

March 20, 2002

Audit Committees

With proposals from President Bush, multiple bills pending in Congress, new SEC rules and guidelines in various stages of promulgation, the NYSE Committee on Corporate Accountability and Listing Standards considering new requirements for listed companies, recommendations from organizations representing investors and corporations and Andersen struggling for survival, it is only natural that directors, and specially members of audit committees, have a number of questions. The following is representative of four current thinking:

1. Andersen. The SEC has issued special rules that facilitate continuing Andersen as a company's auditor. While a number of companies have terminated Andersen, there is no legal requirement that a company do so, and continuing to retain Andersen as a company's auditor is feasible. The basis for retention should be carefully documented and reflected in the minutes of the audit committee and both the committee and the board of directors should have the advice of counsel in making the decision to continue Andersen.
2. The Audit Committee. The charter and procedures of the audit committee should be reviewed to bring them up to the current state of the art. The audit committees should meet with the independent auditors and legal counsel to obtain advice that this is so. In this connection, it would be desirable that the audit committee review a comparison of its practices with the March 11, 2002 speech by Robert Herdman, Chief Accountant of the SEC, setting forth his views as to what those practices should be.
3. Audit Firm's Quality Control. The audit committees should meet with the outside audit firm and review that firm's quality control procedures to determine if they are satisfactory. In this connection, a comparison with the March 11, 2002 Volcker/Andersen Committee decisions would be useful.
4. Accounting Principles. The audit committees should review the company's "critical accounting policies" with management and the audit firm as is being urged by the SEC and as would be required by proposed rules and legislation.
5. Responsibilities of Audit Committee Members. The law is clear that directors and members of the audit committee may rely on the management, internal auditor, independent auditor, legal counsel and other advisors, absent any reason to doubt their competence or fidelity. The indemnity and exculpation provisions of the company's charter are alive and well. So too is D&O insurance (albeit now much more expensive). Absent enactment of some of the more extreme proposals, there will be no change in the liability exposure of directors and members of audit committees. The courts recognize the necessity of not changing the rules that assure directors that they will not be held personally liable for even negligently failing to discover misrepresentations by management and the auditors, and that this assurance is critical to having competent, independent people continue to serve as directors of public companies. What has changed is the amount of time that audit committees will need to spend to meet the procedures referred to above, and companies will have to reexamine the scheduling of audit committee meetings.

M. Lipton