

THE New York Stock
Exchange

RESEARCH
REPORT on:

INDEPENDENT AUDIT COMMITTEES

RESEARCH DEPARTMENT

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INTRODUCTION

To facilitate the formulation of NYSE policy on the issues of outside directors, outside general counsel, and audit committees for U.S. corporations, the Research Department developed a survey of the Exchange's listed companies. The survey had the dual purpose of providing Exchange management with a working knowledge of existing corporate policies and a sounding of listed company attitudes on these questions. This information was deemed particularly timely in view of congressional and SEC concerns in these areas of corporate practice.

The survey methodology involved the use of listing representatives to conduct telephone interviews with top officials of a 150 company sample, randomly selected to represent the corporate policies of the entire NYSE list.

Governmental concerns presumably have, as their underlying purpose, the protection of individual investors. Therefore, the results of the survey interviews are presented in this report to contrast the opinions and policies of 50 listed companies from among the 500 with the largest number of Stockholder-of-Record (SOR) accounts, against those of 50 from among a middle group (ranked 501 to 1,000) and with those of 50 from the 500 with the fewest number of SOR accounts.

This report is confined to the findings of the survey dealing solely with the issue of independent audit committees.

SURVEY METHODOLOGY

The results of the corporate policy survey contained in this report were generated from telephone interviews of top executives of a sample of domestic companies with common stock listed on the NYSE. The interviewers stressed that the answers to the questions should reflect

corporate policy only and not the personal opinions of the executive being interviewed.

The 150 companies included in the survey were picked using the following procedures:

1. The 1,500 domestic companies with common stock trading on the NYSE as of mid-year 1976 were arrayed, in descending order, by the number of Stockholder-of-Record (SOR) accounts owning common stock in each company, starting with AT & T's almost three million SOR accounts.
2. The resulting ranked list of companies was divided into three groups of 500 companies each. The top group (Cell "A") contained the 500 companies with the largest SOR accounts, the middle group (Cell "B") the 500 companies ranked 501 through 1,000, and the lowest group (Cell "C") the 500 companies with the fewest SOR accounts.
3. A random sample of 50 companies were selected from each of the three cells by utilizing a different random start for each cell and then systematically picking every 10th company on the ranked list in each cell.

The following table describes the three groups by comparing the SOR accounts of each cell's 500 company population with that of its 50 company sample.

CORPORATE POLICY SURVEY

SOR Accounts in Sample Companies vs. SOR Accounts in All Domestic NYSE Companies

<u>Companies Grouped by SOR Accounts</u>	<u>Range of SOR Accounts</u>		<u>Total SOR Accounts in Domestic NYSE Companies</u> (000's)	<u>SOR Accounts in 50 Sample Companies</u> (000's)	<u>Sample as % of Total</u> (%)
	<u>High</u> (000's)	<u>Low</u> (000's)			
Top 500 Companies (Cell "A")	2,925	16	33,900	2,778	8.2*
Middle 500 Companies (Cell "B")	16	6	4,904	494	10.1
Lowest 500 Companies (Cell "C")	6	1	1,885	189	10.0
TOTAL	2,925	1	40,689	3,461	8.5

* Cell A's lower percent reflects a random start of #10; therefore, none of the top nine companies ranked by SOR accounts had a chance of being included in the sample.

When top executives of a sample company could not be reached or refused to cooperate, a substitute company was chosen by taking the next company following the sampled company on the ranked list within the same cell.

SUMMARY

- Seven out of ten top companies (Cell A) have an independent audit committee consisting of at least three outside directors, while only two of five small companies (Cell C), have one.

- Almost one-quarter of the companies in the survey, made up mostly of medium and small-sized companies (Cells B and C), do not have any kind of audit committee.

- More than four out of five large companies (Cell A) have their audit committee findings reported directly to the board, while only around half of the companies in the other two groups do.

DETAILED FINDINGS

Seven out of ten companies with the largest SOR's have an independent audit committee consisting of at least three outside directors (NYSE definition of "outside")*, while only two of five companies with the fewest SOR's have such a committee. Combining all three sample company groups produces a total of a little more than half the companies in the survey which employ independent audit committees in their corporate activities. Almost one-quarter of the companies do not have any kind of audit committee, with most of these companies falling in the medium and small company cells. Most, however, do not disagree with the idea of one. The remaining one-quarter of the companies have an audit committee with fewer than three outside directors. These 35 companies reporting a differently defined audit committee are roughly spread evenly over the three sample company groups.

The make-up of the audit committee, however, varies by company size. Among companies reporting both kinds of audit committees (regardless of number of "outside" directors), the top companies are much more likely to have an audit committee which is larger in membership and which is composed of a much greater number of "outsiders." On the other hand, the smallest companies (Cell C) have significantly fewer outside directors serving on their audit committees, even though the overall number of companies and the size of the committees are very similar to the medium-sized companies (Cell B). The only other thing different among sample groups is that medium-sized companies (Cell B) are much less likely to have someone from the company's outside general counsel on the audit committee.

* Outside directors are not officers or employees of the company, nor are they retired officers or employees; relatives of officers, Board members, retired officers or founders of the company; nor outside counsel on regular retainer to the company.

More than four out of five large companies have their audit committee findings reported directly to the board, while only around half of the companies in the other two groups do. In addition, the audit committees of the larger companies (Cell A) are likely to meet with the board much more frequently than in the other companies surveyed. Medium-sized companies, however, are the group most likely to have the audit committees' findings reported to management or the CEO.

Among those corporate boards which do not now have independent audit committees consisting of three or more outside directors, a large majority endorse the concept. Most of these boards already do have audit committees, but they consist of either one or two directors and/or include inside directors, as well as outside directors. Cell C corporations, however, are almost evenly split on the idea of audit committees comprised exclusively of outside directors. They see no need for audit committees made up exclusively of outside directors and prefer to include at least one or two inside directors.

APPENDIX
TABULATIONS

Current Prevalence of Independent AUDIT COMMITTEES*

	<u>Total</u> <u>N=150</u>	<u>Cell A</u> <u>N=50</u>	<u>Cell B</u> <u>N=50</u>	<u>Cell C</u> <u>N=50</u>
Have Audit Committee	81	34	27	20
Have Audit Committee of other definition	35	11	10	14
<u>Do Not</u> have Audit Committee	34	5	13	16

* An independent audit committee consisting of at least three outside directors.

SIZE of Audit Committees

<u>Number of</u> <u>Directors</u>	<u>Total</u> <u>N=116</u>	<u>Cell A</u> <u>N=45</u>	<u>Cell B</u> <u>N=37</u>	<u>Cell C</u> <u>N=34</u>
1 or 2*	8	-	3	5
3	74	30	24	20
4	19	8	4	7
5	10	3	5	2
6 or more	5	4	1	-

* Those audit committees consisting of fewer than three directors are among those committees which do not fit the NYSE definition.

Number of Outside Directors, General Counsel,
and Other Inside Directors on Corporate Audit
Committees

	<u>Total</u> N=116	<u>Cell A</u> N=45	<u>Cell B</u> N=37	<u>Cell C</u> N=34
<u>Outside Directors</u>				
1 or 2	30	10	7	13
3 – 5	74	32	28	20
6 or more	11	3	2	-
None	1	-	-	1
<u>General Counsel</u>				
1 or 2	19	7	3	9
3 – 5	-	-	-	-
6 or more	-	-	-	-
None	97	38	34	25
<u>Other Inside Directors</u>				
1 or 2	26	7	10	9
3 - 5	2	1	-	1
6 or more	-	-	-	-
None	88	37	27	24

Detailed Composition of Independent Audit Committees
with three or more Outside Directors

<u>Composition of Audit Committees with 3 or more Outside Directors</u>	<u>Total N=81</u>	<u>Cell A N=34</u>	<u>Cell B N=27</u>	<u>Cell C N=20</u>
<u>3 Man Committees</u>				
all outside directors	51	21	18	12
<u>4 Man Committees</u>				
all outside directors	10	4	2	4
3 outside and 1 inside	5	3	2	-
3 outside and 1 general counsel	2	-	-	2
<u>5 Man Committees</u>				
all outside directors	3	3	-	-
4 outside and 1 inside	3	-	2	1
3 outside and 2 inside	1	-	1	-
<u>6 Man Committees</u>				
all outside directors	4	2	2	-
5 outside and 1 inside	1	1	-	-
4 outside, 1 general counsel and 1 inside	1	-	-	1

Detailed Composition of Audit Committees
with less than Three Outside Directors

<u>Composition of Audit Committees with less than 3 Outside Directors</u>	<u>Total N=35</u>	<u>Cell A N=11</u>	<u>Cell B N=10</u>	<u>Cell C N=14</u>
<u>1 Man Committees</u>				
inside director	1	1	-	-
outside director	1	-	-	1
<u>2 Man Committees</u>				
both outside directors	7	-	3	4
<u>3 Man Committees</u>				
2 outside and 1 inside	12	6	3	3
2 outside and 1 general counsel	7	2	1	4
1 outside and 2 inside	1	1	-	-
1 outside, 1 general counsel and 1 inside	1	-	1	-
1 general counsel and 2 inside	1	-	-	1
3 outside (different definition)	1	-	1	-
<u>4 or More Man Committees</u>				
1 outside and 3 inside	2	1	-	1
2 outside and 3 inside	1	-	1	-

Size and Composition of Boards of Directors
of Listed Companies without Audit Committees

<u>Board Size and Composition</u>	<u>Total N=34</u>	<u>Cell A N=5</u>	<u>Cell B N=13</u>	<u>Cell C N=16</u>
<u>5 Man Board</u>	<u>2</u>			
all outside		1	-	-
1 outside, 4 inside (1 counsel)		-	-	1
<u>6 Man Board</u>	<u>4</u>			
2 outside, 4 inside		1	-	1
2 outside, 3 inside, 1 counsel		-	-	1
1 outside, 5 inside (1 retired officer)		-	1	-
<u>7 Man Board</u>	<u>3</u>			
4 outside, 3 inside		-	1	1
3 outside, 4 inside (1 relative*)		-	-	1
<u>8 Man Board</u>	<u>5</u>			
4 outside, 4 inside		1	-	
2 outside, 6 inside		-	1	
2 outside, 5 inside, 1 counsel		-	-	
1 outside, 6 inside, 1 counsel		-	-	

<u>Board Size and Composition</u>	<u>Total</u> <u>N=34</u>	<u>Cell A</u> <u>N=5</u>	<u>Cell B</u> <u>N=13</u>	<u>Cell C</u> <u>N=16</u>
<u>9 Man Board</u>	<u>4</u>			
5 outside, 3 inside, 1 counsel		1	-	-
4 outside, 5 inside		-	1	-
3 outside, 6 inside		-	-	1
1 outside, 8 inside (1 retired officer)		-	-	1
<u>10 Man Board</u>	<u>7</u>			
6 outside, 4 inside		-	-	1
4 outside, 6 inside		-	1	-
4 outside, 5 inside (2 retired officers), 1 counsel		-	1	-
3 outside, 7 inside (1 retired officer)		-	1	-
2 outside, 7 inside (4 relatives*), 1 counsel		-	1	-
2 outside, 8 inside (1 relative*)		-	1	-
1 outside, 9 inside		-	-	1
<u>11 Man Board</u>	<u>1</u>			
7 outside, 3 inside, 1 counsel		1	-	-

<u>Board Size and Composition</u>	<u>Total</u> <u>N=34</u>	<u>Cell A</u> <u>N=5</u>	<u>Cell B</u> <u>N=13</u>	<u>Cell C</u> <u>N=16</u>
<u>12 Man Board</u>	<u>4</u>			
8 outside, 4 inside		-	1	-
6 outside, 6 inside		-	1	-
1 outside, 11 inside (4 retired employees)		-	-	1
1 outside, 11 inside (5 relatives*)		-	-	1
<u>13 Man Board</u>	<u>1</u>			
6 outside, 7 inside		-	-	1
<u>15 Man Board</u>	<u>3</u>			
4 outside, 11 inside		-	-	1
3 outside, 12 inside (1 officer)		-	1	-
3 outside, 10 inside (1 officer), 2 counsel		-	1	-

* Refers to relatives of company founders, officers, employees, retired officers or retired employees.

Note: Items in parentheses are included in the count already given for inside directors.

Frequency of Audit Committee MEETINGS with Board During Past Year

<u>Frequency</u>	<u>Total N-116</u>	<u>Cell A N-45</u>	<u>Cell B N=37</u>	<u>Cell C N=34</u>
Once	16	4	4	8
Two-four times	88	37	29	22
Five or more times	3	2	1	-
Not at all	6	1	2	3
Don't know	3	1	1	1

IMPLEMENTATION of Audit Committee Findings

<u>Report to Board</u>	<u>93</u>	<u>39</u>	<u>25</u>	<u>29</u>
Report/give recommendations to (full) board	84	36	23	25
Report to board and management	9	3	2	4
Report to Management/CEO/ <u>Board Chairman</u>	<u>15</u>	<u>2</u>	<u>8</u>	<u>3</u>
Follow-through with <u>Outside Auditors</u>	<u>3</u>	<u>1</u>	<u>1</u>	<u>1</u>
<u>Others</u>	<u>4</u>	<u>1</u>	<u>1</u>	<u>2</u>
<u>No Answer</u>	<u>2</u>	<u>=</u>	<u>2</u>	<u>=</u>