



NATIONAL DIRECTORS INSTITUTE

# Audit Committee Panel – It's Not Just about Financial Risk Anymore

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# Panelists

- Ellen Richstone - Director, eMagin Corporation, Orion Energy Systems, Inc., and Superior Industries International, Inc.
- Susan Skerit – 35 years in the financial services industry. Independent director on the Audit Committees of Tanger Outlet Stores (NYSE:SKT) and the Royal Bank of Canada USA Group Holdings. Senior advisor to Promontory Financial Group.
- Janet Malzone - Grant Thornton LLP Regional Audit Practice Leader
- William Hall – Served as member of the board of directors at 13 public corporations (most recently Grainger, Great Plains Energy, and Stericycle) and member of ten public company audit committees, as well as many PE/VC-backed enterprises.
- Glen F. Hackmann – Vice Chairman of Robert W. Baird and Chairman of Baird’s Audit Committees. Former Managing Director, General Counsel, and Secretary of Baird, as well as member of Executive Committee.
- Ben Ridders, Business Law Partner, Foley & Lardner LLP
- Bryan House, Litigation Partner, Foley & Lardner LLP

# Audit Committee Responsibilities

- What is the proper role of the Audit Committee?
  - It is becoming far more than financial risk.
  - Are Audit Committees becoming, in effect, Risk Committees?
  - Should Companies have both an Audit Committee and a Risk Committee? Is this an industry specific issue?
- How does the Audit Committee balance the traditional financial role with other responsibilities?
  - How do we avoid overburdening the Audit Committee?
- **“HOW DO WE KNOW WHAT WE DON’T KNOW?”**

# Audit Committee Responsibilities

- What is the Audit Committee's role with respect to Enterprise Risk Management?
  - Is this an Audit Committee issue or a full board issue?
  - Is this again an industry specific inquiry?

# Areas of Concern

- Statistics show that SEC financial fraud cases against issuers are down (except for financial institutions given the focus on Main Street Investors).
- Threats come from other risks and the crises that they can create with respect to liability and reputational damage
  - Culture and Ethics
  - Cyber
  - Social Media
  - Product Safety
  - ESG
- The Delaware Supreme Court, in *Marchand* and the Chancery Court in *Clovis*, ruled in two cases that plaintiffs had stated a “Caremark” claim for failure of board oversight.
- Widening interpretation in some states of duties to other constituencies rather than a sole focus on shareholder return.

# Discussion Hypothetical

- Ridgeway, Inc. is a midcap public company manufacturing scaffoldings, ladders, and other equipment used in a wide variety of industries and by the government. The company was founded 20 years ago and has grown rapidly through complementary product lines that are diversified in their industry applications.
- Senior leadership of the Company has have tried to promote an ethical company culture. Operations are global with sales offices in 20 countries and manufacturing in Europe, Mexico, Thailand and Singapore, as well as the US.
- Inspection is a critical part of the manufacturing process and part of quality checks before products are shipped to customers.
- Safety of Ridgeway products is naturally an issue. In the last several months, there have been many reports of product failures and injuries that Ridgeway's product safety group is investigating.

# Discussion Hypothetical

- The Company has been recently receiving large critical orders of the new products – that are time sensitive – so there is heightened focus on the yield/quantities produced/in short time periods.
- For years, there have been no calls to the Whistleblower. A few years ago, the Audit Committee asked management to increase awareness of the Whistleblower Hotline throughout the Company.
- Last week, the Whistleblower Hotline received a call from Bill Jones, an employee in Ohio, with the following information: Fred Preston, a senior manager in the “Inspection Group” (also in Ohio) has a serious drinking problem, and he and his entire team spend their days playing video games and not doing their jobs.
- Fred’s wife, Gilda, who is also with Ridgeway (but in a different group and reporting line) is faking inspection reports to cover up his activities. Fred and Gilda have been with the company for more than 20 years and are generally viewed as good employees.

# Discussion Issues

- The Jones whistleblower complaint has come to the Audit Committee Chair. If you are the Audit Committee Chair, what do you do?
- What are the key issues the Audit Committee needs to think about?
  - Financial impact?
  - Product Safety?
  - Cultural Issues?

# Discussion Issues

- What if the whistleblower complaint was about the use of non-GAAP metrics?
- What if the whistleblower was someone in Ridgeway's accounting department who alleged that Ridgeway senior management was misusing non-GAAP metrics to meet analyst guidance and internal bonus expectations?
- How would the Audit Committee's view of this situation differ from that regarding safety concerns?
- What are the red flags regarding the use of non-GAAP metrics?
- How do Audit Committees exercise oversight to avoid misuse and manipulation of non-GAAP metrics?

# Takeaways

Thank You For Attending