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Audit Committee Alert -*January 13, 2000*
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By Dennis R. Beresford, H. Stephen Grace, Jr., Ph.D., John E. Haupert, Robert S. Roath, and The Honorable William M. Schultz

Recent actions by the SEC, the exchanges, the Big Five, and other important groups involved in corporate governance, have made it quite clear that audit committees are now seen as being responsible for the oversight of both the firm's risk and control environment and its financial reporting processes. Furthermore, shareholders expect these committees to protect the value of their investments. SEC Chairman Arthur Levitt set the benchmarks for audit committee performance in his September 28, 1998 address, and then again in his March 22, 1999 address when he said, "Compare that situation with the audit committee that meets five times a year before each board meeting; where every member has a financial background; where there are no personal ties to the chairman or to the company; where they have their own advisers; where they ask tough questions of management and outside auditors; and where, ultimately, the investor interest is being served." The National Association of Corporate Directors ("NACD"), in its Blue Ribbon Commission on Audit Committees Report, echoed Levitt's standards.

The clarification of responsibilities and the recommendation of operating guidelines are certainly positive steps that will go a long way toward improving audit committee performance and assuring good corporate governance and reliable shareholder information. However, as with any current topic of interest to the media, it is important to be on guard against the hype that always surfaces. Audit committees must be careful to recognize that, while they certainly are expected to do more and may, in fact, be assuming more liability, they are not expected to take over management's role by micro managing. An audit committee working with management and other board members to improve the oversight of a firm's risk and control environment is different than an audit committee "driving change" in the firm. The latter activity represents a confusion of the roles of governance and management.

An audit committee is an element of the governance process — it must be tough minded, but it must be able to interact synergistically with management. With the limited time they have available, the efforts of audit committees must be channeled to the most critical areas. It is of the utmost importance that committee members be independent with the requisite skills. It is also essential that there be a charter in place that clearly lays out their duties, and that a record is available of how those responsibilities were discharged.

If these things are taken care of properly, audit committees can perform efficiently without trying to superimpose themselves as another management layer. They can also protect themselves in litigation and regulatory actions by demonstrating they took prudent steps to do their job, given what might be reasonably expected from an oversight group with recognized limitations.

Chairman Levitt, the NACD, and others, have recommended that audit committees be provided with independent professional advisors. These advisors can enhance audit committees' effectiveness as an element of corporate governance. The key here, just as in the case of audit committee members, is for these advisors to recognize the need for the committee to work proactively with management, while maintaining sufficient independence to insure the integrity of the governance system's checks and balances. Professional advisors who are independent and possess considerable operational experience can assist audit committees in a range of areas including the identification of key value drivers and the analysis of operational cash flows, and they can do so with a sensitivity to the required linkage between the committee, the board, management, the external and the internal auditors.

Such advisors can assist the full board and the audit committee in addressing the training and "financial literacy" requirements of the NYSE, AMEX, and the NASD. They can serve as a sounding board to the committee on technical and operational finance issues, and offer a degree of continuity during transitions in committee membership.

Boards of directors, audit committees, and management are all addressing the evolving requirements for audit committee structure and operation. Consideration is being given to integrating the current mix of CEOs, academics and political leaders with CFOs and CPAs, and independent professional advisors are being selected. All of these parties must recognize the appropriate role of the audit committee and must work synergistically to achieve improved linkage and oversight.

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