THE CURRENT CRISIS OF INVESTOR CONFIDENCE:

CORPORATE GOVERNANCE AND THE IMBALANCE OF POWER

By

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TABLE OF CONTENTS

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Overview

Ted Seabrook, Phillips Exeter Academy's venerable wrestling coach during the 1960's when I was a student there, taught me an invaluable lesson that I have found applicable to a myriad of situations beyond the grappling mat. In describing how to bring a man down when, for example, the wrestlers begin in the down position and one finds himself on the top with the opponent beneath him, Seabrook admonished us that "a man is a table. To bring him down, therefore, all you need do is create an insecurity in one of the legs of the table. Then, you apply force in line with that insecurity." It was this image that came to mind as I began to collect my thoughts about what appeared to be the sudden, widespread failures of corporate accountability as demonstrated by the recent demises of WorldCom, Enron, Tyco, Global Crossing, and the like: This was the result of unrestrained forces acting upon insecurities inherent in the system. The suddenness and widespread nature of the problem seemed to stagger investors' faith in financial markets. Investors globally began to ask, "[H] ow much confidence should…[they] place on companies' financial statements?"[1] Indeed, in the case of WorldCom, Karen Nelson, a professor of accounting at Stanford Graduate School of Business was quoted as saying, "Enron was all about complex partnerships and accounting for special purpose entities. But what WorldCom did wrong is something that's taught in the first few weeks of a core financial reporting class. That is why people are asking, given its basic nature and its magnitude, how could it have been missed."[2]

How indeed? Prior to the recent spate of embarrassments, United States' Generally Accepted Accounting Principles ("GAAP") was viewed as the gold standard to which multinational corporations must conform in order to take the greatest advantage of the efficiencies of international financial markets. As a director of the Vorstung of Germany's Deutsche Bank pointed out to this author, after raising the bank's accounting standards from German mandated GAAP to International Accounting Standards, the bank's senior management determined it was worth spending around an additional $200,000,000 in order to comply with U.S. GAAP so that the bank could be listed on the New York Stock Exchange. The managers realized that such a listing would unlikely have any marked effect on the liquidity of the bank's stock. Indeed they expected it to be thinly traded on the New York Stock Exchange. However it was their view that the bank's stock would always trade at a discount if it could not demonstrate that it had complied with the (perceptually) more accurate U.S. GAAP. Now in light of Enron, WorldCom and other embarrassments, the effectiveness of U.S. GAAP, our corporate accountability system, and United States business ethics in general are all being questioned, with the consequent adverse effects on the prices of issues on public exchanges, and even the dollar approaching parity with the euro (although, admittedly, that may be attributable to other factors as well). Moreover, much like the return of a lesson unlearned from the bank runs of the early Great Depression, a new paradigm of insolvency seems to be facing corporations: bankruptcy not caused by traditional financial problems, but rather by the loss of investor confidence.

Yet for a long time before these events, there seemed to have been a sense that maybe the system was not quite right; that it needed improvement. In 1998 the New York Stock Exchange and the NASDAQ convened a Blue Ribbon Committee (the "BRC") to undertake a study of corporate governance, with particular emphasis on improving the effectiveness of corporate audit committees. Yet the convening of this panel was less an affirmative response by the two exchanges to their own perceived need to tighten accounting procedures and investor accountability, than it was a response to a September 28, 1998 speech by SEC Chairman Arthur Levitt who excoriated the entire audit process as "a game of nods and winks" involving the analysts, the auditors and those in charge of the corporation's affairs. Lamenting that "integrity may be losing out to illusion, he commented on various "hocus pocus" categories that were flagrant distortions of the financial reporting processes. Levitt then introduced a nine-point plan, two of the most important of which focused on the requirement that corporate audit committees take responsibility for their companies and "function as the ultimate guardian of investor interests and corporate accountability."[3] The BRC released its extensive report in February 1999. More recently, following a number of dramatic failures, including Enron, and apparently responding to various Congressional initiatives that will have the effect of impinging upon the independence that public companies have traditionally enjoyed, the New York Stock Exchanged proposed, on June 6, 2002, detailed, stricter standards for its listing members. These standards adopted the recommendations of the BRC and expanded on them in certain important respects.

Clearly the efforts of the BRC and the recent proposals of the New York Stock Exchange are moves in the right direction. What neither proposal analyzes in methodological detail however, are the causes of these dramatic business failures. Absent such analysis it is naturally impossible to predict whether the problem has been properly addressed. Indeed, for example, if GAAP accounting is too antiquated for the current stresses and functionalities of modern business, putting more responsibility on audit committees and tightening rules of corporate governance will do little to address that fundamental problem. Similarly, because CEOs in huge companies cannot possibly be aware of all their firms' financial transactions, it is not realistic to endeavor to solve the problems simply by requiring the CEO to certify that the financials are, in fact, accurate.[4]

My approach in this thesis is a modest, but decidedly different, one than what has been taken thus far. Rather than proposing axiomatic remedies to address specific problems that seem to have appeared in the recent cases, I suggest that the problems have arisen as a consequence of the forces arising from the imbalance of power in our corporate governance system, being unleashed upon the two fundamental weaknesses (or "insecurities" to return to the wrestling analogy at the beginning of this paper) intrinsic to the Anglo-American corporate governance structure; namely the unitary board of directors having conflicting obligations of oversight and management, and the incomplete contract that exists between shareholders and management in defining the parameters of management's authority and obligations, as stockholders' proxies to run the corporate entity. While these weaknesses have existed since the joint stock company came into being with the original English East India Company model, the increasing extent and magnitude of the differential in power dynamics among the three groups ultimately responsible for guarding investor interest and providing for corporate accountability, specifically management, the outside auditors, and the Board of Directors represented by its Audit Committee, has reached the point where it is now overwhelming in favor of management, even after acceptance of the BRC's recommendations and the new proposals of the New York Stock Exchange. Because of this, I submit that it is only by making adjustments in some of the fundamental relations to this "three-legged stool" of corporate accountability as the BRC called it, that a more stable equilibrium in the balance of power among these groups may be achieved and thereby proper accountability restored within the system.

To put this problem another way, both the BRC and the New York Stock Exchange proposals, for example, do delegate new responsibilities to the Board of Directors through its Audit Committee and seek to require the Board to adopt a series of new and constructive protocols to buttress the meaningfulness of the company's financial statements. However unless such delegation of responsibilities is accompanied by assignments of power, the rights sought to be assured to shareholders will likely prove as elusory as those in that famous "piece of paper" held by Chamberlain after his negotiations with Hitler at Munich guaranteeing "peace in our time."

What this thesis offers is a methodological analysis and approach to this growing problem of major international consequence. It focuses primarily on the narrow issue of power dynamics and its relationship to mandated disclosure. A fundamental premise, not examined however, is that disclosure and daylight will ultimately have salutary effects upon corporate governance. Also not examined, is whether or not there may be fundamental problems in GAAP accounting, generally, which need to be addressed systemically. Further, I have not examined whether fundamental, statutory changes in corporate law might aid as well. Thus, I accept as given, for purposes of this paper, the systemic weaknesses of the basic unitary board concept, although I argue that an analysis of it is essential to understand the fragility of the disclosure process and, thereby, its susceptibility to the relative strengths of the three principal players.

I begin with an analysis of the weaknesses of Anglo-American corporate governance stemming from the stockholder's incomplete contract with management, and from the nature of the unitary board, and how these problems can have a paralyzing effect on accountability. I then look at the power attributes and weaknesses of the three principal players in the disclosure process; namely management, the external auditors, and the Board of Directors through its Audit Committee. After demonstrating the gross imbalance of power in favor of management, I analyze the exogenous vectors to which management is subject which impel disclosure and impel concealment.

Following the analysis section, I look at some current examples of corporate audit committee charters and reports as examples of the results of the current process, and the likely inconclusive results that will follow from the current state of affairs, without adjustment to the imbalances of power.

The fourth section discusses briefly other approaches used in Europe, and in particular Germany and the U.K. and why their approaches may or may not be applicable to United States governance.

I next undertake an analysis of the BRC's and the New York Stock Exchange's proposed changes and, in the final section of this paper, make my own suggestions that address the imbalance of power dynamics still present even after such recommendations are adopted. I close with some overall observations and a final question.

Analysis: Development of a Model

1. Systemic Weaknesses:

Boards of Directors under the Anglo-American model of corporate governance have two, primary functions which from any initial analysis, appear to be at odds with each other. First, the Board of Directors is the ultimate head of all executive decisions of a corporation. It is the final arbiter and deliberative body that sets corporate policy, determines and executes stratagems on behalf of shareholders, and is ultimately responsible for compliance with applicable laws. Second, the Board has ultimate responsibility for supervising proper governance of the corporation and assuring the accountability of the executive officers whom the Board has appointed to manage the day-to-day operations of the entity's assets.

In spite of such an inherent conflict, this structure works fine when a corporation is owner-operated and even when there is a small group of investors, venture capitalists, and the like who closely monitor and are a part of the day-to-day decisions of the entity. Once there is a separation of ownership from control, however, two results ensue. First, executives no longer have the same financial incentive as would an operator who is also an owner to increase the future value of the firm. The executive's incentives are defined by his contract. While this will be discussed in greater detail later in this paper, even so-called "incentive contracts" are tied to isolated factors that are intended to be indicia of what the shareholders would prefer; but such factors, obviously, cannot be precise instruments of shareholder interest in all circumstances. Moreover, executives are normally chosen for the their creativity and entrepreneurial attributes which are necessary in order to maximize opportunities presented by the market from time-to-time. Thus, a broad spectrum of freedom of action is normally ceded to such executives. The practical problem, then, is to find a way to promote managerial freedom without jeopardizing their accountability to stockholders. This gap has been referred to as the "costs of agency" and the result of (necessarily) incomplete contracts.[5] As discussed in "Wearing Two Hats: The Conflicting Control and Management Roles of Non-Executive Directors[6], an incomplete contract exists whenever the contracting parties are unable, *ex ante* to specify fully the actions to be taken in every possible future "state of nature". Thus, results that are economically efficient are achieved where the organizational structure of a firm is such that those who ultimately have the final claims to an entity, have the ability to determine the actions of that entity; simply for the reason that the downside of any action taken that does not seek to maximize value will ultimately have to be borne by them. The degree by which separation of ownership from control effects of loss of control over such factors is another way to characterize this "agency cost", and the agency cost, in turn, is a consequence of the need to leave management contracts largely incomplete.

Historically, this problem, as well as the inconsistency of the two obligations of the Board of Directors, has been addressed through requiring detailed disclosure by management to the shareholder. The disclosure requirement, it is thought, will act as automatic checks on the Board vis a vis the shareholders, and on the chief executive officer, vis a vis the Board; the thinking being that if actions with which the shareholders or the Board may disagree are known, they may be overruled, or the offending party removed from office. This system of accountability through disclosure, in turn, has two essential parts to it. The first is the system of legally mandated shareholder rights that gives shareholders the ability to obtain information not otherwise readily available. The second is the automatic disclosure required to be provided by the executives and by the Board itself.[7]

The basic flaws of the system are obvious. First, there is little incentive for the average shareholder effectively to monitor the activities of any large, public corporation. Not only is it extremely expensive for shareholders to launch initiatives (as shown by the exorbitant costs of hostile takeover bids and the like) but the economic benefits inuring to such a shareholder from such monitoring function can, because of such shareholder's relatively small percentage ownership of the overall corporation, only marginally benefit that shareholder. On the other hand, the disincentive to engage in any monitoring activities by such a shareholder is increased by the fact that all other shareholders who have not incurred such costs obtain exactly the same proportional increase in the value of their stockholdings through that shareholder's efforts, while having a "free ride" with respect to the cost of the monitoring activity. "Hence, each shareholder has an incentive to free ride and it becomes irrational for an individual shareholder to devote resources to becoming better informed and to voting intelligently."[8] Additionally, this analysis may begin to give one the sense that the accountability of the executive to the Board is different in kind and scope than the accountability obligations of the Board to the shareholders.

These protections become further diluted by a recognition that stockholders are not the only ultimate residual claimants to a corporation's assets, such that the theoretical unitary goal of "maximizing return to shareholders" cannot be the sole objective function either of the executives or of the Board. Because of that, each may often act in ways contrary to the "interest of the shareholders." By way of example, various studies have shown that numerous non-shareholder constituencies influence corporate decisions. These include customers, labor, senior debt holders, and the like.[9] Further, the general law of fiduciary duty as well as various state statutes throughout the United States provide that when a corporation is "insolvent," officers and directors are required to act in the best interest of creditors, rather than of shareholders. For this very reason, there is no requirement under Delaware law (or the law of any other jurisdiction of which this writer is aware) that the filing of a bankruptcy petition requires a shareholder vote. Indeed, under Section 1107 of the Bankruptcy Code, a corporation whose management continues in control of the company's assets operating its affairs after filing a bankruptcy petition is required, with only one exception, to represent the interests of <u>creditors</u>. The only exception is with respect to a plan of reorganization that the company files. And, with respect to the plan of reorganization, it is at that point that in <u>addition</u> to representing the interests of creditors, management may also represent the interest of the "company." Obviously, the "company" is something other than the shareholders although it may include the shareholders in the concept. One may attempt to argue that such a change in director and management loyalty is only fair in these cases because it occurs under an extreme situation, namely when the company is "insolvent." The problem, however, is that there are at least three definitions of insolvency; thus, one is never certain when "insolvency" commences or occurs.[10]

Finally, the goal of "shareholder" welfare is not by itself equivalent to the concept of share price maximization. Markets systematically under value certain long-term expenditures, particularly expenditures that may fall into the categories of capital investment or research and development spending. This excessive short-term focus yields a form of market myopia that may encourage, therefore, management to view its obligations to increase the share price rather than deal with a more elusory concept of "shareholder value". This tendency, of course, is enhanced when management's own contracts provide bonuses based upon increases in the per share price.[11]

To summarize the foregoing analysis, the incomplete contract that exists between the shareholders and the executive managers of a firm afford the managers a broad range of discretion. The necessary incompleteness of such a contract, as well as the natural conflict between the self-interest of the managers and the differing interests of the shareholders provides the opportunity for executives to act in a manner not necessarily in the best interests of shareholders. Further, there is often the opportunity and, in certain circumstances, the obligation, for management to act in the interests of other parties. Thus the obligations of management to shareholders become weakened and unclear as well as diverted, in certain respects and instances, by obligations to other parties. Further, it is impracticable for individual shareholders themselves to undertake meaningful monitoring activities of management. While this obligation is delegated to the Board, the Board itself is riddled with the same conflicting obligations as has management. Further, the Board, as the commander in chief of operations, is not clearly objective in its supervision of its own policies.

Against this backdrop of these weaknesses inherent in the corporate governance structure, let us now turn to analyze the dynamics of power within the accountability system itself. I propose to do this in two parts. First, I shall analyze the attributes and vulnerabilities of the three primary players in the disclosure process in order to evaluate their relationship to each other and their ability to control reporting outcomes. Second, I shall focus on the forces impelling management towards concealment as well as those forces impelling management towards disclosure; since it is management, as will be shown, who have the decided advantage in determining the context of the disclosure process.

2. The Dynamics of Power – The Three Groups:

A. Dramatis Personae – A few words must be said about the choice of players analyzed in this paper from the perspective of the audit process. I have identified them as falling into one of three categories: management—and particularly the CEO and Chairman of the Board; the outside auditors; and the audit committee of the Board of Directors. Clearly, there are other significant actors involved. The Board itself, the chief operating officier, senior financial management, the internal auditor and the like all have important roles to play in the process. However, since the focus of this paper is on power dynamics, I have viewed the traditional chains of command and authority as establishing separate, distinct groups that, for the most part, resolve disagreements with respect to courses of action within themselves. While this obviously results in some over-simplification, I believe it is useful in view of the scope of the analysis undertaken and the fact that deviations from lines of authority, such as in the case of whistle-blowers; are relatively rare and, in all events, the existence of such deviations from traditional lines of authority would not materially change the fundamental analysis discussed in this paper.

Further, the growing trend in the literature has tended to characterize these three groups as the ones that are the primary players in the audit process.[12]

A second point that must be made relates to the position of the chairman of the Board. Both from my own experience, a review of numerous current articles on the subject, a cursory review of the management structure of some of the largest companies in the United States and from speaking with numerous members of Boards and audit committees, the chairman's views are almost invariably aligned with that of the CEO, except in cases where the chairman is a figurehead or his power is waning, such that he is disregarded or likely to be replaced in the near future. Indeed, in these latter two cases, there is normally a vice-chairman or other party who serves a similar function and who eventually takes over the chair's role. In most instances this alignment is obvious: the chair and the CEO are the same person. This is probably the most common. In a second type of situation, the chair was the CEO but, for various reasons such as age, desire to focus on other issues, or the like, the chair decides to resign his or her position as CEO, picks a successor to that position as his or her proxy, and assumes the chair position so as to be relieved of the burdens of day-to-day management. In the third type of situation, the relationship between the CEO and the chair may have been arrived at independently, but the CEO recognizes that by virtue of the chair's position of great power, he or she will have to work closely with the chair in order to have programs which the CEO proposes be adopted by the full Board. If the chair were to oppose any position of the CEO, the CEO would not likely take it before the Board unless it were a matter of great concern, and then the CEO would likely do so only after having "counted noses" among the other members of the Board. Where the CEO is successful in situations, it is often an indication of a waning of power on the part of the chair.

B. The Model – The relevance of a power dynamics approach is, of course, central to this paper. While I have not done an exhaustive view of the literature in the context of this Master's Thesis, and while I did come across certain articles dealing with organizational power, power between various management groups, and the like, I found no analysis dealing precisely with this subject. Equally surprisingly, in the various recommendations of third parties that will be discussed later in this paper, no mention is made about effecting a balance of power within the three groups responsible for the audit process. The original Cadbury Committee Report, discussed below, the report of the BRC, and recent proposals of the New York Stock Exchange for its listing members seek to assign added responsibilities to the audit committee but, with limited exceptions, do not fundamentally alter either the legal responsibilities of non-executives, the basic structure of the

Board or the system of effecting accountability through disclosure. (See, e.g., Ezzamel and Watson at p. 56.) Additionally, again with only minor exceptions contained in the new recommendations of the New York Stock Exchange, no discussion whatsoever is given of a need to balance power. I found this odd, not only in light of my own experience, but also as a student of the United States Constitution where the concerns and intense focus of the founding fathers were to institute an effective set of checks and balances among our three branches of government. Specifically, the framers of the Constitution did not focus so much on delegations of authority to one branch or to another. Rather, the primary focus within the Constitution was in assignments of power to the various branches that would balance out and temper the power granted other branches of government.

Viewed from this prospective, I suggest a model for looking at the relative strengths and weaknesses of each of the actors forming the "three-legged stool" that are a part of the audit process. While my enumeration of the factors set forth below is somewhat subjective, they are the result of a thorough analysis of their roles and after discussing them with various directors and audit committee chairmen. Further, my purported quantification of each of those factors is also, admittedly, subjective. For that reason I do not suggest that the actual qualitative assignments given each of the three groups in the eighteen categories which follow should be viewed as anything other than a mere statement of the relative dominance of one group over another, and the relative weakness of another group to the others. One may rightfully differ with the absolute numbers assigned as well as whether or not other categories should have been included, but, again, the main purpose is to give an overall view of the relative strengths and weaknesses among the three groups.

What comes through, I submit, is the overwhelming dominance of management, represented by the CEO, compared to that of the audit committee, contrasted with the high vulnerability of the audit committee compared to the other groups. If these factors were to be subject to multiplier effects arising from additional stresses (discussed immediately thereafter), the overall impression with which one is left is that if that model has any validity, important changes must be effected in order to prevent further embarrassments to the integrity of the financial markets as exhibited by the WorldCom and Enron cases.

What sparked this thought process was Exhibit 1-2 to the Report of the National Commission on Fraudulent Financial Reporting delivered in October 1987, a copy of which Exhibit is set forth in Appendix 1. While this figure shows only the internal control environment of corporate culture, and thereby excludes the outside auditor, what is apparent is the overriding and, some would say, dictatorial power of the chief executive officer over the issuance of financial reports. The dotted line indicating the role of the audit committee is, interestingly, far more ephemeral than the solid line emanating from management to the financial reports. Further, this drawing does not show the tie between the chief executive officer and the chairman of the board who exerts substantial control over the Board of Directors itself and, therefore, over the audit committee as well.[13]

This model is divided into two parts. The first part quantifies nine attributes of power within the domain of management, through its CEO, the audit committee, and the outside auditors. The second chart does the same thing for nine vulnerability attributes or weaknesses of each of these three actors. Within each category, I have ascribed a number between 0 and 3 to each actor, depending upon whether the characteristic was non-existent (denominated by the letter N and assigned the numerical value 0), slightly existent (denominated by the letter S and given the numerical value 1), moderately existent (denominated by the letter M and assigned the numerical value 2), or highly existent (denominated by the letter H and assigned the numerical value 3). It is of course legitimate to argue that the "H" valuation should more appropriately be valued at 4, 5 or even 10 in certain instances and that other valuations similarly should have some numbers in between the ones that are assigned. However that would give this chart the misleading appearance of a degree of certainty to which it does not aspire. Again, these numbers are more relativistic than anything else. These two charts are as follows:

	CEO/ MANAGEMENT	AUDIT COMMITTEE	OUTSIDE AUDITORS
Power Attributes	H M S N (3) (2) (1) (0)	H M S N (3) (2) (1) (0)	H M S N (3) (2) (1) (0)
Operational Control	3	0	0
Board Influence	3	1	1
Information Access	3	1	2
Information Restriction	3	0	2
Employee Patronage	3	0	1
Executive Patronage	3	0	0
Hiring of Auditors	3	1	0
Auditor Review	3	2	1
CEO Review/Compensation	2	0	1
Totals	26	5	8

	CEO/ MANAGEMENT	AUDIT COMMITTEE	OUTSIDE AUDITORS
Vulnerability Attributes	H M S N (3) (2) (1) (0)	H M S N (3) (2) (1) (0)	H M S N (3) (2) (1) (0)
Accountability to Board	3	2	1
Accountability to Investors	3	2	2

Accountability to Regulators	3	2	2
Susceptibility to Whistleblowers	3	1	1
Plan Target Failures	3	0	0
Lack of Upside	0	3	2
Subject to Patronage	0	3	2
Lack of Information	0	3	1
Lack of Audit Control	0	3	1
Totals	15	19	12

At this point it would be appropriate for me to say a few words about each of the attributes listed in the left margin, make certain comments regarding some of the numbers assigned to each of the actors, and describe the theoretical source of this model.

"Operational Control" seems rather obvious. It is a major power source for management, particularly with respect to subordinates, and, that aspect of control, portions of which may be picked up by other categories, reflects the realities of a military-like chain of command in favor of management that typifies the modern multi-national corporation. "Board Influence" is high for the CEO and Management, due not only to their natural alignment as discussed previously, but also because of the added power which comes when the CEO and the chair are effectively the same person.

"Information Access" is of course greatest in the CEO, slightly lower when it comes to the case of the auditors, but least of all readily available on a first-hand basis to the audit committee. The obverse side to the issue of being able to have access to information, is, of course, the power to impose "Information Restrictions," and that power is almost exclusively within the domain of management itself, should it desire to do so. The concepts of "Employee Patronage" and "Executive Patronage" relate to the power of the CEO to hire, fire and reward both lower level employees and executive level employees. This is an extremely powerful tool, and becomes even more powerful when this executive is also a member of the Board of Directors.

I listed the power to "Hire Auditors" and the right to "Review Auditors" as separate items. A consultant must always endeavor to please, subject to professional constraints, the person who is responsible for their receiving a paycheck. This person also is likely to be their champion when they come under attack. Because the review of the auditors is an independent process and specifically delegated to the audit committee, this is one area where the audit committee should have some additional strength. On the other hand, the failure of outside auditors to accommodate requests of management on a particular issue may result in their not remaining auditors to the company in the future, or their not receiving lucrative consulting assignments down the road. Thus management has an even stronger hand in this category. Finally, there is the issue of "CEO Review and Compensation." The outside auditors have some influence in this area inasmuch as they do report the financial results of the company. It is the CEO however that has the most power to exert in this area, particularly through the alignment with the chair that provides control over executive compensation plans and bonuses, except in cases where it is abundantly clear that he or she is not living up to expectations.

In his article "Power, Politics and Influence" (op cit.) Robert Vecchio dealt with classical analyses of the bases of power within an organization. His own structure proposed in that article at pages 73 through 75 divided organizational power into five categories: reward powers, coercive power, legitimate power, expert power and referent power. Each of the power attributes listed in the model fall into one of these categories, except for referent power which, by definition, deals with special personal qualities or areas of attractiveness of an individual's personality that cause others to identify with them. A good example of this would be someone like Hitler. Since the instances of that power are specific to individual personalities, I have not included it in this analysis, although it is common that CEO’s are dynamic and personally attractive personalities. However the first two categories of operational control and board influence constitute elements of legitimate power; namely reflections of others’ willingness to accept an individual's direction by virtue of his possessing some aspect of legitimate authority.

The ability to access or restrict information clothes the holder with expert power; that is, a regard for the person having the power as being knowledgeable in a given area, particularly with respect to the personal knowledge base of the other party. The balance of the categories falls into examples of coercive power and reward power.

On the vulnerability side, the first three categories deal with accountability or subservient liability to others. These are consequences of an actor’s susceptibility to coercive and legitimate power of others. Clearly, because of the dominant position of the CEO in formulating business planning and being responsible for overall guidance of the corporate ship, failures in accountability are ultimately laid at the CEO's doorstep. The culpability and exposure of the audit committee and the outside auditors is also high, albeit to a lesser extent. When it comes to issues of the potential failure of the company to achieve targeted goals (the consequence of being subject to reward powers), neither the audit committee nor the auditors have any significant exposure and again, this is appears to be management's susceptibility. Similarly, if there is something to fear from potential whistleblowers (which reflects one's vulnerability to coercive powers), it is primarily management that has exposure to that rather than the other two actors, although they, of course, will have culpability for their own misdeeds. The fear of acting without proper information and the fear of having to be a part of the audit process without full control (the obverse side of expert power) is something which is high on the audit committee's list and a matter of some concern to the outside auditors. It is not generally a matter that effective management is concerned about at all. The next vulnerability of "Lack of Upside" (reflecting an absence of reward power) could easily be a multiplier of these attributes in itself and, in fact, is discussed separately in addition to it being listed here.

What is most difficult for me in looking at these charts is the lack of the upside for the audit committee with respect to the obligations that it currently has, and the additional ones that it may be asked to accept in the future. While management has significant risks and vulnerabilities as the second chart indicates, success will result in its receipt of enormous benefits in the form of compensation and stock options. The audit committee sees none of this. Indeed, as will be discussed below, current recommendations are that the audit committee not receive any special bonus compensation, since to give it such would jeopardize its independence. The relevance of this factor is that one is more likely to redouble one's efforts to do his best job if he sees that there is a large gain if he should do so effectively. Indeed that is the precise theory behind management's incentive contracts. One's appetite for late hours, detailed work, and bucking the entrenched powers of the CEO and chair become substantially lessened if there is not much in it for such a person and, indeed, as reflected in the next category, "subject to patronage" (an example of susceptibility to reward power), in opposing the desires of the Chair/CEO one may be alienating powerful individuals who gave the outside director his audit committee assignment to begin with.[14] Audit committee members have traditionally been assigned their role by the chair as a way of recognizing their status as a senior member of the Board. This "privilege" of an additional title also has some compensatory aspects as well as prestige and therefore may make the designee of this position both beholding to the chair as well as more subject to psychological pressure in the event of any difference between the committee and the chair. Further, and while this next point could have been listed as a separate category, there is a further power weakness that the chairman of the audit committee faces in confrontations with the chairman of the Board. Because the audit committee is still "a committee," its chair is susceptible to having his power undermined by the CEO/Board-Chair through solicitations of the non-chair members of the audit committee not to support a particular position that the audit-chair knows to be correct.

Finally, the last two categories of lack of full information and lack of audit control (vulnerability to expect power) are weaknesses which will inhibit the audit committee from standing too strongly against the CEO or Board-chair, particularly in view of the latter two's much greater access to information and audit control which would allow them to speak more authoritatively on any given issue.

Again to sum up what the above model illustrates is not a measurement of any absolute quantification of each groups aggregate power, but rather the extreme differences in the magnitude of powers between the CEO on the one hand and audit committee on the other hand contrasted with the relatively equal susceptibility to weaknesses on the vulnerability scale of the schedule.

So as not to give a mistaken impression of a level of precision of which this model is not capable, I rejected the temptation to weight the power attributes in the first table with reference to the potential upside of each of the groups. Looking at this issue for just a moment, however, another important qualitative factor reveals itself. Because the principal goal of management is to further the creation of shareholder wealth, attainment of that goal not only customarily results in high levels of compensation (both in terms of money, options and stock for the executive), but to the extent stock is received in compensation, the attainment of that goal has a multiplier effect.

Similarly, judging from the large fees that are paid to the (now) big four auditing firms from not only auditing services but consulting services provided to large, publicly traded companies, there is an extremely lucrative upside for the auditors as well in this process. Now look at the audit committee. Its goals are to exercise prudent business judgment in such a fashion that its members neither embarrass themselves before the public or the Board nor sustain liability for breach of their oversight responsibilities. Thus, putting these statements about the three actors a different way, management and the auditors have a substantial financial reward attendant to the exercise of their powers and prerogatives while the audit committee not only has no real upside, but their principal goal is avoid substantial downside. I believe that human nature is such that when one is given power, one is more likely to exercise it to achieve a positive benefit for oneself, rather than merely to stay out of trouble. Thus, I believe it appropriate to recognize that some multiplier of the power attribute totals would be appropriate for both the CEO/Management and the auditor groups in the above model, which would not be relevant to the audit committee. Of course to do so would widen even further the gap between power and exposure of the CEO verses the audit committee.

3. Forces Impelling Concealment and Disclosure.

It being apparent from the previous model that there is a great disparity between the relative power to vulnerability ratios of the CEO/Management compared to the other two groups, it is useful, as a final part of this analysis, to examine the various exogenous forces acting upon the CEO to apply that power either to effect concealment of financial data adverse to his performance, or to disclose it. This analysis, while not in model form, is again from discussions with various directors and also, in this case, from helpful literature itself. In both cases, there are four forces either impelling concealment or disclosure. I will discuss them each in turn.

A. Forces Impelling Concealment

One of the first places to look for incentives impelling concealment is in the nature of the contract with the executive himself. There has been a great deal written about the basic form of incentive contracts and, undoubtedly, the common type of executive contract for large, publicly traded companies is one which provides quite significant rewards to the executive for his reaching certain levels of earnings or stock price growth. The obvious purpose of such a contract is to endeavor to align the interest of the managers more closely with that of shareholders. The problem, however, is, as stated in part earlier, that the benchmarks used to identify such alignment are only rough approximations of what is desired. Additionally, they divert the focus from a flexible alignment with shareholders interests to a unitary, economic measure that may at times be adverse to shareholder interest. Thus, for example, if the incentive is realizable on profit reaching a designated level for a certain accounting period to which the contract relates, the executive will endeavor to increase the short term accounting profits so as to hit his targets at perhaps the expense of long range business opportunities. Indeed, because the contract represents an "obligation" of the executive, he may feel that he is in fact, obligated to effect such a result.

The basic problem here, of course, is that because "value" is a complex concept, it is usually defined in incentive contracts as revenue growth, earnings per share, or share price and the calculation of any of these three factors generally fails to incorporate value that only is realized over time. In the case of share price, the most common of benchmarks, is commonly proportional to the price to earnings ratio of the corporation's shares as traded. Therefore, an increase in earnings will yield an increase in price, if but only if, the price to earnings ratio at the outset of the executive's contract is at least the same as at the end of the measurement period. Note however, that as earnings, and therefore prices, rise there is often a ratcheting effect which results in the application of an even higher price to earnings ratio; thereby similarly ratcheting the bonus to which the executive is likely to become entitled. Finally, the heavy use of stock options as incentives skews management's judgment criteria heavily towards risk-taking, inasmuch as options have no downside to failure, but an unlimited potential upside.

In sum, what may start out as an innocent skewing of revenue or operational results to realize income sooner or defer expenses later, nonetheless my result in an impetus to distort income.

Second, executive's contracts are invariably measured at least on an annual basis, over the prior annual period, if not on a quarterly basis. The purpose of this is, of course, to keep the "pressure" on the executive to perform. As discussed earlier, because of general market myopia, long term growth strategies, capital investment or R & D programs are discounted by the market, not only because of the immediate, present value of the expenditure compared to the distant future value of the expected return, but because the future value must be discounted further by risk factors, change in the economic environment, other discoveries rendering the activity obsolete in the interim, and the like. Thus, if an executive truly believes that such an expenditure is necessary, there are four options with which he is faced: defer the expenditure, recharacterize the expenditure as a capital investment, or suffer lower earnings or accelerate recognition of income.

Deferral is itself a misrepresentation. If indeed management does believe that a replacement, expansion, change or development is necessary, a failure to do so therefore is a disservice to equity. Further, deferral constitutes a misrepresentation inasmuch as the shareholders do not have the knowledge that the executives do and may be thinking that all is well while matters may invisibly be deteriorating. On the other hand, the executive may undertake the expense but endeavor to effect recharacterizations of one sort or another in order to conceal it. This then may preserve his ability to receive the desired incentive bonus without revealing the truth of the concealment. From the executive's standpoint he has "done right" by the company, because he has both effected a goal which he knows needed to be instituted, while he has not punished himself for doing so. Recharacterization comes in various forms. One may stretch a reportable position on a capital item verses an expenditure as in the case of WorldCom, one may anticipate income or defer expenses as in the cases of Xerox, Tyco and the like, or one may create off balance sheet entities, as in the case of Enron, so that one appears merely to be making an "investment" in a subsidiary that conducts the desired activity that hides expenditures or debt for the corporation were it to do so directly. Another common approach is to take advantage of "cookie jar reserves" which management accumulated by taking excessive reserves in prior quarters or by engaging in "big bath" reserves in order to cushion future expenditures and enhance near term future earnings.[15]

Two additional principals need to be kept in mind when looking at the quarterly review factor, generally. The first is that deferral of a long-term project may also be rationalized as an appropriate activity by management because a large percentage of investors in publicly traded companies are not investors for the long term.[16] Management could characterize its deferral of a needed improvement as proper because short-term shareholders have interests that need to be protected too and his contract (being incomplete as discussed earlier) did not prohibit him from electing, from time to time, to favor one group of shareholders over another. Second, and more importantly, corporate culture is not long on giving second chances to managers who fall short of their targets. The very nature of looking to quarterly results is that each quarter may determine whether or not an executive's contract is renewed or not. Thus, if an executive believes that while he may fall short in one quarter he will more than make it up in subsequent ones, there will be strong incentive either to conceal or overstate the current quarter's results under the assumption that one is merely buying time and can make up for the concealment in subsequent quarters' profits.

The third factor impelling concealment is a general lack of respect for GAAP accounting, generally. As stated in Ezzamel and Watson at p. 55:

> Today, a multitude of "creative accounting" practices which exploit the inevitable ambiguities and many alternative methods of reporting the financial effects of transactions are both available and routinely used by Boards to mislead rather than inform shareholders. [Authorities omitted] A few informed commentators now believe that, despite the increased financial reporting regulations and/or the supposed "independence" of the auditors of the financial statements, the system is unable to prevent effectively a determined Board of executives from adopting reporting practices which greatly hinder accountability.

Indeed, when one requires the application of a system that does not work or whose methodologies do not bear any real resemblance to business requirements, one foments disrespect for the system in general. Such disrespect for GAAP has three basic roots. First, there is a cultural disrespect arising out of "accounting for tax purposes" as opposed to "accounting for shareholder reporting purposes." This divergence of reporting is not permitted in many other countries, such as in Germany, where it is the result shown on the tax returns that must be reported to shareholders and on which trading is based. Further, in the United States tax reporting has acquired, as a part of its culture, the concept of being able to assert a "reportable position" which will not result in a fine, but, if one is not "caught", may result in the reporter "getting away with" a position that may be less than supportable if examined in detail. (Bear in mind also that the American Revolution began as a tax revolt, so this cultural tradition runs deep.) Further, proper tax treatment often turns on using the proper label or structure as opposed to turning on the substance of the transaction. When form prevails over substance, one loses a grounding in the relevance of values; and this can prove fertile territory for deception. Indeed business schools routinely teach that such activities are not a negative. Tax minimization is a lawful and laudable goal and indicates the taking of initiative by executive management.[17] Further, tax avoidance increases earnings per share which in turn generally increases price per share and, thereby, executive compensation. Unfortunately, when the numbers cease to have meaning and the form is more important than the substance, this same approach may easily carry over to reporting for purposes of investor analysis as well.

A second root of disrespect is a philosophical one. The historical cost approach evidenced by GAAP accounting is really not relevant to cash flow issues or future value. By way of example, the historical cost of a plant acquired 100 years ago is irrelevant to its actual correct value. Alternative non-GAAP approaches such as value accounting are being promoted more actively in recent days, although nothing concrete has yet been agreed upon.

Finally, there is a practical aspect. Certain accounting rules that are completely lawful have the practical effect of ignoring the troubled realities of a situation and can only serve to hide more fundamental problems. By way of example, FASB 15, used to effect the restructuring of the debt of a troubled company, allows a lender to convert a non-performing loan, which would be an expense item to the income statement, into a new loan, a portion of which is performing and therefore need not be expensed or may be taken into income if it has previously been expensed, while the balance is in an expensed into a "suspense account" which may be later recovered as additional income when, as and if it is realized. However such characterization tells neither the auditors nor the stockholders anything about the very troubled nature of the loan in which the lender is engaged to begin with and whether the reported portion of that loan may likely be in future jeopardy. Yet this rule, appropriate for accounting purposes, has no tether to the realities of business life, and therefore results in a lack of disclosure with respect to financial condition issues.

The final factor impelling concealment relates to the management's basic confidence in itself. The moral hazard attendant to concealment that one is merely "buying time" until management's plan holds or a new solution is found is all too common. Further, arguments are often heard that "technicalities" should not stop management from carrying out its vision or taking a risk that it knows the Board of Directors either would not, or could not, approve. Management views itself as the only one with all of the facts and, aware of the information asymmetries that exist between itself and the Board and the shareholders on the other hand, yields a disrespect for their opinions or their short-term judgments. Further, the authoritarian, military-style chain of command structure that pervades the large corporate environment is one where obedience of subordinates to the CEO is not only expected, but also culturally engrained. The "tyrannical corporate leader is a well-established figure."[18] Numerous studies have shown that subordinates are highly reticent to disobey commands of superiors, even if they believe that the conduct being ordered is morally or ethically wrong.[19]

B. Forces Impelling Disclosure:

Here again there are four items, although the description is shorter and there are limitations to each of these.

The first relates to the fundamental goodness of mankind's nature. Philosophers have debated whether the basic nature of man is good or evil, but I believe it is a fundamental tenant of American life that fair play is an honorable thing. Thus, there is a basic reticence in all manager's character to engage in deception. Hence the need for justification.

The second positive reason is the notion of a respect for collective wisdom of the Board and its ability to provide fresh insights into operational problems. Yet while this is true as a theoretical matter, it does, nonetheless, have several practical limitations. First, such notion is antithetical to the basic principal that operational issues are management's responsibilities. Thus, if management needs the assistance of the Board, there is a sense that it has in some sense failed. Second, and related to the first, the fault-based nature of our legal system pervades the judgment process attendant to looking at quarterly results. Thus, there is a stigma that attaches to a failure to reach targeted results as opposed to a generalized view that no one manager can have all answers and that therefore the need for more views or more help is normal and acceptable. Third, American culture demands quick and immediate results. Again, this is reflective of the "quarterly report cards" to which management is subject. With so little second chances, there is often a need to buy time. Finally, if the manager should be overruled by the Board, this would obviously be a defeat and be considered shameful by management. Because of this, CEOs routinely lobby the Board before a meeting concerning their proposals and are unlikely to put forth proposals for which there does not appear to be adequate support. Of course this process substantially detracts from the nature of the strength of the Board.

In addition there are two negative reasons impelling disclosure. There is always a fear of getting caught. Yet this is limited by two important constraints. First, management must have a view that what it is doing is wrong to begin with. For the reasons stated earlier, this is often not the case (recall also Enron's original position). Second, there is often a general perception that this will never happen at all. WorldCom is an excellent example of this. Having gotten away with fraud in one quarter, management is emboldened to believe that the same result will follow in subsequent quarters. The second negative factor is the penalty of criminal sanctions in the event of major catastrophes. While the current situations are fresh in our mind and this appears to be a potent force, the truth is that criminal actions are relatively rare and the recent criminal investigations by the SEC and the Attorney General are not routine occurrences. In the past, the principal downside to discovery was being relieved of command and, even in that case, management often was able to find new employment with other corporations.

In summary then, the strong upper hand that management has to effect concealment, combined with its large upside for succeeding with this endeavor, are pushed along by the four cultural, systemic and structural forces towards what may appear to be the benign concealment of crucial financial data. One thing is clear: the current corporate structure does not seem designed to provide meaningful impediments to such activity.

The remainder of this paper examines first what appears to be the meaninglessness of current systems, second, the recommendations of the BRC and the New York Stock Exchange to deal with this problem, and the lessons that may be learned and that may not be learned from other countries. Finally, I will offer my own suggestions as to what may likely restore this balance of power and thereby halt the tendency to effect the deceptions with which financial markets are currently burdened.

Lessons Learned From Current Cases

A review of the audit committee charters of various public companies does not generally reveal marked differences from which one may draw conclusions that might explain why, for example, WorldCom and Enron ended up as they did whereas others have not. On the other hand, this does imply one conclusion that possibly may be drawn from such an analysis: most of the current charters are merely pieces of paper which do not ultimately alter the balance of power within the corporate governance system or mandate disclosure to investors. Appendix 2 annexed hereto contains samples of a number of audit committee charters. These include General Electric, Gillette, Eastman Kodak, and ICANN. Also included are two forms of sample charters, one recommended by Wachtell, Lipton, Rosen & Katz as a "model form of audit committee charter for the post-Enron world," and a another model charter proposed by the American Institute of Certified Public Accountants. Following these are copies of the audit committee charter and, in certain circumstances, the report of the audit committee of WorldCom, Enron, Global Crossing and Adelphia Communications Corporation. It is obvious that the charters of the last four companies failed to provide for any meaningful warning or disclosure to investors. The model charters are just that; current "state of the art" recommended by two distinguished parties. The first group of charters is of various companies of various sizes and in various industries that appear to be well run.

What one may take from reviewing these charters is that the length and the detail contained in them do not seem to affect the outcome. Indeed, Enron's charter appears to be most detailed and most distinguished of the group. GE's on the other hand is more vague and quite lean by comparison. The model charter proposed by Wachtell Lipton contains, at the end, strong exculpatory statements disclaiming culpability and responsibility by the audit committee.

One common thread is that there is a regular trend across these charters to review or listen to the information <u>that is put before the committee by management and the auditors</u>. Further, they are to inquire about disagreements between management and the auditors <u>that are reported to them</u>. There is no power or requirement to do any independent investigation nor is there any real authority to seek independent advice. If a problem does exist, some of the charters provide that the committee should meet with the corporation's in-house general counsel. In sum, therefore, it appears that the audit committee's role is to look at matters to which their attention has been drawn by management or the auditors and to second guess them if it seems appropriate. Nothing in these documents provides a real mechanism for obtaining alternative views or giving the committee a power base from which it could effectively be at odds with the CEO/Chairman. As discussed previously, absent a firm power base by a truly independent audit committee, the asymmetries of power and of knowledge between any committee and the CEO is such that no meaningful challenge could realistically be mounted. In summary, therefore, it appears that to the extent that General Electric and Gillette, by way of example, have financial statements that more or less fairly reflect the financial condition of their companies, that is attributable to the determination of management to do so rather than any independent activity, oversight or input of the audit committees. Each of the charters in Appendix 2 delegates responsibilities and assigns obligations for audit committees to go through certain steps to ask certain questions and look at certain documents. None of these assigns any meaningful power to the committee.

As also discussed previously, the nature of corporate management follows a dictatorial, military structure. In view of the authoritarian nature of such a structure, the phrase "corporate governance" almost seems like a misnomer. Indeed, for the most part shareholders are a docile group with the only disturbances of note at annual meetings coming from special interest groups, such as environmentalists, that seek to inject political issues extraneous to traditional business operations before the Board. Occasionally there are also proxy fights, but these are far and few between. Thus, one must ask if this is what citizens of the United States truly refer to as governance?

> Imagine a system of government in which there are annual elections, that these are almost never contested. Whenever they are, the incumbent government wins by an overwhelming majority. All the information about the state of the nation which the voters receive is controlled and distributed by the government and is glossy and self-congratulatory in tone. Changes in the senior leadership do take place, normally through an orderly process of retirement in which the incumbent leaders select and groom their successors. Occasionally there is more violent change. Sometimes this takes the form of an internal *coup d'état* or it may occur as a result of the intervention of the hostile government of another state. This is not a description of Eastern Europe before perestroika and glasnost. It is a description of the system by which

> public companies [under the Anglo-American system]…are controlled and governed.[20]

In sum, the contents of the audit committee charters merely reflect the institutional dominance of the chairman/CEO in the Anglo-American corporate system. The detailed areas of inquiry put forth in the Enron audit committee charter did not prevent management from engaging in a myriad of schemes to distort and hide the true financial condition of the company. Pieces of paper and assignments of obligations can never do that. Only the granting of power to truly independent entities can.

<u>Recent Recommendations</u>

Outside of the Report of the National Commission on Fraudulent Financial Reporting (October 1987) referred to earlier, there has been little official action to deal with this disclosure problem, generally. The two principal initiatives have been report of the Blue Ribbon Committee, also previously referenced, and the June 6, 2002 proposed amendments to requirements for the New York Stock Exchange listed companies submitted by the Exchange's Corporate Accountability and Listing Standards Committee to the Securities and Exchange Commission.[21] In rendering their reports, the Blue Ribbon Committee as well as the New York Stock Exchange did not appear to undertake a conceptual or philosophical analysis of the fundamental problems of corporate governance so that they could explain how their recommended, new oversight procedures would address those fundamental problems. One may assume that this was in part because they held a belief (albeit an untested one) in the fundamental soundness of the corporate structure and because they would have viewed it as beyond their authority to suggest changes in basic, legal rules. Then again, sometimes change must be effected in increments, and recommendations of the direction in which change must proceed give society the opportunity to adjust to the realities that inevitably must take hold. On the other hand, these recommendations were not inspired by independent determination that something was wrong with this system and that a type of self-analysis must be undertaken in order to derive recommendations responsive to that analysis. The Blue Ribbon Committee was a response to a challenge and extreme criticism leveled by the then SEC chairman. The new proposed recommendations of the New York Stock Exchange similarly fell hard on the heels of SEC criticism in the wake of the Enron disaster and the consequent clamor among various politicians for immediate change. Indeed numerous bills have been proposed in the Congress and are still under examination, some of which seek to impose governmental oversight over matters correctly within the private control of individual companies. In this light, these recommendations may be viewed as an effort to take initiative voluntarily and thereby blunt the need for Congressional action and intervention.

Whatever its purpose, the direction is clearly a correct one. The Blue Ribbon Committee focused most closely on what ought to be a commanding, separate role for the Board of Directors' audit committee and sought to strengthen its power by expanding greatly the requirements of independence and financial literacy. Further, it sought to mandate independent lines of communication between the auditors and lower level internal audit staff on the one hand, and the committee on the other hand. With respect to this last point, there was, regrettably, no real power granted to the audit committee to effect the meaningfulness of that communication. Appendix 3 hereto sets forth a summary of the lengthy Blue Ribbon Committee Report (taken from the sidebar of the Wise and Whyte article), as well as a copy of the bibliography appended to the official report. What is notable from the bibliography is the lack of extensive research of a theoretical nature, as well as the total inattention to the voluminous work of the British (discussed below) in addressing the same problems in a similar system.

The recent New York Stock Exchange proposals are even broader and go even further than the recommendations of the Blue Ribbon Committee. These recommendations apply to corporate governance issues generally, the compensation committee, the audit committee, ethics issues, ongoing education, and the like. A summary of these points and a comparison of their recommendations to those of the Blue Ribbon Committee are contained in Appendix 4 hereto.[22]

While the New York Stock Exchange proposed regulations do go even further than those of the Blue Ribbon Committee, they stop short of creating a full power base in the audit committee. On the positive side, independence is greatly strengthened with, limitations on stock ownership,a five-year cooling off period from company relations for all former employees, consultants, business partners and the like, as well as a limitation on bonus compensation to directors. For the first time, the audit committee is given the sole power to hire and fire auditors as well as to approve any non-audit work done by the auditors. Further, the audit committee is now involved directly with the 8-Ks (press releases) issued by the company as well as in the preparation of the normal portions of all 10-Qs (quarterly reports) and 10-Ks (annual reports) entitled "management discussion and analysis."

An interesting dichotomy is presented in the New York Stock Exchange recommendations that reflects the reticence of the Exchange fully to empower the audit committee. One of its recommendations is to require regularly scheduled private meetings among non-management directors (who are also required to be a majority of all Boards). On page 8 of these recommendations, the Corporate Accountability and Listing Standards Committee writes that "regular scheduling of such meetings is important not only to foster better communication among non-management directors, *but also to prevent any negative inference from attaching to the calling of such executive sessions*." [Emphasis supplied] The regularizing of these meetings is an essential and an empowering assignment of power. First, it is a tacit acknowledgment that the non-management directors may be influenced by the management directors and the CEO in their discussions and that it is necessary to free them from that overpowering influence by promoting separate meetings. Second, the exchange correctly recognized that there would be a great reluctance on the part of directors to call such executive sessions since, to do so would telegraph the message that they were concerned about something--that something was wrong -- and thereby give the management directors the opportunity to lobby to quash that meeting.

This was an important change. However, note the lack of similarity with respect to the issue of access to independent counsel and consultants, such as auditing consultants. Rather than mandating that such consultants and advisors be on retainer and be required regularly to attend all audit committee meetings so as to be able to be consulted on all issues, the recommendations merely “permit” such consultants to be retained it the committee believes that it requires such assistance. While it is true that permission to initiate such retention was granted to the audit committee, similarly, there will be great pressure put on them to use general counsel or the “independent auditors” rather than hire "expensive outsiders" when a problem ensues since outsiders threaten the CEO with loss of control over resolution of that problem. On the other hand, if availability to such expertise is part of the regularized process, then there will be no adverse inference from such advisors being at a meeting and, more importantly, no opportunity to interfere with truly independent advice and analysis. Further, and perhaps resulting in an even greater propensity for empowerment, would be the courage that would be imparted to an audit committee by virtue of such independent advice. Any individual member may be subject to political and emotional pressures exerted by the chair/CEO not to insist upon a particular disclosure or interpretation. As a practical matter, it would be hard to resist concerted efforts in this fashion.

However, if one received clear advice from one's own counsel and auditors to the contrary, an audit committee member would have both a legitimate power base from which to refuse such a request from the chair ("I would like to go along with you but my lawyer tells me I cannot"), as well as the recognition that if the audit committee were to take a position against the advice of its counsel and independent accountants, then the existence of that advice would be conclusively damming if the matter warned against proved to be a problem in the future. It is my personal opinion that the different treatment for the audit committee with respect to this issue is because it really would make the audit committee completely independent in a way that would not be palatable to most chairs or CEO's of modern corporations. Putting it another way, while such a step probably should be implemented, the exchange may be concerned about whether it may be forcing too much change on its listing members at a time when they may not be ready for such change.

Other alternatives have also been suggested. GAAP itself has come under criticism and accountancy professionals are generally addressing in what ways GAAP itself should be changed. Congress is now talking about requiring CEOs to certify the accuracy of financial data. Peter Knutson, Emeritus Professor of Accounting at Wharton, is of the view that it is impossible for CEO's in large companies meaningfully to make such a certification. "How is a CEO to certify that the financials are accurate? Think of GE, for instance, and [former CEO] Jack Welch. Could Welch know whether the firm's numbers were accurate? He had to rely on the controller, the chief accounting officer. He relied on the officer in the controller's department whose job it is to prepare the annual report. They have to have people they can rely on."[23] In another approach, the Massachusetts Legislature had a bill pending before it imposing strict liability upon accountants simply for a failure to detect fraud by the company they audited. No finding of negligence by the auditors would be at issue. As reported in the Boston Globe on June 30, 2002, Massachusetts

Senate President Thomas Birmingham's deleting this absolute liability requirement was highly criticized and an effort was made to connect his actions to his receipt of modest campaign contributions from the accounting industry. While it seems illogical to mandate that auditors be liable for fraud absent negligence on their part (particularly since certified audits regularly state clearly that they are not fraud audits and that it is beyond their scope to detect fraud) it is still indicative of the national mood and the need for a definitive solution to this problem.

Other solutions that have been proposed include mandatory rotation of auditors, elimination of consulting engagements for outside auditors and SEC oversight review of financial reporting by public companies.

All of these proposals do have one thing in common, they seek to create a separate power base that is independent of and has a separate line of authority to which corporate management must conform. Therefore, if indeed public corporations are to avoid governmental intervention in their internal auditing processes to an even greater extent, one must ask if there is not a way further to buttress the recent proposals of the New York Stock Exchange in a way that accomplishes this result without mandating an entirely new system of corporate governance. Perhaps something might be learned by looking at how other countries have addressed this issue.

Lessons Learned from the U.K. and Germany

In Geert Hofstede's article "Cultural Constraints In Management Theories"[24] an analysis is made of various corporate governance structures throughout the world, particularly with their relevance to the American system of corporate governance. Hofstede however, both begins and ends his article with the acknowledgement that despite efforts to arrive at "culture free theories of management," nonetheless, all such available concepts "for this purpose are themselves alive with culture, having been developed within a particular cultural context. They have a tendency to guide our thinking toward our desired conclusion." Nonetheless certain observations of foreign debate on the issue may prove enlightening to the issues discussed in this paper.

The issue of supervision of management became a controversial issue in the negotiations over the formation of the European Union. The debate over this issue focused on the development of the European Economic Community's proposed "Fifth Directive."[25]

As originally proposed, the Fifth Directive contemplated a two-tier structure of governance for all corporations as is more typical in France and particularly in Germany. As finally adopted in 1983, the Fifth Directive allowed countries to elect a choice between the original two-tier structure and a unitary board as is customary in the U.K. However -- and this is important -- the compromise for the inclusion of the one-tier structure was a requirement that the majority of the members of the unitary board be non-executives. With respect to the two-tier structure, executives would be excluded from the upper-tiered, supervisory counsel.

This two-tier form is typical in the German system where publicly held companies established that managers be supervised fully by non-managers through two Boards of Directors. The lower Board, the "Vorstung" is a board made up of manager-directors who supervise and direct the day-to-day operations of the company. In effect, the powers of this board are much akin to the powers that are vested in one CEO in the United States. As a practical matter, these directors delegate specific areas of authority to each other, but each is responsible overall for the performance of the company to the upper board. The upper board, the "Aufstichsrat," is made up exclusively of non-managers. Indeed, members of the Vorstung are not permitted to be on the Aufstichsrat. As a practical matter, the chairman of the upper board has enormous amount of power.

This system works effectively in Germany due to the heavy participation of the banks in the process, normally as important members of the board. Because most stock certificates in Germany are in bearer form and the certificates are held by banks, corporations have no way of knowing who the ultimate holders of the stocks are and rely on the banks to take a leadership role in communicating with shareholders and, in the case of shareholders' meetings, to obtain requisite proxies. However the banks in obtaining such proxies, do not do so on behalf of the management committee. Rather, they solicit proxies that they are authorized to exercise themselves. As a consequence, and because banks therefore cast most of the ballots, they normally elect shareholders, bank representatives and various official experts as members of the upper board.[26] Further, while it is not expressly clear under German law, German jurists are of the opinion that it is implicitly forbidden for management to participate in the solicitation of proxies.[27] Banks in the United States however, cannot as a practical matter, and likely may not as a legal matter, take the active role that German banks do in electing directors.[28]

Obviously this sort of authoritative supervision is not a concept that comports well with United States culture, let alone United States law. Nonetheless the concept that management and supervision should be divided between two separate bodies seems better calculated to provide a separate and effective balancing of power. Of greater interest to the United States system, is the compromise in the Fifth Directive of permitting a unitary board provided a majority of the directors are "independent." This then raises the issue of how the British responded to this impetus.

While not recognized by the background research of the Blue Ribbon Committee, there has been extensive public comment and numerous separate, official reports issued in Britain with respect to this very issue. After Britain had suffered a recession after 1990, there were a number of bankruptcies and firm failures that lead to scandals, and the exposure of corruption and abusive power by corporate executives. The business failures hurt many individual investors. In response to this, and in an effort again to restore the confidence that seemed to have eroded, the Stock Exchange and Financial Reporting Council established a committee of inquiry (the "Cadbury Committee") to conduct an investigation and to issue a report relative to corporate governance. The final report was released in 1992 and includes a code of best practices and various voluntary recommendations. These were followed by the Greenberry Report in July of 1995, the Hempel Report in January of 1998, and the Turnbull Report in September of 1999.[29] These reports analyze and come to many of the same conclusions and recommendations as has the New York Stock Exchange, although the analysis is greater in depth. Like the Blue Ribbon Committee Report and the recent New York Stock Exchange proposals, these reports do not question the fundamental concept of the unitary board. However, beginning with the Cadbury Report, and stated in greater detail in the Hempel Report, is an analysis that begins with the acknowledgment that there are, in fact, two key tasks that must be undertaken at the very top level of management: "the running of the board and the executive responsibility for running the company's business" (Hempel Report at p. 16). With respect to this issue, the Hempel Report, at §3.17 (p. 28), states as follows:

> Cadbury recommended that the roles of chairman and chief executive officer should in principal be separate; if they were combined in one person, *that represented a considerable concentration of power*. We agree with Cadbury's recommendation and reasoning… . Our view is that, other things being equal, the roles of chairman and chief executive officer are better kept separate, in reality, as well as in name. Where the roles are combined, the onus should be on the Board to explain and justify the fact. [Emphasis supplied].

None of these British Reports have the authority of law, such that compliance with their proposals requires voluntary observance. Some commentators on these reports have argued that the Cadbury Report and its progeny resulted in a missed opportunity significantly to enhance monitoring roles. They say this because their analysis "restricted its proposals to what could be achieved without fundamentally altering the *legal responsibilities* of non-executives, the basic structure of the unitary board, or the U.K.'s 'accountability through disclosure' system." [Emphasis supplied].[30] As this comment points out, it appears to be a necessity that empowerment of independent directors be effected through ceding them legal rights so that ultimately the system may rebalance itself.

Both the Fifth Directive, and the various U.K. Reports and comments focus on the same issue that has been central to this paper; namely, reallocations of power dynamics to counteract the dictatorial imperative of the chairman/CEO in United States public companies. Some commentators have expressed despair as to whether this is in all events possible. For example, in the Conrad article cited earlier (at p. 1480), the author states that "whether effective supervision of management is possible in the United States for very large, very widely held corporations is debatable. It will not be brought about merely by electing a majority of directors who are "independent." … Effective supervision will not take place unless it is accompanied by additional measures to activate it."

Indeed, it is my very thesis that such "activation" requires an assignment of power.

Conclusions and Recommendations

Public companies in the United States have risen truly to be multi-national entities that rival the economic size of most countries. As reflected in Appendix 5 hereto, the gross revenues of the United States' largest company exceeds the gross domestic product of the thirty-second largest country in the world, while the one-hundredth largest company has gross revenues in excess of the gross domestic product of the ninety-eighth largest country in the world.[31] Viewed from this context, one might rightfully question whether the enormous economic power controlled by such companies should be vested primarily in one man, absent the existence of checks and balances that realistically and effectively prohibit the abuses of power, such as those of the type that we have so recently seen. The issue becomes even clearer when one recognizes that these companies are both entrusted with savings of a wide variety of private individuals, and also are relied upon as key components of the financial markets, generally. While it is not the purpose of this paper to analyze or suggest mechanisms of public intervention, it is its purpose to examine whether in light of the fact that such multi-national companies have grown to the point where they have the ability to exercise power having a magnitude, from an economic standpoint, of large countries, it is not unreasonable at this point to require that they observe meaningful protocols of corporate governance and be required to show respect for differing views of "loyal opposition" within the company. United States citizens have fared well under the deliberative democracy that was established through James Madison's influence on the drafts of the United States Constitution. One might question, when as has apparently become the case, companies grow to the size of governments, whether they would benefit from the constructive and encouraged exchange of ideas to which our own government is subject. Whether or not that is the case, at some point when power grows so great, there must be an effective balance to it lest it be consumed with its own unbridled power. Referring back to the model developed earlier, this may be accomplished by mechanisms that would lessen each of the four power bases that may be exerted by the CEO in this process and by supplementing each of such power bases on the part of the audit committee. This leads me to make six recommendations, and leave unanswered one crucial question that I have not been able properly to address.

First, the chairman of the board and the CEO should be two independent and unrelated individuals. I would even go so far as to insist that the chairman of the board also be an independent director. This must be accomplished in fact rather than having the chair a mere figurehead, with some other executive director holding the real power on the board. Such a rule would lessen the CEO's legitimate, coercive and reward powers. Directors of European companies with whom I spoke have taken the view that no management should even be on the board whatsoever and that their presence there, if at all, should only be in an *ex officio* capacity; without power to vote. As it is my, instinct that it is essential to have those in management who work day-to-day with the company's operational issues, people, customers and vendors provide their guidance and knowledge to those who are independent, as an integral part of the board.

Second, directors' compensation, and particularly the compensation of audit committee directors must be addressed to be meaningful and related to their level of responsibility and required effort, while not exorbitant. Further, it should minimize the number of shareholdings that they have compared to their net worth so that their judgment will not be affected by their own financial stake in the enterprise. This would likely mean severely limiting or eliminating stock options for directors. In so doing, the director's susceptibility to reward and coercive powers would be lessened.

My final four recommendations relate to the audit committee. I accept the judgment of the Blue Ribbon Committee that this committee ought, indeed, to be the "first among equals." I accept further former SEC Chairman Levitt's view that audit committees are to "function as the ultimate guardian of investor interests and corporate accountability." In order for these goals to be achieved, the audit committee must function with separate mandates, separate power and, effectively, a type of separate, second board of directors of within the unitary board structure. It should be, in effect, be a type of Aufstichsrat but only with respect to financial disclosure and oversight. To accomplish this, in addition to the current recommendations of the New York Stock Exchange, I recommend the following:

First, as discussed above, the audit committee should have on retainer its own independent counsel and auditing consultant, neither of whom has or recently has had any significant relationship with the subject company. Such representatives are to meet regularly with the audit committee and to be available for consultation with them, and particularly with the chair, on an as needed basis. This recommendation would raise both the legitimate power and the expert power of the committee.

Second, audit committee meetings must not be attended by any other management-director or management representative, absent an invitation for that to occur. Further, the meeting should not be held at the same time as the board meetings. The presence of the audit committee at board meetings should only be for purposes of rendering a report previously prepared or for answering questions regarding that report or additional concerns of the board. This requirement lessens the susceptibility of the audit committee to the coercive and reward powers of the CEO/chair. The purpose of this requirement is to insulate the audit committee from the influence of the chair and to permit it freedom of deliberation without pressure of having to come to a conclusion and resolve issues to meet deadlines of others. Too often, audit committee meetings are scheduled for an hour or so before the official board meeting. In such instances, if problems arise there may be too much pressure to let the matter slip because it cannot be dealt with in the abundance of time that a full deliberation of the matter requires.

Third, any changes in the composition of the audit committee should be treated exactly in the same fashion as a change in the outside auditor. The matter must be publicly reported and reported to the SEC and a detailed explanation of the reason for the change must be given. Again, this will both enhance the committee's status of legitimate power and insulate it from coercive power.

Finally, it is possible for difficult audit committee members to be voted off after only a year. Further, there is a great deal of work that needs to be done in order to bring audit committee members up to speed and have them familiar with the processes. For that reason, audit committee members should have three (3) year terms, which may be staggered so as to provide continuity and the opportunity for each member to oversee a three (3) year span of financial statements. This enhances both expert and legitimate power while providing additional protection from coercive power.

I believe the foregoing recommendations, in addition to those proposed by the New York Stock Exchange, will more adequately establish a separate focus of power which will allow the audit committee to be immune from manipulation by management while providing mechanisms for reasonable oversight without interfering with management prerogatives. Again, such a highly independent audit committee is one that would be independent solely for the purpose of financial oversight and audit statement review. Particularly since management's compensation often turns on the accuracy of those financial statements, it seems most appropriate that someone who is fully independent be appointed to "count the change" that management is handing back to them. If management is indeed comprised of men and women of principle, then they will recognize that these recommendations will in no way interfere with their executive authority in terms of managing the day-to-day business of the company and, in view of their honesty, they should welcome the opportunity to have a certification as to the propriety of their conduct. On the other hand, if management is not so scrupulous, then so much more is the reason that such change is needed.

The one question that I must leave open at the end of this paper, regrettably, is the question of why anyone would want to serve on such an audit committee. Clearly, there ought to be a reward of some sort for undertaking such a valuable service to the investing public. Most authorities seem to feel that stock options are not the way to go. Further, this is not like public service where the low wages paid to congressmen, and even to our own president, are ameliorated by the prestige attendant to holding such office as well as the basic notion that one should fulfill a public duty that is a part, I assume, of most politicians' decision to seek such a job. Clearly, there ought to be some benefit for all the risks so undertaken; otherwise, how many qualified individuals would be attracted to the position in the first place. Perhaps an answer may lie in recognizing such public service through a separate pool of stock options of all companies, administered in a blind fashion and available to those who serve on audit committees. Perhaps it would lie in providing committee members immunity from suit by any *private* individuals (i.e., non-governmental plaintiffs) for alleged defalcations of their duty of care in exchange for an agreed waiver of any attorney-client privilege between the members and their official committee counsel. These, of course, would have to be governmental initiatives.

However an analysis of that question will have to wait for another day.

Endnotes

[1] "What went wrong with WorldCom?" *http://knowledge.wharton.upenn.edu/whatshot.cfm* (accessed 3 July 2002).

[2] Ibid.

[3] "Who was Enron's Ultimate Guardian of Investor Interest and Corporate Accountability?," Richard L. Wise and John J. Whyte, scheduled to be published in the August, 2002 edition of United States Business Review.

[4] What went wrong with WorldCom, op cit.

[5] O. Hart, "Corporate Governance: Some Theory and Implications", 105 *Economic Journal* 678-89 (1995).

[6] Mahmoud Ezzamel and Robert Watson, (herein, "Ezzamel and Watson") from *Leadership*, edited by Robert P. Vecchio, University of Notre Dame Press, 1997, Chapter 3.

[7] Ezzamel and Watson at p. 54.

[8] Ezzamel and Watson, note 4 at p. 59.

[9] "The Economics of Corporate Governance: Beyond the Marshallian Firm," G. Garvy and P. Swan, 1 *The Journal of Corporate Finance*, 139-74 (1994).

[10] Insolvency can be defined as "balance sheet insolvency," i.e, liabilities in excess of assets; an inability to pay debts when due in the ordinary course; or the existence of inadequate capitalization.

[11] *Corporate Governance: Economic and Financial Issues,* edited by Keasey, Thompson, and Wright, Oxford University Press 1997: "Introduction: The Corporate Governance Problem – Competing Diagnoses and Solutions" by Keasey Thompson and Wright at p. 5.

[12] See, for example, *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees* at p. 7: "A proper and well-functioning system exists, therefore, when the three main groups responsible for financial reporting – the full Board including the audit committee, financial management including the internal auditors, and the outside auditors – form a 'three-legged stool' that supports responsible financial disclosure and active participatory oversight. However, in the view of the Committee, the audit committee must be 'first among equals' in this process, since the audit committee is an extension of the full Board and hence the ultimate monitor of the process."

[13]See, for example, "Power, Politics and Influence" by Robert Vecchio in *Leadership,* op. Cit. At pp. 73 et seq.

[14] See "Designed by Committee," *The Economist,* 15 June 2002 at pp. 69-71.

[15] Each of these was raised in the original September 1998 speech by of SEC Chairman Levitt cited earlier which resulted in appointment of the BRC.

[16] Much of the bases of this and the subsequent points are taken from *The Corporate Paradox* by Wouter H.F.M. Cortenraad, Kluwer Academic Publishers, 2000, pp. 165-169.

[17] One of the then, big five accounting firms that had bid on the Enron account that was eventually won by Arthur Anderson was advised that they had been passed over because they had failed to exhibit sufficient "creativity."

[18] Designed By Committee, supra at 70.

[19] Robert P. Vecchio in "Power, Politics and Influence," supra at pp. 93-94, summarized the stunning and oft cited studies of Stanley Milgram on obedience to authority in the face of violation of moral principals. He states:

> In the early 1960s, Stanley Milgram of Yale University conducted a series of studies to examine the extent to which people would obey, even if the demands of authority violated their moral responsibilities. As part of this research, 40 adult males from a wide variety of occupations were paid to serve as subjects in a learning experiment. Each subject was told that he was participating in a study of the effects of punishment on learning. The subject was then asked to help another adult (actually the researcher's confederate) learn a lengthy list of word pairs by using electric shock as a penalty for each incorrect answer.
>
> The subject (teacher) met with the alleged learner and then watched as the learner was strapped into an apparatus that looked like an electric chair. The experimenter then took the subject into the next room and showed him how to communicate with the learner through an intercom system. The experimenter also explained how to administer the punishment for any errors the learner might make in responding to stimulus works in the list of work pairs. The shock generator contained 30 switches, one for each of 30 different voltage levels ranging from 15 to 450 volts. The switches were also labeled in terms of the increasing strength of the voltage: slight shock, moderate shock, strong shock, very strong shock, intense shock, extreme intensity shock, danger: severe shock, and XXX.
>
> After reading the list of word pairs to the learner, the teacher was to begin quizzing the learner. For each incorrect response, the teacher was to administer an electric shock, and for each additional incorrect response, the teacher was to apply the next higher voltage level on the generator.
>
> The trials passed uneventfully until the learner began to make numerous mistakes. Then, in short order, the teacher found himself administering fairly high levels of voltage to the learner. At that point, the learner would begin to protest, saying he wanted to drop out of the experiment because his heart was bothering him and the pain of the shocks was too much for him. If the teacher hesitated, the experimenter would encourage him to proceed, saying, for example, "Please go on" or "It is essential that you continue." If the teacher refused to proceed after four verbal encouragements, the experiment was discontinued.
>
> As the voltage levels increased, the confederate (in accord with the experiment's protocol) would voice even stronger objections: He would pound on the wall and, at one point, scream loudly. Beyond a certain voltage level, the learner would no longer answer any of the teacher's questions, giving the impression that he was injured or dead. When this silence occurred, the experimenter would tell the teacher to treat the learner's failure to respond as an incorrect response, to administer the punishment, and to continue on with the next word pair.
>
> Given these conditions, you would probably assume that very few subjects would obey the experimenter. But the actual results revealed that a majority of the subjects administered the maximum voltage on the shock generator and continued in their participation of the experiment despite the learner's objections.
>
> We should note, however, that although most subjects gave the maximum level of shock to the learner, they did not enjoy doing so. Typically, the subjects displayed strong signs of nervous tension, such as nail biting, trembling, and groaning. Many of them also laughed nervously whenever the learner protested or pleaded. However, the constraints of the situation compelled the subjects to continue their participation.

[20] E. Davis and J. Kay, “Corporate Governance, Takeovers, and the Role of the Non-Executive Director,” in M.Bishop and J. Kay (eds.) *European Mergers and Merger Policy*, Oxford University Press (1993), Ch. 5 at p. 200.

[21] In addition to the foregoing, on April 11, 2002, Hardwick Simmons, the Chairman and Chief Executive Officer of the NASDAQ filed a 5½-page letter with SEC Chairman Harvey Pitt suggesting "a number of tentative conclusions", as well as areas for further study, that had been deemed appropriate by NASDAQ. In light of the more detailed reports of the Blue Ribbon Committee and the New York Stock Exchange, the thinness of this response does not reflect well on the NASDAQ. By way of example, this letter boasts that the NASDAQ now "requires that each member of the audit committee be 'able to read and understand fundamental financial statements, including a company's balance sheet,

income statement, and cash flow statement'." The NASDAQ's lack of seriousness in addressing this matter is itself a commentary on the inadequacy of corporate oversight processes.

[22] Courtesy of John J. Whyte.

[23] Knowledge at Wharton, "What Went Wrong at WorldCom", http://knowledge.wharton.upenn@edu/whatshot.cfm (downloaded July 3, 2002). Note, however, that it is customary for the CEO and the CFO to give exactly such representations to its outside auditors.

[24] *Leadership*, Robert Vecchio (ed.) op. cit., at 465-483.

[25] This item kept its name of the Fifth Directive even though it eventually became the Tenth in order of approval and is entitled "Commission Directive, Proposition d'une cinquieme directive tendant a coordonner les garanties qui sont exigees dans les Etats membres, des societes, au sens de l'article 58 paragraphe 2 du traite, pour proteger les interets, tant des associes que des tiers en ce qui concerne la structure des societes anonymes ainsi que les pouvoirs et obligations de leurs organes, art. 58, J.O. COMM. EUR. (No. C 131) 49 (Oct. 13, 1972) [hereinafter cited as "Fifth Directive"].

[26] Alfred F. Conrad, "Comparative Law: The Supervision of Corporate Management: A Comparison of Developments in European Community and United States Law." 82 Mich. L. Rev. 1459 (1984) at p. 1470.

[27] Ibid.

[28] For example, under SEC Regulation 17 C.F.R. §230.405, they would likely be "controlling persons" and would then have prima facia liability for securities violations of such companies. Further, sales of large blocks of stock would require new registration.

[29] Each of the foregoing reports may be viewed in full at http://www.independentdirector.co.uk/Reference.htm.

[30] Ezzamel and Watson at p. 56.

[31] Note that this comparison is slightly inaccurate in that the excerpt from the Fortune 500 list annexed is for 2002 and the most recent figures for gross domestic product appear to be a couple of years old. Nonetheless, the numbers are still relatively comparable today.

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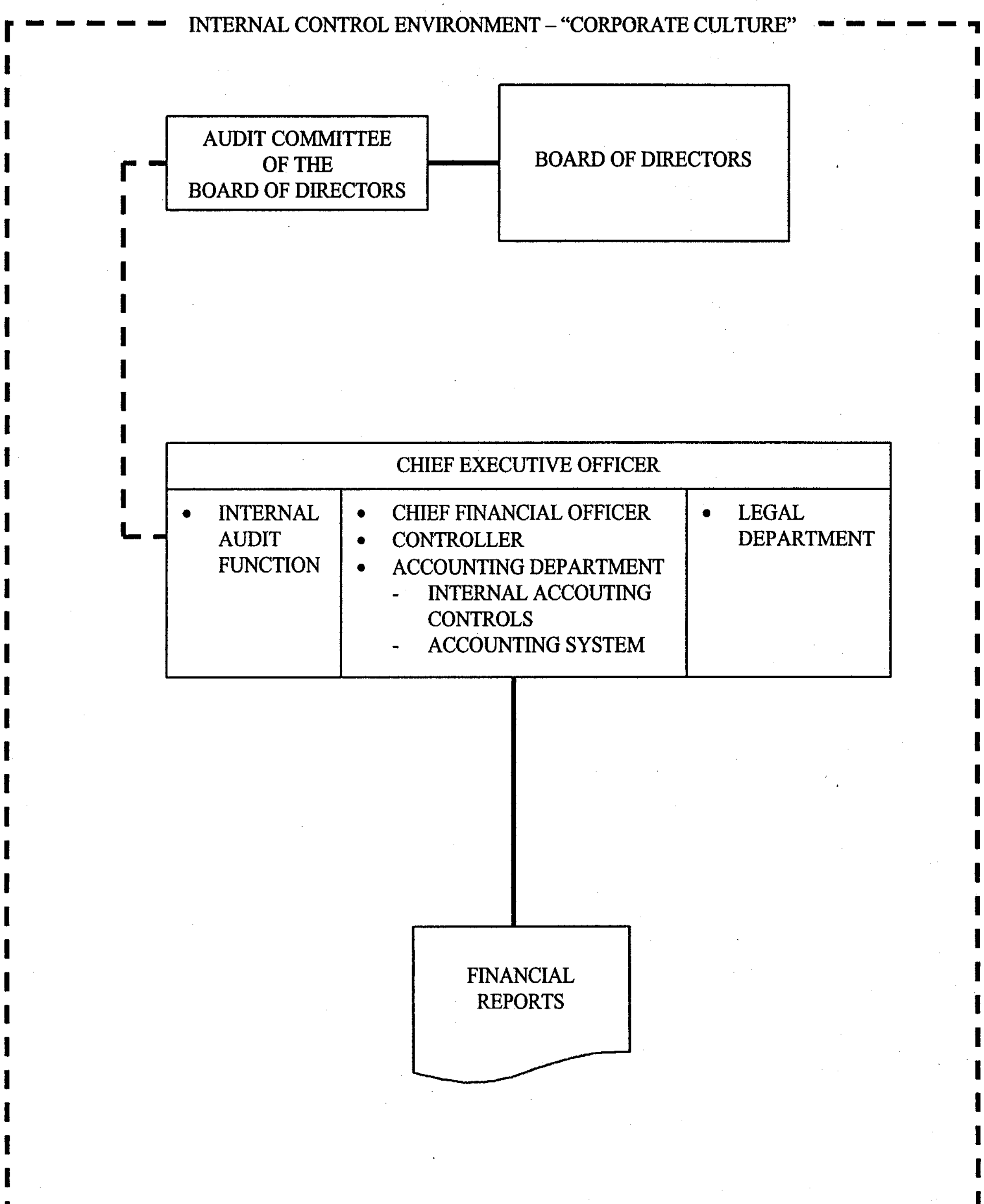
APPENDIX 1

EXHIBIT 1-2
THE PUBLIC COMPANY



APPENDIX 2

GE Audit Committee Charter: March 9, 2001 Form 14A

APPENDIX A

AUDIT COMMITTEE CHARTER

The Audit Committee (Committee) shall consist of a minimum of three directors. As determined by the Board of Directors in accordance with applicable requirements, all members of the Committee shall be independent directors having no relationship that may interfere with the exercise of their objective judgment in discharging the responsibilities set forth below. As also determined by the Board of Directors, all members of the Committee shall have sufficient financial experience and ability to enable them to discharge such responsibilities, and at least one member shall have accounting or related financial management expertise. The Committee shall have the following responsibilities with respect to the Company, which term shall include without limitation its subsidiaries General Electric Capital Services, Inc., and General Electric Capital Corporation:

1. To recommend to the Board of Directors, for share owner approval, the independent auditor to examine the Company's accounts, controls and financial statements. The independent auditor is ultimately accountable to the Board of Directors and to the Committee, and the Board of Directors and the Committee have the ultimate authority and responsibility to select, evaluate and if necessary replace the independent auditor.

2. To review and approve the scope of the examination to be conducted by the independent auditor. In addition, the Committee shall at least annually obtain from the independent auditor a formal written statement delineating all relationships between the independent auditor and the Company, and shall at least annually discuss with the independent auditor any relationship or services which may impact the independent auditor's objectivity or independence, and shall take or recommend that the Board take appropriate actions to ensure such independence.

3. To review and approve the Corporate Audit Staff functions, including: (i) purpose, authority and organizational reporting lines; (ii) annual audit plan, budget and staffing; and (iii) concurrence in the appointment, removal and compensation of the Vice President -Corporate Audit Staff.

4. To review results of the examinations of the financial statements of the Company by the independent auditors, their evaluation of the Company's internal system of audit and financial controls, and their annual report on the Company's financial statements.

45

<PAGE>

5. To review, with the Senior Vice President-Finance, the Vice President - Corporate Audit Staff or such others as the Committee deems appropriate the Company's internal system of audit and financial controls and the results of internal audits.

6. To review the Company's financial reporting, the accounting standards and principles followed by the Company and significant changes in such standards or principles or in their application. ,

7. To review and investigate any matters pertaining to the integrity of management, including conflicts of interest, or adherence to standards of business conduct as required in the policies of the Company. In connection therewith, the Committee will meet, as deemed appropriate, with the General Counsel and other Company officers or employees.

In discharging its responsibilities, the Committee will periodically meet with the Company's auditors without the presence of any Company officer or employee.

CHARTER
Audit Committee of the Board of Directors
The Gillette Company

The Audit Committee of the Board of Directors of the Company was established by the action of the Board in adopting the Bylaws of the Company. The provisions of the Bylaws set forth the basic responsibilities and board procedures for the Audit Committee. This Charter is intended to supplement the Bylaw provisions and to specify in more detail the membership and responsibilities of the Committee, as outlined below:

Membership

The Audit Committee shall consist of not fewer than three nor more than five members of the Board of Directors. No member of the Committee shall be an active or retired employee of the Company, and all of them shall be independent of management and free from any relationship that, in the opinion of the Board of Directors, would interfere with their independent judgment as a member of the Committee.

Responsibilities

The Audit Committee serves as the representative of the Board for the general oversight of Company affairs in the area of financial accounting and reporting and the underlying internal controls as well as the financial aspects of the Company's funded benefit plans. Through its activities, the Committee will facilitate open communication among directors, the Company's independent accountants, its internal audit function, and corporate management.

The Audit Committee will assist the Board in discharging its fiduciary responsibilities to shareholders, providing assurance as to the independence of the Company's outside accountants and the adequacy of disclosure to shareholders and to the public.

Specifically, the Audit Committee will:

1. Hold no less than three regularly scheduled meetings each year, normally in February, June and October, and other meetings from time to time as may be called pursuant to the Company's Bylaws. A majority shall constitute a quorum of the Audit Committee. A majority of the members in attendance shall decide any question brought before any meeting of the Committee.

2. Recommend to the Board, annually, the appointment of a finn of

independent public accountants as the Company's outside auditors.

3. Review with representatives of the independent accountants:
   - The plan for and scope of its annual audit of the Company's fmancial statements.
   - The Results of the annual audit.
   - Any recommendations with respect to internal controls and other financial matters, including any perceived weaknesses in the Company's internal controls, policies, and procedures.
   - Any significant changes made by management in the basic accounting principles and reporting standards used in the preparation of the Company's fmancial statements.
   - Review the Annual Report in detail with the outside auditors.

4. Review the extent of any services outside the audit area performed for the Company by its independent accountants.

5. Review the fees proposed by the Company's independent accountants for their services.

6. Review the work of the Company's internal audit department with the Internal Auditor including management's responses to recommendations made and plans for future audit coverage.

7. Review whether management has sought a second opinion regarding a significant accounting issue, and, if so, obtain the rationale for the particular accounting treatment chosen.

8. Review compliance by officers and employees with the Company's policies on business ethics and public responsibility.

9. Make such other recommendations to the Board on such matters, within the scope of its functions, as may come to its attention and which in its discretion warrant consideration by the Board.

10. Review the investment performance of the Retirement Plan, the Savings Plan and the Employee Stock Ownership Plan and recommend to the Board the appointment and replacement of investment managers.

11. Meet privately from time to time with representatives of the independent accountants, the Internal Auditor and management.

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Eastman Kodak Company Annual Report 2000

Exhibit II – Audit Committee Charter

I. Purpose

The primary purpose of the Audit Committee is to assist the Board of Directors in fulfilling its oversight responsibilities with respect to the Company's:

1. financial statements and financial information provided to shareholders and others,
2. system of internal controls,
3. financial reporting principles and policies,
4. internal and external audit processes, and
5. regulatory compliance programs for ethical business conduct.

II. Composition

The Audit Committee shall consist of at least three members of the Board who meet the requirements of independence under the NYSE rules, that is, each of whom:

1. is not and has not been an employee of the Company or a Company subsidiary,
2. has no relationship to the Company that may interfere with the exercise of such director's independence from management and the Company,
3. is financially literate or will become so in a reasonable amount of time,
4. has no "cross compensation committee link" as that requirement is defined in Section 303 of the NYSE Listed Company Manual, and
5. has no family relationship with any executive officer of the Company or any affiliate of the Company.

Prospective members shall be recommended by the Committee on Directors with input from the Chairman and CEO and elected by the Board. One member shall be designated by the Board as the Chairman of the Committee.

At least one member of the Committee shall have accounting or related financial management expertise.

▲ TOP

◂ PREVIOUS | CONTINUE ▸

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Eastman Kodak Company Annual Report 2000

Exhibit II – Audit Committee Charter

III. Meetings

The Audit Committee shall meet at least four times per year or more frequently as circumstances require. The Audit Committee shall review its charter at least annually.

The Committee may have in attendance at meetings such members of management or others as it may deem necessary to provide the information to carry out its duties.

IV. Duties and Responsibilities

The Audit Committee shall have the following duties and responsibilities with respect to:

1. Independent Accountant
   - (a) Serve as the Board's primary avenue of communication with the independent accountant.
   - (b) Make recommendations to the Board regarding the selection, evaluation, retention, or discharge of the independent accountant.
   - (c) Ensure understanding by the independent accountant and management that the Board, as the shareholders' representative, is the independent accountant's client and therefore the independent accountant is ultimately accountable to the Board and the Audit Committee.
   - (d) Provide the opportunity for the independent accountant to meet with the full Board as deemed necessary and appropriate by the Committee.
   - (e) Confirm and assure the independence of the independent accountant by:
     - (i) accepting receipt of their annual submission of a formal written statement delineating all relationships between the independent accountant and the Company,
     - (ii) monitoring fees paid to the independent accountant for consulting and other non-audit services, and
     - (iii) engaging in a dialogue with the independent accountant with regard to any disclosed relationships or services that may impact the objectivity or independence of the independent accountant.
   - (f) Review the annual audit plan of the independent accountant and its scope.

▴ TOP ◂ PREVIOUS | CONTINUE ▸

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Exhibit II – Audit Committee Charter

2. Internal Auditors

(a) Serve as the Board's primary avenue of communication with the Director of Corporate Auditing.

(b) Review and concur in the appointment, replacement, reassignment, or dismissal of the Director of Corporate Auditing.

(c) Confirm and assure the independence of the internal auditors.

(d) Review the annual internal audit plan of the internal auditors and its scope, and the degree of coordination of this plan with the independent accountant.

(e) Review periodically the internal audit activities, staffing, and budget.

3. Financial Statements

(a) Inquire of the independent accountant and management as to the acceptability and appropriateness of financial accounting practices and disclosures used or proposed by the Company.

(b) Review and discuss with management and the independent accountant prior to releasing the year-end earnings and at the completion of the annual audit examination:

(i) the Company's financial statements and related footnote disclosures,

(ii) the independent accountant's audit of the statements and its report thereon,

(iii) any significant changes required in the independent accountant's audit plan,

(iv) any serious difficulties or disputes with management encountered during the course of the audit, and

(v) other matters related to the conduct of the audit which are to be communicated to the Committee under generally accepted auditing standards.

▲ TOP ◂ PREVIOUS | CONTINUE ▸

ICANN

Audit Committee of the Board

The ICANN Board's Audit Committee is responsible for (1) recommending the selection of external auditors to the Board, (2) receiving, reviewing, and forwarding to the Board the annual financial report of the external auditors, and (3) such other matters as may warrant its attention.

Background.

The Audit Committee of the ICANN Board was established by resolution on November 4, 1999:

> "RESOLVED [99.127], that there be, and there hereby is, effective immediately, designated a Committee of the Board to be named the 'Audit Committee,' responsible for recommending the selection of external auditors to the Board; receiving, reviewing, and forwarding to the Board the annual financial report of the external auditors; and such other matters as may warrant its attention."

Members of the Committee.

The members of the Audit Committee are Frank Fitzsimmons (Chair), Lyman Chapin, and Jun Murai.

Audit Committee Charter

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Page Updated 22-Apr-2002

ICANN

Audit Committee Charter

(Adopted by ICANN Board 10 March 2000)

I. Purpose

The Audit Committee of the ICANN Board is responsible for recommending the selection of external auditors to the Board; receiving, reviewing, and forwarding to the Board the annual financial report of the external auditors; and such other matters as may warrant its attention.

II. Membership of Audit Committee

The Audit Committee shall be comprised of three or more directors as determined and appointed annually by the Board, each of whom shall be free from any relationship that, in the opinion of the Board, would interfere with the exercise of his or her independent judgment as a member of the Committee. Unless a chair is appointed by the full Board, the members of the Committee may designate a Chair by majority vote of the full Committee membership.

III. Scope of Audit Committee Work

In accomplishing its assigned responsibilities, the Audit Committee will review the following listed matters and such other matters as may warrant its attention. It may, with approval of the Board, engage additional assistance to undertake such reviews of financial management performance as it deems necessary.

(1) Recommend to the Board of Directors the selection of ICANN's external auditors and the annual fees to be paid for services rendered by the external auditors, review each proposed audit plan developed by management and the external auditors, periodically review the performance of the external auditors, and recommend to the Board any proposed retention or discharge of the external auditors.

(2) Review the Corporation's annual financial statements and reports as required by the Bylaws, including the compliance of the Corporation's accounting and financial management systems and reports with generally accepted accounting principles for nonprofit organizations.

(3) Review and forward to the Board the annual financial management letter of the external auditors, with such comments of its own as may be appropriate.

(4) Periodically review the Corporation's system of internal controls, including its risk management policy and any accompanying insurance coverage, and make recommendations to the Board for changes it considers desirable.

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Page Updated 11-March-00

Audit Committee Charters in the P ost-Enron World
Martin Lipton and Eric S. Robinson
Special to law.com

Wachtell, Lipton Rosen & Katz
February 21, 2002

The Enron/Andersen scandal has already forced the major accounting firms to take proactive steps, including limitations on providing certain consulting or internal audit services to their audit clients. The crisis has shaken investor faith in corporate governance as well as in the accounting firms. Congress and regulators are considering more far-reaching efforts to respond, to the crisis

Although new laws and regulations are not needed in the area of corporate governance, it is incumbent upon boards of directors to review the practices and procedures of audit committees to improve their effectiveness and help restore investor confidence. The following is an updated model audit committee charter to include a recommended "best practices" in the current environment.

MODEL AUDIT COMMITTEE CHARTER [FOOTNOTE *]

(NYSE Listed Company)

The Audit Committee is appointed by the Board to assist the Board in ii monitoring (1) the integrity of the financial statements of the Company, (2) the compliance by the Company with legal and regulatory requirements and (3) the independence and performance of the Company's internal and external auditors.

The members of the Audit Committee shall meet the independence and experience requirements of the New York Stock Exchange. In particular, the Chairman of the Audit Committee shall have accounting or related financial, management expertise. The members of the Audit Committee shall be appointed by the Board on the recommendation of the [Nominating and Governance Committee].

The Audit Committee shall have the authority to retain special legal, accounting or other consultants to advise the Committee. The Audit Committee, may request any officer or employee of the Company or the Company's outside, counselor independent auditor to attend a meeting of the Committee or to meet with any members of, or consultants to, the Committee. The Audit Committee may also meet with the Company's investment bankers or financial analysts who follow the Company.

The Audit Committee shall make regular reports to the Board.

The Audit Committee shall:

1. Review and reassess the adequacy of this Charter annually and recommend any proposed changes to the Board for approval.

2. Review the annual audited financial statements with management, including major issues regarding accounting and auditing principles and practices as well as the adequacy of internal controls that could significantly affect the Company's financial statements.

3. Review an analysis prepared by management and the independent auditor of significant financial reporting issues and judgments made in connection with the preparation of the Company's financial statements, including an analysis of the effect of alternative GAAP methods on the Company's financial statements and a description of any transactions as to which management obtained Statement on Auditing Standards No.50 letters.

4. Review with management and the independent auditor the effect of regulatory and accounting initiatives as well as off-balance sheet structures on the Company's financial statements.

5. Review with management and the independent auditor the Company's quarterly financial statements prior to the filing of its Form 10-0, including the results of the independent auditors' reviews of the quarterly financial statements.

6. Meet periodically with management to review the Company's major financial risk exposures and the steps management has taken to monitor and control such exposures.

7. Review major changes to the Company's auditing and accounting principles and practices as suggested by the independent auditor, internal auditors or management.

8. Recommend to the Board the appointment of the independent auditor, which firm is ultimately accountable to the Audit Committee and the Board.

9. Review the experience and qualifications of the senior members of the independent auditor team and the quality control procedures of the independent auditor.

10. Approve the fees to be paid to the independent auditor for audit services.

11. Approve the retention of the independent auditor for any non-audit service and the fee for such service.

12. Receive periodic reports from the independent auditor regarding the auditor's independence, discuss such reports with the auditor, consider whether the provision of non-audit services is compatible with maintaining the auditor's independence and, if so determined by the Audit Committee, recommend that the Board take appropriate action to satisfy itself of the independence of the auditor.

13. Evaluate together with the Board the performance of the independent auditor and, if whether it is appropriate to adopt a policy of rotating independent auditors on a regular basis. If so determined by the Audit Committee, recommend that the Board replace the independent auditor.

14. Recommend to the Board guidelines for the Company's hiring of employees of the independent auditor who were engaged on the Company's account.

15. Discuss with the national office of the independent auditor issues on which it was consulted by the Company's audit team and matters of audit quality and consistency.

16. Review the appointment and re placement of the senior internal auditing executive.

17. Review the significant reports to management prepared by the internal auditing department and management's responses.

18. Meet with the independent auditor prior to the audit to review the planning and staffing of the audit.

19. Obtain from the independent auditor assurance that Section 10A of the Securities Exchange Act of 1934 has not been implicated.

20. Obtain reports from management, the Company's senior internal auditing executive and the independent auditor that the Company's subsidiary/foreign affiliated entities are in conformity with applicable legal requirements and the Company's Code of Conduct, including disclosures of insider and affiliated party transactions.

21. Discuss with the independent auditor the matters required to be discussed by Statement on Auditing Standards No.61 relating to the conduct of the audit

22. Review with management and the independent auditor any correspondence with regulators or governmental agencies and any employee complaints or published reports which raise material issues regarding the Company's financial statements or accounting policies.

23. Review with the independent auditor any problems or difficulties the auditor may have encountered and any management letter provided by the auditor and the Company's response to that letter. Such review should include:

(a) Any difficulties encountered in the course of the audit work, including any restrictions on the scope of activities or access to required information, and any disagreements with management.

(b) Any changes required in the planned scope of the internal audit.

(c) The internal audit department responsibilities, budget and staffing.

24. Prepare the report required by the rules of the Securities and Exchange Commission to be included in the Company's annual proxy statement.

25. Advise the Board with respect to the Company's policies and procedures regarding compliance with applicable laws and regulations and with the Company's Code of Conduct.

26. Review with the Company's General Counsel legal matters that may have a material impact on the financial statements, the Company's compliance policies and any material reports or inquiries received from regulator s or governmental agencies.

27. Meet at least quarterly with the chief financial officer, the senior internal auditing executive and the independent auditor in separate executive sessions.

While the Audit Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Audit Committee to plan or conduct audits or to determine that the Company's financial statements are complete and accurate and are in accordance with generally accepted accounting principles. This is the responsibility of management and the independent auditor. Nor is it the duty of the Audit Committee to conduct investigations, to resolve disagreements, if any, between management and the independent auditor or to assure compliance with laws and regulations and the Company's Code of Conduct.

Martin Lipton and Eric S. Robinson are partners at the law firm Wachtell, Lipton Rosen & Katz.

::::FOOTNOTES::::

FN* Charter must be adopted by the Board.

AUDIT COMMITTEE CHARTER[1]

CONTINUOUS ACTIVITIES-GENERAL

1. Provide an open avenue of communication between the independent auditor, Internal Audit, and the Board of Directors.

2. Meet four times per year or more frequently as circumstances require. The Committee may ask members of management or others to attend meetings and provide pertinent information as necessary.

3. Confirm and assure the independence of the independent auditor and the objectivity of the internal auditor.

4. Review with the independent auditor and the Director of Internal Audit the coordination of audit efforts to assure completeness of coverage, reduction of redundant efforts, and the effective use of audit resources.

5. Inquire of management, the independent auditor, and the Director of Internal Audit about significant risks or exposures and assess the steps management has taken to minimize such risk to the AICPA and Related Entities.

6. Consider and review with the independent auditor and the Director of Internal Audit:

   (a). The adequacy of AICPA's and Related Entities' internal controls including computerized information system controls and security.

   (b). Related findings and recommendations of the independent auditor and Internal Audit ltogether with management's responses.

7. Consider and review with management, the Director of Internal Audit and the independent auditor:

   (a). Significant findings during the year, including the Status of Previous Audit Recommendations.

   (b). Any difficulties encountered in the course of audit work including and restrictions on the scope of activities or access to required information.

   (c). Any changes required in the planned scope of the Internal Audit plan. (d) The Internal Audit Department charter, budget and staffing.

   (d). Meet periodically with the independent auditor, the Director of Internal Audit and management in

8. separate executive sessions to discuss any matters that the Committee or these groups believe should be discussed privately with the Audit Committee.

[1] Reprinted with the permission of the American Institute of Certified Public Accountants.

9. Report periodically to the Board of Directors on significant results of the foregoing activities.

10. Instruct the independent auditor that the Board ofDirectors, as the member's representative, is the auditor's client.

CONTINUOUS ACTIVITIES -RE: REPORTING SPECIFIC POLICIES

1. Advise financial management and the independent auditor they are expected to provide a timely analysis of significant current financial reporting issues and practices.

2. Provide that financial management and the independent auditor discuss with the audit committee their qualitative judgments about the appropriateness, not just the acceptability, of accounting principles and financial disclosure practices used or proposed to be adopted by the Institute and, particularly, about the degree o(aggressiveness or conservatism of its accounting principles and underlying estimates.

3. Inquire as to the auditor's independent qualitative judgments about the appropriateness, not just the acceptability, of the accounting principles and the clarity of the financial disclosure practices used or proposed to be adopted by the Institute.

4. Inquire as to the auditor's views about whether management's choices of accounting principles are conservative, moderate, or aggressive from the perspective of income, asset, and liability recognition, and whether those principles are common practices or are minority practices.

5. Determine, as regards to new transactions or events, the auditor's reasoning for the appropriateness of the accounting principles and disclosure practices adopted by management.

6. Assure that the auditor's reasoning is described in determining the appropriateness of changes in accounting principles and disclosure practices.

7. Inquire as to the auditor's views about how the Institute's choices of accounting principles and disclosure practices may affect members and public views and attitudes about the Institute.

SCHEDULED ACTIVITIES

1. Recommend the selection of the independent auditor for approval by the Board of Directors and election by Council, approve and compensation of the independent auditor, and review and approve the discharge of the independent auditor.

2. Consider, in consultation with the independent auditor and the Director of Internal Audit, the audit scope and plan of the independent auditor and the internal a~ditors.

3. Review with management and the independent auditor the results of annual audits and related comments in consultation with the Finance Committee and other committees as deemed appropriate including:

(a). The independent auditor's audit of the AICPA 's and Related Entities' annual financial statements, accompanying footnotes and its report thereon.

(b). Any significant changes required in the independent auditor's audit plans.

(c). Any difficulties or disputes with management encountered during the course of the audit.

(d). Other matters related to the conduct of the audit which are to be communicated to the Audit Committee under Generally Accepted Auditing Standards.

4. Review the results of the annual audits of member reimbursements, director and officers' expense accounts and management perquisites prepared by Internal Audit and the independent auditor respectively.

5. Review annually with the independent auditor and the Director of Internal Audit the results of the monitoring of compliance with the Institute's code of conduct.

6. Describe in the AICPA 's Annual Report the Committee's composition and responsibilities, and how they were discharged.

7. Arrange for the independent auditor to be available to the full Board of Directors at least annually to help provide a basis for the board to recommend to Council the appointment of the auditor.

8. Assure the auditor's reasoning is described in accepting or questioning significant estimates by management.

9. Review and update the Committee's Charter annually.

"WHEN NECESSARY" ACTIVITIES

1. Review and concur in the appointment, replacement, reassignment, or dismissal of the Director of Internal Audit.

2. Review and approve requests for any management consulting engagement to be performed by the Institute's independent auditor and be advised of any other study undertaken at the request of management that is beyond the scope of the audit engagement letter.

3. Review periodically with general counsel legal and regulatory matters that may have a material impact on the AICPA 's and Related Entities' financial statements, compliance policies and programs.

4. conduct or authorize investigations into any matters within the Committee's scope of responsibilities. The Committee shall be empowered to retain

independent counsel and other professionals to assist in the conduct of any investigation.

Report of the Audit Committee

Our audit committee is composed of four of our outside directors: Max E. Bobbitt (chairman) James C. Allen, Judith Areen and Francesco Galesi. Our board of directors and the audit committee believe that the audit committee's current member composition satisfies the rule of the NASD that governs audit committee composition, including the requirement that audit committee members all be "independent directors" as that term is defined by NASD.

In accordance with its written charter adopted by the board of directors, the audit committee assists the board of directors with fulfilling its oversight responsibility regarding the quality and integrity of our accounting, auditing and financial reporting practices. In discharging its oversight responsibilities regarding the audit process, the audit committee:

- reviewed and discussed the audited financial statements with management;
- discussed with the independent auditors the material required to be discussed by .Statement on Auditing Standards No.61; and
- reviewed the written disclosures and the letter from the independent auditors required by the Independence Standards Board's Standard No.1, and discussed with the independent auditors any relationships that may impact the auditors' objectivity and independence. In addition, in accordance with the SEC's auditor independence requirements the audit committee has considered the effects that the provision of non-audit services may have on the auditors' independence.

The members of the audit committee are not professionally engaged in the practice of auditing or accounting and are not experts in the fields of auditing or accounting, including in respect of auditor independence. Members of the audit committee rely without independent verification on the information provided to them and on the representations made by management and the independent auditors. Accordingly, the audit committee's oversight does not provide an independent basis to determine that management has maintained appropriate accounting and financial reporting principles or appropriate internal control and procedures designed to assure compliance with accounting standards and applicable laws and regulations. Furthermore, the audit committee's considerations and discussions referred to above do not assure that the audit of our financial statements has been carried out in accordance with generally accepted auditing standards, that the financial statements are presented in accordance with generally accepted accounting principles or that our auditors are in fact "independent."

Based upon the review and discussions described in this report, and subject to the limitations on the role and responsibilities of the audit committee referred to above and in the charter, the audit committee recommended to the board of directors that the audited financial statements .be included in our Annual Report on Form 10-K for the year ended December 31, 2001, to be filed with the SEC.

THE AUDIT COMMITTEE
March 6, 2002

Max E. Bobbitt, Chairman
James C. Allen
Judith Areen
Francesco Galesi

ANNEX E

WORLDCOM, INC.
AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

CHARTER

PURPOSE

The primary function of the Audit Committee of the Board of Directors of WorldCom, Inc. (the "Company") is to assist the Board of Directors (the "Board") in fulfilling its oversight responsibilities to shareholders, potential shareholders and the investment community relating to the Company's system of internal controls, corporate accounting, financial reporting, legal compliance and ethics that management and the Board have established.

The Audit Committee's primary duties and responsibilities are to:

- Serve as an independent and objective party to monitor the Company's financial reporting processes and internal control systems.
- Review and appraise the audit efforts of the Company's independent accountants and internal auditing department.
- Provide an open avenue of communication among the independent accountants, financial and senior management, the internal auditing department, and the Board of Directors.

COMPOSITION

The Audit Committee shall be comprised of three or more directors as determined by the Board, each of whom shall be an independent director, and free from any relationship that, in the opinion of the Board, would interfere with the exercise of his or her independent judgment as a member of the Committee. Members of the Audit Committee shall be considered independent if they have no relationship with the Company that may interfere with the exercise of their independence from management and the Company. All members of the Committee shall have a working familiarity with basic finance and accounting practices including the ability to read and understand fundamental financial statements and at least one member of the Committee shall have accounting or related financial management expertise.

The Committee shall meet at least three times annually, or more frequently as circumstances dictate. As part of its job to foster open communication, the Committee should meet at least annually with management, the Vice President of the Internal Audit Department and the independent accountants of the Company in separate executive sessions to discuss any matters that the Committee or each of these groups believe should be discussed privately. In addition, the Committee or at least its Chair should meet with the independent accountants and management of the Company quarterly to review the Company's financial statements.

RESPONSIBILITIES AND DUTIES

To fulfill its responsibilities and duties the Audit Committee shall:

1. Obtain the full Board's approval of this Charter and review and reassess this Charter periodically, at least annually, as conditions dictate.

2. Review the annual financial statements of the Company contained in the annual report to shareholders with management and the independent auditors of the Company to confirm that the independent auditors are satisfied with the disclosure and content of such financial statements.

3. Review the regular internal reports to management of the Company prepared by the internal auditing department and management's response.

4. Discuss with financial management and the independent accountants of the Company the matters described in AU Section 380, as amended (Communications with the Audit Committee) prior to the filing of the Company's Form 10-0 or prior to the release of earnings. The Chair of the Committee may represent the entire Committee for purposes of this discussion.

5. Recommend to the Board of Directors the selection of the independent accountants of the Company, considering independence and effectiveness, and approve the fees and other compensation to be paid to the independent accountants.

6. On an annual basis, obtain from the independent auditors a formal written statement delineating all relationships between the auditors and the Company, consistent with Independence Standards Board Standard One. Engage in dialogue with the independent auditors with respect to any disclosed relationships or services that may impact the objectivity and independence of the auditors and take appropriate action to ensure such independence. Consider the nature of non audit services provided by the independent auditor and the effects if any, those services may have on auditor independence.

7. Communicate to the independent auditors that they are ultimately accountable to the Board and the Audit Committee as representatives of the shareholders.

8. Review and concur with management's appointment, termination or replacement of the Vice President of the Internal Audit Department.

9. Provide sufficient opportunity for the internal and independent auditors to meet with the members of the Audit Committee without members of management present to discuss the Company's accounting, financial reporting, internal controls and other matters of interest to the Audit Committee.

10. Consider the independent accountants' judgments about the quality and appropriateness of the Company's accounting principles as applied in its financial reporting.

11. Review any significant disagreement among management and the independent accountants or the internal auditing department of the Company in connection with the preparation of the financial statements.

12. Perform any other activities consistent with this Charter, the Company's Bylaws and governing law, as the Committee or the Board deems necessary or appropriate.

ENRON CORP.

AUDIT AND COMPLIANCE COMMITTEE CHARTER
(AS AMENDED FEBRUARY 12, 2001)

The Board of Directors of Enron Corp. (the "Company") has heretofo constituted and established an Audit and Compliance Committee (the "Com with authority, responsibility and specific duties as described in this and Compliance Committee Charter. This document replaces and supersedes entirety that certain document adopted by the Board of Directors of the on August 9, 1988, entitled "Authority and Responsibility of the Audit Compliance Committee of the Board of Directors."

COMPOSITION

The Committee shall be comprised of three or more directors who, i opinion of the Board of Directors, as evidenced by its election of such Committee members, have no relationship to the company that may interfe the exercise of independent judgement as a Committee member. All member Committee shall be financially literate or become financially literate reasonable period of time after appointment to the Committee, and at le member of the Committee shall have accounting or related financial mana expertise, in each case as interpreted by the Board of Directors.

MISSION STATEMENT AND PRINCIPAL FUNCTIONS

The Committee shall serve as the overseer of the Company's financi reporting process and internal controls. As such, the Committee will ha access to financial, legal, and other staff and consultants of the Comp consultants may assist the Committee in defining its role and responsib consult with Committee members regarding a specific audit or other issu may arise in the course of the Committee's duties, and conduct independ investigations, studies, or tests. The Committee has the authority to e such other accountants, attorneys, or consultants to assist the Committ deems advisable. The Committee's principal functions shall include:

Ensure Audit Function Independence

- Recommend to the Board of Directors, for subsequent submission t shareholders of the Company, the firm to engage as the Company's independent auditor; and, if warranted in the discretion of the Committee, recommend to the Board of Directors the termination o engagement. Furthermore, ensure that the independent auditor is ultimately responsible and accountable to the Committee and the Directors as representatives of the Company's shareholders.

- Review the independent auditor's compensation, the terms of its engagement, and its independence. On a periodic basis, the Commi should obtain a formal written statement from the independent au

delineating all relationships between the auditor and the Compan
hold active discussions with the auditor with respect to any dis
relationships or services that may impact the objectivity or ind
of the auditor. In response to the report and if necessary, the
should take action or recommend that the Board take appropriate
to satisfy itself of the outside accountant's independence. In a
review the planning of the independent audit, the performance of
independent auditors, and review any special audit procedures re

A-1

- Serve as a channel of communication between the independent audi the Board of Directors and between the executive responsible for audit functions provided internally or by contract and the Board Directors of the Company.

- Review the Company's annual financial statements and any signifi disputes between management and the independent auditor that aro connection with the preparation of those financial statements, i any restrictions on the scope of work or access to required info

Assess Internal Controls and Quality of Financial Reporting

- Discuss with the independent auditor information relating to the auditor's judgments about the quality of the Company's accountin principles, including such matters as the consistency of applica the Company's accounting policies, as well as the clarity and completeness of the Company's accounting information contained i financial statements and related disclosures filed with the Secu and Exchange Commission and distributed to the Company's shareho

- Review, in consultation with the independent auditor and the exe having responsibility for the internal and contract audit functi adequacy of the Company's internal financial controls. Among oth things, determine whether these controls provide reasonable assu that the Company's publicly reported financial statements are pr fairly in conformity with generally accepted accounting principl

- Review the Company's electronic data processing procedures and c on a periodic basis. Also review any deficiencies noted by the independent auditor in such electronic data processing procedure control.

- Approve major changes and other major questions of choice regard appropriate accounting principles and practices to be followed w preparing the Company's financial statements for the purpose of recommendations to the Board of Directors as necessary.

Review Financial Statements

- Review financial statements included in the Annual Report to Shareholders, footnotes, and management commentaries, Form 10-K made with the Securities and Exchange Commission prior to releas statements and filings. In addition, review findings of any exam by regulatory agencies, such as the Securities and Exchange Comm

- Publish a written report in the annual proxy statement indicatin (a) the Committee has reviewed and discussed the financial state with management, (b) the Committee has discussed the quality of Company's accounting principles as applied in its financial repo (c) the Committee has received the written report from the indep auditors delineating all relationships between the auditor and t

Company, (d) the Committee has discussed with the independent au
their independence and taken or recommended action, if necessary
to independence concerns and (e) nothing has come to the Committ
attention that would cause them to believe that the financial st
included in the Annual Report on Form 10-K contain an untrue sta
omit a material fact, and thus recommend to the Board that the a
financial statements be included in the Company's Annual Report
10-K. Furthermore, the Committee will take action where necessar
in compliance with all applicable rules and regulations.

A-2

- Review with management and the independent auditor each quarterl 10-Q prior to its filing. The Chair of the Committee may represe entire Committee for purposes of this review.

- Review with management the Company's policies and practices for communications with analysts.

Other

- Approve for recommendation to the Board of Directors the Company policies and procedures regarding compliance with the law and wi significant Company policies, including but not limited to, code conduct expressing principles of business ethics, legal complian Foreign Corrupt Practices Act, and other matters relating to bus conduct, and programs of legal compliance designed to prevent an violations of law.

- Review with the general counsel any legal and regulatory matters have a material effect on the Company's financial statements, co policies, and programs.

- If necessary, institute special investigations and, if appropria special counsel or experts to assist.

- Perform other oversight duties and responsibilities as may be as the Committee, from time to time, by the Board of Directors of t Company and/or the Chairman of the Board of Directors.

- Review and, to the extent that the Committee determines is appro update this Charter periodically, at least annually, as conditio dictate.

MEETINGS

The Committee shall meet at least four times annually, or more fre as circumstances dictate. Meetings may be called by the Chairman of the Committee and/or management of the Company. In addition, the Committee itself available to the independent auditors of the Company as requeste independent auditors. All meetings of the Committee shall be held pursu the Bylaws of the Company with regard to notice and waiver thereof, and minutes of each meeting shall be duly filed in the Company records. Rep meetings for the Committee shall be made to the Board of Directors appr the Committee. On a regular basis the Committee will meet with the inde auditor independent of management, and it will meet with Company manage independent of the independent auditor on a regular basis.

While the Audit and Compliance Committee has the responsibility an set forth in this charter, it is not the duty of the Audit and Complian Committee to plan or conduct audits or to determine that the Company's statements are complete and accurate and are in accordance with general accepted accounting principles. This is the responsibility of managemen

ENRON CORP/OR/ filed this DEF 14A on 03/27/2001.

Outline Printer Friendly
« Prev Page Entire Filing Next Page »

director independence and performance. This committee met three times d year ended December 31, 2000. The Nominating and Corporate Governance C is currently composed of Messrs. Wakeham (Chairman), Mendelsohn, Meyer Gramm.

During the year ended December 31, 2000, each director attended at 75% of the total number of meetings of the Board of Directors and the c on which the director served, except Mr. Chan.

AUDIT AND COMPLIANCE COMMITTEE REPORT

The Audit and Compliance Committee (the "Audit Committee") operate written charter adopted by the Board of Directors (attached hereto as E and is comprised of six independent directors, each of whom is able to understand fundamental financial statements and at least one of whom ha experience in accounting or related financial management experience. Th of the Audit Committee are Messrs. Jaedicke (Chairman), Chan, Mendelsoh Pereira, Wakeham and Dr. Gramm.

The Audit Committee serves as the overseer of Enron's financial re internal controls and compliance processes. At five meetings during the ended December 31, 2000, the Audit Committee met with the independent a as well as with Enron officers and employees who are responsible for fi reporting, accounting, internal controls, and legal matters. In additio recommending the appointment of the independent auditors to the Board o Directors, the Audit Committee reviews the scope of and fees related to audit, accounting policies and reporting practices, internal auditing a internal controls, compliance with Enron's policies regarding business and other matters as deemed appropriate.

The Audit Committee has met and held discussions with management a independent auditors. Management represented to the Audit Committee tha consolidated financial statements were prepared in accordance with gene accepted accounting principles, and the Audit Committee has reviewed an discussed the audited consolidated financial statements with management independent auditors. The Audit Committee discussed with the independen auditors matters required to be discussed by Statement on Auditing Stan 61 (Communication with Audit Committees). Enron's independent auditors provided to the Audit Committee written disclosures required by Indepen Standards Board Standard No. 1 (Independence Discussions with Audit Com and the Audit Committee discussed with the independent auditors that fi independence.

Based upon the Audit Committee's discussion with management and th independent auditors and the Audit Committee's review of the representa management and the report of the independent auditors to the Audit Comm the Audit Committee recommended that the Board of Directors include the consolidated financial statements in Enron's Annual Report on Form 10-K year ended December 31, 2000 filed with the Securities and Exchange Com

Audit and Compliance Committee:

Dr. Robert K. Jaedicke (Chairman)
Mr. Ronnie C. Chan
Dr. Wendy L. Gramm
Dr. John Mendelsohn
Mr. Paulo V. Ferraz Pereira
Lord John Wakeham

AUDIT FEES

During 2000, Enron retained its principal auditor, Arthur Andersen provide services in the following categories and amounts:

Principal Auditor Fees:	$25 milli
Financial Information Systems Design and Implementation Fees:	$
All Other Fees: (1)	$27 milli

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(1) Other fees primarily related to business process and risk managemen consulting, tax compliance and consulting, due diligence procedures to acquisitions or other activities, work performed in connection w registration statements and various statutory or other audits.

Audit Committee

The Audit Committee consists of Messrs. Conway (chairman) and Hippeau and, effective April 2001, Ms. Lagomasino, each of whom is "independent" as defined in Sections 303.01(B)(2)(a) and (3) of the New York Stock Exchange's listing standards. Prior to April 2001, Mr. Kent was also a member of the Audit Committee. The Audit Committee held six meetings during 2000. The primary purpose of the Audit Committee is to assist the Board in fulfilling its oversight responsibilities relating to financial information that will be provided to our shareholders and others, our systems of internal controls, and the audit process. In fulfilling this purpose, the Committee performs the functions specified in the Audit Committee Charter attached as Annex A to this proxy statement.

Report of the Audit Committee

Management is responsible for the preparation of the Company's financial statements and the independent auditors are responsible for examining those statements. In connection with the preparation of the

7

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December 31, 2000 financial statements, the Audit Committee (1) reviewed and discussed the audited financial statements with management; (2) discussed with the auditors the matters required to be discussed with the Committee under generally accepted auditing standards, including Statement on Auditing Standards No. 61 (as amended by Statement on Auditing Standards No. 90); (3) discussed with the auditors the auditors' independence from management and the Company, including the disclosures required by Independence Standards Board Standard No. 1; and (4) considered the compatibility of non-audit services with the auditors' independence.

Based upon these reviews and discussions, the Audit Committee recommended, and the Board of Directors approved, that the Company's audited financial statements be included in the Annual Report on Form 10-K for the fiscal year ended December 31, 2000, for filing with the Securities and Exchange Commission. The Audit Committee also recommended, subject to shareholder approval, the appointment of Arthur Andersen as independent auditors for the fiscal year ending December 31, 2001, and the Board concurred in such recommendation.

THE AUDIT COMMITTEE
William E. Conway, Jr., Chairman

Eric Hippeau
Geoffrey J.W. Kent

Annex A

BOARD OF DIRECTORS

Audit Committee Charter

Membership

The Audit Committee shall be comprised of not less than three nor more than seven Directors, as appointed by the Board. Each Committee member shall be free from any relationship that, in the opinion of the Board, would interfere with the exercise of his or her independent judgment as a member of the Committee.

Meetings

Meetings of the Committee shall be held on a regularly scheduled basis, with special meetings to be held as needed. The Committee should periodically meet with management, the Director of Internal Audit, and the external auditor in separate executive sessions to discuss any matters that the Committee or these groups believe should be discussed separately. The Committee shall report to the Board on its activities on a regular and current basis. The Committee shall review the adequacy of this charter at lease annually and propose changes to the Board, if appropriate.

Functions

The primary purpose of the Committee is to assist the Board in fulfilling its oversight responsibilities relating to financial information that will be provided to the Shareholders and others, the Company's systems of internal controls, and the audit process. In fulfilling this purpose, the Committee performs the following functions:

Financial Information

- Reviews the Company's audited financial statements and oversees the Company's financial reporting process, specifically concerning itself with significant accounting and reporting issues such as (1) significant changes in accounting principles, (2) explanations for significant accounting reserves, accruals and estimates, and (3) the existence of significant transactions not made in the ordinary course of business.

- Inquires regarding areas of disagreement between management and the

independence, (4) reviewing internal and external audit plans and objectives and the degree of coordination between them, and (5) ensuring that the internal auditors have appropriate resources and operate in an independent manner.

- Reviews significant findings of all audits performed by the external and internal auditors.

Outside Consultants and Delegation

The Committee may retain, at the Company's expense, such consultants, counsel or other third party experts as it may deem advisable to assist the Committee in the independent discharge of its responsibilities. To the extent permitted under applicable law, the Committee may delegate to management such responsibility for the discharge of its responsibilities as the Committee deems appropriate.

ADELPHIA COMMUNICATIONS CORPORATION Audit Committee Charter

Form 14A Definitive Proxy Filing: July5,2001

APPENDIX B

Audit Committee Charter

I. Audit Committee Purpose

The Audit Committee is appointed by the Board of Directors of Adelphia Communications Corporation (the "Company") to assist the Board in fulfilling its oversight responsibilities. The Audit Committee's primary duties and responsibilities are to:

- Monitor the integrity of the Company's financial reporting process and systems of internal controls regarding finance, accounting, and legal compliance.

- Monitor the independence and performance of the Company's independent auditors and internal auditing department.

- Provide an avenue of communication among the independent auditors, management, the internal auditing department, and the Board of Directors.

The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the independent auditors as well as anyone in the organization. The Audit Committee has the ability to retain, at the Company's expense, special legal, accounting, or other consultants or experts it deems necessary in the performance of its duties.

II. Audit Committee Composition and Meetings

Audit Committee members shall meet the applicable independence and experience requirements, in effect from time to time, of the National Association of Securities Dealers, Inc. ("NASD") or such other applicable stock exchange or association on which the Company's common stock is then listed. The Audit Committee shall be comprised of three or more directors as determined by the Board. All members of the Committee shall have a basic understanding of finance and accounting and be able to read and understand fundamental financial statements, and at least one member of the Committee shall have accounting or related financial management expertise.

Audit Committee members shall be appointed by the Board on recommendation of purposes of this review.

Independent Auditors

5. The independent auditors are ultimately accountable to the Audit Committee and the Board of Directors. The Audit Committee shall review the independence and performance of the auditors and annually recommend to the Board of Directors the appointment of the independent auditors or approve any discharge of auditors when circumstances warrant.

6. Approve the fees and other significant compensation to be paid to the independent auditors.

7. On an annual basis, the Committee should review and discuss with the independent auditors all significant relationships they have with the Company that could impair the auditors' independence.

8. Review the independent auditors audit plan--discuss scope, staffing, reliance upon management, and internal audit and general audit approach.

9. Prior to releasing the year-end earnings, discuss the results of the audit with the independent auditors. Discuss certain matters required to be communicated to audit committees in accordance with SAS 61.

10. Consider the independent auditors' judgments about the quality and appropriateness of the Company's accounting principles as applied in its financial reporting.

Internal Audit Department and Legal Compliance

11. Review the budget, plan, changes in plan, activities, organizational structure, and qualifications of the internal audit department, as needed.

12. Review the appointment and performance of, and any decision to replace, the senior internal audit executive.

13. Review significant reports prepared by the internal audit department together with management's response and follow-up to these reports.

14. On at least an annual basis, review with the Company's counsel, any legal matters that could have a significant impact on the organization's financial statements, the Company's system for monitoring compliance with applicable laws and regulations, including response to any material inquiries received from regulators or governmental agencies.

Other Audit Committee Responsibilities

the Nominating Committee. If an Audit Committee Chair is not designated or present, the members of the Committee may designate a Chair by majority vote of the Committee membership.

The Committee shall meet at least four times annually, or more frequently as circumstances dictate. The Audit Committee Chair shall prepare and/or approve an agenda in advance of each meeting. Audit Committee members may attend meetings in person, by telephone conference or similar communications equipment, or as otherwise permitted by law. The Committee should meet privately in executive session at least annually with management, the director of the internal auditing department, the independent auditors, and as a committee to discuss any matters that the Committee or each of these groups believe should be discussed.

III. Audit Committee Responsibilities and Duties

Review Procedures

1. Review and reassess the adequacy of this Charter at least annually. Submit the Charter to the Board of Directors for approval and have the document published in accordance with applicable Securities and Exchange Commission ("SEC") and NASD regulations.

2. Review the Company's annual audited financial statements prior to filing or distribution. Review should include discussion with management and independent auditors of major issues regarding accounting principles, practices, and judgments that could significantly affect the Company's financial statements.

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3. In consultation with management, the independent auditors, and the internal auditors, consider the integrity of the Company's financial reporting processes and controls. Discuss any significant financial risk exposures and the steps management has taken to monitor, control, and report such exposures. Review significant findings prepared by the independent auditors and the internal auditing department together with management's responses.

4. Review with financial management and the independent auditors the Company's quarterly financial results prior to the release of earnings and the Company's quarterly financial statements prior to filing or distribution. Discuss any significant changes to the Company's accounting principles and any items required to be communicated by the independent auditors in accordance with Statement on Auditing Standards No. 61 ("SAS 61") (see item 9). The Chair of the Committee may represent the entire Audit Committee for

15. Annually prepare a report to shareholders as required by the Securities and Exchange Commission. The report will be included in the Company's annual proxy statement as required by the applicable rules of the SEC and NASD.

16. Perform any other activities consistent with this Charter, the Company's by-laws, and governing law, as the Committee or the Board deems necessary or appropriate.

17. Periodically report to the Board of Directors on significant results of the foregoing activities.

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Scope of Duties

18. While the Audit Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Audit Committee to plan, direct or conduct audits, or to determine whether the Company's financial statements are complete and accurate and are in accordance with generally accepted accounting principles. These are the responsibilities of management and/or the independent auditors. Nor is it the duty of the Audit Committee to conduct investigations, to resolve disagreements, if any, between management and the independent auditors or to assure compliance with laws and regulations and any internal rules or codes of conduct of the Company.

APPENDIX 3

Summary Of Guiding Principles For Audit Committee Best Practices As Well as Official Recommendations

As stated in the accompanying article, the Blue Ribbon Committee established five guiding principles for Audit Committee Best Practices, which principles were used to derive ten, specific recommendations. The recommendations themselves fall into three categories. The first three recommendations deal with audit committee member qualifications. The second two deal with the procedural safeguards of the audit committee. Recommendations six through eight, inclusive, deal with relations between the audit committee and auditors, while recommendations nine and ten impose disclosure obligations upon the audit committee. A summary of the guiding principles and ten recommendations are as follows:

Guiding Principles

Principle 1: The Audit Committee's Key Role. This discussion emphasizes the key role of the Audit Committee in monitoring those responsible for the audit process. "The audit committee, the first among equals, oversees the work of the other actors in the financial reporting process…" "From this basic understanding of the relevant roles and responsibilities of each participant in the process, the audit committee will be in a position to devise appropriate questions on how each participant carries out its functions. These questions should not be merely a "checklist" of standard questions to be asked each year, but should be tailored to a company's particular circumstances."

Principle 2: Independent Communication With Internal Auditors. This principle emphasizes the need for complete independent communication and information flow between the audit committee and the internal auditor. It recognizes the tension that can exist between management and an auditor that is dependent upon management for substantial fees.

Principle 3: Independent Communication With External Auditors. This principle is similar to principle 2 although it focuses on the need for independent communication and information flow between the audit committee and the outside auditors.

Principal 4: Candid Discussions With Management and Auditors. This principle focuses on the need for full, candid and frank discussions with management, the internal auditor and the outside auditor regarding issues involving judgment and impacting the quality of financial statements in addition to technical compliance with GAAP. Concepts here include timely, periodic review of documents and statements, regular presentations concerning changes in accounting principles, significant transaction accounting, budget variances, and the like, the seeking of any "second" opinions, management's response to assessments provided by the internal and outside auditors, and matters concerning a specifically enumerated list of ten matters that currently may form the basis of problematic judgments on the part of the auditors and management.

Principal 5: Diligent and Knowledgeable Committee Members. This principal focuses on the need to formulate an audit committee which has membership which is both diligent and knowledgeable, as well as encouraged to act with full responsibility solely to shareholders and investors.

Specific Recommendations

A. Committee Member Qualifications

Recommendation 1: "Independence" Defined. A new definition of independence is created for committee members. Instances evidencing lack of independence of management include:

- Being employed by the corporation (or any affiliates) during the past five years;
- Accepting any compensation from the corporation (or any affiliates) other than for board service or under a tax qualified retirement plan;
- Being a member of the immediate family of an individual who has been employed within the past five years by the corporation (or any affiliate) as an executive;
- Being a partner (or controlling shareholder) or executive officer of any other (for-profit) business to which the corporation made or received any significant payments within the past five years;
- Being employed as an executive of another company, where any of the corporation's executives serves that company's compensation committee.

Recommendation 2: Independence Requirement. The audit committee should consist solely of independent directors (large companies only).

Recommendation 3: Financial Literacy Requirement. Audit committee members should have "accounting and/or related financial expertise – where 'expertise' signifies past employment experience in finance or accounting, requisite professional certification in accounting, or other comparable experience or background which results in the individual's financial sophistication, including being or having been a CEO or other senior officer with financial oversight responsibilities."

"Literacy" signifies the ability to read and understand financial statements, including balance sheets, income statements, and cash flow statements.

Companies should have a minimum of three audit committee members, each of whom is financially literate.

B. Audit Committee Structure and Processes

Recommendation 4: Adoption of Charter. Adoption of a formal written charter should be done by Board vote, specifying the "scope of the committee's responsibilities, and how it carries out those responsibilities, including structure, processes and membership requirements." The charter must be reviewed and reassessed for adequacy on an annual basis.

Significantly, the Blue Ribbon Panel did not "recommend mandating every detail to be included in the guidelines for every Audit Committee. There are too many variables amongst the multitude of different corporations comprising our economy."

Recommendation 5: Letter to Shareholders. The audit committee is required to disclose in a corporation's proxy statement for its annual meeting whether it has, in fact, adopted a formal written charter, and whether it has satisfied its responsibilities under the charter during the prior year. The contents of the charter must also be disclosed in the annual report every three (3) years.

"Such transparency is at the heart of good governments . . . and also acts as a disciplinary measure on the committee . . . Disclosure will guide the committee to responsible practices, as sunlight generally does."

C. Audit Committee Relationships With Management, Internal Auditor, Outside Auditors.

Recommendation 6: Accountability for Auditor Relations. The "outside auditor is ultimately accountable to the board of directors and the audit committee, as representatives of the shareholders, and . . . these . . . representatives have the ultimate authority and responsibility to select, evaluate and, where appropriate, replace the outside auditor."

In this regard, " the audit committee, as the delegate of the full board, is responsible for overseeing the entire [audit] process."

Recommendation 7: Disclosure of Outside Auditor Relationships. The "audit committee is responsible for ensuring its receipt from the outside auditors of a formal written statement delineating all relationships between auditor and the company . . . and . . . also responsible for actively engaging in a dialogue with the auditor with respect to any disclosed relationships or services which may impact the objectivity and independence of the auditor and for taking, or recommending . . . appropriate action to ensure the independence of the outside auditor.

Recommendation 8: Adequacy of Company Accounting. The company's outside auditor must "discuss with the audit committee the auditor's judgments about the quality, not just the acceptability of the company's accounting principals as applied...; the discussion should include such issues as the clarity of the company's financial disclosures and the degree of aggressiveness . . . of the company's accounting principals and underlying estimates and other significant decisions made by management in preparing the financial disclosures… . This requirement should be written in a way to encourage open, frank discussion and to avoid boilerplate.

D. Audit Committee Disclosure Requirements.

Recommendation 9: 10-K Disclosure. The audit committee must send a letter to be included in the company's annual report to shareholders disclosing whether or not (a) management has reviewed the audited financial statements with the audit committee, including . . . the quality of the accounting principals as applied and significant judgments effecting the company's financial statements; (b) the outside auditors have discussed with the committee their "judgments of the quality of those principals as applied under the circumstances; and (c) that the audit committee members have discussed among themselves without management or the outside auditors present, the information" so disclosed and they believe "that the company's financial statements are fairly presented in conformity with General Accepted Accounting Principals . . . in all material respects."

Recommendation 10: Review of Quarterly Reports. The auditor should discuss quarterly reports before the 10-Q filings, including involving the Audit Committee and the interim financial review. Further, there should be discussions "with the Audit Committee, or at least its chairman, and a representative of financial management," certain other significant matters, "including significant adjustments, management judgments and accounting estimates significant to accounting policies and disagreements with management."

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APPENDIX 4

	NYSE recommendations	BRC
1	Toughen "Independence" standards for audit committees only in 2 ways: 1) Zero tolerance on any kind or amount of compensation for anything other than the director/audit committee fees, except Pension or Deferred Compensation. 2) "Independent" members who own more than 20% of equity (directly or indirectly) cannot chair or vote. This includes "Independent" directors that are "associated" with 20+% shareholders. Note: NYSE supports higher fees for audit committee members for responsibility and extra effort required.	NYSE is tougher on compensation and stock ownership.
2	Audit committee **<u>Chair</u>** must have financial expertise.	BRC say one person on Audit Committee should be expert in related financial matters.
3	Either limit the number of audit committees a member can sit on or each Board must determine that more than 3 will not interfere with performance. Disclose in the proxy.	New.
4	Grant audit committees sole authority to hire/fire auditors and to approve any significant non-audit work done by the auditors. This takes authority from both management and the Board as a whole.	New.
5	Perform evaluation of the auditors and lead audit partner and consider rotation of the partner or of the audit firm. Present conclusions to the Board.	New.
6	While the recommendations speak to what the Audit Committees charter should say, none of the suggestions are materially new	Not new, but some broader language recommended.
7	Obtain a report from the auditors on the results and follow up of peer review and any governmental review.	New.
8	Discuss the 10Q's with management and auditors (not new) including, the Management Discussion and Analysis (new). Discuss press releases and analyst guidance.	This is a lot of new Audit Committee work. Now done informally with the Chair, this seems to add 4-6 new committee meetings.
9	Empower audit committee to retain, without Board approval, Independent Counsel and/or Accounting Consulting.	Not new, but strengthened.
10	Discuss risk, risk guidelines and policies, risk monitoring, and risk control systems with management.	New.
11	Meet in private, at least, quarterly with management, internal auditors, and external auditors.	Not new but more often and extensive.
12	Review with auditor's issues related to management, various audit function, and internal control functions.	While not new the specific examples mentioned, e.g., passed entries, national office issues, and internal control functions, broaden the scope of the review and discussions.
13	Set rules for the hiring of ex-employees of the auditors.	New.
14	Regularly, discuss with the Board financial issues, compliance, and auditor performance.	As a requirement "*regularly*" is new.
15	Annual performance evaluations of the audit committee. This is also required for the Board.	New.
16	"the audit committee must review: (a) ……..; (b) analyses prepared by management and/or the independent auditor setting forth significant financial reporting issues…. including alternative methods; (c) the effect of regulatory and accounting initiatives, as well as off-balance sheet structures on the financial statements of the company; and (d) earnings, (d) press releases (paying particular attention to any use of "pro forma," or "adjusted" non-GAAP, information),and earnings guidance provided to analysts"	New.
17	Board to approve annually Audit Committee Charter. This is not new but the level of attention to the Charter is certainly higher than ever.	This is not new but the level of attention to the Charter is certainly higher than ever.
18	Code of Ethics to include "fair dealings".	New.
19	"we believe the most crucial element of effective corporate governance is the service of competent, ethical people as directors"	Not new, but a public statement with significance to the selection process.
20	*"Once an officer or director of a public company has failed the public trust, he or she should not have the opportunity to do so again."*	New tougher concept.
21	*"steps must be taken to assure that directors will actually know how to use all the instruments in their toolboxes. We therefore recommend that the NYSE encourage all public companies to establish orientation programs for their new directors.* *We recommend that the NYSE and the New York Stock Exchange Foundation enhance their existing support to continuing education programs for corporate directors and officers at universities"*	Orientation is new as a formal statement, but fairly normal for many Audit Committees. Continuing Education is new.

APPENDIX 5

The World through GLOBASTAT

GROSS DOMESTIC PRODUCT (GDP)

Rank	Country Name	GDP (million $)
1	United States	9,963,000.0
2	China	4,500,000.0
3	Japan	3,150,000.0
4	India	2,200,000.0
5	Germany	1,936,000.0
6	France	1,448,000.0
7	United Kingdom	1,360,000.0
8	Italy	1,273,000.0
9	Brazil	1,130,000.0
10	Russia	1,120,000.0
11	Mexico	915,000.0
12	Canada	774,700.0
13	Korea, South	764,600.0
14	Spain	720,800.0
15	Indonesia	654,000.0
16	Argentina	476,000.0
17	Australia	445,800.0
18	Turkey	444,000.0
19	Iran	413,000.0
20	Thailand	413,000.0
21	Netherlands	388,400.0
22	Taiwan	386,000.0
23	South Africa	369,000.0
24	Poland	327,500.0
25	Philippines	310,000.0
26	Pakistan	282,000.0
27	Belgium	259,200.0
28	Colombia	250,000.0
29	Egypt	247,000.0
30	Saudi Arabia	232,000.0
31	Malaysia	223,700.0

32	Switzerland	207,000.0
33	Austria	203,000.0
34	Bangladesh	203,000.0
35	Sweden	197,000.0
36	Ukraine	189,400.0
37	Greece	181,900.0
38	Hong Kong	181,000.0
39	Algeria	171,000.0
40	Portugal	159,000.0
41	Vietnam	154,400.0
42	Chile	153,100.0
43	Venezuela	146,200.0
44	Denmark	136,200.0
45	Romania	132,500.0
46	Czech Republic	132,400.0
47	Norway	124,100.0
48	Peru	123,000.0
49	Finland	118,300.0
50	Nigeria	117,000.0
51	Hungary	113,900.0
52	Israel	110,200.0
53	Singapore	109,800.0
54	Morocco	105,000.0
55	Kazakhstan	85,600.0
56	Ireland	81,900.0
57	Belarus	78,800.0
58	New Zealand	67,600.0
59	Burma	63,700.0
60	Tunisia	62,800.0
61	Sri Lanka	62,700.0
62	Uzbekistan	60,000.0
63	Iraq	57,000.0
64	Slovakia	55,300.0
65	United Arab Emirates	54,000.0
66	Syria	50,900.0
67	Dominican Republic	48,300.0
68	Bulgaria	48,000.0
69	Guatemala	46,200.0
70	Kenya	45,600.0
71	Libya	45,400.0
72	Ethiopia	39,200.0
73	Puerto Rico	39,000.0
74	Ghana	37,400.0
75	Ecuador	37,200.0
76	Sudan	35,700.0
77	Nepal	33,700.0
78	Congo, Democratic Republic of the	31,000.0
79	Uruguay	31,000.0
80	Kuwait	29,300.0
81	Zimbabwe	28,200.0
82	Lithuania	26,400.0
83	Cote d'Ivoire	26,200.0
84	Paraguay	26,200.0
85	Uganda	26,200.0
86	Cameroon	26,000.0
87	Tanzania	25,100.0
88	Costa Rica	25,000.0
89	Croatia	24,900.0
90	Yugoslavia	24,200.0
91	El Salvador	24,000.0
92	Azerbaijan	23,500.0

93	Slovenia	22,900.0
94	Georgia	22,800.0
95	Korea, North	22,000.0
96	Afghanistan	21,000.0
97	Bolivia	20,900.0
98	Oman	19,600.0
99	Turkmenistan	19,600.0
100	Cuba	19,200.0
101	Mozambique	19,100.0
102	Lebanon	18,200.0
103	Jordan	17,300.0
104	Latvia	17,300.0
105	Honduras	17,000.0
106	Panama	16,600.0
107	Cambodia	16,100.0
108	Senegal	16,000.0
109	Luxembourg	15,900.0
110	Qatar	15,100.0
111	Estonia	14,700.0
112	Yemen	14,400.0
113	Nicaragua	13,100.0
114	Haiti	12,700.0
115	Kyrgyzstan	12,600.0
116	Madagascar	12,300.0
117	Mauritius	12,300.0
118	Papua New Guinea	12,200.0
119	Burkina Faso	12,000.0
120	Moldova	11,300.0
121	Trinidad and Tobago	11,200.0
122	Albania	10,500.0
123	Botswana	10,400.0
124	Angola	10,100.0
125	Bahrain	10,100.0
126	Armenia	10,000.0
127	Guinea	10,000.0
128	Niger	10,000.0
129	Cyprus (Greek)	9,700.0
130	Jamaica	9,700.0
131	Malawi	9,400.0
132	Mali	9,100.0
133	Laos	9,000.0
134	Macedonia, The Former Yugoslav Republic of	9,000.0
135	Zambia	8,500.0
136	Chad	8,100.0
137	Gabon	7,700.0
138	Namibia	7,600.0
139	Tajikistan	7,300.0
140	Togo	7,300.0
141	Iceland	6,850.0
142	Benin	6,600.0
143	Bosnia and Herzegovina	6,500.0
144	Rwanda	6,400.0
145	Central African Republic	6,100.0
146	Brunei	5,900.0
147	Fiji	5,900.0
148	Malta	5,600.0
149	Mauritania	5,400.0
150	Lesotho	5,100.0
151	Mongolia	4,700.0
152	Bahamas, The	4,500.0
153	Burundi	4,400.0

154	Swaziland	4,400.0
155	Somalia	4,300.0
156	Barbados	4,000.0
157	Guyana	3,400.0
158	Liberia	3,350.0
159	Congo, Republic of the	3,100.0
160	West Bank	3,100.0
161	Eritrea	2,900.0
162	Sierra Leone	2,700.0
163	Bhutan	2,300.0
164	Virgin Islands	1,800.0
165	Gambia, The	1,500.0
166	Suriname	1,480.0
167	Andorra	1,200.0
168	Guinea-Bissau	1,100.0
169	Equatorial Guinea	960.0
170	Solomon Islands	900.0
171	Monaco	870.0
172	San Marino	860.0
173	Cyprus (Turkish)	830.0
174	Belize	790.0
175	Liechtenstein	730.0
176	Saint Lucia	700.0
177	Cape Verde	670.0
178	Seychelles	610.0
179	Maldives	594.0
180	Djibouti	574.0
181	Samoa	571.0
182	Antigua and Barbuda	533.0
183	Comoros	419.0
184	Grenada	394.0
185	Saint Vincent and the Grenadines	322.0
186	British Virgin Islands	311.0
187	Dominica	290.0
188	Saint Kitts and Nevis	274.0
189	Micronesia, Federated States of	263.0
190	Vanuatu	245.0
191	Tonga	225.0
192	Sao Tome and Principe	178.0
193	Palau	129.0
194	Marshall Islands	105.0
195	Kiribati	76.0
196	Nauru	59.0
197	Tuvalu	11.6
	World	43,600,000.0

Source: CIA World Factbook 2001.

Notes

FORTUNE HOME COMPANY PROFILES INVESTING CAREERS SMALL BUSINESS

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COMPANIES
- Fortune 500
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- Small Business 100 NEW
- 50 Best for Minorities
- Washington Power 25
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America's Largest Corporations

This year was a record low for the FORTUNE 500. What made this such a terrible year? Sluggish revenue growth and a 53% drop in profits.

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View FORTUNE 500 by:

Full List Company CEO Industry Top Performers Arrivals Displaced

1-100

Rank	Company	Revenues ($ millions)
1	Wal-Mart Stores	219,812.0
2	Exxon Mobil	191,581.0
3	General Motors	177,260.0
4	Ford Motor	162,412.0
5	Enron	138,718.0
6	General Electric	125,913.0
7	Citigroup	112,022.0
8	ChevronTexaco	99,699.0
9	Intl. Business Machines	85,866.0
10	Philip Morris	72,944.0
11	Verizon Communications	67,190.0

12	American Intl. Group	62,402.0
13	American Electric Power	61,257.0
14	Duke Energy	59,503.0
15	AT&T	59,142.0
16	Boeing	58,198.0
17	El Paso	57,475.0
18	Home Depot	53,553.0
19	Bank of America Corp.	52,641.0
20	Fannie Mae	50,803.0
21	J.P. Morgan Chase	50,429.0
22	Kroger	50,098.0
23	Cardinal Health	47,947.6
24	Merck	47,715.7
25	State Farm Insurance	46,705.2
26	Reliant Energy	46,225.8
27	SBC Communications	45,908.0
28	Hewlett-Packard	45,226.0
29	Morgan Stanley	43,727.0
30	Dynegy	42,242.0
31	McKesson	42,010.0
32	Sears Roebuck	41,078.0
33	Aquila	40,376.8
34	Target	39,888.0
35	Procter & Gamble	39,244.0
36	Merrill Lynch	38,793.0
37	AOL Time Warner	38,234.0
38	Albertson's	37,931.0
39	Berkshire Hathaway	37,668.0
40	Kmart	36,910.0
41	Freddie Mac	35,523.0
42	WorldCom	35,179.0
43	Marathon Oil	35,041.0
44	Costco Wholesale	34,797.0
45	Safeway	34,301.0
46	Compaq Computer	33,554.0
47	Johnson & Johnson	33,004.0
48	Conoco	32,795.0
49	Pfizer	32,259.0
50	J.C. Penney	32,004.0
51	MetLife	31,928.0
52	Mirant	31,502.0
53	Dell Computer	31,168.0
54	Goldman Sachs Group	31,138.0
55	United Parcel Service	30,646.0
56	Motorola	30,004.0
57	Allstate	28,865.0
58	TXU	27,927.0
59	United Technologies	27,897.0

60	Dow Chemical	27,805.0
61	ConAgra	27,194.2
62	Prudential Financial	27,177.0
63	PepsiCo	26,935.0
64	Wells Fargo	26,891.0
65	Intel	26,539.0
66	International Paper	26,363.0
67	Delphi	26,088.0
68	Sprint	26,071.0
69	New York Life	25,678.2
70	Du Pont	25,370.0
71	Georgia-Pacific	25,309.0
72	Microsoft	25,296.0
73	Walt Disney	25,269.0
74	Aetna	25,190.8
75	Ingram Micro	25,186.9
76	Lucent Technologies	25,132.0
77	Lockheed Martin	24,793.0
78	Walgreen	24,623.0
79	Bank One Corp.	24,527.0
80	TIAA-CREF	24,230.6
81	Phillips Petroleum	24,189.0
82	BellSouth	24,130.0
83	Honeywell Intl.	23,652.0
84	UnitedHealth Group	23,454.0
85	Viacom	23,222.8
86	Supervalu	23,194.3
87	PG&E Corp.	22,959.0
88	Alcoa	22,859.0
89	American Express	22,582.0
90	Wachovia Corp.	22,396.0
91	Lehman Brothers Hldgs.	22,392.0
92	Cisco Systems	22,293.0
93	CVS	22,241.4
94	Lowe's	22,111.1
95	Sysco	21,784.5
96	Bristol-Myers Squibb	21,717.0
97	Electronic Data Systems	21,543.0
98	Caterpillar	20,450.0
99	Coca-Cola	20,092.0
100	Archer Daniels Midland	20,051.4

From the April 15, 2002 Issue

Current View: 1-100

Back