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## A New World of Accountability

Directors must come to grips with the merging of business and public agendas

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TODAY'S CORPORATE DIRECTORS FACE A DAUNTING accountability environment. They are challenged by both the government and the public. While those agendas frequently intersect, they also diverge in increasingly complicated and unpredictable ways. Governments, in the wake of the financial crisis, are revising, originating and implementing financial regulation as never before – and on a global scale that's unprecedented. The regulatory storm continues across numerous other spheres of corporate involvement, such as climate change, healthcare and national security.

Many of these regulatory initiatives are designed to serve public accountability, by protecting public investment, expanding reporting requirements, increasing transparency and generally opening up the activities of corporations to more and deeper scrutiny. Beyond that, however, public accountability has taken on a life of its



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own, moving beyond having its needs articulated solely by government legislation. With social media continuously monitoring and disseminating the minutia of corporate activity, directors face a broader slate of publicly generated “responsibilities” than ever before – one that continues to morph and grow as technology, culture and public interest evolve.

Many corporate directors and senior executives feel there’s been a fundamental shift in the way governments intervene in the economy and in the way the public condones and extends that intervention. Events and trends suggest that public accountability now transcends traditional notions of corporate responsibility: government responses to mortgage meltdowns and market failures; unprecedented international co-operation to stabilize global financial markets; and the proliferation of 24/7 media – both traditional and social – which cover these events in real-time and remarkable detail, forcing governments and businesses to prioritize fast response and damage control over the “long view.” While conventional compliance is still critical, directors must now answer to a broader public audience. And they must work to understand and anticipate where the intersection of regulatory change and public accountability will take them.

The Deloitte report, *A New Age of Public Accountability: Implications for Directors*, explores the evolution of this dynamic, the forces shaping accountability today, how governments and businesses are reacting and what the new environment means for directors.

### **Governments have always intervened – business has always adapted**

Directors are no strangers to the ways business, government and the public interest intersect. While today that relationship takes on new forms and introduces unexpected challenges, governments have always involved themselves in the policies and activities of their private sectors to ensure the broader interests of society.

Current examples of economic intervention include setting monetary policy, controlling trade and directing environmental reform. Businesses are also affected by less obvious practices, such as direct and indirect taxation, user fees and government procurement policies. Regulation, of course, remains the central way governments exert influence on

business. Virtually every aspect of the value chain is affected, from use of land and raw materials to cross-border shipping and waste disposal.

The 20<sup>th</sup> century reveals a long history of intervention in response to dramatic events, including the creation of central banks; the establishment of Crown agencies; the formation of the IMF, World Bank and European Union; and the introduction of regulated stock exchanges. In the wake of the financial crisis, there have been thousands of new or revised regulations affecting global business since early 2007.

Capping the public-accountability revolution, the ubiquitous lens of social media and 24-hour news coverage has collapsed government and corporate privacy walls, further blurring the line between the two. In this historical and social context, public demand for greater accountability is soaring, and a new form of interventionist government is emerging.

### **It’s different this time: Government and business come closer together**

The beginning of the new age of accountability can be traced to the turn of the millennium. A sequence of global events, social trends and financial repercussions have drawn government and business even closer together, mediated by the ever-changing filters of public pressure and opinion.

- **9/11** – As a long-term preventive response to these tragic events, governments imposed unprecedented demands on businesses for access to all kinds of information, from the customers they serve to the products they ship. Remote sensing, bar coding, CCTV, and digital information exchange have become commonplace, providing government agencies with unprecedented transparency of business operations. Recent government demands for gaining access to e-mail and instant messages is just the newest frontier as governments expand their reach into the realms of corporate and personal information.
- **Enron and Sarbanes-Oxley** – In reaction to a series of public accounting scandals, such as Enron and WorldCom, the *Sarbanes-Oxley Act* substantially raised standards for all U.S. public company boards, management and public accounting firms. The extent of this legislation showed

the willingness of government to step in when corporate governance fails.

- **Fiscal imbalances** — The financial crises exacerbated the fiscal challenges many Western governments were already facing, by forcing governments to backstop struggling businesses and stimulate the economy. But a new age of government austerity is emerging and governments' financial support to business is likely to decline. As a result, social responsibility is shifting to the private sector, and businesses that seek government support are being pressured to create and protect jobs.
- **Demographics** — The working-age population of most industrialized countries is shrinking, while the cost of services for those ageing populations continues to rise. As governments struggle to face these challenges, businesses will need to consult, collaborate and participate in solutions.
- **Global, state-sponsored enterprises** — The energy sector is a prime example of how state-owned enterprises like Petrobras, China National Oil Company, Saudi Arabia oil giants and Russia's Gazprom are growing in size and influence. Governments around the world are being compelled to adapt foreign-ownership rules and develop strategies to help domestic enterprises compete.
- **Social media** — Social networking lets individuals and interest groups share information and opinion with unprecedented immediacy and unanticipated consequences. It is a powerful instrument for pressuring the corporate and government worlds to achieve social change. As the lines between private enterprise and public accountability continue to blur, understanding the public agenda is becoming vital. When WikiLeaks announced that it was holding unflattering information on some of the world's largest banks, share values dropped on concerns that reputational damage could follow.

### Where will government, business and public interaction lead?

Far from abating, this trend will likely see government, business and the public become even more interconnected. Governments' efforts to stimulate economic growth through investment and tax cuts will be countered by public pressure to address complex social, political and environmental issues. Businesses, too, will need to respond to these pressures, while being mindful of the far-reaching impacts their

policies and decisions may have. Several key trends are likely to emerge:

**Governments will assume a stronger regulatory role:** The public will expect governments to intervene more readily and more comprehensively. Regulatory mandates will shift from telling businesses what they must do to telling them what the outcomes of their actions should be. While this results-focused approach offers businesses some freedom in their specific activities, it ups the ante on doing the right thing and being accountable for both the intended and unintended consequences of their actions.

**Near-term agendas will dominate:** The cycle of government policy development has shrunk from years to months. With social media enabling the viral dissemination of public opinion, governments face considerable pressure to focus more on immediate, short-term policy announcements — possibly at the expense of long-term solutions.

**Corporate information will be increasingly disclosed:** The open-government movement, regulatory compliance and the release of data by special interest groups and sites like WikiLeaks will lead to more corporate information being exposed to the public. In response, businesses need to find ways to adapt to and manage within this new atmosphere of public disclosure.

**Governments will demand greater access to electronic records:** In the quest to improve cyber security, governments will demand more access to private electronic business records. Foreign investor-disclosure requirements in the U.S. *Foreign Accounts Tax Compliance Act* (FATCA) provide a cautionary example of an area where government and business agendas may collide, rather than intersect, in the future.

### What's a director to do? New public accountability imperatives

The tools traditionally used to mitigate regulatory and reputational risk are no longer enough when time-tested brands can be damaged or destroyed with Internet speed. In today's increasingly complex business environment, directors need to look at the organization in new ways, applying a new standard of public accountability. A few specific steps can

help directors deal with this new age of public accountability:

**Understand public risk** — In this new age of public accountability, directors will need to expand their risk-management responsibilities beyond regulatory compliance. Regulators, shareholders and citizens will expect boards to promote public accountability throughout the enterprise and across the value chain.

**Look at the larger public picture** — Directors must be mindful that repercussions of business actions go beyond traditional enterprise boundaries. When Apple faced criticisms about the working conditions at its supplier plants in China, it commissioned and published a third-party report on conditions across its China value chain to demonstrate accountability and action.

**Test compliance systems** — Assuming that intense public scrutiny is on the rise and transparency is inevitable, directors must undertake worst-case scenario planning. They must also ensure management regularly monitors, tests and assesses public and regulatory risk.

**Collaborate with policy-makers** — Governments make better decisions when they have a clear understanding of business and specific industries. By moving from compliance to collaboration, directors can facilitate a dialogue between government and business that clarifies public issues for both.

**Develop a culture of public accountability across the enterprise** — Encourage executives and staff to think like citizens — rather than only shareholders or customers — and to value public interests. Citizens are much more empowered today to hold businesses publicly accountable. Toyota's experience last year with cell phone videos of vehicles failing to brake effectively provided evidence of that. What used to be an acceptable corporate response to safety or other issues may not be sufficient today, and what's accepted today may not be tomorrow. Given the real dangers of public outcry in the social-media age, directors must stay on top of core societal values and concerns to protect both the public interest and shareholder value.

### Your business is on the public agenda

Many board members find the director's chair increasingly uncomfortable. The reason for this discomfort is not because these emerging challenges have dampened their enthusiasm or dedication to serving, but because identifying the true scope of board responsibility is becoming so difficult. Change is rapid, influencing factors are diverse and the stakes — for individual businesses, the economy and the public interest — are higher than ever. At the same time, accelerating levels of transparency, scrutiny and public pressure leave directors and companies little time to react, much less stop to analyze long-term repercussions.

Ultimately, this unease probably augurs well for directors and the companies they oversee. If the director's seat is becoming uncomfortable, it's time to shift positions and look at public accountability in a different light. By working to understand public expectations, dialoguing with policy makers, encouraging citizen discussion, and promoting ethics and accountability across the organization, directors can begin to build true public accountability into the organization. This newfound accountability will not only meet the challenges of today, but build an adaptive corporate paradigm for tomorrow.

For a more in-depth analysis of the changing accountability landscape, read the full Deloitte publication, *A New Age of Public Accountability: Implications for Directors*.

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