

8-August-2007



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Senior Executives And Lawyers Jointly Ponder Audit Committee Liabilities - November 23, 1999

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Senior Executives And Lawyers Jointly Ponder Audit Committee Liabilities

By H. Stephen Grace, Jr. Ph.D.,
The Hon. William M. Schultz, and Richard W. Simmons, Esq.

The SEC's current initiative to provide the legal framework to guide audit committees in meeting their responsibilities to the shareholders of U.S. public corporations while welcomed as a measure long overdue is merely a good first-step. Without thoughtful, diligent, and continuing development of its independence, skills, and experience as the company changes, the audit committee members and board will certainly run the risk of litigation from various plaintiff's class-action attorneys. The committee must continually address the changes prompted by the evolution of the company, so it can comprehend and analyze evolving risks that are likely to be ultimately reflected in the company's financial statements. Failure to do so will invite intrusion, disruption, and unnecessary risks and costs.

Companies must continually remind themselves that the Audit Committee charter is merely a thoughtful roadmap for committee members, the CEO and other company constituencies. Standing alone, the charter provides no protection.

As litigation rises from the stock price volatility and unanticipated economic events (the McDonnell Douglas criminal indictment and the Rite Aid economic difficulties being two of the latest) that inevitably occur, audit committee members should expect to have hurled at them a host of complex, and often sophisticated questions. Ranging from the company's risk and control environment, to the committee members' skills and access to advisors, on to the impact of the company's incentive compensation plans. These questions will range broadly and probe deeply.

Many boards have practice drills regarding hostile takeovers. Audit committees will be well served to periodically conduct practice drills regarding their operating procedures and the questions they would be asked if involved in a lawsuit or in a regulatory action. Those audit committees undertaking such drills have quickly identified multiple areas of concern to themselves, other board members, and management.

It will be years before the court and SEC decisions will provide safe-harbors or bright line tests, and this will not impact the growing recognition that the buck stops with the board, the audit committee and management. Failing to address the changing responsibilities of audit committees poses a substantial risk to senior management, the board, the audit committee, and ultimately, to the shareholders.

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