

January 28, 2002

Enron/Andersen

The Enron/Andersen debacle has raised a number of questions for directors and members of audit committees. The following are typical of what we have been responding to:

1. Andersen is our accountant: (1) Do we have to switch? (2) Should we switch? (a) Despite the notoriety and the admission of errors by Andersen in the Enron situation, there is no legal requirement that a company switch accountants for any reason and, at this time, there does not appear to be any reputational or Wall Street credibility reason militating a switch. The board of directors or the audit committee should review the resumes of the key Andersen people on the account as well as the Andersen explanations of the Enron and other recent problems to satisfy themselves as to Andersen's competence and integrity and the result should be reflected in the minutes. (b) Since there is no requirement to switch, the question is solely in the discretion of management and the board.

2. Our accountant does substantial consulting work for us. Should we separate completely our audit work from consulting work? Again, there is no legal or other extraneous reason to do so. However, this practice is coming under increased criticism and attack by activist investors and corporate gadflies. The SEC will not agree that resolutions requesting separation proposed for inclusion in proxy statements may be excluded. Legislation or SEC regulation mandating separation is a real possibility. It may be prudent to at least begin separation of these tasks.

3. Can we continue to use off-balance sheet financing? There is absolutely no legal or other reason to stop using off-balance sheet financing. However, it should be noted that the SEC has just reiterated and strengthened its guidelines for financial statement and MD&A disclosure of off-balance sheet financing and failure to comply with these guidelines will result in exposure to enforcement and liability actions.

4. Will the fallout from Enron result in greater exposure to liability for boards of directors and audit committees? While bad cases make bad law, the danger from Enron is much more the possibility of onerous new legislation and regulation than the likelihood of a change in the law with respect to director liability. If directors and those who are members of audit committees follow customary procedures, there should be no increased liability exposure. We recommend that boards and audit committees do a full review with counsel of their procedures and practices to be sure they are state-of-the-art.

5. How can the board and audit committee protect against collusion between management and the accountants? If not actual collusion, the accountants not being forceful in calling to the attention of the audit committee issues that should be— including making sure the audit committee understands that there are alternative GAAP methods that would result in lower revenues and/or profits and in higher asset write-offs and/or greater liabilities? In the first place, it is the job of management that these types of accounting issues are understood by the directors and audit committee. For its part, the audit committee should insist that the accountants explain

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any such alternatives at least annually. If there is any unresolved issue in this area or if the audit committee is concerned that it is not receiving full information, the audit committee should consult with an independent advisor. It is important that the efforts to deal with the Enron situation not drive a wedge between management and members of the board and audit committee.

6. Should we rotate accountants on a five-year basis? There is no legal reason to do so, but we recommend that this be discussed by the audit committee. The minutes should reflect that this option was considered and that the committee determined that it was not necessary or desirable.

7. Should the company refrain from hiring key members of the accountant's team that services our account? Yes, for at least three years after an individual last worked on the company's account. At no time should a significant number of the company's finance and accounting staff be former employees of the accountant.

8. What else should the audit committee do in addition to the usual? The audit committee should review all the analysts reports and any press stories about the company's accounting and disclosures. Where this would entail reviewing voluminous material, a member of the internal audit or compliance staff could be assigned to highlight negative comments. Management and the accountants should be required to explain negative comments.

9. What about indemnification, exculpation and D&O insurance? There should be no impact other than on D&O rates which have already been increased substantially. The worst possible result of the Enron/Andersen situation would be increased liability for directors and audit committee members resulting in a company's inability to get competent people to serve. We recommend that counsel review for the board and the audit committee their legal responsibilities as well as appropriate actions and policies in order to ensure that the directors' duties are being properly discharged.

10. I'm not sure I and the other members of the audit committee understand completely the accounting. What should we do? First, request a tutorial from management and the accountants. If you are not satisfied, then consult with an outside advisor. There are university groups that will provide consulting services to audit committees. While directors and audit committee members have a duty to monitor, they are not guarantors and do not have an obligation to assure perfect accounting or perfect disclosure. Their obligation is to use reasonable efforts to ensure that management and the accountants are discharging their obligations.

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