


3-1-2004

## Current Issues in Corporate Governance for Mexican Companies, including Effects of Sarbanes-Oxley

Thomas S. Heather

Follow this and additional works at: <https://digitalrepository.unm.edu/usmexlj>

 Part of the [International Law Commons](#), [International Trade Law Commons](#), and the [Jurisprudence Commons](#)

### Recommended Citation

Thomas S. Heather, *Current Issues in Corporate Governance for Mexican Companies, including Effects of Sarbanes-Oxley*, 12 U.S.-Mex. L.J. 55 (2004).

Available at: <https://digitalrepository.unm.edu/usmexlj/vol12/iss1/10>

This Article is brought to you for free and open access by the Law Journals at UNM Digital Repository. It has been accepted for inclusion in United States - Mexico Law Journal by an authorized editor of UNM Digital Repository. For more information, please contact [disc@unm.edu](mailto:disc@unm.edu).

# CURRENT ISSUES IN CORPORATE GOVERNANCE FOR MEXICAN COMPANIES, INCLUDING EFFECTS OF SARBANES-OXLEY

THOMAS S. HEATHER\*

## INTRODUCTION

The principal objective of my comments is to focus on developments in corporate governance in Mexico.

First of all it is relevant to point out that many months before the U.S. Congress and U.S. authorities responded to the many public outcries over the well publicized and high-profile corporate, accounting, and legal scandals,<sup>1</sup> the Mexican Banking and Securities Commission (the *Comisión Nacional Bancaria y de Valores*) (CNBV) began to develop, discuss and promote comprehensive regulations designed to improve the quality and transparency of financial reporting, as well as the functions of independent board members and audit committees, strengthen the independence of firms that audit public companies, and basically, to increase corporate responsibility and disclosure standards. As members of the Commission, leading issuers, and members of the Mexican bar were going through this process of discussion, revision, and consultation, a number of very material scandals dealing with corporate abuse and misconduct broke out in the United States, eventually leading to the introduction of the Sarbanes-Oxley Act (SOA).<sup>2</sup>

## BACKGROUND INFORMATION OF SOA

The relatively recent implementation in March 2003 of such regulations, is what we call the *circular única* ("*Disposiciones de carácter general aplicables a las emisoras de valores y a otros participantes del Mercado de Valores*, Official Daily, D.O. March 19, 2003),<sup>3</sup> applicable to Mexican issuers, may be best understood by briefly referring to the Code of Best Corporate Practices<sup>4</sup> (the Code), which has been previously referred to by José García Mata.<sup>5</sup> This Code was issued in late 2000, and it was developed by a committee (Committee) that included, among others, the chairmen of many leading public companies, the President of the Mexican Institute of Public Accountants (*Instituto Mexicano de Contadores Públicos*), the Mexican Institute of Finance Executives (*Instituto Mexicano de Ejecutivos de Finanzas*), the

---

\* Thomas S. Heather is a partner in the Mexico City law firm of Ritch, Heather y Mueller, S.C. He is a member of the board of directors of a leading bank and of several Mexican corporations and is a member of the Executive and Audit committees of *Grupo Modelo*.

1. Enron, Tyco, WorldCom, among others. See Carrie Johnson, *Ex-CEO Turns Himself In; Skilling Pleads Not Guilty to Fraud and Conspiracy in Firm's Collapse*, The Washington Post, Feb. 20, 2004 at A01.

2. Sarbanes-Oxley Act Search Term End of 2002, Pub.L. No. 107-204 (2002).

3. The provisions were issued pursuant to the statutory authority of the CNBV afforded under the *Ley del Mercado de Valores*.

4. The Code of Best Corporate Practices was published in 1999. The purpose of this code is to provide Mexican companies with a set of recommendations that will allow them to increase the efficiency of managerial performance and to provide timely and reliable information to their stockholders and creditors. As of January 1, 2001 the CNBV began to require that all companies listed on the stock market disclose their compliance with the Code on an annual basis.

5. Mr. García Mata was the previous speaker to Mr. Heather. He is a partner of Deloitte & Touche and heads the Best Practices Advisory Group of the firm in Mexico.

Mexican Bankers Association, one cabinet minister, and one member of the Board of Governors of the Central Bank (*Banco de México*). The point here is that there was ample representation on this committee, and in reality, its moral authority to establish usages in this field is beyond question.

The Code was accepted unanimously by the Committee and since April of 2001 Mexican public companies have been required to report to the stock exchange the extent to which they follow the provisions of the Code.

### REPERCUSSIONS OF THE CODE OF BEST CORPORATE PRACTICES

A recurring phenomenon in Mexico, is to view matters by focusing on form over substance. Some of these reports to the stock exchange take a very literal reading, while some of these rules have some degree of subjective flexibility. For example, the Code recommends the establishment of a compensation committee or a planning committee, of the board of directors. Many companies simply check the box stating "not in place" but then proceed to explain that the compensation or planning functions are taken very seriously, and while the board committees do not exist, "compliance" is met by hiring consultants, outside experts and the like, whose advice is taken seriously. Consequently, the companies erroneously believe they are in full compliance. So there are some questions about the reliability of any so-called compliance statistics.

The Code was based on the Organization for Economic Cooperation and Development<sup>6</sup> (OECD) principals of corporate governance. Mexico is part of the OECD. In April of 1998 the OECD council endorsed the adoption of Codes of proper corporate governance by its member countries. Mexico proceeded to implement the Code because it was bound by the relevant convention of the OECD and by its April 1998 vote in favor of the council action.

The Code establishes a number of non-mandatory recommendations applicable generally to all Mexican corporations. Obviously, the principal intent was to develop the Code for companies that trade on the Mexican Stock Exchange, but it can apply to other corporations. For example, in bank bailouts, the Institute for the Protection of Bank Savings<sup>7</sup> (Spanish acronym: IPAB), an equivalent to the FDIC<sup>8</sup> and the RTC<sup>9</sup> in the U.S., imposes requirements on corporations it controls and banks it bails out. Many of the Code recommendations are on a mandatory basis.

The capital structure of Mexican "public" companies is generally concentrated in the hands of a limited number of controlling family members. The Code recognizes and focuses on the fact that these controlling shareholders should

---

6. The OECD is an international organization created in 1961. It superseded the Organization for European Economic Cooperation, which had been founded in 1948 to coordinate the Marshall Plan for European economic recovery following World War II. The organization has 29 full members: Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Great Britain, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey, and the United States. The headquarters are in Paris.

7. IPAB is a decentralized public entity of the Mexican federal government created to provide depositors with an explicit and limited deposit insurance system and to regulate the execution of bank assistance programs. IPAB protects depositors by defining institutional guidelines and policies in the areas of deposit insurance and bank resolutions, both aimed at providing certainty and stability to the Mexican financial and banking system.

8. Federal Deposit Insurance Corporation

9. Resolution Trust Corporation

maintain a higher degree of scrutiny on the businesses they own. The Code recommends that although potential conflicts of interest may arise, such shareholders should participate very actively in board deliberations since they maintain a material interest in the corporation's results given their huge stake in these companies. These shareholders act as a permanent oversight factor in regard to their investment. So the Code recognizes that this permanent oversight will benefit all of the shareholders of a company.

A majority of the Mexican companies on the stock exchange have adopted many of the principals in the Code. In any event, the role taken by the Mexican Banking and Securities Commission was really quite substantial in trying to implement some of these rules into law, especially in early 2001. In fact, in July of 2001, the Mexican Securities Law (*Ley del Mercado de Valores*) was amended to incorporate a limited number of principles from the Code, mainly with respect to the disclosure of related-party transactions, minimum board standards, a new concept of mandatory independent members, and, principally, the mandatory establishment of audit committees composed primarily by independent members.

The Code introduces some further timid protection by lowering the shareholder requirement in order to bring an action against a board member to 10% of total equity. The minimum threshold includes non-voting or limited voting shares. In addition, the ability to sell only non-voting or limited non-voting stock to the public—as opposed to voting equity—was dramatically curtailed, together with the former ability to link voting and non-voting stock through “*unidades vinculadas*” or “linked units.”

These structures are now frowned upon by the CNBV. It plans to eventually require all future placements to be based on voting stock, or limit the maximum number of non-voting or limited-voting stock, to 25% of total equity. Companies that already have these structures, however, are grandfathered in to a great extent. Moreover, the changes to the law addressed board representation, allowing shareholders of limited voting stock to appoint one board member for every 10% of equity. It limited the maximum number of board members to 20, although the Code of Best Practices limits it to 15. However, doing so is difficult. We had many companies, especially many leading banks or insurance companies, where 44 board members was the norm. More importantly, for the first time, audit committees became mandatory.

#### AUDIT COMMITTEES

Audit Committees became mandatory pursuant to applicable provisions of the Mexican Securities Law as of the year 2002, and many are in the process of implementing charters on internal regulations. It has been difficult to convince controlling family shareholders why an audit committee is required, to explain why the audit committee asks so many questions, and to justify the increased cost.

Nevertheless, things are moving forward. There have been many developments related to SOA, and it has transformed the way Mexican companies' CEOs and CFOs are looking at things. In addition, more Mexican businessmen are sitting on the boards of U.S. corporations, so that has increased awareness.

### “THE NEW REGULATIONS”

I will now briefly refer to the rules that were issued in March 2003, which we call the *circular única*, or the new regulations (the Rules). First of all, the Rules concentrated in one place a number of prior regulations applicable to all public issuers. More significantly, the Rules introduced a number of mandatory provisions and addressed a number of the principal issues contained in SOA. The Rules also added, and significantly expanded, the role and the responsibility of audit committees; the reporting requirements for subsidiaries of a listed company; and the audit committees' ability to look into the internal controls, not only of the holding company, which was always the focus with these companies, but also those of the operational subsidiaries. These regulations clarify that the group, per se, is subject to these rules and the corresponding disclosures.

There is an initial obligation to have CFO and CEO certifications of the annual reports. In addition, the chief legal officer also has certain certification responsibilities with regard to any type of new issues. Moreover, the Rules address auditor independence requirements, and the reporting and approval by the audit committee of certain of the non-auditing functions performed by external firms. The compensation paid to external auditors also must be disclosed. The Rules impose a number of obligations on the auditing firms, including the introduction of a policies and procedures manual. These provisions focus on the concept of independence and also some limitations as to multi-disciplinary services, including those of a legal nature.

With regard to securities lawyers, some basic rules are introduced relating to the independence of their certification of issuers' documents or of certain facts dealing with fair disclosure. Attorneys on boards will not qualify as independent or outside counsel for purposes of issuing legal opinions in public offers. The rules I have described were being developed well before Sarbanes-Oxley. Their development was probably slowed down because the CNBV has been overburdened by its bank regulatory authority. It regulates not only securities activities and the market, but also all areas of banking. The CNBV also has jurisdiction over money-laundering and related topics, so it has very broad responsibilities. Consequently, its focus depends on the “flavor of the month” (i.e., the problem at hand) which may sometimes cause things to get bogged down. But I must say that one of the factors that slowed down the introduction of the Rules was the reluctance, the natural reluctance, by a number of family-controlled “public” corporations to actually make more disclosure to the market than was customary. Obviously, it took many months of discussions to reach a consensus and then certain intermediate banking crises got in the way.

### PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

I turn to the Public Company Accounting Oversight Board (PCAOB),<sup>10</sup> created by Sarbanes-Oxley, which creates a registrations system for public accounting firms. There is also a deadline for registration by foreign public accounting firms, such as

---

10. The PCAOB is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002, to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

the ones we have in Mexico that prepare or issue audit reports on Mexican companies considered as foreign private issuers, those that have publicly placed securities of some sort in the U.S. markets, or those that in any way play a "substantial role" in the preparation or issuance of such reports. That deadline is April of 2004. The PCAOB poses some very interesting questions because the registration requirements do not exempt non-U.S. public accounting firms. Section 106 of the SOA<sup>11</sup> issued by the PCAOB specifically address firms that assist or that carry out material services that a U.S. public accounting firm may rely upon in connection with the issuance of its own audit report or any opinion therein concerning a publicly traded company in the U.S. The U.S. accounting firm shall be "deemed to have consented" to produce its audit work papers to the PCAOB or the SEC<sup>12</sup> in connection with any relevant investigation that is subject to the jurisdiction of the courts of the United States.

---

11. Sarbanes-Oxley Act of 2002 § 106, 15 U.S.C.A. § 7216 (West Supp. 2004).  
Foreign Public Accounting Firms

(a) **APPLICABILITY TO CERTAIN FOREIGN FIRMS-**

(1) **IN GENERAL-** Any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer, shall be subject to this Act and the rules of the Board and the Commission issued under this Act, in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the United States or any State, except that registration pursuant to section 102 shall not by itself provide a basis for subjecting such a foreign public accounting firm to the jurisdiction of the Federal or State courts, other than with respect to controversies between such firms and the Board.

(2) **BOARD AUTHORITY-** The Board may, by rule, determine that a foreign public accounting firm (or a class of such firms) that does not issue audit reports nonetheless plays such a substantial role in the preparation and furnishing of such reports for particular issuers, that it is necessary or appropriate, in light of the purposes of this Act and in the public interest or for the protection of investors, that such firm (or class of firms) should be treated as a public accounting firm (or firms) for purposes of registration under, and oversight by the Board in accordance with, this title.

(b) **PRODUCTION OF AUDIT WORKPAPERS-**

(1) **CONSENT BY FOREIGN FIRMS-** If a foreign public accounting firm issues an opinion or otherwise performs material services upon which a registered public accounting firm relies in issuing all or part of any audit report or any opinion contained in an audit report, that foreign public accounting firm shall be deemed to have consented—

(A) to produce its audit work papers for the Board or the Commission in connection with any investigation by either body with respect to that audit report; and

(B) to be subject to the jurisdiction of the courts of the United States for purposes of enforcement of any request for production of such work papers.

(2) **CONSENT BY DOMESTIC FIRMS-** A registered public accounting firm that relies upon the opinion of a foreign public accounting firm, as described in paragraph (1), shall be deemed—

(A) to have consented to supplying the audit work papers of that foreign public accounting firm in response to a request for production by the Board or the Commission; and

(B) to have secured the agreement of that foreign public accounting firm to such production, as a condition of its reliance on the opinion of that foreign public accounting firm.

(c) **EXEMPTION AUTHORITY-** The Commission, and the Board, subject to the approval of the Commission, may, by rule, regulation, or order, and as the Commission (or Board) determines necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions exempt any foreign public accounting firm, or any class of such firms, from any provision of this Act or the rules of the Board or the Commission issued under this Act.

(d) **DEFINITION-** In this section, the term 'foreign public accounting firm' means a public accounting firm that is organized and operates under the laws of a foreign government or political subdivision thereof.

12. U.S. Securities and Exchange Commission

Following registration, a U.S. accounting firm that relies on the opinion of a Mexican accounting firm shall also be deemed to have consented to supply the audit work papers of the Mexican firm. These provisions raise a number of issues (e.g., up-the-ladder reporting requirements) to which the Mexican legal profession is not yet subject. The two principal areas of concern are confidentiality and extraterritoriality. There are Mexican rules, regulations and practices that deal with the issue of secrecy and address the issue of confidence. There is a 1945 statute, called the Law of Professions or *Ley Reglamentaria del Artículo 5° Constitucional Relativo al ejercicio de las Profesiones*,<sup>13</sup> that requires any person holding a professional degree, which obviously includes accountants, to keep in "strict secrecy" the matters revealed by their client, except for reports required by law. This law also governs the rules for the establishment of professional institutes, such as the *Instituto Mexicano de Contadores Públicos*,<sup>14</sup> which is the professional body for public accountants. It is a very well organized body and it has what I believe to be a very solid and specific code of ethics from which we in the Mexican Bar could take some guidance.

These rules—Section 106 and others—are not technically the law of the land in Mexico. They are not imposed as a result of a treaty signed by Mexico. They are not a law passed by the Mexican Congress. Therefore, there are questions as to whether or not there would be violations of the constitution in the event that a court in the United States or any other authority would try to enforce those provisions in Mexico. Our constitution protects the legality of proceedings in Mexican tribunals; laws must be issued prior to an action being brought to court; we have the concept of a competent authority. The *Ley de Amparo*,<sup>15</sup> protects individuals, corporations, foreigners, or nationals, against the wrongful application of law or lack of due process. An action in Mexico based solely on the extraterritorial application of a PCAOB rule would be disallowed. Mexico will not look favorably on an attempt by a foreign entity such as the PCAOB to enforce a rule or regulation on an extraterritorial basis. In addition, there would be questions about the code of ethics applicable to the accounting profession, which addresses the independence of external auditors. There also would be questions about the requirement that a public accountant keep secret the data relating to his practice, and "under no circumstance" reveal to anyone the facts, data or circumstances disclosed to him in the exercise of his engagement. Nevertheless, with the authorization of the client, the public accountant may provide information and documentation requested by competent authorities (i.e., Mexican authorities).

### CONCLUSIONS

The objective of these regulations, and generally of Sarbanes-Oxley, is understandable. They were developed to further the public interest in the preparation of informative, accurate, and independent audit reports for companies whose securities are sold to and held by and for public investors in the largest market in the world. Even so, there is also a labor law issue. Mexican labor law is based on an

---

13. Prescribed Law of Constitutional Article 5 Relative to the Exercise of the Professions

14. Mexican Institute of Public Accountants

15. "Ley de Amparo Reglamentaria a los artículos 103 y 107 de la Constitución Política de los Estados Unidos Mexicanos," as amended, D.O. January 10, 1936.

implied duty of confidence. Therefore, under some circumstances, the disclosure of confidential information pertaining to accountant-employees, such as past criminal records or problems with any regulatory authority, raises questions of consent forms. Nevertheless, these issues may be addressed by adding internal guidelines or regulations within each of the accounting firms and individual consent forms. I believe in this regard that consents, acknowledgements, or instructions by the corporate clients or other parties named in the audit work papers, to provide information if required, would be sufficient to cure potential problems. For example, pursuant to the Mexican Federal Tax Code and its regulations,<sup>16</sup> auditing professionals rendering tax reports (*dictámenes fiscales*<sup>17</sup>) on behalf of clients, do obtain a consent in the engagement letters to provide information as necessary. A similar practice is followed with regard to banks, insurance companies, and other financial-sector entities, where these entities pre-consent to the delivery of information required by Mexican authorities. In my view, the bottom line is that if a foreign issuer voluntarily makes the decision to access U.S. capital markets and play in the "big leagues," issuers, counsel, and accountants should be willing and ready to comply with and abide by the applicable rules, and to follow the path of transparency and legality. Finally, the CNBV has embarked on a new initiative: the introduction of a modern securities law that is expected to be submitted to Congress during the second quarter of 2004. It is clearly intended to introduce far-reaching reform in the area of corporate governance by emphasizing the responsibilities of the board, independent directors, and that of controlling shareholders. In addition to enhancing the authority and powers of the audit committee, it will establish a mandatory committee of corporate practices. This committee will comprise independent directors and will establish fiduciary duties of diligence, loyalty, and fidelity on all directors, chief executives, and external auditors. A new era of corporate accountability will soon be ushered in.

---

16. Código Fiscal de la Federación, as amended, D.O. December 31, 1981

17. Fiscal Opinions



