

Pegasus



A newsletter for the Caux Round Table Network
Looking at business above the clutter and confetti

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Moral Capitalism At Work

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Pegasus

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INTRODUCTION

This issue of Pegasus brings you some reflections on responsibility of mind. Ethics and morality require application of our minds. Negligence as well as willful stubbornness in being too selfishly concerned lead to actions that trigger ethical and moral concern. What habits of mind we have readily at hand, therefore, becomes an issue for each of us. Father John Haughey eases our way to better habits of mind with his comment on discernment.

The Buddhist approach to living in this world similarly centers on mindfulness as I present reflections on recent CRT work in Thailand with Buddhist scholars. In Minnesota, the CRT was a co-sponsor of a public discussion of the role of religious leaders - what constructive contributions can religious "mindfulness" bring to successful democratic politics?

In corporate social responsibility, boards of directors should play a crucial role of stewardship. They are the values-center of the corporation and hire the senior officers who are to implement the values guiding the firm. Roderick M. Hills, a former Chair of the U.S. Securities and Exchange Commission, writes on the interaction over the past several decades between regulation and boards of directors - interactions driven by scandals and failures on the part of private enterprise.

I hope this issue will make for fruitful reflection among our readers, whose interest and support are most appreciated.

Stephen B. Young
Global Executive Director

LED! HOW? TO WHAT? WHOM?

The following essay was presented by Fr. John Haughey SJ at the “Sustainable Business Leadership Forum: Ethics, the Professions and Society”, organized by CRT Fellow Dr. Lester Myers for Georgetown University with co-sponsorships by the Caux Round Table and the Sustainable Business Network of Washington. The Forum was held at Georgetown University on March 5-6, 2012. CSR-Wire was a media partner for the Forum.

Fr. John Haughey SJ
Woodstock Theological Center
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Ignatian lore is not of a piece with business lore nor ethical theory nor rationally construed principles from which applications follow and decisions are made.

It is lore that was produced in the soul of Ignatius Loyola back to the mid 16th century when he was recuperating from a canon ball that hit and crippled him in Pamplona. He spent months in the castle of his brother sorting out what was going on in him. What he learned was a kind of soul science which has been very helpful all these centuries for Jesuits and for 100s of 1000s who were and are not.

If he had not written down what he learned about his volatile interior conditions in the Spiritual Exercises and tested them with men and women for the next 15 years of his life, we wouldn't have any knowledge of them. Their usefulness to a person depends on whether those who want to learn from them are willing to accept the conditions for learning them.

The primary condition is to be Sabbath-able. In Ignatius's case it was involuntary and many months long. In Jewish spirituality it is a weekly thing, from sundown on Friday night till sundown on Saturday. Ignatius would say that the most practical thing practically minded achievers can do is to learn how to get some space from their immediate practicalities.

What he came face to face with were his conflicted desires. What he had to ask himself was what is it that I desire apart from the immediate desire now for this, now for that. He was a sucker for women's attention and the closer they were to power the more he desired their attention and affection.

So in his enforced sabbatical this is what he experienced: there is a battle going on in me beneath the surface of my everyday doings and choosings. It is a battle between my better self and my “all-about-me” self. In his culture it was concern about “his own glory.”

His better self was drawn by God's Spirit to an ideal, i.e., to live his life for God's Glory. To accept this as his primordial calling entailed a radical change in the range of his desires and of living according to this calling. The conviction he was given



San Ignacio de Loyola, 1609 - 1622, Meadows Museum

to consider is that the purpose of my life is God's Glory. It entailed a life in which prayer and the sacraments and the worship of God became his most frequent practices. That was the vertical aspect of it. There was a horizontal side to it too, i.e., it was to live a life of service of whoever came his way or sought him out or whoever he felt moved to serve. The character of his service was to help the person in their claimed need and, if they seemed so disposed, he would introduce them to considerations and spiritual practices that could make them attentive to the movements in their affections and to live their lives singlemindedly since that was where their joy was.

I have a distaste for the word leader. What has always been interesting to me about both Jesus and Ignatius was that each accepted being *led*. I don't mean to put them on a par but after Ignatius' experience of his calling, being-led-by-the-Spirit was the kind of person he chose to become and became. I think there are such persons; I have experienced them. Seldom have they been in leadership positions but their integrity and faith have had the effect of leading me to a greater singlemindedness.

None of this was possible by Ignatius wanting it to be so or thinking or talking himself into it. It was possible because of the action of the Spirit of God in him but it was action he had to become aware of and accede to. The awareness was initially affective and from its detection it had a cognitive content.

Ignatius also came to realize very soon that his pliability about being led could be naïve. In other words, he could be misled by seeming lights that weren't really well discerned. His usefulness, therefore, for many subsequently has been teaching about how to discern false lights and true ones. He had learned enough of Thomas Aquinas to believe that intelligence can participate in the *prima lux divina*.

He had always styled himself as a free spirit. The longer he convalesced the deeper he saw that he wasn't as free as he had thought. He found himself conflicted and experiencing two different kinds of affect. One he eventually called *consolation*: love of neighbor and love of God (and I might add: love of his better self) came more easily. The other affective movement he called *desolation*; in general,

turmoil. In some ways the turmoil was about glory. The challenge was to seek the glory of God through the concrete choices and actions he was free to make...free from concern about himself even with about "how am I going over" with whatever population or persons I am telling myself I am serving. It's too much about me. Again: for whose glory am I performing these services?

Three things Ignatius personally learned in the course of being led by God to living a life for God's glory. One was repentance which initially a grace given to him in spades, evident in his many tears for his sins. But the grace of repentance for his sins was on-going. The second was to learn who he himself was through contemplation of who the person of Christ was and is now, which the Spirit taught him. His better self was Christ. (Paul: For me to live is Christ.) The third thing he learned was that insofar as one was open to seeking God's glory that God would help them to see how to live this way in their always particular circumstances and opportunities, through their choices and discerned desires. He eventually became a master of reading the motions of his own soul and that of others. St. Paul called this a gift of the Spirit, the gift of discernment of the spirits.

If all of this sounds other-worldly or obscurantist, so be it. Ignatian Principles are not rationally taught principles but graced insights enabling one to find their better self as that opens out before him or her through discernment of their deeper desires. The discernment is not so much about the thing to do in this situation or that but being better at hearing the music playing below my thinking self – my emotions, the attractions or disaffections, desolation or consolation – and, therefore, having a degree of self awareness that is more foundational and interior than even about the objective particulars of the decision to be made.

Again one of two spirits in each of us is in the ascendancy. In Ignatius' 16th century piety he understood these as the Holy Spirit and the other which he named "the enemy of your soul." St. Paul may be more helpful by suggesting that your gut is probably better at knowing which of the two is operating and in the ascendancy....there is generally peace, joy, compassion, patience, kindness, self control if the Holy Spirit is; or if there is inner

turmoil, an impatience, the absence of community, competitiveness, greed. In general, if it's a focus that's "all-about-me" then the enemy of your soul is in the ascendancy. (Gal 5: 19-23)

This may sound too mystical or insufficiently empirical. Ignatius was a very practical man. His experience was that when there is a lack of energy about the good and the true, one's interiority has to be accessed at a deeper level for the energy for these to be generated. Prayer, usually guided, works, he found.

Over time, Ignatius discerned that there were three characteristics that often accompanied the work of this "enemy of your soul" or "spirit of flesh." (Ignatius personified this; I'm not sure that needs to be done. "Evil is the absence of a due good." Ontologically it takes its being from the acts done out of synch with and despite the movements to enact one's better self) The first is, it conceals itself, preferring to stay hidden from the attention of those in whom it is operating since it is promoting a false identity in the self; secondly and paradoxically, it operates true to its scriptural name of light bearer (Lucifer) by lighting up possibilities in the mind and imagination and sensuality which, if followed, only brings those yielding to them further away from their better selves and living in consolation; thirdly is cunning by deepening one's self deception and keeping them on the lookout for what is to their own advantage and comfort and reputation. In brief, its effect is to keep the person wrapped up in his or her self concern, sensuality and self love and content to stay there.

The presence of these two contrary spirits are usually perceived more clearly through the experience one has with one's own conscience. A troubled conscience does its best to look the other way so as not to give attention to its own uneasiness. What needs to be adverted to is the ways in which this inadvertence to one's unease and conflict gets prolonged. Frequently being out of touch with one's better, deeper self, and conscience takes the form of overwork or obsessing about things like looks or slights or reputation or getting even or by excessive drinking etc. The remedy the good spirit (definitely, and rightly, personified) provides is for the person to come to terms about what is going on in them rather than running from it. The needed insight is

into one's "disordered affections." Assisted by the Spirit of truth, insight can be gained about what would bring order to the affections, usually an order in one's relationships and a fidelity to the demands of these. In general, the good spirit's agenda is to bring one into connection with their better self.

How does the Spirit, alias the good spirit, alias the Holy Spirit, alias the friend of our soul who would accompany us in our seeking the more, the magis tend to operate? Ignatius: in those who have dulled their conscience it stings it. In those who have an untroubled conscience it attracts them to a further good to be done. Its accompaniment strengthens their better self to a greater altruism, to concern for the well being of those close to them in general, to love of neighbor and God. The greater glory of God!

The paragraph that describes this session has many nouns including the common good, social justice, corporate integrity and concern about the world's poor. All of these matters would also be central to Ignatius but his own experience and that of the many men and women he directed was that if God is the One who is moving the person to the good to be done by him or her, their particular form of service will serve the common good, assist the integrity of the community, do justice to the neighbor and be more and more attuned to whether the poor are being slighted or ignored. God co-authors all self-emptying.

Led to what? Led to the two We's God had in mind in making creation. One of these is to a communion with the Persons of the Trinity and to the communities of those who are called to give glory to God, though this is usually unbeknownst to them. The Spirit's energies are poured out so that those on whom it is poured out can be instrumental in furthering the whole making mission of the Spirit in bringing about communion between what God has made and what 'we the made' make in furthering this end. So it's not "all about me," it's "all about we." The praxis that is most helpful in seeing this and doing the truth of it is liturgical worship. Recall: "the blessing cup, is it not communion with the blood of Christ?"



A BUDDHIST PHILOSOPHY FOR CORPORATE SOCIAL RESPONSIBILITY

Stephen B. Young
Global Executive Director
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Buddhism most generally explained pertains to individuals and their confrontation with life's realities, both seen and unseen. Buddhism presents both an understanding of the transcendent, other-worldly, possible futures for all beings as well as specific guidance for optimal traversing of this world's circumstances. A common-place understanding of Buddhism, especially Theravada Buddhism, is that it calls for renunciation of this world and its passions, attachments, and motivations and focuses our attention on transcending the norm of self-centrality.

And yet, an often overlooked reality of Buddhism is how much guidance the religion provides on how to live well in this world. Roughly speaking, Buddhism suggests the helpful role that right awareness can play in reducing our subjection to the vicissitudes of emotions and events. In this context, Buddhism provides advice for better decision-making.

Corporate Social Responsibility ("CSR") similarly demands a certain level of awareness of the stakeholders who both influence a firm's success and who bear the consequences of decisions made by the firm. CSR, therefore, can be understood in simple terms as a decision-making framework for business.

The Buddhist paradigm for CSR brings Buddhist understandings of reality and guidance derived from those understandings to decisions made by the firm and its stakeholders.

The core of Buddhism is the law of Karma – a fixed connection between actions, reactions and interactions and resulting states of being. Karma puts emphasis on the power of actions, reactions and interactions to influence the quality of our being. A mind aware of the working of Karma seeks to become more and more sensitive to the range of actions, reactions and interactions that are possible so that wise choices can be made in the application of our conscious will to our circumstances. The "enlightened" mind in Buddhist terms has acquired full awareness of what is happening subject to the law of Karma and so seeks behaviors that minimize tensions and frictions, stresses and strains, which arise out of life's complexities and contradictions.

Such an enlightened mind can bring the Dharma, or best practices of Buddhism, into this life through knowledge of oneself, faith in oneself, control of oneself, contentment of oneself with oneself, and respect of oneself. With the Dharma so internalized and not confined to external texts or limited to periods of mindfulness meditation, one can act wisely, react wisely, and interact with maximum good effect. Following the Dharma in thought and action permits one to take constructive advantage of the law of Karma.

When the self has understanding of where it is vis-à-vis others and the world around it, it gains an important form of wisdom. Self-confidence is needed to provide the will and courage to overcome doubt, ambiguity, uncertainty and confusion. Self-control is needed to move from understanding to action. Not to act is an affliction that arises in the mind. Contentment of the self comes from awareness that our understanding is firm and our acts are rightly directed. If we are not content, then we are falling short of our best efforts. Dint of effort leads to the experiencing of such contentment. Self-respect measures awareness that one can indeed make constructive efforts, that one has potential for the good, and that one's mind is indeed – right now – ready for deeper understanding.

The application of the Dharma to one's life can be eased by the eight step path that takes advantage of Karma:

STEP ONE: Right quality of awareness (wisdom and understanding) which eases one's way to:

STEP TWO: Right quality of thoughts, which eases one's way to:

STEP THREE: Quality speech (framing actions, reactions, and interactions) which eases one's way to:

STEP FOUR: Quality action, quality reaction and quality interaction, which ease one's way to:

STEP FIVE: Living in awareness of consequences, which eases one's way to:

STEP SIX: Constraining effort within an ethical framework, which eases one's way to:

STEP SEVEN: enhancing mindfulness, which eases one's way to:

STEP EIGHT: Deepening the power of concentration, which eases one's way to:

STEP ONE: Right quality of awareness, and so the cycle continues on and on.

The eight step path is a process of continual improvement in the Buddhist quality of one's living, making it easier and easier with experience and endeavor to have a proper quality of decision-making readily at hand at all times. Wisdom opens the door to conduct; conduct then facilitates acquisition of mental discipline; improved mental discipline brings new wisdom.

One can enter the progression of continuous improvement at any step and then move, step by step, towards a more enlightened state of thinking and acting. One, for example, could start with an action step: taking a leap of faith that acting with restraint of ego, anxieties and desires will bring new insights that in turn will facilitate higher quality actions, reactions and interactions later on. Or one could start with a step towards heightened mental discipline, such as a meditative practice. This would lead to greater wisdom and so on to more enlightened actions, reactions and interactions.

The summit of the progression of continuous improvement is acquisition of ten excellent qualities, or Paramitas. These qualities of action are: generosity, giving of oneself; virtue, morality, proper conduct; renunciation; transcendental wisdom, insight; energy, diligence, vigor, effort; patience, tolerance, forbearance, acceptance, endurance; truthfulness, honesty; determination, resolution; loving-kindness; and equanimity, serenity. Such a person would appear to be emotionally and mentally released from so many of the trials and tribulations that come with living in the world. In addition, such a person would have capacity to enhance the lives of others without seeking recompense. Such a person could be easily trusted.

BUDDISM AND THE FIRM

The incorporation of this Buddhist approach into



a firm's decision-making leads to corporate social responsibility. This paradigm of the business as following the eight step path in its decisions presumes that the firm also constitutes a repository of Karma just as an individual is. When the Dharma is then incorporated into the decision-making of the firm, Karma will lead to a higher quality of being for the business.

Any business beyond individual entrepreneurship is a collective effort. Under Buddhism, collectives too are subject to the law of Karma. An enterprise, then, is a locus of Karmic dynamics just as an individual person is.

Individuals constitute the collective. They include a sub-set of relevant stakeholders: those in governance, owners, employees of course. But also customers, whose values and behaviors shape firm operations in the marketplace, suppliers who feed into the firm's ability to deliver its goods or services, creditors and regulators who encourage or thwart firm actions. External demands on the firm from civil society activists or community leaderships trigger reactions and interactions which define the firm's Karma as being positive or negative. Seeking to accumulate positive Karma – or trying to avoid negative Karma – displays an enlightened self-interest that will facilitate sustainable profits and higher valuation of the business on a going concern basis.

BUSINESS APPLICATION OF THE EIGHT STEP PATH

The core of application of mindfulness under conditions of awareness of the law of Karma lies in choosing how best to act, how best to react, and how best to interact. Karma imposes a system perspective on decision-making. The self – the ego object of Karma – is never isolated or alone; it is always in relationships – with natural forces and processes and with human purposing in surrounding social and cultural milieu. The Karma of others impinges on the self; the intentions and emotions of others impinge on the self; the interests and ambitions of others impinge on the self – just as the self impinges on others. Actions of the self breed reactions from others; actions of others breed reactions from the self; self and others are in interactions

every day. Just so for a collective like a business, initial wisdom leads to constructive conduct which turns Karma in favor of the enterprise which in turn enhances acquisition of more wisdom.

But not just any scope of awareness will enhance a firm's Karma. Narrowness in any form – the blinders imposed by selfish profit maximization, lack of technical knowledge, illusions of power or being in the right all the time – works against the acquisition of better Karma. Under the Dharma, wisdom variables should promote knowledge of firm, faith in the firm's vision, mission and strategy, control of its destiny, contentment with the firm's actions and prospects, and respect for the firm's values. Wisdom variables look upon the firm systemically, observing all its circumstances, its various salient stakeholders, and heighten awareness of the consequences of multiple firm interactions with stakeholders.

The wisdom of a firm – its equivalent to awareness and quality of thoughtfulness – resides in its culture – its sense of vision and mission, its business model and competitive strategy. And the wisdom of a firm also lies in the personalities of its decision-makers. Metaphorically, the firm revolves as a chariot wheel with the board of directors as the hub and the senior managers as the outer rim to contain the actions, reactions and interactions of those who act for the entity. The spokes are the stakeholders whose merits or demerits shape the Karma of the firm.

Thus, a firm cannot benefit from application of the Dharma unless it engages with stakeholders. It needs to apply mindfulness to its customers, its employees, its owners, its investors, its suppliers, and its physical and social environments.

For example, a firm obtaining merit and avoiding demerit will not mislead or take advantage of customer ignorance, emotional insecurities, and excessive desires (greed, lust, anger, etc.). The mindful firm will be transparent as to the consequences of its products and services and will price them without seeking undue market power or using them as a means of unfair rent extraction.

With respect to its employees, the mindful firm

will pay them fair compensation that will enhance their livelihoods, not subject them to degrading or harmful conditions of work. It will react to their reasonable needs with concern and constructive approaches. It will interact with employees as recommended by the quality movement to engage their best thinking on the firm's behalf and encourage their personal commitment to the firm's success.

The mindful firm will similarly be fair and transparent to owners, open and reasonable with creditors, solicitous of suppliers to obtain quality inputs, protective of the physical environment, and a steward of community progress. Obviously, such a firm will refrain from corrupt and illicit initiatives.

Having a vision, mission, and strategy which embrace stakeholders is the starting point of excellence in CSR management. If a firm ignores fundamental CSR perspectives, it cannot possess adequate wisdom about Karma. Where there is such poverty of wisdom, a firm cannot optimize Karma to its advantage in the rough and tumble of circumstances. The actions, reactions, and interactions it chooses will not meet the standard of wise conduct leading to more focused mental discipline as time flows on. Its unwise conduct will expose it to illusions, short-sightedness, regrets, untimely interventions, and failure to keep up with changes and new market opportunities.

A shortage of wisdom will lead to failure in stakeholder relationships. Actions taken, reactions to stakeholder interests and demands, interactions with the systemic drivers of firm profitability will all fall short of what is possible to promote sustainable firm success.

CIVIL DISCOURSE: CAN RELIGION HELP?

*One challenge to the advocacy of ethical standards is finding a suitable answer to the question: “whose ethics?” It seems that the evolution of a common cosmopolitan global culture places great stress on atomized individualism. Thus, individuals are privileged to seek their own standards of ethics and, in a sense, anything goes. Socialized normative standards are often suspect and seen as parochial, limited to this or that culture or religion and without a strong claim to global validity. In such conditions of nihilism, bridging communities of normative discourses becomes a first priority. In Minnesota, the Caux Round Table has made limited efforts in this regard to bring together other local think tanks from the political right and the political left for joint programs. One such program was a discussion of the role of religious leaders in a polarized political system now choking American policy making. A report in the Minneapolis **Star Tribune** newspaper provides background on this initiative.*

Susan Hogan
Star Tribune
February 20, 2012

Addressing a crowd at the Humphrey School of Public Affairs recently, the Rev. Leith Anderson, president of the National Association of Evangelicals, told a story about the now-defunct “Civility Project.”

That bipartisan project folded last year after only three of 585 political leaders (535 congressional leaders, 50 governors) signed the following pledge:

“I will be civil in my public discourse and behavior. I will be respectful of others whether or not I agree with them. I will stand against incivility when I see it.”

Anderson was one of two Minnesota clergy, each with national prominence, invited to address the question: “How can our religious institutions and leaders reduce partisan animosity and arrogance?”

“We cannot unilaterally depolarize politics or eliminate incivility,” said Anderson, the recently retired pastor of Wooddale Church in Eden Prairie. “But we can help. We can do our part.”

Also speaking was the Rev. Peg Chamberlin, past president of the National Council of Churches and executive director of the Minnesota Council of Churches.

“In order for Christians and Christian institutions to lead toward civility and away from antagonism in the public square, we have to be in the public square and value democracy,” she said.

The event marked the fourth annual lecture honoring John Brandl, the former dean of the Humphrey School, who died in 2008. Sponsors were the Caux Round Table, Center of the American Experiment, Growth & Justice, Citizens League, Minnesota Free Market Institute, Minnesota Council of Churches and Transform Minnesota.

Chamberlin asked evocative questions of the audience. Can Democracy be valued as an act of faith? Is there a theology of democracy that encourages citizenship and allows for civility?

“Let me be clear, my God is my highest value — higher than my country, higher than my political philosophy, higher than any party, or any political



Each speaker said their faith compelled them to work for the common good. Anderson cited his organization’s support for Catholic bishops in the recent birth control flap with the Obama administration.

In speaking out for others, he spoke of the need to go beyond one’s constituency.

“I was one of the first to speak to the national press about the church in Florida that threatened to burn the Qur’an,” he said. “Not only did I receive appreciation from Muslims, but it also helped send a signal to American Christians that this was not acceptable behavior.”

Amen.

Susan Hogan is a Star Tribune editorial writer.



TO REFORM CORPORATE GOVERNANCE, REFORM ACCOUNTING STANDARDS

*The following essay was presented by **Roderick M. Hills** at the “Sustainable Business Leadership Forum: Ethics, the Professions and Society”, organized by CRT Fellow **Dr. Lester Myers** for Georgetown University with co-sponsorships by the Caux Round Table and the Sustainable Business Network of Washington. The Forum was held at Georgetown University on March 5-6, 2012. CSRWire was a media partner for the Forum.*

Roderick M. Hills
Hills and Stern

I am asked today to give you my point of view about corporate governance. It will not be a conventional view. It is forged by scars I have collected over the past 43 years as a corporate director 20 times, 12 times an audit committee chair, and 3 times the chairman or CEO of a troubled company.

Along the way there were 10 corporate train wrecks, including Republic Pictures, Mayflower Van Lines, Drexel Burnham, Waste Management, Sunbeam-Oster; 11 CEO's were replaced: there was even a nasty proxy fight.

The audit committees on which I served wrote off some \$6 billion of assets created by fraudulent accounting. And during my 3 years at the SEC we discovered over 400 companies that had bribed foreign officials.

I like to tell the story about Oscar Levant, a famous composer and humorist alive when I was young, who, as a political science student at Princeton, was asked to discuss the issues involved in the International Fisheries Dispute and to explain the point of view of each of the countries involved. He wrote: **“having enjoyed too many study evenings in local pubs, I cannot answer the question as posed. I choose instead to answer the question from the point of view of the fish”**.

So you are getting the poor fish point of view about corporate governance.

Corporate governance was not much in the public eye until it became a federal issue in 1977 when the SEC was able to persuade the NYSE to require listed companies to have independent audit committees. How did corporate governance and audit committees **evolve** from that time through the three great corporate scandals that have occurred since:

- The foreign bribery cases that gave us the FCPA;
- The accounting scandals that gave us Sarbanes Oxley; and
- The failures of financial institutions that gave us Dodd-Frank.

I will first offer you my view of what was wrong. Then after telling you what was done about it I will give you my view as to whether the actions taken were a rational response.

BRIBERY OF OFFICIALS

In the late 1970's the SEC, as I mentioned, forced some 400 companies to disclose that they had bribed foreign officials. Those cases covered a very wide spectrum of venality. At one end there was Lockheed that gave Japan's Prime Minister \$21 million to sell airplanes to Japan. At the other were a number of companies that paid smaller amounts, as little as \$500 to get some official to do something he or she was legally obliged to do. As I recall, DuPont paid about \$5,000 to get equipment worth more than a million out of a government warehouse.

What was wrong?

Practically all of those payments were made out of secret bank accounts. Neither auditors nor directors knew of them. No transparency and no accountability.

What was done about it?

There were two responses. At the SEC we took steps that:

- Required corporations to have specific internal financial controls;
- Required auditors to report suspicious financial entries to someone completely independent of that suspicion; and
- Caused the NYSE to require listed companies to have independent audit committee so that the auditors had some place to go with their concerns.

We thought we had fixed the problem.

But Congress had a second response. It passed the Foreign Corrupt Practices Act (FCPA) making it a crime to bribe a foreign official. Over time I have come to believe that the FCPA is okay but there are

problems with it.

The first problem is that the law does not make an understandable distinction between the Lockheed type bribery and that of DuPont. It says only that you can give money to an official to make him do something he is legally obliged to do. But it is understood that a facilitating payment cannot be too large. A few hundred dollars to get goods out of a warehouse may be okay but paying \$100,000 to do so may be a crime. Also how do you tell what an official is legally obliged to do? If you want your equipment on Thursday and he threatens to hold it for 30 days, can you give him a tip to get it out earlier?

This uncertainty about what is and what is not a facilitating payment, and therefore what is and what is not a crime, has created an incentive to conceal payments. Corporations today have many more independent consultants in foreign countries to deal with facilitation issues. For most companies they are not using consultants to conceal bribery. They only want to avoid arguments about what is and what is not "facilitating".

Now the OECD has proclaimed that facilitating payments should also be illegal and Great Britain has obliged with its new anti-bribery law. It is I think a serious mistake. It is a law that cannot be enforced. If, for example, Westinghouse has a multimillion dollar machine idle in Indonesia and needs a 7 day work visa to get an engineer in to fix it, they may need to pay as much as \$100 of coffee money to get that visa. The visa giver in Indonesia often says "Well I need to talk to a couple of other guys and it will cost me for coffee". Companies must find ways to make these kinds of payments through consultants or otherwise.

Fortunately, Great Britain has a wise man who runs England's new bribery law. He says he will not prosecute facilitating payments if a company tells him their problem. He will work with the company and will not bring a criminal action. That is essentially what we did at the SEC 36 years ago.

The second problem is that the FCPA is a bad precedent for countries that do not have fair and effective law enforcement. Here we have effective

governance from auditors, audit committees, the SEC and the plaintiff's bar. We have every reason to believe that its enforcement here is even handed. Much of the rest of the world, however, does not have systems that create the transparency that we have here. A law like the FCPA in Indonesia, for example, would be a hunting license for whichever party may be in power to go after their opposites.

ACCOUNTING SCANDALS

The massive loss of billions of dollars in the accounting scandals of Waste Management, Enron and Global Crossing steamrolled Congress into passing Sarbanes Oxley.

What was wrong?

First, by the late 1990's the traditional external audit had become a commodity with no real intrinsic value; it was far more of a compliance tax than a management tool. Price pressure had put junior people on the front line of audits who became little more than rule checkers.

Second, the independent audit committees that we were proud to have created 20 years earlier took no real interest in the annual bout between management and auditor over how to value assets and liabilities. If management and the auditors agreed, the audit committees seldom asked about what issues might have arisen in fixing those values. Auditors who resisted unduly aggressive management had good reason to believe that the audit committees would not protect them.

What was done about it?

The Sarbanes Oxley legislation, often called SOX, was hastily passed, but was nevertheless a proper and effective response to the problem. It created the PCAOB which is in effect an academy that has retrained the auditors. Some companies complain about the cost of the enhanced audit but most, I believe, understand that the audit has become a management tool.

And SOX put the fear of god on audit committees. They know they must understand the issues that come up between the auditors and management

and they must share responsibility for how those issues are resolved. As a result, the engagement partners of the audit firms know now that they do work for the audit committee and they bring issues to it.

THE GOVERNANCE OF FINANCIAL INSTITUTIONS

The collapse or misbehavior of some of our largest financial institutions in 2008, beginning with AIG and ending with the SEC case against Goldman Sachs, again steamrolled Congress; this time into the passage of Dodd-Frank.

What was wrong?

At the end of 2009 when the dimensions of the financial collapse were understood, but before Dodd Frank was passed, fifty-one prominent men and women from international financial institutions, major accounting and law firms, academia, media, and research and policy institutions participated in a colloquium to understand the causes of the financial crisis. Participants included twenty-one current or former regulatory officials.

Their consensus was that the crisis was a failure of competence. First, they noted that bank regulators did not have the training or the assignment to identify financial risks. They like the auditors of the 90's had become rule checkers. Second, their consensus was that:

"Boards of directors failed in their oversight responsibilities."

We might have expected Congress to pass something like SOX. In fact, in 2009 the colloquium participants noted that a model for reforming the role of bank regulators might be found in the experience that the PCAOB had in reforming the auditing profession.

No such luck. Nothing in Dodd Frank deals with training regulators. It only gives the same regulators even more complicated rules to employ.

And not a word legislated about corporate governance. Dodd Frank has hundreds of pages of laws and rules that miraculously have nothing to do

with the financial collapse they were passed to cure.

WHAT MORE NEEDS TO BE DONE

I wish I could say that we can now be comfortable about the state of corporate governance. However, there is much reason to believe that a large number of corporate directors still do not get it. They just do not have a sufficient sense of their need to watch management.

In all the trouble I have seen over these more than 40 years there have always been one or two directors who are just not willing to challenge the guy (usually a “guy”) that put them on the board.

It need not be this way.

It has come about because there is a crazy paradox about corporate governance. In theory corporations are supposed to be formed by shareholders who appoint directors who will hire and oversee management. In fact, with rare exception it is management in our country that selects the directors. Until we make it clear that managers must stay out of the business of selecting directors we will not have the independence on boards that is sorely needed.

A 2006 report of the Committee for Economic Development put it this way.

“In our view, the best approach to building high-quality boards is to assign to truly independent nominating committees the responsibility for recommending new board candidates and for evaluating the performance of existing board members. The nominating committee should also have the responsibility of recommending committee assignments.”

There are other problems with the state of corporate governance. The traditional financial statement for example is obsolete and allows considerable mischief as a result.

But let’s talk a bit about what I have been preaching.

THE OBSOLETE FINANCIAL STATEMENT

The biggest shortcoming of corporate governance today is our prolonged failure to redesign the traditional financial statement used throughout the world. It is obsolete.

It was created in the days of bricks and mortar when assets were tangible and the investment community was content with historical costs. If a table cost \$200 the only issue for the auditor was whether management’s proposal to depreciate that table over a period of, say, 10 years, was reasonable.

Today we are in the world of intangible assets with the increased need to use current values rather than historical values. So, most of the asset values placed on financial statements are created by the estimates and assumptions made by management with some oversight by auditors and some, hopefully, by audit committee. The range of values available to even the most conscientious managers is enormous.

The problem is that a large part of the investing public believe that these asset values are reliable.

The Economist magazine in 2003 warned that “the brittle illusion of accounting exactitude ... tends to collapse in periods of economic strain.” That illusion collapsed in the 1970’s with the conglomerate craze, it collapsed again in the 80’s with the dot.com phenomena, and at the beginning of this century with the Enron type scandals.

Each year auditors give fairness opinions as to financial statement numbers and every 3 months managements solemnly proclaim that they have made a precise number of pennies per share in the last 3 months. But a slight change in an assumption or estimate could make an enormous difference in those proclamations.

In 2003, under the auspices of the American Assembly, 57 experts in the World of Accounting predicted:

“The balance sheet of the future will be a more flexible instrument able to adapt to a wide variety of industries and circumstances. It will encompass a wider array of numbers so that users recognize



when management and auditors are making judgments on transactions and asset valuations that are not, and cannot be, ‘hard and fast.’”

Until that “balance sheet of the future” exists, audit committees should be carefully evaluating the assumptions and estimates made by management. Auditors should make certain that audit committees understand the alternatives that were open to management and should, with the audit committees, determine whether management’s choices from those alternatives were “fair” choices.

Too many auditors and too many audit committees fall short of that standard.