- Does the board have a mechanism to consult, convene and take action absent management setting the board in motion? (meet alone; board leadership)
- When management failure or potential wrongdoing may be at issue, do independent directors have the ability to conduct separate investigations? And, can they hire their own advisors?

[SLIDE 10]

The quality of supervisory board governance is in the hands of the supervisory board. Any real improvements in actual practice must be generated by the board itself.

This is why periodic reflection on the board's own performance is important; the goal should be continual self-improvements.

**CONCLUSION**

- Delaware Supreme Court Chief Justice Norman E. Veasey recently listed seven fundamental board practices that should help directors perform their roles.

[SLIDE 11]

- Every board should have a "heavy majority of purely independent directors."
- The board "should be involved in actual governance."
- Directors should have face-to-face, comprehensive meetings on a regular basis.
- Directors should limit the number of boards on which they serve.
- Directors should have a system to evaluate the CEO regularly and the independent directors should meet regularly in executive session.
- The board "should carefully review disclosure documents."
- And, the board should establish and monitor effective law compliance programs.
- I'll add to these that the board should determine its agenda and ensure that it receives the information it requires.
- These are the hallmarks of an effective board and, for the most part, they do not require changes in law or regulatory framework -- just dedicated application by the private sector.