CORPORATE GOVERNANCE—ROLE OF THE DISCLOSURE AND NOMINATING/CORPORATE GOVERNANCE COMMITTEES

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While audit committees justifiably attract most of the attention when corporate governance issues are discussed many other board committees also play an important role in providing objective expertise when seeking to resolve various issues relating to the operation of reporting companies. In this article we discuss the role of two of those committees—the disclosure committee, which oversees preparation of required reports to the Securities and Exchange Commission and other public dissemination of information regarding the business and financial condition of reporting companies, and the nominating committee, which vets potential directors and safeguards the independence of members of the board through careful analysis of their actual and potential business relationships with the company.

A. Disclosure Committee

The officer certification requirements in the Securities Exchange Act of 1934 ("Exchange Act") pertaining to periodic reports require that the CEO and CFO assume responsibility for the establishment and maintenance of "disclosure controls and procedures," as well as responsibility for internal accounting controls. In addition, officers must evaluate the effectiveness of the disclosure controls and procedures within 90 days prior to the filing of a periodic report and disclose their conclusions regarding the effectiveness of these controls and procedures. In light of these responsibilities issuers must establish and maintain disclosure controls and procedures that can be relied upon in connection with Exchange Act periodic reporting obligations; prospectuses used in public offerings registered under the Securities Act; private placement memoranda or offering circulars used in offerings exempt from the registration requirements of the Securities Act; earnings press releases; earnings guidance communicated to analysts and market professionals pursuant to; and disclosures required under stock exchange rules and regulations. Responsibility for disclosure processes and internal controls within public companies is vested with a variety of individuals and organizational bodies, including the CEO, CFO and other senior managers; The board of directors as a whole and the audit committee in particular; other specialized committees created by the board of directors, particularly the disclosure committee; the head of the company's internal audit or controls

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function and that person's internal audit team; other designated managers, including a disclosure controls monitor; and the company's outside auditors.

Disclosure controls and procedures must be rationally created and effectively managed. While senior management, particularly the CEO and CFO, are confronted with substantial obligations in this area, it is generally not practical to assume that those executives can handle the entire task on their own. In fact, it is common for public companies to establish a disclosure committee with responsibility for collection of information that may be needed to fulfill the issuer's disclosure obligations; preparation of the initial drafts of required reports and other disclosure documents; revision of drafts of required reports and other disclosure documents and completion of due diligence necessary to support the information disclosed in such reports and documents; resolution of issues relating to "materiality" and the timing of required disclosures; and establishment and ongoing evaluation of the issuer's disclosure controls and procedures.

1. Staffing

When putting together the team for the disclosure committee, the issuer should be mindful of making sure that the members have the requisite skills and experience relating to the overall disclosure obligations and determination of what constitutes "material" information that must be disclosed. In addition, the members must have the technical expertise necessary to understand the regulatory requirements that will apply to the content and presentation of the information. The SEC and other commentators have recommended that disclosure committees should include, among others the principal accounting officer; the controller; the general counsel or other senior legal officer; the principal risk management officer; the chief investor relations officer; the internal auditor; and the heads of the issuer's key business units. Since titles may vary among organizations, emphasis should be placed on the actual activities and responsibilities of the persons designated for the committee. As such, the committee will often include the issuer's chief operating officer, who has responsibility for overseeing the activities of several positions listed above, and the senior manager with chief responsibility for the issuer's internal controls. Some issuers have also added the CEO and/or CFO to their disclosure committees, although this decision is best made by reference to the size of the organization and the time that is available for these senior executives to participate in the committee's activities.

2. Coordination and Organization of Disclosure Committee

It is recommended that the membership of the disclosure committee designate a "disclosure coordinator" who can manage the entire disclosure process; assign responsibilities to each of the committee members and monitor their progress; and ensure that all procedures have been properly documented, disseminated and enforced. The logical candidates for the coordinator position include the issuer's general counsel or the chief accounting officer or another senior financial manager. The disclosure committee should have the necessary personnel support, and it is common to designate one or more

employees from internal controls or the in-house legal team to assist the committee in general and the coordinator directly.

At least one member of the disclosure committee should have specific responsibility for identifying and analyzing specific business and regulatory risks that might increase the possibility that the issuer will fail to make timely and full disclosure of material information. The biggest risks come from external conditions that lie outside the issuer's control, such as new legal and accounting requirements and changes in overall business conditions that trigger the need to adopt new and unfamiliar business models. However, risks may also be created by deliberate actions of the issuer, such as acquisitions or divestitures, layoffs, or mistakes made by employees during the information collection and review process.

Another area of special focus might be identification of important new business trends and collection of information that may be necessary to adequately disclose the nature of the trends and the impact that they might have on the company's business. For example, if it is anticipated that there will be significant new sales opportunities in a specific geographic region, information should be collected to substantiate this belief, perhaps through customer surveys or detailed interviews with mid-level managers. The analysis should then be expanded to other functions that may be called upon to support strategies implemented to capitalize on the opportunity, such as purchasing, manufacturing, inventory control and logistics.

The disclosure committee may also form its own subcommittees to handle specific activities or disclosure-related issues or problems. For example, a subcommittee may be created to deal with disclosure issues that may require immediate action, thereby making it impossible for the entire committee to meet to fully consider the issues and make a timely decision. Other subcommittees may deal with particular types of reports or with disclosure obligations that arise with respect to specific transactions, such as preparation of a Securities Act registration statement or proxy materials for a proposed acquisition.

Coordination and management of the activities of the disclosure committee is often facilitated by detailed time and responsibilities schedules that would apply to each required report or disclosure document. While such schedules have long been common practice for preparation of annual reports and proxy materials for annual meetings, they must now take into account the additional types of disclose obligations, as well as the new deadlines, adopted by the SEC. While the complexity and formality of the schedule will vary depending on the disclosure event, it will always be important to allow sufficient time for collection and testing of data; review of specific regulatory disclosure requirements; review of comparable disclosures by competitors; and review by outside experts, the audit committee and senior management.

3. Written Charter and Procedures

The activities and impact of the disclosure committee can be quite extensive. In order to ensure that the role of the committee is understood throughout the organization, a number

of issuers have promulgated a written charter that sets out the general duties and responsibilities of the committee. Commentators have recommended that the charter be limited to a statement of the general principles underlying the committee's activities, as opposed to a list of the specific activities that the committee will be undertaking. If a written charter is used, it should be reviewed and amended on a regular basis to take into account the rapidly changing regulatory framework relating to disclosures.

While the written charter includes general principles, the disclosure committee should also promulgate written procedures relating to the preparation and submission of SEC reports and other documents that may need to be filed with the SEC or otherwise publicly disseminated (e.g., earnings releases). The procedures should address the following issues:

- Responsibilities of various employees for the collection of information required for each report or other document;
- Responsibilities for drafting and review of each report or other document;
- Procedures for presentation of drafts, and any material disclosure issues, to the disclosure committee on a timely basis; and
- Responsibilities of the disclosure committee, as well as others involved in the disclosure process (e.g., outside auditors and counsel, senior management, and the audit committee), for reviewing drafts and resolving any disclosure issues and finalizing the content of the reports and other documents.

The disclosure committee should also be responsible for establishing and administering policies and procedures relating to the disclosure of material information to the public and members of the media. A related issue that also needs to be considered is creating policies and procedure to enforce prohibitions on "insider trading" and "tipping."

4. Interaction with Management and Other Organizational Elements

Fulfillment of its duties and obligations will require that the disclosure committee have substantial interaction with senior management and key departments and units within the organization. For example:

- The committee will be the primary support system for the CEO and CFO in their efforts to establish and maintain the overall scheme of disclosure controls and procedures;
- The committee will consult with the issuer's finance department and internal controls personnel to ensure that information regarding all aspects of the issuer's business and financial condition is being collected and consistently reviewed and tested;
- The committee will present the various periodic reports and other disclosure documents to the CEO and CFO for their review and approval and provide such persons with back-up certificates relating to the committee's compliance with the disclosure controls and procedures; and
- The committee will generally make a separate presentation on a regular basis to the audit committee and the entire board of directors.

Committee members will also be involved in discussions with outside parties having a need for information regarding the issuer and its disclosure controls, including the issuer's independent auditors and investment bankers involved in an offering of the issuer's securities. In addition, the designated disclosure coordinator may take on the role of "corporate responsibility officer," which may include the right and duty to report serious disclosure issues or problems, including misconduct by senior officers, directly to the board.

B. Nominating Committee

Companies should have a nominating and corporate governance committee consisting entirely of independent directors. Among other things, such a committee would be responsible for identifying individuals qualified to become board members and selecting, or recommending that the board select, the nominees for election at the annual meeting of shareholders; hiring and firing any search firm to be used to find appropriate director candidates; and overall evaluation and oversight of the board of directors and management. The committee would also orchestrate director orientation and continuing education programs, as must be included in the corporate governance guidelines. Both the NYSE and NASDAQ have indicated that they will be active in developing and sponsoring appropriate director education and training programs.

The responsibilities of the committee should be explicitly spelled out in the charter or a board resolution that is included in the company's proxy statement and posted on the company's web site. Basic responsibilities of the committee that should be listed in the charter include the following:

- Recommending nominees to the board and its committees, including development of criteria for membership on the board, review of candidate qualifications and potential conflicts of interest, and assessment of contributions of board members being considered for re-nomination;
- Monitoring and safeguarding the independence of the board;
- Establishing policies and procedures for reviewing related party transactions;
- Overseeing and reviewing the company's internal processes for communicating information to the board on a timely basis;
- Developing and recommending a set of corporate governance principles to the board; and
- Overseeing evaluation of board and management performance.

Evaluations of board and management performance should be conducted no less frequently than annually. The corporate governance committee should have the sole authority, supported by adequate funding, to retain and dismiss outside advisors that may provide consulting services in connection with the committee's responsibilities, such as search firms used to identify board and management candidates.