Editorial
Disney revisited: The audit committee redux

The Disney decision has been much touted as the harbinger of the end of the corporate scandal era, as an exemplar of the pendulum swinging the other way. Never mind that the decision related to events occurring before the enactment of Sarbanes-Oxley or dealt with the actions of the Compensation Committee rather than the audit committee. The acquittal of Richard Scrushy, after the first prosecution under the criminal penalties provision of Sarbanes-Oxley, is an equally poignant reminder of the limits of corporate governance reform. No matter how many provisions of the law target fraud, getting a jury to convict reminds us that fraud must be pleaded with particularity, and that white collar crime is particularly difficult to prove.

In this column however, and in the pages of this Journal, we have done much to equate good corporate governance with an effective and empowered audit committee. It is hard to see that the $35bn spent by corporate America on internal controls is an effective deterrent to accounting fraud except insofar as whistleblowers make use of the ability to report to the audit committee, that the audit committee ensures that the 'tone of the top' is appropriate for the management of a public company, that in all fundamental respects the audit committee is 'effective' under Auditing Standard No. 2, employs the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework for fraud detection, namely 'seeking benchmarks from management' and, most importantly, takes seriously its responsibility for hiring (and firing) auditors and approving additional services to be performed by auditors.

That the measures for effective corporate governance reside largely in the audit committee, and can pretty much be encapsulated in a single sentence, speaks volumes about how the corporate governance debate has been misdirected and subverted by accountants and lawyers. At the meeting of the American Bar Association in the summer of 2005, lawyers involved with the panel on director's liability were clearly charting a strategy to convince clients that, after Disney, concerns about director's liability could be papered over by appropriate ticking of boxes documenting the meetings of boards of directors and audit committees. In tandem with the internal controls extravaganza presided over by the Big Four accounting firms, the medieval practice of selling indulgences seems mild and was, I am sure, carried out at much more reasonable prices.

Certain facts cannot be gainsaid: (1) Enron and WorldCom made people pretty mad, (2) institutional investors demanded that independent directors be made to go 'out of pocket' in settlements, perceiving that these directors were derelict in their duty of care to shareholders, (3) Sarbanes-Oxley imposes new responsibilities on directors. Regardless of whether courts adjudicate cases in which directors are held liable for breaching the duty of care owed to shareholders, new Securities and Exchange Commission (SEC) actions are beginning to target directors and plaintiffs attorneys are bringing cases. With the stock market still in stratospheric territory as of this writing, there may be few bankruptcies on the order of Enron and WorldCom — yet, should this pendulum swing as it indubitably will, one ought to

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have a few words of wisdom for members of the audit committee.

Remember that your pivotal responsibility is to use your best efforts to be assured that the financial statement reflects, in all material respects, the financial condition of the company. Beware of amorphous concepts such as the strategic audit which attempt to minimise this statutory duty. Employ consultants such as lawyers and forensic accountants, take *bona fide* whistleblowers seriously and establish some dominion over the auditors. Do not take lawyers and accountants at face value. Do what the reasonably prudent person would do in the conduct of her own affairs. Directors represent shareholders, not management.

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Editor