



New York Stock Exchange Special Committee on Corporate Accountability and Listing Standards

Good evening. My name is Kathy Gibson and I am here today representing the American Society of Corporate Secretaries, an organization whose membership includes over 3,800 individuals whose professional responsibilities are focused on corporate governance and board related matters.

I appreciate the opportunity to provide input to the Committee. My goal is to provide you with a practical perspective based on our collective experience in interacting with corporate boards. Over the last 15 years I have had the opportunity to work with audit committees at several different companies of different sizes and complexities. Through the Society, I have also had the opportunity to Chair a national committee on Board practices and provide input to the Blue Ribbon Committee in late 1998.

We believe there is no substitute in the corporate governance arena for diligence and integrity. Since no regulation or listing standard can guarantee these intangible qualities, we recognize the current necessity of providing additional regulatory guidance related to corporate governance in order to bolster investor confidence in our corporations and our boardrooms. However, we must exercise caution that new regulations or listing standards do not significantly increase the risk of serving on an audit committee or make it increasingly more difficult to attract and retain quality directors of diverse backgrounds.

While the task of restoring investor confidence will require reforms focused on the auditing profession, corporate disclosure, corporate governance and audit committees, my remarks will center on corporate governance and audit committee issues given our area of expertise. But, please feel free to ask questions that go beyond the topics mentioned in these prepared remarks.

The topics I'll address are:

- Board independence;
- Audit committee independence;
- Private meetings with the independent auditor and the internal auditor
- Number of audit committee meetings;
- Audit committee financial literacy requirements;
- Audit committee training;
- Audit committee rotation; and
- Mandatory rotation of independent auditors.

In many of these areas, we recommend that the Exchange endorse "best practices" guidance for listed companies rather than mandating specific listing requirements. Given the wide range of factual

circumstances in listed companies, it is often difficult to find a "one-size-fits-all" formula in the corporate governance area.

Let me start with **Board Independence**.

We continue to support the Exchange's current definition of independence that gives boards the discretion to view the relevant facts and circumstances in determining whether a board member is independent. We suggest that the Exchange recommend as a "best practice" that its listed companies' boards should be comprised of a majority of independent directors using the Exchange's current definition. According to a survey of our member companies, 71% responded that their boards had a majority of independent directors.

The appropriate definition of "independence" has been a matter of public debate for some time. As a result, public companies have to satisfy a number of different definitions of independence - e.g., Section 16 of the Securities Exchange Act; Section 162(m) of the Internal Revenue Code and the Exchange's definition of "independence" for audit committees. We feel strongly that the Exchange retain its general definition of independence for purposes of recommending that boards of listed companies should be comprised of a majority of independent directors.

Next, I'll address the issue of **Audit Committee Independence**.

While the Exchange's current definition of independence for audit committee members has several disqualifying categories (such as serving as a consultant) it leaves the ultimate decision to the board to determine whether a business relationship would impair a director's ability to exercise independent judgment.

In light of the recent public debate involving charitable contributions by corporations to organizations with ties to a board member, we recommend that the Exchange's definition of independence for audit committee members be revised to have the Board review not only business relationships between a company and a director but also other relationships, such as charitable contributions to an organization affiliated with a director. We feel strongly that the ultimate decision regarding the impact of charitable contributions or business relationships on a director's independence be left to the Board's discretion. Specific dollar limits that have been proposed in the legislative arena for charitable contributions, such as \$10,000, are simply not practical given the vast array of factual circumstances that may arise.

We do not recommend any other changes to the current definition of independence for audit committee members, as we feel the current definition (with the one suggested revision) contains an appropriate balance of board discretion and specific disqualifying factors.

Private Meetings with The Independent Auditor and Internal Auditor

In order to further promote candid discussion between the audit committee and each of the independent auditor and the chief internal auditor, we would support a listing requirement that audit committees meet privately with each of the independent auditor and the internal auditor at least once a year. Our sense is that this is a widely followed "best practice" that is appropriate to institute as a requirement.

The next topic is the **Number of Audit Committee Meetings**.

Given the recent increase in expectations of audit committees, we would support a specific requirement that audit committees meet at least four times a year. Again, our sense is that this is a widely followed best practice that is appropriate to institute as a requirement.

I'll now address Audit Committee Financial Literacy Requirements.

In 1998, the Society expressed its view to the Blue Ribbon Committee that the role of the audit committee is one of oversight. Despite recent unfortunate events, the role of the audit committee continues to be one of oversight.

An effective audit committee member - and indeed an effective board member - does not need to be intimately familiar with the latest pronouncement from FASB. While having one or more individuals on a board who have finance acumen is desirable, we believe it is impractical and unwise to revise the Exchange's current requirements regarding financial management expertise to a level suggested by some commentators. We believe it would be much more beneficial for an audit committee to spend time meeting privately with the independent auditor asking questions such as those suggested by Warren Buffet (e.g., if you were solely responsible for the preparation of the financial statements, what changes in accounting policy would you make) rather than expecting audit committee members to delve into the complexities of in-process r&d.

The Exchange's current requirements leave the determination to the board's discretion as to whether an audit committee member is financially literate or has financial management expertise. We would support the Exchange recommending as a "best practice" that a board consider the Blue Ribbon Committee's definitions of financial literacy and financial management expertise in making its determination. We believe this would continue to give boards the necessary flexibility in recruiting directors with broad backgrounds and experience, rather than trying to fill one or more slots with a "super accountant".

I am not denying that there are some accounting issues within a given company that are important to understand but these are issues that management and the auditors should fully discuss and explain to the audit committee (and, if appropriate to the full Board). As a result of the SEC's recent guidance, companies' public disclosures and presentations to Board and audit committee meetings are beginning to focus on critical accounting policies. I think this is an area where reforms are needed in the accounting rules and in the disclosure requirements to increase the transparency of these critical policies. Filling your board with former auditors would not be nearly as effective.

The next topic is Audit Committee Training.

We would support the Exchange recommending as a "best practice" that audit committees receive continuing education. We believe that the appropriate amount and subject matter of continuing education is most appropriately determined on a company specific basis. Many of our member companies routinely provide updates to the audit committee on significant accounting rule changes and also provide periodic reports to the committee on topics that may be significant to the company - such as revenue recognition. Increasingly, companies will be providing tutorials to audit committees on critical accounting policies.

I want to strongly emphasize the point that effective education for audit committee or other board members cannot be "one-size-fits-all". The issues faced by audit committees are very much dependent on factors such as the company's industry, size, complexity, geographic reach, degree of regulation. Also, the benefit that individual board members may receive from "general" as opposed to tailored, company specific education will necessarily vary depending on the director's past

experience. If a board member chooses to attend an outside course - such as Directors College - they should be encouraged to do so with the financial support of the company. Certainly, they should not be required to do so.

We do not believe that the creation of a bureaucracy dictating annual course requirements for audit committee members will further the goal of bolstering investor confidence in corporate America. We do think it will make it more difficult to recruit and retain audit committee members.

I'll now move to the topic of Audit Committee Rotation.

Many of our member companies strongly oppose **specific** mandatory rotation requirements for audit committees. It may be appropriate for the Exchange to recommend as a "best practice" that there be periodic rotation of audit committee members, including the chairman, but leave the timing of the rotation to the discretion of the Board. Periodic rotation is an appropriate goal, but specifying the number of years limits the discretion of the board in the committee succession process.

I'll now briefly address the issue of Mandatory Rotation of the Independent Auditor.

We believe that having a mandatory requirement to change auditors on a regular basis would be costly and inefficient. The decision to change auditors is most appropriately left to the discretion of the board. However, the Exchange may consider recommending as a best practice that the partner in charge of an audit engagement be rotated on a periodic basis. Several of the accounting firms require periodic rotation of the partner in charge.

In closing, I would like to share a few thoughts regarding audit committee effectiveness:

- An effective audit committee is comprised of independent and diligent directors and has an open and candid relationship with management and the external auditors
- An effective audit committee will complement, not duplicate, the work of the internal and external auditors
- An effective audit committee is willing to ask tough questions of the internal and external auditors, and
- An effective audit committee will satisfy itself that there are processes in place to make sure that significant issues will "bubble up" to the attention of the committee or the full board.
- Since audit committees are not "one-size- fits-all" in nature, the development of "best practices" in many cases is preferable to prescriptive regulation.

Again, I thank the Committee for the opportunity to provide input on behalf of the American Society of Corporate Secretaries. Going forward, the Society would be happy to assist the Committee in any way possible, such as surveying members on a particular topic. I am happy to answer your questions.

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