

2005 SPECIAL SUPPLEMENT



WHAT
DIRECTORS
THINK

The Corporate Board Member/PricewaterhouseCoopers Survey

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Profile of U.S.
Corporate Boards

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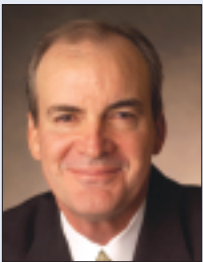
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construed as legal or accounting advice.
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INTRODUCTION

More so than ever before, corporate directors know it takes more than just showing up to do their jobs well. During the last year, several landmark legal cases, including Enron, WorldCom, and Disney, became stark reminders of board members' ongoing duties of loyalty and care to shareholders. In response to these public events, as well as to the structural and regulatory changes mandated by Sarbanes-Oxley, most corporate boards have willingly raised the bar on ethics and accountability. Yet the job is far from over.

What Directors Think, a research report by *Corporate Board Member* and PricewaterhouseCoopers LLP, collected responses from more than 1,100 corporate directors in 2005 about how they are meeting current demands to serve corporate governance ideals. Overall, great strides were made in the implementation of good governance practices, yet more emphasis on strong board leadership and independence is needed.

We hope you'll find this supplement, a companion to the *Corporate Board Member* magazine published in October, useful in providing you with additional information on how directors view their role as fiduciaries for investors and the public markets and what steps they are taking to better meet their responsibilities. In addition, we would like to thank the board members who participated in this survey, whose opinions made this study possible.



A handwritten signature in black ink, appearing to read 'TK Kerstetter'.

TK Kerstetter
President
Corporate Board Member



A handwritten signature in black ink, appearing to read 'Herb Schulken'.

Herbert C. Schulken Jr.
Partner and U.S. Leader for Corporate Governance
PricewaterhouseCoopers LLP

Corporate Governance Improving, But More Momentum Needed

Since 2002, corporate boards have made steady progress to improve their culture of ethics and standards for governance. Yet for many companies, material change has occurred more slowly than expected three years after the passage of the Sarbanes-Oxley Act, according to the *Corporate Board Member/PricewaterhouseCoopers 2005 What Directors Think* study.

For example, although boards have a heightened awareness about establishing independence, 74% of the 1,103 corporate directors responding to the survey say the CEO is still primarily responsible for setting the board meeting agenda. Furthermore, 10% of directors say the CEO is responsible for establishing meeting agendas for the audit, compensation, and governance/nominating committees— even though the New York Stock Exchange listing standards mandate these committees be comprised of only outside, independent directors.

“While significant strides have been made, more work still needs to be done,” says Herbert C. Schulken Jr., a partner with PricewaterhouseCoopers and the leader of its corporate governance group. “Not enough people are getting the message—and boards have not taken charge of setting their own agendas. The good news is that, for the most part, independent directors seem to be taking charge of their committees, even if they’re still looking to the CEO to set the scope for the overall board.”

Establishing leadership

Thus, even with an increased emphasis on improving board practices, the survey demonstrates that boards aren’t taking enough control over their activities. Nearly half (47%) of the respondents believe board leadership should emanate from the CEO, compared to the 38% who say leadership should come from a nonexecutive chairman.

This response provides fodder for a heated debate over the appropriate balance of power and leadership in corporate entities. “A board can effect change in the corporate culture in two major ways—through the hiring of the CEO and by setting the tone for ethics throughout the organization,” says TK Kerstetter, president of *Corporate Board Member*. “There is no question that the CEO should lead the corporation in his or her vision, but the board needs its own independent leadership to effectively meet its responsibilities to the shareholders.”

Management succession is another issue boards haven’t yet been able to wrestle with fully, according to the research. Almost half of the directors responding (47%) say they are not satisfied with their

succession planning efforts. Of those, 66% do not include the topic on their regular agendas, and 26% say they have chosen not to address the issue because their CEO was uncomfortable with the topic.

“Succession planning is one of the most important areas of responsibility for a board,” says Kerstetter. “Finding the right CEO and managing risk are the two most crucial things boards should do. Yet this research indicates these are the two things boards believe they are least effective in doing.”

Adds Schulken: “Succession planning means more than having a performance evaluation for the CEO. The board needs to have a process in place in the event they must replace the CEO on an immediate basis. Certainly, that need can be driven by a performance-related issue, but unfortunately we’ve also seen situations where the sudden death or incapacity of a CEO causes the board to have to act quickly and decisively. And the process is not about having a name in an envelope. It’s about boards knowing what they would do if they were faced with having to replace the CEO.”

Executive compensation

The survey showed directors strongly believe boards are effective in overseeing CEO compensation. However, other survey responses suggest a disconnect in the various aspects of managing compensation. While 84% of directors believe they are doing a good job of managing CEO compensation—up slightly from last year—70% of all respondents believe boards are having trouble controlling the level of executive pay, and only 14% want to spend more time on compensation issues. Not surprisingly, when this response is analyzed according to the title of the respondent, 75% of outside directors said they thought boards were having a difficult time managing CEO compensation, while only 48% of CEOs agreed. Moreover, shareholders—and employee groups—are concerned about the level of CEO pay.

“Everywhere I go, directors are talking about compensation. And corporate governance experts agree CEO compensation is the next big issue for boards. In fact, I recently heard one director say he believed that the hardest job on the board had shifted from being the chair of the audit committee to being the chair of the compensation committee,” says Schulken.

He also says more boards are insisting that the compensation consultant work directly for the compensation committee, and that they be prohibited from doing work for management.

“While I agree this is an important way to ensure the consultants’ independence, boards still need to focus more on the metrics that go into determining how much the CEO receives,” Schulken says. “They also need to do more sensitivity analysis—i.e., understanding how the CEO’s pay will be affected if certain events occur—and fully understand all elements of the overall pay package, and ensure shareholders do as well. Too often, boards have admitted after the fact that they didn’t fully understand how much the CEO was being paid.”

Other highlights

Other highlights from the 2005 What Directors Think study include the following:

Despite risk, most directors are staying put. Media coverage of directors’ personal liability resulting from corporate downfalls has made board members more cautious, but it doesn’t appear to be sending them scurrying from the boardroom. When asked about the WorldCom and Enron personal settlement payments made by those companies’ outside directors, 89% of respondents said they were either very concerned or somewhat concerned; two-thirds (66%) said they will conduct expanded due diligence before accepting any additional board appointments.

Fully 73% of respondents said they believe their risk as a director has increased over the last 12 months—an increase from 68% last year—but only 1% said they would resign all of their board seats.

“The good thing here,” Schulken says, “is that directors haven’t overreacted to these recent settlements. Directors, by and large, are not leaving board service because of liability concerns. If that had happened, it would not have been good for boards or the capital markets.”

Most boards aren’t prepared for crisis. In a time when catastrophes are making headlines regularly, boards need to be more involved in risk management. More than half (51%) of responding boards said they do not have an action plan in place if their company faces a major crisis; another 8% were not sure if they did. This, says Schulken, points to a need for greater involvement by boards. “If we are to move into an era of improved corporate governance as anticipated under the Sarbanes-Oxley legislation, directors need to step up to the plate,” he says.

“Crisis management is critical,” agrees Kerstetter. “If boards are doing enterprisewide risk management correctly, the percentage of boards with an action plan in place should be much higher. The sudden loss of a CEO, for instance, can be a major crisis. But there

are many other events that could happen—such as product quality or legal compliance issues—that could be far better handled with proper forethought.”

This doesn’t mean boards should be in charge of creating crisis management policies themselves. However, Schulken says, “the board should be asking management, ‘What have you been doing to prepare for various crisis scenarios?’”

More training is needed. While 55% of directors report they are encouraged or required to participate in outside director training, 30% of boards responded that their company has no formal training program for directors. “In particular, the directors who are new to board service should gain a broad background in board best practices to help them do their job better, and focused director training programs can be a valuable source of this information,” says Schulken. “It’s also a good way to meet other directors and leading experts in a variety of governance-related topics.”

Looking beyond the bottom line. Boards sometimes succumb to tunnel vision when it comes to their governance role in the organization. Financial matters are critical, but there are equally compelling issues surrounding the three major constituencies directors must serve: customers, employees, and shareholders. When asked about materials they receive to prepare for board meetings, 89% say they receive financial and business data, but only 47% of directors receive information on employee values and satisfaction, and just 42% receive information about customer satisfaction.

“I view this as a red flag,” Kerstetter says, “because these three elements should always be in balance. If too much attention is paid to one constituency, to the detriment of the other two, it’s a warning signal for problems in the organization.”

Conclusion: Raise the bar

Governance reforms continue to foster higher levels of ethics and good corporate citizenship, yet many boards need to take additional steps to empower themselves. While deferring to the CEO in matters of management and the execution of policy is acceptable and, in most cases, prudent, leadership on policy direction and corporate culture should emanate from the board of directors. Furthermore, adequate preparation for management succession and potential crises is critical, as is taking back ownership for determining an appropriate level of executive compensation. When these responsibilities are met, *Corporate Board Member* and PricewaterhouseCoopers believe boards will become stronger and better able to withstand crisis, manage risk, and increase value for shareholders in the long term.

Board Leadership and Succession Planning

The concept of leadership is linked intrinsically with our understanding of the role of the board, yet current debate on where leadership emanates from and how an organization determines its balance of power is sparking heated discussions in governance circles today. To add fuel to that debate, the 2005 *Corporate Board Member/PricewaterhouseCoopers What Directors Think* study reveals several key findings about how corporate boards define leadership.

Who's in charge?

As directors prepare for each meeting, one document—the agenda—serves as a road map that leads the board through the issues necessary for discussion or action. Generally speaking, the agenda focuses the board's attention on specific responsibility within each meeting. Thus, the individual who plays the key role in setting that agenda assumes an important leadership position within the board itself. In some organizations, this function is handled by management; in others, the agenda may be set by a nonexecutive board chair or a lead director in consultation with the CEO and with input from other directors.

When the 2005 *What Directors Think* study surveyed directors about who is primarily responsible for setting their board meeting agendas, 74% said agenda direction comes from the CEO. Only 14% said a nonexecutive chair sets the agenda and 10% said leadership emanates primarily from either a lead director or the general counsel/corporate secretary (see Figure 1).

This finding might raise eyebrows among strict proponents of board independence, but it appears to be ingrained in many companies' culture. When asked where board leadership should emanate from, 47% believe it should come from the CEO (see Figure 2). Only 38% of directors believe board leadership should emanate from a nonexecutive chair.

While the CEO has long been defined as the managerial leader of the organization, these findings suggest that the power wielded by the CEO remains strong, despite an emphatic movement toward best practices and independent boards. It also suggests that many board members seem to be willing to allow a CEO a great deal of latitude in running the company and directing the focus of their oversight. The crucial test will come when those boards' vision for the company departs from the CEO's.

FIGURE 1

Who is primarily responsible for establishing your board meeting agenda?

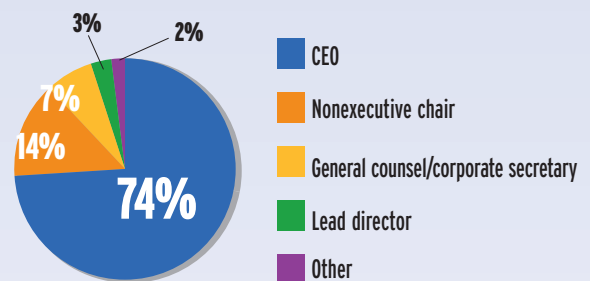


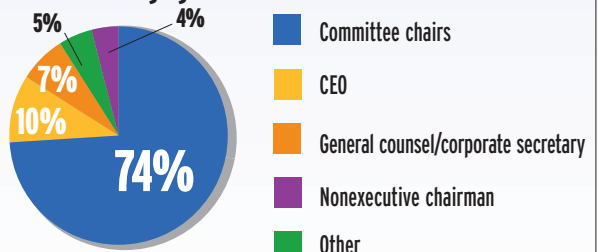
FIGURE 2

Board leadership should emanate from...

CEO	47%
Nonexecutive chair	38%
Nominating/governance committee chair	7%
Lead director	4%
Board/directors	3%
Other	1%

FIGURE 3

Who is primarily responsible for establishing your committee meeting agendas?



Committee agendas

Next, the survey turned to questions about leadership within board committees. While the CEO often takes an active role in full board meetings because of his or her responsibility for business strategy and company performance, it's widely accepted that board committees should be independent of managerial control. When asked who is primarily responsible for establishing committee meeting agendas, 74% said the various committee chairs set the agendas. However, as further evidence of the breadth of CEO influence in some companies, 10% responded that the CEO handles the responsibility for setting committee meeting agendas (see Figure 3).

Board nominations

Another aspect of leadership concerns oversight for board composition. When a board seat becomes available, it may be difficult to find a candidate with the experience and skill sets needed. A board that is not adequately prepared may find that identifying qualified directors becomes a contentious and frustrating exercise.

When searching for new board members, 62% of directors said one of the most frequent and reliable sources of candidates is other board members (see Figure 4). Nearly a third (29%) reported a good source for candidates is search firms, and 23% said a reliable source is the CEO. Only 1% of the survey group reported shareholders as a reliable source for qualified candidates.

Succession planning

Year after year, succession planning plagues America's boardrooms, and this year's survey found no exception. Nearly half (47%) of the 2005 survey respondents reported being unsatisfied with their company's succession planning efforts (see Figure 5).

Several reasons may fuel this dissatisfaction. About two-thirds (66%) say management succession is not a regular item on the board meeting agenda, and 41% say their board tries to handle management succession only as the need arises (see Figure 6). Further, of those who are dissatisfied with their succession planning efforts, 26% say it is because the CEO is "uncomfortable" with the topic. This finding again harkens to the need for directors to take a more active role if their boards are to rise to the level of best practices for corporate governance.

FIGURE 4

Which are the most frequent and reliable sources of candidates for the board?

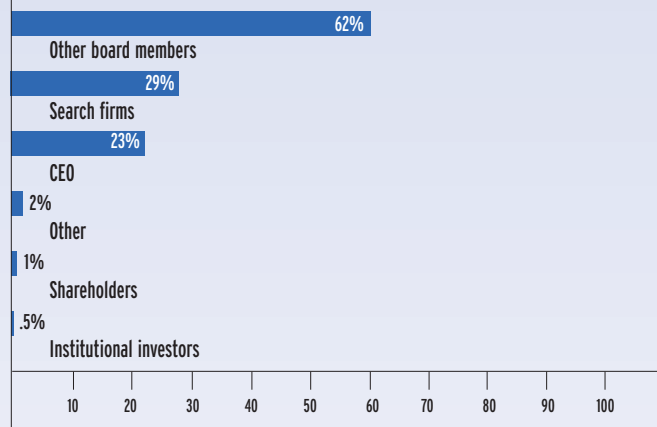


FIGURE 5

Are you satisfied with the planning of your company's management succession?

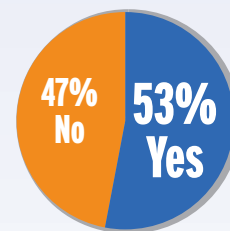
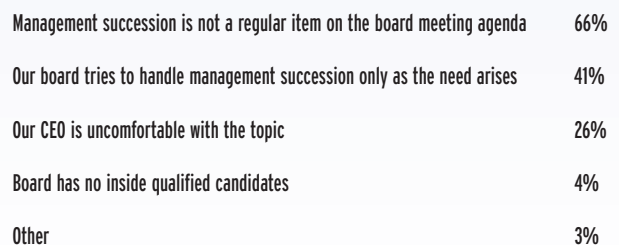


FIGURE 6

With which elements of your company's management succession planning are you dissatisfied?



Performance and Evaluation

Undergoing objective evaluation is a necessary function for any healthy organization or group of individuals. And while evaluating a board's performance can be challenging, that doesn't mean it should be avoided. In measuring the effectiveness of their performance, boards should address such matters as how well they live up to standards of independence; their ability to oversee risk management; their effectiveness in discharging their various responsibilities; their ability to balance the sometimes-competing demands of all major constituencies (shareholders, customers, and employees); their ability to effectively plan for a potential crisis; and how well members work with management and among themselves toward strategic goals.

Boards also need to evaluate the CEO's performance—an often-sensitive function that generally accompanies the executive's compensation review and one with which many boards wrestle.

CEO evaluation by the board

While it is refreshing that the study shows the vast majority of boards (85%) perform a thorough annual review of the CEO's performance (see Figure 7), surprisingly, 15% either aren't doing so or perhaps don't consider their evaluations to be "thorough." Given the intense scrutiny by investors on CEO pay policies in the current environment, even this small percentage points to questionable practices on the part of some boards.

Among boards that do perform CEO evaluations, 91% believe they are either very well equipped or reasonably equipped to do so (see Figure 8). The study found that after the evaluation is complete, the majority of boards (54%) assign the compensation committee chair the task of discussing the evaluation with the CEO, and 32% assign the responsibility to the lead director (see Figure 9).

Use of board evaluations

Today, board performance evaluations are much more ingrained in the corporate fiber than several years ago. When asked whether the entire board's performance is evaluated on a regular basis, for example, 84% of respondents answered yes (see Figure 10), a 154% increase since 2002, when just over 33% reported having regular board evaluations. In addition, the usefulness and quality of board evaluations has apparently grown: Today 67% say such evaluations are either very effective or effective, whereas three years ago only 37% felt that way.

FIGURE 7

Does the board perform a thorough annual review of the CEO's performance?

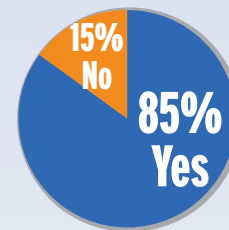


FIGURE 8

How well equipped do you believe your board and/or compensation committee is to perform the CEO's review?

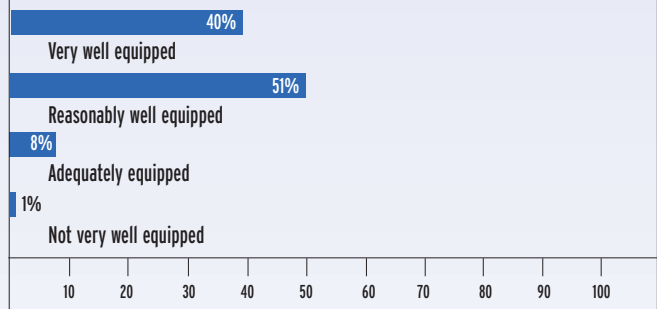


FIGURE 9

Who discusses the CEO's performance evaluation with him/her?

Board chair	18%
Lead director	32%
Chair of the compensation committee	54%
Chair of the nominating committee	7%
Entire board	16%
Other	3%

Individual director evaluations are also growing in popularity, though they are not as widely performed as full board evaluations. Thirty-seven percent (37%) of directors responded that their board evaluates individual members on a regular basis—nearly double the 19% who answered affirmatively in 2004 (see Figure 11). Of those whose boards evaluate individual directors, 70% say they are either effective or very effective, compared to 36% in 2002. In addition, when asked whether individual directors should be regularly reviewed as to their performance, more than three-quarters (77%) said yes (see Figure 12).

Self-review

Self-evaluation is the most common way for the board to benchmark its own strengths and weaknesses. The study asked directors in which areas they believed their board to be most effective. The results are as follows:

	Very Effective	Effective	Somewhat Effective
The board's ability to stand up and challenge management when appropriate	50%	37%	11%
The audit committee's ability to monitor accurate financial reporting	48%	46%	6%
The board's ability to adopt a meaningful ethics policy	39%	48%	12%
Compensation committee's ability to properly oversee CEO compensation	39%	45%	13%
The board's ability to complete a management succession plan	20%	37%	35%
The board's ability to create an agenda that best uses the board's limited time	15%	51%	29%
The board's ability to monitor a risk management plan to mitigate exposures	11%	50%	36%

These responses show responding directors are more confident in their ability to stand up to management and oversee financial reporting and ethical standards than they are in handling management succession, developing an effective agenda, and risk management.

FIGURE 10

Is the entire board's performance formally evaluated on a regular basis?

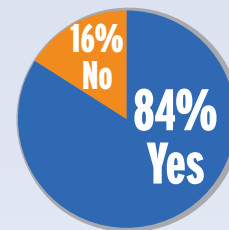


FIGURE 11

Does your board evaluate individual directors on a regular basis?

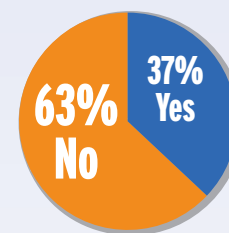
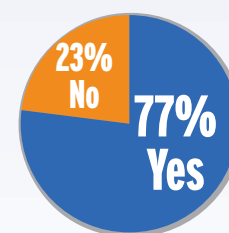


FIGURE 12

Should individual directors be evaluated regularly as to their performance?



Executive and Board Compensation

The board's role in overseeing executive compensation has gained much attention recently due to several well-publicized cases where excess and a lack of accountability were apparent. As a result, shareholders have stepped up their scrutiny over both executive and board pay—as have hungry plaintiff's attorneys. Therefore, the 2005 What Directors Think study posed several questions to ascertain how boards are dealing with executive and director compensation.

A new paradigm for compensation committees

During the past few years, investors and the media turned up the heat on several boards for awarding generous CEO pay or golden parachute packages. In addition, sweeping reform of deferred compensation plans was enacted in the wake of corporate scandals after proxies showed executives deferring wages at little or no risk of loss. Another issue casting a cynical eye on compensation programs was the SEC's probe into "backdating," or manipulation of stock option grant dates. Finally, at the end of 2005, legislation was proposed that, among other things, requires disclosure on all severance agreements, pensions, bonuses, perks, and calculations for most types of short-and long-term executive pay.

The seriousness of these issues has, within a relatively short period of time, dramatically changed the role of corporate compensation committees. Thus, compensation committee members must discharge their responsibilities more carefully, and at the same time, learn to operate under a microscope.

Executive compensation perceptions

With the increase in public awareness due to a few high-profile cases, it is no surprise that the vast majority of directors (70%) believe U.S. companies are having trouble controlling CEO pay (see Figure 13). As to specific areas, directors are most concerned with options and equity plans (77%), bonus programs (66%), and termination agreements (60%) (see Figure 14).

Looking forward, the challenge for compensation committees will be to create competitive pay packages that align the executive's long-term interests with those of shareholders, while ensuring these programs feature the transparency and accountability required in this new paradigm. The old practice of pegging the CEO's compensation to the top quartile of the peer group—especially when the company's performance isn't in the top quartile—is no longer acceptable. In the future, this mandate will

FIGURE 13

In general, do you believe U.S. company boards are having trouble controlling the size of CEO compensation?

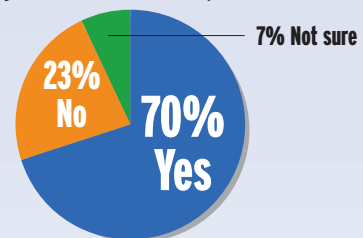


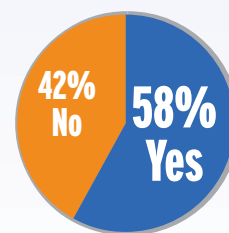
FIGURE 14

Which areas are of concern in controlling CEO salary?

Option and equity plans	77%
Bonus programs	66%
Termination agreements	60%
Special retirement plans	46%
Executive perks	30%
Base salary	22%
Benefits	13%

FIGURE 15

Has your director's compensation increased during the last 12 months?



require compensation committees to ensure they properly align compensation with both compliance and business objectives in order to create compensation programs that are effective and drive desired behavior.

Board and committee compensation

In the majority of cases, it appears director pay for board meetings has generally kept pace with the increase in responsibilities and time necessary to do the job. Just over half (58%) of directors reported receiving an increase in their director compensation in the last 12 months (see Figure 15); 63% believe their director compensation is adequate (see Figure 16).

The need to reexamine certain aspects of director pay, however, has emerged in the three-plus years since Sarbanes-Oxley. Specifically, it is widely accepted that certain committees, especially their chair positions, carry the lion's share of added time and workload related to the new governance culture.

Therefore, when asked which committee chair positions they believe should receive additional compensation, 86% of directors responded with the audit committee chair; 61% believe the lead director should be awarded additional pay; and 53% feel the compensation committee chair is due additional compensation (see Figure 17).

Pay components

Another area of focus is determining how to structure the mix of components that combine to form the total compensation package. When asked which parts of the board compensation package need to be enhanced, 56% chose retainer, 41% believe it should be the equity program, and 35% selected meeting fees (see Figure 18).

FIGURE 16

Do you believe your compensation for serving as a director is adequate?

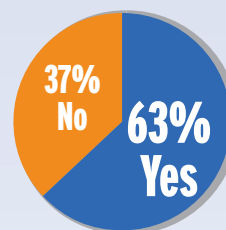


FIGURE 17

Which positions should receive additional pay?

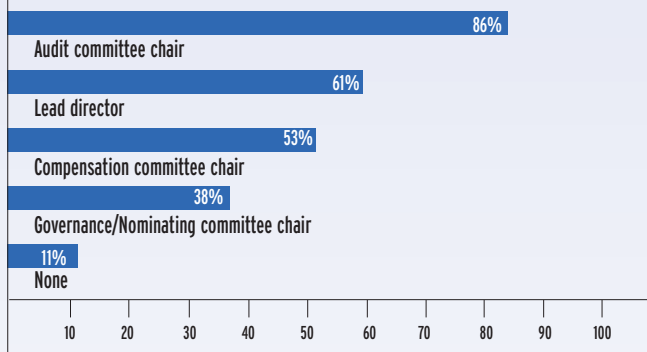
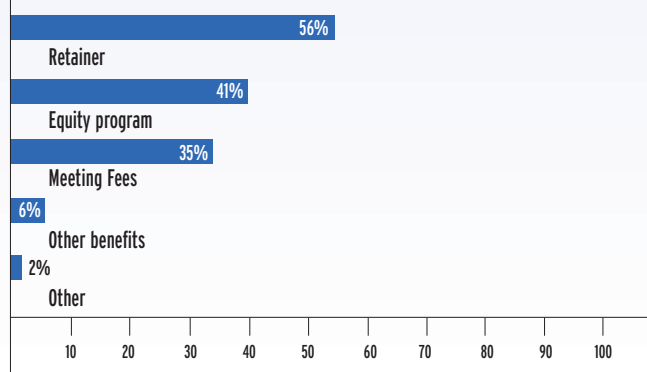


FIGURE 18

What parts of your board compensation package do you feel need to be enhanced?



Risk and Liability

In 2005 the corporate world was rocked by two seminal legal events: the agreement by the outside directors of Enron, then later WorldCom, to pay personal settlements to plaintiffs—\$13 million and \$18 million respectively—as a result of securities class-action lawsuits against them.

While these settlements did not constitute an admission of wrongdoing on the part of the directors, they have had a profound influence on the concept of liability related to board service, such that today, there is concern that future plaintiffs will consider these cases as benchmarks for settlement. According to the 2005 What Directors Think study, 23% of respondents are very concerned about these personal settlement cases, and 56% say they are somewhat concerned (see Figure 19).

In addition, another prominent case regarding directors' fiduciary duties involving the Disney board sheds light on how the Delaware courts currently view directors' duties. While legally exonerating the board, the *Disney* court was critical of the directors' handling of the company's severance package for former Disney president, Michael Ovitz. Some experts believe this case has raised the bar on director accountability.

Liability perceptions

In light of these and other cases, the study asked directors if they felt their risk had changed in the last 12 months. Seventy-three percent (73%) responded they believed their risk as a director had increased (see Figure 20).

The positive news, however, is that directors are not responding with a mass exodus from the boardroom. Most directors appear to be circumspect about risks associated with board service, although 66% say they'll increase their due diligence when considering any future board seats (see Figure 21).

D&O insurance

Directors taking a relatively calm view of the liability landscape might assume that despite the inherent risks, their personal assets are protected by their directors and officers liability policy. Since most companies cover their directors with adequate insurance—as well as indemnify them where allowed by law—legal experts contend that directors who take their responsibilities seriously and do their jobs well will most likely be protected by the legal system and will not have to pay settlements out of pocket.

FIGURE 19

How concerned are you with the WorldCom and Enron personal settlements?

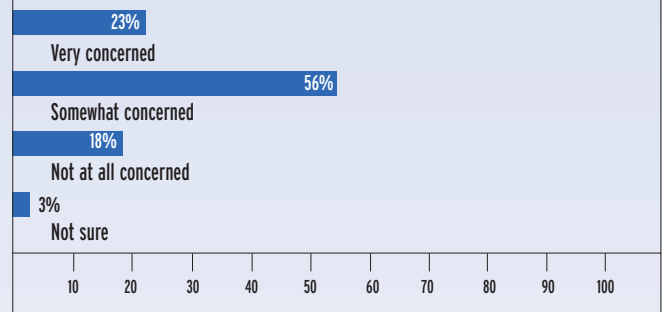


FIGURE 20

In the last 12 months, do you feel your risk as a director has...

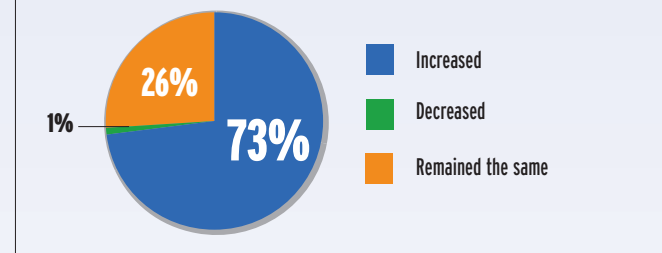
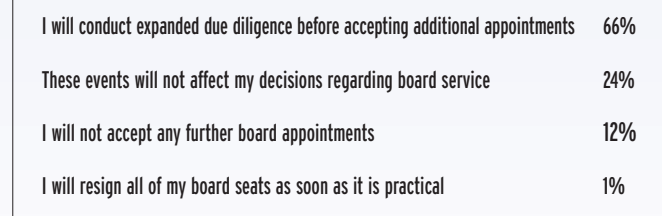


Figure 21

What impact have Enron/WorldCom personal settlement payments had on your board service?



However, it is always good to be proactive in matters regarding liability, and 88% of directors reported they have reviewed their board's D&O policy during the last 12 months (see Figure 22). The study found, though, many respondents do not fully understand their policy.

D&O policies have three components commonly referred to as Side-A (non-indemnifiable director and officer personal assets coverage), Side-B (indemnifiable corporate balance-sheet coverage), and Side-C (indemnifiable entity coverage). Since each of these components is applied in different aspects of claims, the policy limits for one side can drastically affect the others. Thus a board that reviews its policy but doesn't have a thorough understanding of these three components may put itself in a position of vulnerability. It is concerning that nearly half of those surveyed (46%) said they either did not understand the policy's components (25%) or were not sure they understood their D&O policy (21%) (see Figure 23).

Some directors appear to be aware of this shortcoming, which is perhaps a step in the right direction. Only 27% of respondents reported they were completely satisfied with their understanding of their liability coverage and 28% of respondents say they were not sure if any changes had been made to their coverage in the last 12 months. Clearly there is room for improvement here if boards are to be made comfortable about their decision to assume the risks inherent in board service.

Crisis management

Turning to another of the board's critical functions, the study asked respondents whether their board had discussed an action plan in the event the company faced a major crisis. Only 41% answered affirmatively, leaving over half of all boards in what can only be construed as a state of vulnerability (see Figure 24).

Today, when good governance demands a comprehensive assessment of enterprisewide risk management, these figures demonstrate a lack of leadership in this critical area. Whether the crisis comes from a CEO's death or disability, a weather disaster, a labor dispute, or even a sudden, preemptory strike by a competitor, the board owes it to shareholders, employees, and customers to have an action plan to keep the corporation moving forward.

FIGURE 22

Has your board reviewed the company's D&O policy during the last 12 months?

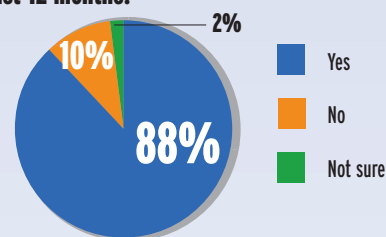


FIGURE 23

Do you have a basic understanding of the three basic insuring agreements housed in the D&O policy commonly referred to as Side A, Side B, and Side C?

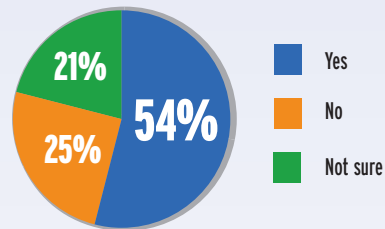
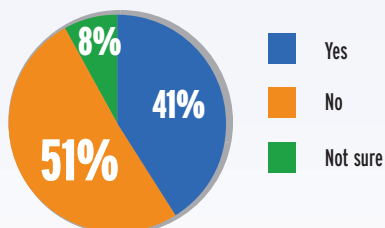


FIGURE 24

Has your board discussed an action plan should your company face a major crisis?



Governance and Ethics

Since the passage of governance reform, corporate ethics has played an increasingly prominent role within U.S. companies and their boardrooms. Sarbanes-Oxley required a code of ethics for senior financial officers; as a result, instituting an ethics and compliance program for the entire organization is now seen as an essential component of corporate governance.

Executive sessions

One of the major tenets of good governance is having a majority of independent directors who are free to govern without conflict of interest or undue influence. At times, however, this exercise may be stifled by the presence of the CEO or other insiders in the boardroom. Therefore, outside directors must be free to hold executive sessions whenever they believe it is necessary.

The 2005 What Directors Think study found most boards (59%) hold executive sessions on a quarterly basis; another 22% hold such sessions each time the board meets—a 46% increase since 2003 (see Figure 25). The majority of boards (54%) do not keep minutes of these sessions (see Figure 26). However, for boards that do keep such records, the respondents say the duty of taking minutes is generally handled by the lead director or the nonexecutive chair. In most instances, respondents said executive session minutes consist of a brief summary of the matters discussed or short bullet points.

Whistle-blower procedures

One of the best ways to demonstrate support for a company's code of ethics is for the board to ensure a process for the airing of complaints and/or tips on misconduct. Whistle-blower programs, now required by law under Sarbanes-Oxley, allow employees and others to report concerns—including those about corporate fraud—and thus allow the board to take early corrective action.

An essential feature of a successful whistleblower program is having employees feel comfortable enough to share sensitive information—and providing an anonymous means to do so. Moreover, employees must believe their actions will be taken seriously, so it is important to communicate information about the program throughout the organization. Employees will support a process that sends clear and consistent messages about ethical behavior and a board that acts quickly and appropriately when the policy has been violated.

FIGURE 25

How often does your board hold executive sessions?

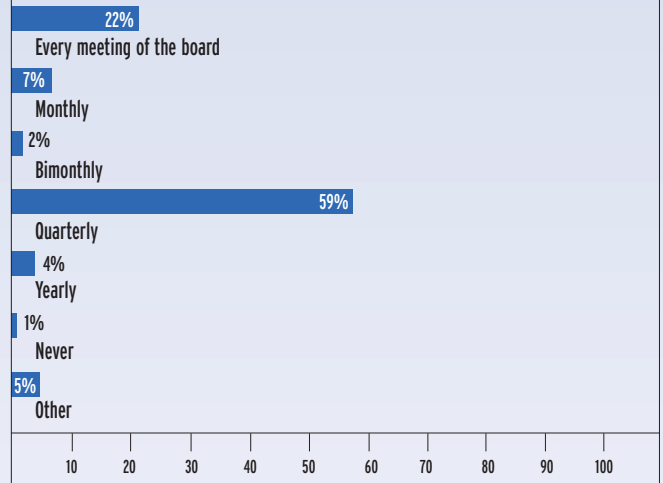


FIGURE 26

Are minutes kept for executive sessions of the board?

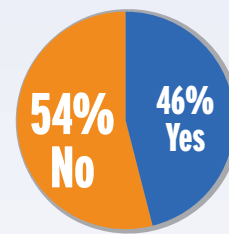


FIGURE 27

How does the company handle the complaint process regarding accounting, auditing, and control matters?

They are reported directly to the audit committee	53%
They are reported directly to the general counsel	32%
They are reported directly to an independent third party	24%
They are reported directly to the internal auditor	14%
They are reported directly to the outside counsel	3%
Not sure	4%
Other	3%

This year's study asked directors how complaint matters were handled within their companies. Fifty-three percent (53%) said complaints regarding accounting, auditing, and control matters were reported directly to the audit committee; 32% said such complaints were routed directly to the general counsel; and 24% send such reports directly to an independent third party (see Figure 27). Most directors review whistleblower complaints at each meeting (39%) or on an as-needed basis (36%) (see Figure 28).

Internal control

Internal control has garnered a great deal of the attention over the past two years, as companies addressed compliance with Sarbanes-Oxley Section 404. This section of the law created a maelstrom from the moment it was passed, and then spawned a cottage industry to assist with 404 compliance matters. While Section 404 reporting will likely become a smoother process for public companies, the time and expense of the requirements will continue to be a concern for corporate America. Directors clearly would like to see costs decrease and make recommendations for how that could be accomplished (see Figure 29).

Governance training

With the sea change in governance culture, directors are expected to embody the highest levels of ethics and leadership as well as to support the company's success, thereby increasing shareholder value. Moreover, the information directors must digest to prepare for meetings continues to grow. To better help themselves understand their responsibilities, more and more directors are turning to board education programs.

This year's study shows 67% of corporate boards provide an orientation program for new directors, and 55% of board members are either encouraged or required to participate in director education outside the boardroom (see Figure 30). More striking, however, is that for one-third of all responding boards, there is no formal program for director training within their companies. Clearly, there is room to expand both the offerings and opportunities for directors to participate in ongoing education in the years ahead.

FIGURE 28

How often are whistleblower activities discussed with the audit committee?

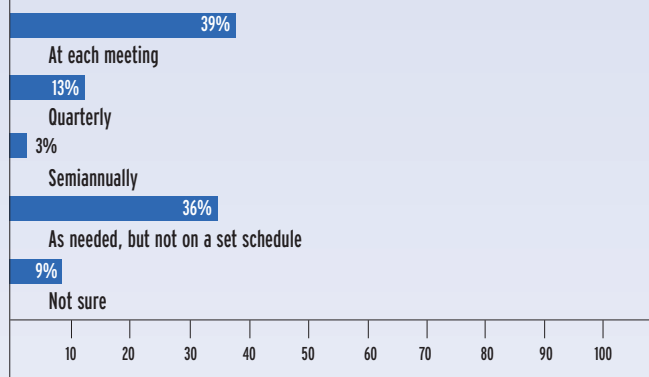


FIGURE 29

What changes would you like to see made to section 404?

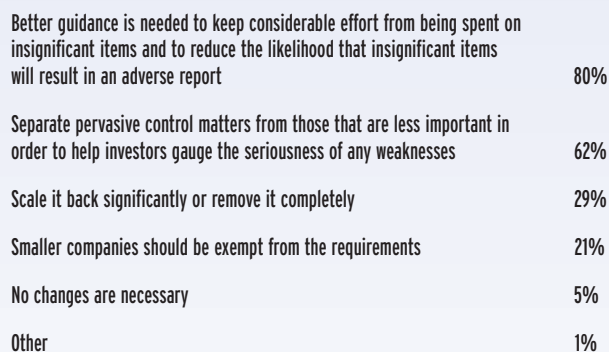
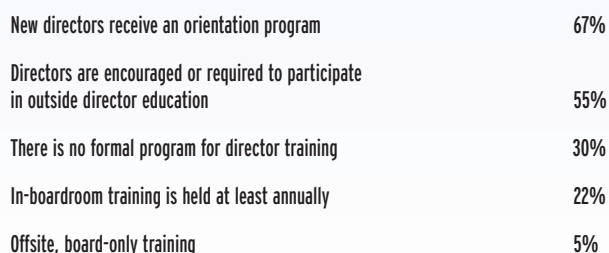


FIGURE 30

What level of training does your board receive?



Board Meetings and Structure

The amount of time spent on activities related to board service has increased steadily over the past four years, as has a corresponding amount of responsibility. Yet board structure has remained fairly constant—an average of 8-9 directors per board—as has the number of meetings. What has changed, though, are directors’ perceptions about how wisely they spend their time and how useful the materials and meetings have been in fulfilling their board duties. The 2005 What Directors Think study polled respondents in order to monitor trends and levels of satisfaction related to board meetings and time spent on the job.

Time on the job

In this fourth year of the study, the graph showing the time directors spend on board matters is telling. In 2005, directors reported spending an average of 22 hours per month on board-related work (see Figure 31).

The largest jump in time spent on the job was noted between 2002 and 2003, after Sarbanes-Oxley hit corporate America full throttle and the average length of time spent each month jumped from 14 hours to 19 hours. Since 2003, the year-to-year changes have been less marked.

Preparation for meetings

The board meeting agenda is often packed with a wide variety of issues, requiring solid leadership from the chair or lead director to keep the business moving along. On a positive note, the vast majority of directors (92%) said they have sufficient time to comply with their duties as a director within the scope of the meeting time (see Figure 32).

Informational needs

In order to comply with duties within the meeting timeframe, board members must take adequate time to prepare and assemble the right background materials on the agenda topics. When asked which types of information they receive to prepare for board meetings, most directors responded that comparison financial and business data from peer groups was provided to them (see Figure 33).

Interestingly, nearly twice as many boards receive financial and business performance data compared with information related to employees and customers, yet optimally, information should be balanced among these three scorecard constituencies.

FIGURE 31

How many hours per month do you estimate that you spend on board matters?

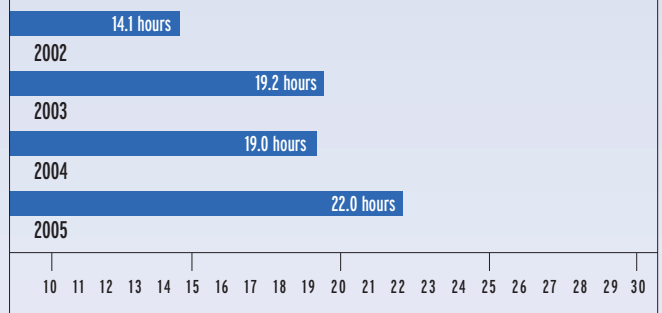


FIGURE 32

Do you have sufficient board meeting time to comply with your duties as a director?

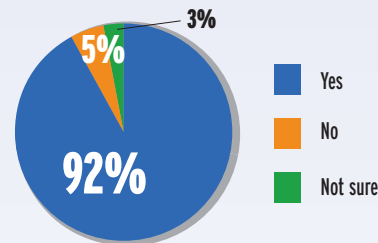


FIGURE 33

Which types of information do you receive to prepare for board meetings?

Comparison peer group financial and business data	89%
Information on employee values and/or satisfaction	47%
General and/or specific customer satisfaction research	42%

Director wish lists

Finally, although nearly all directors surveyed said they have sufficient meeting time to comply with their duties, nearly 20% say they would like to devote more time to critical board topics (see Figure 34).

The survey attempted to ascertain which types of issues directors felt they ought to spend more time addressing. Clearly, Figure 35 shows an overwhelming desire to devote more time and effort to strategic planning, succession planning, and issues related to managing business performance. Spending more time on such things as reports, regulations, and governance guidelines rated low on responding directors' wish list.

FIGURE 34

Are you satisfied that you are devoting enough time to critical board topics?

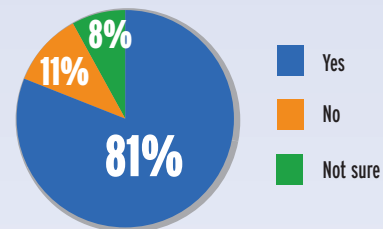


FIGURE 35

On which issues would you prefer to devote more time?

Strategic planning	59%
Meeting key managers	44%
Succession planning	44%
Visiting company sites	42%
Discussing the competition	42%
Discussing the industry	37%
Risk management	29%
Reviewing M&A in industry	21%
Monitoring performance	17%
Compensation issues	14%
Getting CEO updates	11%
Analyst updates	10%
Stock strategies	10%
Governance guidelines	7%
Compliance/regulatory	4%
Section 404 analysis	2%

Profile of U.S. Corporate Boards

The profile of boards of directors from publicly traded U.S. companies published below is the most recent snapshot available from *Corporate Board Member's* comprehensive database of directors and officers serving on boards of publicly traded companies listed with the NASDAQ Stock Market, New York Stock Exchange, and American Stock Exchange¹.

Number of directors per board

At the end of 2005, directors on U.S. corporate boards totaled 50,151 from 5,894 publicly traded companies. This represents an average of 8.5 directors per board, with boards from larger companies averaging a higher number of directors than those from smaller companies, as shown below.

(\$) Revenue Size	Companies	Directors	Average
>10B	352	4,444	12.6
1B-10B	1,176	11,745	10.0
500M-1B	597	5,281	8.8
100M-500M	1,457	11,703	8.0
50M-100M	634	4,873	7.7
10M-50M	1,070	8,021	7.5
<10M	608	4,084	6.7
Entire Database	5,894	50,151	8.5

Number of directorships held

The highest number of directorships held by one individual is 9. The vast majority of directors, 33,434, hold only one board seat. The table below shows the distribution of the number of directorships held by U.S. corporate directors.

# of Directorships	Directors
9	1
8	4
7	14
6	40
5	152
4	494
3	1,437
2	4,643
1	33,424

Inside versus outside directors

U.S. corporate boards had 9,526 inside directors representing an average of 1.6 inside directors per company, and 40,625 outside directors representing an average of 6.9 outside directors per company.

(\$) Revenue Size	Companies	Inside	Avg. Inside	Outside	Avg. Outside
>10B	352	987	2.8	3,457	9.8
1B-10B	1,176	2,025	1.7	9,720	8.3
500M-1B	597	871	1.5	4,410	7.4
100M-500M	1,457	2,145	1.5	9,558	6.6
50M-100M	634	998	1.6	3,875	6.1
10M-50M	1,070	1,609	1.5	6,412	6.0
<10M	608	891	1.5	3,193	5.3
Entire Database	5,894	9,526	1.6	40,625	6.9

Inside versus outside chairmen

Out of a total of 5,609 chairmen on U.S. corporate boards, 2,926 (52.2%) are inside chairmen and 2,683 (47.8%) are outside chairmen. These ratios hold steady among revenue size categories, as shown below.

(\$) Revenue Size	Inside Chair	%	Outside Chair	%
>10B	191	55.4%	154	44.6%
1B-10B	640	55.2%	519	44.8%
500M-1B	321	54.9%	264	45.1%
100M-500M	704	50.4%	694	49.6%
50M-100M	316	52.9%	281	47.1%
10M-50M	474	48.5%	503	51.5%
<10M	280	51.1%	268	48.9%
Entire Database	2,926 ²	52.2%	2,683	47.8%

Gender of directors

There are 4,004 seats on U.S. boards occupied by women, averaging 0.7 per board and showing a 5% increase from 2004. Larger company boards have a significantly higher representation of women compared to smaller companies.

(\$) Revenue Size	Companies	Female Directors	Avg. per Company
>10B	352	561	1.6
1B-10B	1,176	1,233	1.0
500M-1B	597	444	0.7
100M-500M	1,457	748	0.5
50M-100M	634	309	0.5
10M-50M	1,070	496	0.5
<10M	608	213	0.4
Entire Database	5,894	4,004	0.7

¹ Excludes over-the-counter stock companies.

² At the time of this report, 387 companies did not report a chairman.

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