Statement of Brian P. Anderson
Chief Financial Officer
Baxter International Inc.
before the
Senate Committee on Banking, Housing, and Urban Affairs
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Mr. Chairman, and members of the Committee: I am Brian P. Anderson, senior vice president and the chief financial officer of Baxter International Inc. Baxter International is a global health-care company, listed on the New York Stock Exchange, with approximately $8 billion in sales and 50,000 employees in more than 100 countries worldwide.

I am very pleased to have this opportunity to join you today, along with my colleagues from the business community and others, to look at the Sarbanes-Oxley Act one year later. Looking back, two years after the Enron story became public, followed by WorldCom, Adelphia, Tyco and Global Crossing, one easily concludes that these corporate governance and accounting scandals seriously threatened the public confidence that is fundamental to the efficiency of our capital markets, an essential component of our free enterprise system. By passing the Sarbanes-Oxley Act of 2002, Congress took a bold step toward restoring public confidence and rebuilding trust. The question before us now is whether this law, and the tools it provides for reform, have accomplished the intended objective of restoring public trust through meaningful change within corporate America.

The Sarbanes-Oxley Act seeks to effect change through many avenues. For purposes of my comments today, I will address them within the fundamental structure

that comprises our modern corporate system: the shareholders/investors, the board of directors and the senior management of the corporation.

Beginning with the management of the corporation, I believe the most significant aspect of the Sarbanes-Oxley Act in this regard is the visibility and emphasis it places on corporate executives to ensure that financial information is correct. Obviously, the public's confidence in the integrity of financial reporting was seriously eroded as a result of the corporate scandals, and the individual investors who invested their funds based on this information were ultimately the ones who were most harmed by this failure. As you are aware, the Act places responsibility for ensuring enhanced and accurate financial statement disclosure not only upon management of corporations, but also upon public accountants and audit committees of board of directors.

Among the measures designed to improve investor confidence in corporate reporting are (1) significantly enhanced and more timely financial and non-financial disclosure requirements, (2) CEO/CFO certification of periodic reports and (3) a redesigned approach to regulations of the accounting profession, including auditor independence. In general, my opinion is that these rules have served their intended purpose well. Issuer disclosure in both financial and non-financial arenas has improved significantly and, perhaps just as importantly, management's time, energy and focus on enhanced disclosure has increased, whether through disclosure committees or otherwise. This necessarily serves to protect investors and ensure the reliability of the financial information available to the investing public. One of the most positive outgrowths of this initiative will hopefully be an increase within corporations of a climate of compliance.

For example, at Baxter, we formalized our disclosure committee and documented our disclosure controls and procedures, which we found to be a productive and worthwhile exercise. We found that, for a multinational company operating in over 100 countries, we had a very rigorous reporting and control environment; however, there were improvements that could still be made. We view this as a living and breathing process that, in accordance with the new rules, is reviewed on an ongoing basis and refined as necessary.

On the other hand, I believe that it still remains to be seen whether the time, effort and expense required by issuers and management to comply with Section 404 of the Act (not to mention the independent auditors) will ultimately result in significantly enhanced internal controls and procedures. Please do not misunderstand my comment: I believe management should acknowledge its responsibility for the adequacy of the company's internal control structure and procedures for financial reporting, and should assess the effectiveness of the company's internal control over financial reporting. At this point, however, it is not obvious to me that corporations today have mastered the most effective method of accomplishing this goal.

While I understand and agree with the intent behind Section 404 of the Act, the time and costs involved are not insignificant or incremental. It will virtually double Baxter's internal and external audit costs. Complying with Section 404 of the Act not only imposes significant and time-consuming obligations on reporting companies, it requires an attestation of management's internal control report by independent auditors. My overall concern here is that both reporting companies and external auditors will spend an enormous amount of time, energy and money to ensure compliance with section 404

without necessarily achieving the desired outcome of ensuring that companies have systems in place to identify potential weaknesses in their financial reporting.

In general, however, I believe that the increased responsibilities and focus that Sarbanes-Oxley has brought upon independent auditors is a positive development. The importance of the public's trust in accountants, particularly as it relates to audits of public companies, cannot be emphasized enough. In that regard, I believe that Congress has, through Sarbanes-Oxley, successfully implemented important and significant changes designed to ensure auditor independence. By severely limiting the kinds of non-audit services that can be performed for audit clients, restricting relationships that can result in a lack of independence, establishing "cooling off" periods and ensuring mandatory audit partner rotation, there should be significantly improved independence of audit firms from their public company clients.

In addition, I support the notion that the previous system of accounting firm self-regulation required substantial revision. Accordingly, I believe that the creation of a Public Company Accounting Oversight Board will serve to enhance investor confidence in the value that independent auditors can bring to our corporate system.

The Act has also, through Section 202, solidified an important link between the independent auditors and the audit committees of boards. At Baxter, we have had several of these initiatives and processes in place for many years, including executive sessions between the Audit Committee and our independent auditors, and audit partner rotation. We have, since the enactment of the Act, changed our practices in the area of non-audit work to conform to the new rules. Overall, I believe that the new rules imposed by the

Act with regard to public audit firms and their activities should result in significant positive change.

Turning to Boards of Directors, I believe that the Act has had and will continue to have a significant positive impact on how boards interact with management and each other. The exposure of serious problems around corporate governance and the heightened awareness of this topic have served to put the public spotlight on issues such as board independence, board qualifications and the roles and responsibilities of board committees. This can only improve accountability and responsibility of our corporate boards, which, in turn, means better representation on behalf of the shareholders.

At Baxter, we are proud of our strong commitment to maintaining the highest standards of corporate governance. In 1995, Baxter became one of the first companies to adopt formal Corporate Governance Guidelines, long before corporate America was required to meet today's new standards. Most of the new rules the government now mandates are practices we've had in place for years. In fact, as a result of Baxter's many years of attention to corporate governance, the Sarbanes-Oxley Act as well as the proposed New York Stock Exchange rules, has not dramatically impacted Baxter's practices.

The company's corporate governance guidelines, which are annually renewed and revised as appropriate, address issues such as board size, structure, composition, qualifications, diversity, director term limits, retirement ages, strategic planning and succession planning. Working with our Chief Corporate Governance Officer, the Board continually discusses Baxter's governance practices, changing our policies when necessary and identifying areas where we need to improve our performance.

The board recently adopted categorical independence criteria by which director independence will be assessed. As of September 2003, 10 out of 11 directors were independent under the new criteria, with Harry Kraemer, Baxter's chairman and CEO, being the only non-independent director.

While our CEO and other members of our Executive Management Team attend Board Committee meetings to share their thoughts and perspectives, our Board and its Committees also regularly meet in executive session without any members of Baxter's management team present. These "executive sessions" (where no management is present) are very important to help ensure the objectivity of the board. But we recognize that these practices were not necessarily commonplace prior to enactment of Sarbanes-Oxley, and we commend Congress for raising the bar for all companies.

With respect to shareholders, I believe the Sarbanes-Oxley Act has had, and will continue to have a positive impact. While shareholder confidence was justifiably shaken by corporate scandal and fraudulent behavior, there is a renewed energy and optimism among shareholders these days. The Sarbanes-Oxley Act, as well as the pending changes to be implemented by the New York Stock Exchange and NASDAQ, have provided shareholders with confirmation that their government is attempting to eliminate opportunities for abuse. Debate is increasing regarding the rights of shareholders and the matters over which they should have control, or at least a voice. Shareholders are seeking control over executive compensation, increased access to the proxy statement, increased participation in corporate affairs and direct access to the board, including board nominations.

Thus, Mr. Chairman, looking back at what has occurred since the enactment of Sarbanes-Oxley, I believe we see on balance a very positive and encouraging picture. It is clear that, in light of the corporate governance and accounting scandals that began to emerge two years ago, strong medicine was needed *quickly* to restore investor confidence, create independent oversight, and eliminate the serious conflicts of interest that led to these abuses in the first place.

To those who feel that Sarbanes-Oxley may have gone too far, I would say that the strong medicine appears to be working and that we must not abandon the treatment just because there may be some unwanted or unpleasant side effects. At the same time, to those who might feel that Sarbanes-Oxley may not have gone far enough, I would also urge caution and strongly encourage them to closely monitor the impact of the law to make sure we haven't tipped the balance too far in any one direction.

Specifically, looking forward, I believe we must pay close attention to the balance between federal and state law, the potential erosion of the business judgment rule, increased liability for directors and the increasing hesitancy of qualified individuals to serve on corporate boards, especially on audit committees.

Federal law historically has regulated the securities markets by requiring specified financial public disclosures from publicly traded companies. State law, on the other hand, has provided guidance on corporate governance, such as corporate structure, shareholder rights and the fiduciary responsibilities of directors. Although neither the Sarbanes-Oxley Act, nor the pending exchange proposals, technically create a new cause of action for stockholders, some of the provisions within Sarbanes-Oxley, as well as pending stock exchange rules, overlap into areas traditionally covered by state law, such

as definitions of director independence and audit committee composition and responsibilities.

In addition, with the balance between federal and state law in flux, the state courts are sending the signal that they too are expecting more from corporate boards. The Delaware Supreme Court recently has reversed several chancery court decisions that upheld director decision making, and the decision of the Chancery Court in *In re the Walt Disney Company* to deny the defendants' motion to dismiss points to a willingness by the courts to second guess director decision making and question the good faith and duty of care elements of the business judgment rule. The consequences of this trend may be the creation of a new standard of care for directors that could dissuade some qualified, high caliber individuals from serving as a director of a public company because of the uncertain potential liability.

Finally, I believe all three of the constituencies I have addressed—corporate management, corporate boards and shareholders—would be better served if the SEC exercised its authority to implement more of the Sarbanes-Oxley provisions through its well established and respected rule-making process. The SEC has been granted the authority to address unfair and inequitable situations that might arise out of, for example, the section 402 loan restrictions, or to provide guidance where there are questions of interpretation, but the Commission has stated that it will not do so.

Mr. Chairman, we very much appreciate having the opportunity to appear before this committee today to underscore the importance of what you have accomplished with the enactment of the Sarbanes-Oxley Act, and to express our strong support for the overall goals that this legislation is intended to serve. As I hope I have articulated, I

believe that Congress has addressed in a full and fair manner all aspects of our public corporate system through legislation that impacts corporate management, corporate boards and corporate shareholders, and has taken a dramatic step towards restoring public trust and confidence in our capital markets system. I would be happy to respond to any questions you might have.

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