
Business & Corporate Planning Series

The Legal Audit **What is it?** **Who needs it?**

What is a Legal Audit?

- It is similar to an internal financial audit, but is only focused on the legal issues of the business.
- It is designed to uncover the overlooked and often unknown risks that may exist in any business, and then provide strategies to mitigate or reduce risks.

Who needs a Legal Audit?

- Any business in a rapid growth mode.
- Any business that is considering a major change in either leadership or ownership (including stock or asset sale).
- Any business that has had only limited legal guidance in the past.

The benefits of a Legal Audit.

- Reduce risks from previously undisclosed legal issues.
- Reduce risks from uncovered abuses or oversights.
- Reduce risks from governance problems.
- Reduce risks from contractual terms.
- Reduce risks from problematic regulatory compliance issues.
- Provide strategies to manage outstanding litigation.

What is Discovered in the Legal Audit?

- Employment / HR issues (Local, State, Federal).
- Oversights in contractual language.
- Risk issues in business operations or documentation.
- Risk issues regarding management, ownership and issuance of securities.
- Adequacy of succession planning / exit strategies.
- Adequacy of the protection of trade secrets and non-public information.

How serious can a failure to have a Legal Audit be?

- Legal deficiencies in a business can result in:
 - Decreased value of the business.
 - Loss of investors and shareholders (current and prospective).
 - Legal actions by terminated employees.
 - Loss of customers and/or technology.
 - An increase in lawsuits.
 - Increased management time to defend pending and threatened lawsuits and regulatory matters.
- If proper risk mitigation procedures are not in effect and followed, an enterprise treads in dangerous waters.

Short List – Corporate Issues

- Minutes prepared and filed properly?
- Personal and business accounts kept separately?
- Corporate documents signed in corporate capacity?
- Shareholder's, Operating and Buy-Sell agreements in place?
- Transaction documents
 - Non-public information confidentiality maintained?
 - Any rights of first refusal?
 - Any assignment prohibitions?

- Limitations on Warranty provisions?
- Any personal guarantees?
- Separation of Safe Assets from Dangerous Assets?
- Adequate insurance?
- Isolation of Real Estate from business?

Short List – HR Issues

- Confidentiality and Employee Invention Agreements in place?
- Employment Manual updated for current law? Being followed?
- Covenants not to compete enforceable?
- Wage and Hour issues addressed?
- Occupational Safety and Health issues addressed?
- Employee Benefits issues addressed?
- Employee vs. Independent Contractor Analysis conducted?
- Whistleblower statute (CEPA) education.
- Discrimination education.

Examples

- Here is an example of how a legal audit could have prevented an adverse outcome:
 - A principal was about to sell his company. A few weeks before closing, it was discovered that the ex-spouse still held Company shares. These shares should have been redeemed as part of the divorce. Knowing the Company has a pending sale, the ex-spouse “asked for” \$250,000 in consideration of stock redemption. For fear of killing the deal to sell the Company, the principal was forced to pay the \$250,000.
 - Had a legal audit been performed before the principal agreed to sell his Company, this stock redemption issue could have been handled much more cost effectively.

Summary

- A legal audit is not about laying all of a business's faults on the table for public display. It is about limiting the business' risks and exposures.
- A legal audit is a form of preventative law (as compared to reactive law) that should be a common business practice for every business.
- A legal audit can be as thorough or as limited and focused as the client determines.



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