

**SEC Institute's
21st Midyear SEC Reporting Forum

Controllers Roundtable**

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My Experience

- **Vice Chairman – Approva Corporation**
- **Former CFO**
 - World Wrestling Entertainment
 - Catalina Marketing
 - Celestial Seasonings
- **Director and Audit Committee Chairman**
 - Cott Corporation - \$2B soft drink company
 - Broadsoft – leading VoIP systems provider
- **Former CEO Financial Executives International – heavy involvement in SOX passage**
- **CPA, MBA**
- **Ultimate financial training – Raiders 1980/81!**

*The process of holding directors
and management accountable
to the corporation's
shareholders.*

Be a Student of Corporate Governance

“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.”

The Business Roundtable, May 2002

Colgate Palmolive Governance Principles

- **Our Board is independent, experienced and diverse**
- **Our Board focuses on key priorities and leadership development**
- **Open communication between and among directors and management fosters effective oversight**
- **Established policies guide governance and business integrity**
- **Our Board plays an active role in overseeing the integrity of the financial statements of the Company**
- **Good governance is the responsibility of all Colgate people**
- **Good governance thrives from continuous improvement**

GE Governance Principles

- **Added emphasis on:**

- “talking externally the way they run GE internally”
- “satisfying the spirit, not just the letter, of new governance requirements”
- Implementing changes as soon as possible, not postponing until a mandated date.

Governance Tools at Microsoft

- **Direct communication with the board via – askboard@microsoft.com**
- **Whistleblowers and complaints via – “msft.buscond@alertline.com”:**
- **Posting of the “Microsoft Finance Code of Professional Conduct”**

A Reform Program from a Governance Crisis

“Corporate Governance Initiatives”

- **Specific governance-enhancement initiatives to date include:**

- Development of written charters for the Board, Board committees, the Executive Chairman, the Chief Executive Officer and the Chairs of the Nominating and Corporate Governance Committee, and of the Audit Committee
- Underscoring in the written job description the Chairman of the Corporate Governance Committee's leadership position on the Board
- Reviewing the committee structure and the membership of each Board committee
- Reviewing the system of director compensation
- Discontinuing stock options for directors in favor of deferred stock units

A Reform Program from a Governance Crisis

“Corporate Governance Initiatives”

- **Increasing the frequency of in-camera meetings of directors**
- **Establishing a Board Secretariat and other resources to provide directors with the information and support they need to perform their duties**
- **Reviewing the existing disclosure process**
- **Establishing a Disclosure Committee consisting of senior officers of the Company**
- **Initiating a formal performance-evaluation process covering the Board, its committees and individual directors**
- **Announcing that all members of the Board will become members of the National Association of Corporate Directors**

A Reform Program from a Governance Crisis

“Corporate Governance Initiatives”

- **Instituting a comprehensive continuing-education program for all directors**
- **Adopting a formal orientation program for new directors**
- **Adopting individual voting for nominees to the Board**
- **Initiating a Board-renewal and succession process**
- **Developing profiles of director candidates**
- **Engaging a search firm to assist in that process**
- **Separating the roles of Chairman and CEO**
- **Appointing a CEO and other senior executives**
- **Engaging an advisor (law firm) and leading legal authority on governance matters, to advise the Board on best practices.**

Hot Topics in Corporate Governance

- **True Pay for Performance**
 - Case of John Mack – CEO of Morgan Stanley
 - Employment contract called for a min of \$25M over two years OR the amount earned by his peers if that was higher
 - Press screamed, investors screamed – NO RISK
 - Within 24 hours he announced that his contract would be changed
- **Severance Packages and Pension Plans**
- **Entrenched management teams or boards not responsive to shareholders**
- **Activist Investors Pressing Over-Capitalized Companies**
 - Give the capital back to investors, let them allocate it
 - Better discipline for management
- **Stock Option Accounting and Performance-Based Stock**
- **Revised Option Plans**
 - Shorter lives – 5 years increasingly instead of 10 years
 - Premium priced option and stock price targeted vesting
 - Accelerated vesting

Hot Topics in Corporate Governance

- **CEO involvement in director selection**
- **Appropriate EQUITY compensation structures for directors and management**
- **Fairness of severance and pension provisions**
- **“Lead director” role**
 - Still finding a balance
- **Board Effectiveness**
 - Oversight role vs. strategic input
- **Advisers for compensation and audit committees**

Nature of the Current Problem

- **Agency abuse – executives or boards that abuse the power entrusted to them to promote their personal interests**
- **Weak boards that allow excessive management compensation**
- **Ineffective audits on behalf of shareholders**
- **Financial reporting misstatement toward stock price manipulation**
- **Misappropriation or outright theft of company assets**
- **Conflicts of interest toward personal gain at shareholders' expense**

Agency Abuse

- Understand that in our governance system, management is entrusted with control of the company's assets
- Recent charges filed against Conrad Black allege:
 - An acquisition “required non-compete payments” be paid to the top executives
- Many of these cases are simply low-tech theft. No better than the guy that robs the local Seven Eleven. They should be treated that way.
- Abuse of this power as agent of shareholders is a problem
 - Self Dealing
 - Inappropriate relationships
 - Deferred compensation plans
 - Personal use of company aircraft and other benefits

Phil's Personal Red Flags

- **SPIN Masters**
 - CEO's think that they can TALK their way out of anything
 - Communication restricted and defensive
- **Obnoxious Corporate Culture**
 - "we're better than anybody"
 - "you just don't understand our business"
 - "we're different"
 - "you don't get it"
- **Weak board and superficial meetings – going through the motions**
- **Indecipherable Financial Reporting**
 - Take pride in utility and readability
 - Take shame in obfuscation!
- **High leverage and constant asset sales**
- **Complicated business models are more often a sign of problems, not genius**

Did You Know? – I Didn't

- **SFAS 123R Issues Around Retirement Eligibility**
 - SEC requiring us to expense options over the period to the date an employee becomes ELIGIBLE for retirement if that's shorter than normal vesting period
- **There is such a thing called Mezzanine financing that is NEITHER a liability or equity in the financial statements**

Simplifying Financial Reporting – It's In YOUR Hands!

- **Need to make financial statements READABLE and FUNCTIONAL for the INVESTOR**
- **Tables and charts, not text**
- **No elevator music!**
- **Real business issues and trends**
- **End of hard copy reports is in sight**
 - **TECHNOLOGY! TECHNOLOGY! TECHNOLOGY!**

Keeping Me Up At Night - Revenue Recognition

- **60% of restatements historically from revenue recognition issues**
- **Usually, silly timing issues brought about by earnings pressure**
- **Lack of PRACTICAL, but formalized, policies**
- **Software industry particularly difficult**

Other High Risk Areas

- **Financial Close Process**
- **Related Party Transactions**
- **Account Reconciliations**
- **Transactions Centered in Critical Accounting Policies**
- **Segregation of Duties**
- **Capitalization policies**
- **Variances in budget and forecasts to actuals**

Capital Allocation – Be Proactive

- **Acquisitions**

- Do they hit the pre-deal projections?
- Do we get the synergies we projected?
- Does the return generate net shareholder value or destroy shareholder value?

- **Capital expenditures**

- New capacity really needed?
- Cost savings really materialize?
- Positive or negative IRR?

- **Share Buybacks**

- Great balancer in capital allocation equation

- **Dividend Policy**

- Tax treatment equivalent to capital gain has eliminated the tax disincentives to dividends

Bottom Line

Clean, crisp financial reporting more valuable than ever

Investors clearly avoiding messy, complicated companies.

Premium valuations for companies that have clear business models and clear financial reporting.

Ability of financial officers to impact shareholder value, greater than ever.

Real Promotion of Ethical Conduct

- **We still aren't doing enough here**
- **Employees need to know we are serious about snuffing out unacceptable behavior**
- **Communication must be repeated and come from the top**
- **Companies largely doing the least amount required**

Expectations of All Financial Executives

The Three “I”s

Integrity

Initiative

Independence