#CORPORATE GOVERNANCE TWEET

How Corporate Governance Adds Value to Your Business

BRAD BECKSTEAD, CPA, CISA, CRISC

BOOK 01

A THiNKaha® BOOK

#CORPORATE GOVERNANCE tweet
Book01
How Corporate Governance Adds Value to Your Business

Book Excerpt

By Brad Beckstead

THiNKaha®
E-mail: info@thinkaha.com
20660 Stevens Creek Blvd., Suite 210
Cupertino, CA 95014

BOOK EXCERPT Table of Contents

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Section I: Effective Corporate Governance

Section I

Effective Corporate Governance

Corporate governance (CG) is a set of standards, code of ethics, or rules by which the company and its stakeholders agree to be governed. CG is not a wish list or set of documents to be drafted, filed away, and dusted off when trouble arises.

CG is established by the board of directors and is administered by three committees formed out of its members: the nominating committee, the compensation committee, and the audit committee. Each committee independently conducts itself pursuant to charters adopted by the board.

The nominating committee independently conducts preliminary interviews, due diligence, and background checks. It also presents board member and executive candidates to the board of directors with hiring recommendations.

The compensation committee administers and monitors the compensation plans and wage negotiations with company executives and high level management.

The audit committee oversees the hiring of independent auditors, the administration of audits, the internal audit function, and monitors the financial reporting process.

1

Under effective CG, employees, vendors, customers, and shareholders know the company executives have their back.

2

Corporate governance = honesty = trust

3

CG gives a competitive edge,
even by perception.

4

A company with CG is legitimate. A
company without CG appears weak,
shady, or "fly by night."

Section III

Overcoming Misperceptions and Resistance to Corporate Governance

I once worked with an individual who was the company's founder, chairman of the board, and CEO. When I approached him with the standard talks of implementing corporate governance and a system of internal controls, he went on a rant that included some of the following comments:

"We don't need documented controls! We use controls every day that are simply logical!"

"I'm not going to use our company's precious cash to pay high-priced consultants to tell me what to do!"

"Do you think I'm stealing from the company?"

"I don't want to have to chase down [the controller] every time I need a [expletive] check!"

"What good do controls do if there's no one to segregate duties with? We don't have enough staff to implement internal controls!"

As intense as this conversation was at the time, I now reflect on it with great insight. I appreciate the individual's concern for how corporate governance might bog down "efficient" decision-making. I appreciate his desire to preserve the company's valuable resource of cash. And I appreciate his need to fill his ego with an "I've got it all under control" attitude. Ego-centric leaders are very typically offended by the idea of having to be held accountable to others who they perceive to be underlings that are simply there to row while they set the course and steer the ship.

However, in today's business environment of accountability and transparency, the ego-centric leaders have gone the way of two guys named Bernie—Madoff and Ebbers—who are now enjoying life behind bars. In the name of saving themselves from embarrassment and lawsuits, business leaders now have acumen when it comes to the concept of "best practices." Given this new business environment, the misperceptions and resistance to corporate governance have been mostly overcome by the daily news. Now is the age of learning, understanding, and implementing systems and controls that "prove" compliance and accountability. By so doing, company directors and executives can point to a break-down in the "system" rather than personal misconduct or malfeasance as the root of any errors or financial misstatements that might occur during their tenure.

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A common misperception:
executive decision-making
is handcuffed by CG.

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Decision-making is actually enhanced and more productive under CG because of collective agreements and strategic unity.

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Consultants have abused clients in the past with excessive fees creating the perception that CG and internal control systems are costly.

34

Investors and venture capital firms should demand accountability through a system of CG and internal controls.

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Allocation of funds to CG and internal controls should be a requirement of initial funding from investors and venture capital firms.

Section IV

Encouraging Corporate Governance within Your Organization

Often times in newly developed organizations, the founding principles become the members of the board and top level executives by default. This is typically true because these individuals "gave birth" to the new business model, have the licenses or credentials that are key to the operations of the company, or have invested time or money during the incubation phase. Does this mean that the founders also contain the skill set and knowledge base to conduct themselves under a system of accountability and controls? No. In fact, the majority of them are offended by the very thought of it (see Section III).

So how do you—the top executive of a newly formed company, the newly appointed committee chairperson, or board member—persuade your counterparts that CG and a system of internal controls should be priority number one in creating value to the company?

The key is to remember that the best way to convince others is to lead by example. If the CEO gets offended and goes on a rant about added levels of red tape and paperwork, demonstrate to him or her that you are fully compliant in your department and can still function and perform at a pace that keeps up with him or her and the other departments. Tell the CEO how you can sleep at night knowing that your department's "house" is in order, and that if anything goes wrong under your watch, fingers will be pointed at a break-down in the system, and not at you personally. Discuss the risks of not having CG and internal controls, including personal legal exposure. Eventually, he or she will get the picture and want to be fully protected. Implementing CG and a system of internal controls is a lot like having an insurance policy. No one likes to pay the premiums, but they're sure glad they have it when a crisis hits.

41

In most small companies, executives are major shareholders and can remove board members at will. This fact overshadows board power.

42

Recognize that bylaws are generally the "teeth" that give the board "bite."

43

Board electorates should demand CG and internal control policies be in place before or during their tenure on the board.

Section VI

Having an Effective System of Internal Controls

Many founders do not understand what it means to have an effective system of internal controls. This is typically because they are entrepreneurial individuals who have either invented an idea or concept and have devoted their lives to it, or they are highly skilled professionals who have not been exposed to formal policies and procedures of conducting business under CG and internal control systems. This section attempts to expose those individuals to the top-level concepts and language associated with CG and internal control systems.

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Internal controls provide the guidance and mechanisms for seamless transitions caused by employee turnover.

59

A system of internal controls establishes an environment of accountability, quality, and success.

60

A system of internal controls should start with a risk-based analysis of the company's accounting processes and significant accounts.

61

A company should use a quantitative methodology to identify its significant accounts and processes.

Section VIII

Value-Added Benefits of Corporate Governance and Internal Controls

> Even if corporations do not rely primarily on foreign sources of capital, adherence to good corporate governance practices will help improve the confidence of domestic investors, reduce the cost of capital, underpin the good functioning of financial markets, and ultimately induce more stable sources of financing. [...] To remain competitive in a changing world, corporations must innovate and adapt their corporate governance practices so that they can meet new demands and grasp new opportunities.[4]

In addition to the well-said statement above, a company adds value to its equity and bottom line through viable CG and internal controls by saying to its stakeholders, "We are a company you want to be invested in or doing business with." The benefits of CG and internal controls are felt by all of the company's stakeholders, from shareholders to employees to the community in which it resides.

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4. Organisation for Economic Co-operation and Development, "OECD Principles of Corporate Governance," *OECD*, 2004, http://www.oecd.org/dataoecd/32/18/31557724.pdf.

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Shareholders feel a level of comfort that their interests are put first and foremost by the board, executives, management, and employees.

116

The board feels a level of comfort that executives, management & employees are accountable and demonstrating good faith through compliance.

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Executives feel a level of comfort that the board is reflecting the will of shareholders, and that any failures don't fall entirely on them.

118

Management feels a level of comfort that their team is accountable and that their performance can be measured and compensated accordingly.

Section X

Why Pursue "Quality"?

"It takes 20 years to build a reputation, and five minutes to ruin it. If you think about that, you'll do things differently."

-Warren Buffett

"Remain a corporation and retain control if you like, but behave as a servant leader in a partnership."

-Sam Walton

"Quality is never an accident; it is always the result of high intention, sincere effort, intelligent direction and skillful execution; it represents the wise choice of many alternatives."

-William A. Foster

Why do I end this book with a discussion on "quality," and why do I quote the successful men above? Because at the end of the day, we are all attempting to attract the same pool of fish by convincing them that our worms are better tasting. In other words, it is the quality of our goods and services that are attractive to our stakeholders. Investors will want to invest their hard- earned dollars because they see a group of leaders who put CG and internal control systems in place to assure the company's stakeholders that "quality" sits on the foundation of self-governance and accountability. Employees will want to work for a company whose culture is grounded on ethical behaviors and a drive for quality products and services. People will want to have businesses in their communities who demonstrate environmental sensitivities and fiscal responsibility.

"Quality" in business can only be achieved when all stakeholders have full trust in a company's adherence to self-governing edicts and fully implemented and effective systems of internal control.

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Companies with quality corporate governance and internal control systems can easily adapt to changing environmental and economic trends.

About the Author

Brad Beckstead specializes in audits, corporate governance, and internal control design and implementation for smaller public companies. He is a Certified Public Accountant, a Certified Information Systems Auditor, and is Certified in Risk and Information Systems Control. Brad is Audit Principal and SOX specialist at L.L. Bradford & Co., CPAs in Las Vegas, Nevada. He is the former Managing Partner at Beckstead and Watts, LLP, an audit firm that won a case in 2010 before the Supreme Court against the Public Company Accounting Oversight Board. Brad has trained numerous U.S. and China-based companies on the effective design, implementation, and testing of internal control systems in accordance with Section 404 of the Sarbanes-Oxley Act. He has also conducted training programs for Sun Microsystems during the rollout of their virtual office concept. Brad created corporate governance, internal control, and accounting policies and procedures templates, which are bundled and sold on his website, http://www.SOX404Lite.com.

For internal control and corporate governance resources, access any of the following websites developed by Brad:

http://www.UnitedCFO.com—SOX and accounting consulting for U.S.-based companies

http://www.SECAccountants.com—Contract CFO services for U.S.-based companies

http://www.SOX404Lite.com—SOX compliance templates

http://www.JABAccounting.com—SOX and accounting consulting for China-based companies

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