

The Corporate Legal Audit
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At the core of how to make your company profitable is the question of how to minimize legal risks and expense. One solution to the question of how to stay out of trouble is the legal audit. There are many areas of potential trouble. One of my favorite small business stories to illustrate risk is about two businessmen who operated their corporation profitably for 20 years. One day the Vice President came to the President of the Company and pointed out that their faithful secretary Mary had been a significant part of their success. He suggested that as a small token of appreciation to her for her very large part in bringing about their success, each of them give her 1% from their 50% ownership in the stock. They both agreed and made the award. Two days later the President received a call from the Vice President who said “You’re fired”, to which he received the response, “Who is this and what do you mean?” The Vice President explained that he was in Las Vegas and he had just married Mary. He and Mary were now the majority stockholders and with 51% of the vote, had a meeting and elected themselves the only directors and as such, were terminating his employment. Ouch! Well the story is a little oversimplified, but it illustrates one of the risks of doing business, and the power of a majority.

What are some other risks and how do you identify them? Some of the highest levels of risk are found on the following checklist:

- Employees and personnel matters
- Business housekeeping (maintenance of minutes, checkbook, etc.)
- Contracts
- Insurance
- Advertising and other written materials and communications
- Financing the business—borrowing money and raising capital
- Antitrust compliance
- Unfair competition
- Trademarks and business names
- Trade secrets, confidential information
- Copyrights
- Environmental Law
- Products liability
- Sales
- Warranties
- Transportation of Products
- Patents
- Securities Regulation (Including the new corporate responsibility law signed by President Bush on July 30, 2002, see discussion below)
- Franchising
- Real Estate purchases, sales, and leasing
- Government contracting
- Computer software
- Responsibility of shareholders, directors and officers of companies

There are other risks, but this list will work for purposes of this article. Not all of these matters apply to every company, some are involved only for manufacturers. They may apply to your business whether it is a corporation, a limited liability company, a partnership or a sole proprietorship. The right way to minimize your risk is to review the checklist with the questions in mind: Does this topic apply to my business? If so, what can I do to reduce or avoid the risk? One solution is to bring in one or more of your business team for a legal audit: use your lawyer, accountant, banker, insurance representative, consultant to review areas within the scope of their expertise. The risk topics that clearly don't apply will be readily apparent. Others with some to moderate risk will require further analysis. High risk areas for your business should be identified and study and action taken to reduce your risk. Your team can expand your experience by theirs.

Another guide to avoiding trouble is to learn from your experience. No well used contract can avoid being amended to solve the trouble its owner has encountered with it. That is the way it should be--in a continual state of improvement.

As a result of the corporate responsibility legislation signed into law, the profile of working responsibly in business has reached a higher level. Although the law applies to publicly traded companies, investors, stockholders and customers have grown more skeptical of business and increased the reason for even small business owners to act responsibly. Under the new law, the penalty for mail and wire fraud will be raised to 20 years in prison from the current five years. Accounting firms will be limited on the consulting work they can do for the clients they audit. Chief executives and chief financial officers are now personally responsible for their corporate financial statements. The stakes have grown higher as a result of improper and criminal actions taken by a few. President Bush commended the leaders who "give the free enterprise system an ethical compass" and for "helping to restore the people's trust in American business". Those terms should be adopted by all of us involved in small business.

I suggest the use of this risk checklist and possibly a legal audit to assist you to identify any risks that may apply to your business and that you come up with a planned solution to the highest levels of risk faced by your business, and watch your partner and the secretary.

