



# Audit Committee Resource Guide



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# Contents

|   |           |
|---|-----------|
| <b>Message from Cathy Engelbert</b><br>Chairman and CEO of Deloitte & Touche LLP..... | <b>1</b>  |
| <b>Preface</b> .....  | <b>2</b>  |
| <b>SECTION ONE</b>  |           |
| <b>Audit committee leading practices and trends</b> .....                             | <b>3</b>  |
| <b>SECTION TWO</b>  |           |
| <b>Audit committee essentials</b> .....   | <b>6</b>  |
| Audit committee charter   |           |
| Independence and qualifications of audit committee members                            |           |
| Financial literacy and expertise  |           |
| <b>SECTION THREE</b>  |           |
| <b>Key responsibilities</b> .....   | <b>12</b> |
| Oversight of financial reporting  |           |
| Fraud and internal control over financial reporting                                   |           |
| Review of earnings press releases and use of non-GAAP financial measures              |           |
| Interaction with the internal auditors  |           |
| Risk assessment and oversight   |           |
| Code of ethics  |           |
| Complaint helpline/hotline procedures   |           |
| <b>SECTION FOUR</b>   |           |
| <b>Interaction with the independent auditor</b> .....                                 | <b>29</b> |
| Auditor communications  |           |
| Auditor independence  |           |
| Fee disclosure  |           |
| Evaluation of the independent auditor   |           |
| <b>SECTION FIVE</b>   |           |
| <b>Education and evaluation</b> .....   | <b>39</b> |
| Board education   |           |
| Audit committee performance evaluation  |           |
| <b>SECTION SIX</b>  |           |
| <b>Additional responsibilities</b> .....  | <b>43</b> |

## APPENDICES

|                   |   |           |
|-------------------|---|-----------|
| <b>Appendix A</b> | Sample audit committee charter .....                          | <b>46</b> |
| <b>Appendix B</b> | Planning tool:<br>Audit committee calendar of activities..... | <b>54</b> |
| <b>Appendix C</b> | Audit committee performance evaluation .....                  | <b>59</b> |



# Message from Cathy Engelbert

Chairman and CEO of Deloitte & Touche LLP

The expectations of audit committees are higher than ever. As you are aware, shareholders rely on audit committees to execute their oversight duties while keeping up with an increasingly complex financial reporting environment and an ever-changing regulatory landscape. Setting the appropriate tone at the top has never been more important for audit committees or boards as a whole.

As an audit committee member, your judgment is important to management and shareholders who depend on you to appropriately execute your governance responsibilities. To fulfill their responsibilities, audit committees need a clear understanding of what is required by the committee's charter, NYSE and NASDAQ listing requirements, and relevant SEC and PCAOB rules.

While the specific duties of audit committees vary depending on the company's governance structure, audit committees are typically expected to:

- Oversee the integrity of the financial reporting process
- Oversee the process for identifying and addressing financial and related risks
- Ensure the company has policies and programs to prevent and detect fraud
- Oversee earnings releases, as well as the financial information and earnings guidance provided to analysts and ratings agencies
- Support a culture that embraces the importance of ethics and compliance and develop a process for investigating related allegations
- Oversee the internal auditors and their audit plan
- Appoint, compensate, and oversee the independent auditors
- Discuss with the independent auditors those matters required to be communicated under applicable auditing standards.

As a result, many audit committees are meeting more often with members of management. According to a recent study<sup>1</sup>, the percentage of audit committees meeting with the chief compliance officer increased from 28 percent in 2012 to 58 percent in 2014. Additionally, 34 percent now meet with the chief risk officer, up from 14 percent in 2012, and 30 percent of audit committees now meet with the chief technology/information security officer, up from just 5 percent in 2012.

In the pages that follow, we offer practical considerations and resources to help audit committee members execute these activities. By providing regulatory requirements, questions to consider, and tools and resources, this guide consolidates relevant information in one place for your reference.

While the NYSE, NASDAQ, and SEC do not provide specific guidelines on audit committee education and self-assessment, these topics are of increasing importance, particularly given the enhanced focus on board and audit committee responsibilities. Research shows that 66 percent of audit committees evaluate member performance and this topic is also addressed in this guide.

In addition to the specific information included here, the guide also contains links to an array of tools and resources provided by Deloitte's [Center for Corporate Governance](#) and other governance organizations.

The *Audit Committee Resource Guide* is an example of our commitment to providing audit committee members with resources and leading practices to help fulfill their responsibilities and raise the bar continually on individual and overall audit committee performance. I hope you find this guide valuable as you execute your governance responsibilities as an audit committee member.

**Cathy Engelbert**  
Chairman and CEO  
Deloitte & Touche LLP

<sup>1</sup> [2014 Board Practices Report: Perspectives from the Boardroom](#) – Deloitte and the Society of Corporate Secretaries and Governance Professionals.

# Preface

The *Audit Committee Resource Guide* presents an overview of audit committee requirements, common practices, and considerations for U.S public companies. The guide is a reference for both seasoned and new audit committee members as they address areas such as oversight of internal controls, financial reporting, and risk; interaction with the internal and independent auditors; and review of earnings press releases.

Please note that the *Audit Committee Resource Guide* is not a comprehensive view of all audit committee requirements. Companies should review applicable SEC and NYSE or NASDAQ exchange rules and regulations and consult a qualified professional adviser to understand their full compliance needs.

If you have any questions or comments about this guide, please contact [auditcommittee@deloitte.com](mailto:auditcommittee@deloitte.com).



You can access an interactive edition of the *Audit Committee Resource Guide* and Deloitte's periodical, the *Audit Committee Brief*, through a free, easy-to-use tablet app. Deloitte's Audit Committee Resources application is available in the iTunes App Store.

Click [here](#) or visit the App Store and search for "*Deloitte Audit Committee Resources*" to download the application.

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Section One

# Audit committee leading practices and trends

## Section One

# Audit committee leading practices and trends

The following is a summary of certain leading practices and trends for audit committees. The list is not all-inclusive, and certain activities may be the responsibility of the full board or another committee.

### Committee composition and dynamics

- ▶ Focus on committee composition, including members' independence and financial expertise, as well as their industry, risk management, business, and leadership experience.
- ▶ Limit the number of audit committee members to four or five to optimize effectiveness.
- ▶ Consider periodically rotating audit committee members, including the chairman.
- ▶ Meet at least quarterly, or more frequently as circumstances dictate.
- ▶ Engage independent advisers when needed.
- ▶ Maintain appropriate coordination between the audit committee and other board committees.

### Oversight of internal controls and financial reporting

- ▶ Understand key controls and reporting risk areas as assessed by financial management, the internal auditors, and the independent auditor.
- ▶ Emphasize oversight of corporate taxes, an area where high-risk and high-dollar decisions are often made.
- ▶ Leverage the value of internal controls beyond compliance.
- ▶ Consider levels of authority and responsibility in key areas, including pricing and contracts, acceptance of risk, commitments, and expenditures.
- ▶ Understand complex accounting and reporting areas and how management addresses them.
- ▶ Understand significant judgments and management estimates and their impact on the financial statements.
- ▶ Stay abreast of pending financial reporting and regulatory developments and understand how they may affect the company.
- ▶ Consider the nature of SEC comment letters being issued to companies in similar industries.
- ▶ Understand the issues raised in SEC comment letters received by the company, as well as management's planned response.

### Risk oversight

- ▶ Focus on financial risk oversight and assessment and understand financial risk management policies and processes.
- ▶ Avoid becoming overly dependent on checklists for monitoring financial risk.
- ▶ Periodically reassess the list of top risks, including which member of management and which board committee is responsible for each.
- ▶ Evaluate information technology (IT) projects and related risks, particularly those with financial statement impact.
- ▶ Consider post-acquisition reviews to evaluate the reliability of initial acquisition assumptions and make adjustments to future acquisitions if necessary.
- ▶ Have appropriate business leaders periodically provide an overview of their business, focusing on financial risks and other factors influencing the financial statements.
- ▶ Communicate the company's financial risk story to stakeholders.
- ▶ Understand the issues raised in SEC comment letters received by the company, as well as management's planned response.

### Ethics and integrity

- ▶ Focus on the tone at the top, culture, ethics, and hotline monitoring.
- ▶ Provide oversight of compliance with the company's code of ethics/conduct.
- ▶ Initiate internal/independent investigations on matters within the committee's scope of responsibility.
- ▶ Understand the risk and mitigation mechanisms with regard to management override of controls.

### Interaction with the CFO and finance organization

- ▶ Conduct annual evaluations of the CFO.
- ▶ Understand management's process for early identification and resolution of accounting and other issues.
- ▶ Understand plans to address new accounting and reporting requirements and related risks.
- ▶ Provide input into management's goal-setting process.
- ▶ Discuss succession planning for the CFO and staff, including bench strength.

### Interaction with the internal auditors

- ▶ Ensure that the internal auditors have direct access to the audit committee.
- ▶ Consider having internal audit report directly to the audit committee and administratively to senior management.
- ▶ Play an active role in determining the highest and best use of internal audit, as well as the appropriate structure of the group (e.g., in-house versus outsourced resources).
- ▶ Be involved with the internal audit risk assessment and audit plans, including activities and objectives regarding internal control over financial reporting.
- ▶ Conduct annual evaluations of the chief audit executive.
- ▶ Understand internal audit staffing, funding, and succession planning, particularly the adequacy of resources; consider performing peer benchmarking to compare relevant metrics.

### Interaction with the independent auditor

- ▶ Exercise ownership of the relationship with the independent auditor.
- ▶ Focus on the independent auditor's qualifications, performance, independence, and compensation, including a preapproval process for audit and nonaudit services.
- ▶ Get to know the lead audit partners and meet periodically with specialists (e.g., tax, IT, actuarial, SEC).
- ▶ Establish expectations regarding the nature and method of communication, as well as the exchange of insights.
- ▶ Set an annual agenda with the independent auditor and engage in regular dialogue outside of audit committee meetings.
- ▶ Provide formal evaluations and regular feedback.

### Executive (private) sessions

- ▶ Audit committee meetings should be preceded or followed by private sessions with the CFO, the internal auditors, and the independent auditor.
- ▶ Use an executive session for committee members to discuss how the meeting went and to identify agenda topics for future meetings.
- ▶ Discuss succession plans for the finance organization with the CEO and CFO annually during a private session.
- ▶ Establish expectations as to what sort of topics and discussions are expected of the independent auditor in private sessions.

### Committee effectiveness and self-assessment

- ▶ Review and approve the audit committee charter and align activities with a calendar that incorporates required activities and allows flexibility for additional topics.
- ▶ Develop meeting agendas in consultation with management; resist the urge to repurpose existing agendas without discussion.
- ▶ Align audit committee meeting materials and agendas with priority areas.
- ▶ Distribute briefings and other materials well in advance of meetings.
- ▶ Reports should include executive summaries that highlight issues and critical discussion points to allow for discussion versus presentation during meetings.
- ▶ Manage meeting attendees to allow open and candid discussions.
- ▶ Perform a robust self-assessment annually.
- ▶ Discuss the results of the self-assessment with the audit committee in an executive session and develop tactical actions to address findings.

### Member orientation and education

- ▶ Provide orientation of new members that focuses on audit committee responsibilities and involves committee members, the CEO, the CFO and finance management, internal audit, and the independent auditor.
- ▶ Address board education in the company's corporate governance guidelines to be consistent with NYSE or NASDAQ listing standards.
- ▶ Include educational topics on the agendas 1-2 times per year; topics may include: a deep dive on a specific area of the business and related risks, or a refresher on a significant accounting estimate.
- ▶ Consider offering annual continuing education opportunities in financial reporting and other areas relevant to the audit committee (e.g., specialized or regulated industry matters, new regulations, operations, and emerging topics such as cybersecurity).

### Executive compensation

- ▶ Coordinate with the compensation committee on incentive compensation goals.
- ▶ Work with the compensation committee to understand the implications of the incentive structure, including its impact on employee retention and potential increases in fraud risk.
- ▶ Increase focus on the compensation of officers and directors, including the appropriate use of corporate assets.

## Section Two

# Audit committee essentials

Audit committee charter

Independence and qualifications of audit committee members

Financial literacy and expertise



## Section Two

# Audit committee essentials

Periodically, audit committees should review their composition and membership to confirm that they encompass the knowledge and experience needed to be effective. In addition to industry knowledge, committee members should have a strong grasp of financial reporting and accounting issues, such as revenue recognition, pensions and other post-employment benefits, financial instruments, other critical accounting policies, and internal control over financial reporting.

## Audit committee charter

*“You need to be thoughtful about the charter. Don’t let its review be a perfunctory activity. If a committee is doing things outside the charter, update it accordingly.”*

*Fortune 500 company  
audit committee chairman*

An annual review of the charter is recommended for all audit committees and is required for NASDAQ-listed entities. Updates may be necessary as a result of:

- Changes in regulatory or legal requirements, including new disclosure requirements within the purview of the committee
- The board’s delegation of new responsibilities to the audit committee or reassignment of certain responsibilities that are not required of the audit committee by law or regulation
- Changes in the company’s bylaws that affect the composition of the committee or how members are appointed
- Identification of practices the committee wants to include among its responsibilities.

SEC rules require public companies to disclose in their proxy statements whether the board has adopted a written charter for the audit committee and, if so, to disclose whether a copy of the charter is available on the company’s website and to provide the company’s Web address.

To help execute its role in a timely and efficient manner, the audit committee should consider using the responsibilities outlined in the charter to develop an annual calendar and meeting agendas. In addition to addressing responsibilities prescribed by regulation, the charter should consider the audit committee’s recurring responsibilities as well as its responsibility for significant transactions and unusual events. The charter also should allow the committee to meet outside the official calendar when needed. Concurrent with the charter review, the committee can examine its calendar of activities and consider modifications based on the changes to the charter. The committee may also reconsider the frequency and timing of activities already on the calendar.

When updating the charter and calendar, it may be helpful to consult with management, the internal auditors, and the independent auditor. When appropriate, the committee should also seek legal counsel in reviewing the charter and the calendar.

## Tools and resources



Deloitte developed a template for an audit committee charter based on observations of selected companies and the requirements of the SEC, the NYSE, and NASDAQ. The template, which is located in [Appendix A](#), can be used with the calendar planning tool in [Appendix B](#).



## Audit committee charter requirements

Both the NYSE and NASDAQ outline minimum requirements for the content of the audit committee charter. Refer to the charter template in [Appendix A](#) for more detail on these responsibilities.

### NYSE

The NYSE requires the audit committee charter to include oversight of:

- ▶ The integrity of the company's financial statements
- ▶ The company's compliance with legal and regulatory requirements
- ▶ The independent auditor's qualifications and independence
- ▶ The performance of the company's independent auditor and internal audit function.

In addition, charters of NYSE-listed companies must set forth the audit committee's responsibility to discuss policies with respect to risk assessment and management; discuss the company's earnings press releases and information provided to analysts and rating agencies; meet in private sessions with management, the internal auditor, and the independent auditor; assess the audit committee's performance annually; comply with Section 10A of the Securities Exchange Act of 1934; and various other responsibilities specified by the NYSE listing standards.

### NASDAQ

The NASDAQ requires an annual review and assessment of the adequacy of the formal written charter. The charter should include the committee's purpose of overseeing the company's accounting and financial reporting processes and the audits of its financial statements. The charter should also address the scope of its responsibilities and how the committee carries out its responsibilities, including structure, processes, and membership requirements. The responsibilities in the charter must include:

- ▶ Obtaining a written statement from the independent auditor delineating all relationships between the auditor and the company, consistent with PCAOB Ethics and Independence Rule 3526
- ▶ Communicating with the independent auditor with respect to any relationships or services that may affect the auditor's objectivity and independence
- ▶ Overseeing the independence of the auditor.

## Independence and qualifications of audit committee members

The independence of board and audit committee members should be continuously maintained and reviewed at least annually and more often as necessary. Listed companies should have policies in place to facilitate timely identification of changing relationships or circumstances that may affect the independence of audit committee members. Many companies require directors to complete an independence questionnaire when appointed to the board and annually thereafter and to notify the company of any changes that may affect independence. For audit committee members, these questionnaires should be tailored to reflect the independence criteria of either the NYSE or NASDAQ. Companies may want to involve legal counsel in assessing the independence of directors.

**SEC requirements.** The SEC requires audit committee members of listed companies to be independent and sets forth the criteria for independence. The NYSE and NASDAQ listing standards also outline criteria for director independence.

Section 10A of the Securities Exchange Act of 1934 specifies general criteria for independence. Under these criteria, other than in his or her capacity as a member of the audit committee, board, or other board committee, an audit committee member may not:

- Accept any consulting, advisory, or other compensatory fee from the issuer or any subsidiary thereof
- Be affiliated with the issuer or any subsidiary thereof.

The SEC's rule prohibits any compensation other than that accepted as a board or committee member, whether it is received directly or indirectly. Prohibited compensation includes, but is not limited to, compensation for services rendered by a law firm, accounting firm, consulting firm, investment bank, or similar entity in which the audit committee member is a partner, executive officer, or the equivalent. The SEC's prohibition does not cover payments made by the company in the ordinary course of

business for services other than legal, accounting, consulting, investment banking, or financial advisory services. Prohibited indirect compensation includes payments to spouses, minor children or stepchildren, and adult children or stepchildren who share a home with the audit committee member.

The SEC's rule also includes a definition of "affiliate" for the purpose of determining independence. An affiliate is a "person that directly, or indirectly through one or more intermediaries, controls or is controlled by or is under common control with the person [or entity] specified." The rule also states that the following are considered affiliates: anyone who is an executive officer, both a director and an employee, a general partner, or a managing member of an affiliate.

The definition of "control" is consistent with the definition in the 1934 Exchange Act, as amended: "The possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person [or entity], whether through the ownership of voting securities, by contract, or otherwise." The SEC's rule includes a safe harbor for a person who is not an executive officer of an entity and who does not hold at least 10 percent of the entity's shares. Such a person would not be considered to have control of the entity.

In addition, the SEC's rule includes exceptions for certain overlapping board relationships, initial public filers, investment companies, and foreign filers. With respect to overlapping board relationships, an audit committee member may sit on the board of a listed company and that of any affiliate if the member otherwise meets the independence requirements of each entity.

The NYSE and NASDAQ listing standards incorporate the SEC's independence requirements. Both also define their own requirements for director independence.

**Director qualification disclosure requirements.** The SEC requires proxy disclosures about the background of directors and nominees. The disclosure should include information

about the experience, qualifications, and attributes considered in the nomination process and the reasons why individuals should sit on the company's board. Disclosures regarding individual board committee qualifications are not required, but companies may want to consider including the qualifications of the member as discussed during the committee selection process as a part of the overall board qualification disclosure.

## Independence considerations

### NYSE – Not independent if:

- ▶ The director is an employee, or an immediate family member is an executive officer, of the listed company or was during the past three years.
- ▶ The director or an immediate family member received more than \$100,000 in direct compensation from the listed company in any 12-month period during the previous three years, except for director fees and other permitted payments.
- ▶ The director or an immediate family member is a current partner of the company's internal or independent auditor; the director is a current employee of such a firm; the director has an immediate family member who is a current employee of such a firm and personally works on the company's audit; or the director or an immediate family member was, within the previous three years (but is no longer), a partner or employee of such a firm and personally worked on the company's audit during that time.
- ▶ The director is a current employee, or an immediate family member is a current executive officer, of another company that made payments to, or received payments from, the listed company for property or services in an amount that, in any one of the previous three fiscal years, was in excess of the greater of \$1 million or two percent of the other company's consolidated gross revenues.

### NASDAQ – Not independent if:

- ▶ The director is an employee, or a family member is an executive officer, of the listed company or was during the previous three years.
- ▶ The director or a family member accepted compensation payments in excess of \$120,000 from the listed company in any 12-month period during the previous three years, except for director fees and other permitted payments.
- ▶ The director or a family member is a current partner of the listed company's independent auditor or was a partner or employee of the listed company's independent auditor who worked on the company's audit during the previous three years.
- ▶ The director or a family member is a partner, controlling shareholder, or executive officer of another organization that received from, or made payments to, the listed company for property or services in an amount in excess of the greater of 5 percent of the recipient's gross revenues or \$200,000, or did so during the previous three years (with certain limited exceptions).



## Financial literacy and expertise

In designating an audit committee financial expert (ACFE), the board of directors should abide by the SEC, NYSE, and NASDAQ requirements.

**SEC requirements.** The SEC requires an issuer to disclose whether at least one ACFE serves on the audit committee. The SEC defines the ACFE as an individual who the board of directors determines possesses all of the following attributes:

1. An understanding of financial statements and generally accepted accounting principles (GAAP)
2. An ability to assess the general application of GAAP in connection with the accounting for estimates, accruals, and reserves
3. Experience preparing, auditing, analyzing, or evaluating financial statements that present a breadth and level of complexity of accounting issues generally comparable to what can reasonably be expected to be raised by the issuer's financial statements, or experience actively supervising those engaged in such activities
4. An understanding of internal control over financial reporting
5. An understanding of the audit committee's functions.

The rule indicates that the attributes may be acquired by:

- Education and experience as a principal financial officer, principal accounting officer, controller, public accountant, or auditor, or experience in positions that involve similar functions
- Experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor, or someone performing similar functions
- Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing, or evaluation of financial statements
- Other relevant experience.

These criteria permit a chief executive officer who "actively supervised" the specified individuals to qualify as an ACFE if he or she possesses the five necessary attributes.

Disclosure of whether at least one audit committee member is an ACFE is required in the annual report filed on Forms 10-K, 10-KSB, 20-F, or 40-F and, if the committee does not have such an expert, why it does not. The SEC's rule also requires disclosure of the name of the ACFE and whether that individual is independent of management. It is at the company's discretion to disclose if more than one member meets the criteria.

The SEC rule states that designation as an ACFE does not imply that an individual is an expert for any purpose under the Exchange Act or otherwise. Furthermore, it does not elevate the duties, obligations, or liabilities of that member or lessen those of other board and audit committee members.

**NYSE requirements.** The NYSE requires all audit committee members to be "financially literate" as interpreted by the business judgment of the company's board, or to become financially literate within a reasonable period after being appointed to the committee.

In addition, at least one member must have "accounting or related financial management expertise," again as interpreted by the board. Although the NYSE listing standards do not require the audit committee to include a person who satisfies the SEC's definition of an ACFE, a person so designated will satisfy the accounting or related financial management expertise required by the NYSE.

**NASDAQ requirements.** NASDAQ listing standards require all audit committee members to be able to read and understand financial statements at the time of their appointment to the committee. NASDAQ also requires at least one audit committee

## Audit committee financial literacy recommendations



- ▶ Self-assessment should be thorough, not merely a compliance exercise, and should be repeated periodically.
- ▶ Members should understand auditing, accounting, and financial reporting issues relevant to the company and how management and the independent auditor address them.
- ▶ Committees should anticipate and understand how pending financial reporting and regulatory developments may affect the company, and particularly its talent needs.
- ▶ Members should focus on committee composition, including independence, financial expertise, risk management, broad business or leadership experience, and succession planning.

member to be “financially sophisticated.” Financial sophistication may be obtained through employment experience in finance or accounting, professional certification in accounting, or any comparable experience, including current or past employment as a chief executive officer, chief financial officer, or other senior officer with responsibility for financial oversight. Like the NYSE, NASDAQ does not require an ACFE on the audit committee, but if the board determines an individual is an ACFE, that individual is also deemed financially sophisticated. The board of directors should also consider the SEC’s five attributes and prescribed methods of acquiring this expertise. After seeking appropriate legal counsel, the board should decide whether at least one member is an ACFE. Many companies have multiple ACFEs. In making this determination, the board of directors may have audit committee members complete a questionnaire or use the [American Institute of Certified Public Accountants’ decision tree](#) to evaluate whether an individual meets the criteria.

Although ACFEs are not expected to lose that expertise, it is important for the audit committee members to invest the time needed to understand the latest developments in financial reporting and auditing standards. Many boards have a process for reconfirming the financial literacy of their audit committee members and revisiting the ACFE designation periodically. It is also important for the board and the audit committee to consider succession planning, with an emphasis on the need for members with financial experience. Refer to the board education section for a discussion of common practices related to general board education and financial literacy training.

## Questions for audit committees to consider



- ▶ Are audit committees periodically assessing the financial literacy of their members?
- ▶ Are modifications to the committee’s education plan necessary?
- ▶ Are the audit committee’s training and education programs designed to maintain financial literacy?

## Tools and resources



Refer to the [Audit Committee section](#) on the [Center for Corporate Governance website](#)



### Section Three

# Key responsibilities

Oversight of financial reporting

Fraud and internal control over financial reporting

Review of earnings press releases and use of non-GAAP financial measures

Interaction with the internal auditors

Risk assessment and oversight

Code of ethics

Complaint helpline/hotline procedures

## Key responsibilities

### Oversight of financial reporting

To effectively oversee financial reporting, the audit committee should be familiar with the processes and controls management has established and understand whether they were designed effectively. The following is a summary of related requirements of the NYSE and SEC.

**NYSE requirements.** NYSE listing standards require the audit committee to review major issues regarding accounting principles and the presentation of the financial statements. These include any significant changes in the company's selection or application of accounting principles, the adequacy of internal controls, and any special audit steps adopted in response to what the NYSE terms "material control deficiencies." These discussions with management can be held during the review of the quarterly financial statements to be filed with the SEC.

The audit committee is also required to review management's analyses of significant issues in financial reporting and judgments made in preparing the financial statements, including the effects of alternative GAAP methods. This discussion can be held during the review of the quarterly financial statements.

Additionally, the audit committee should review the effect of regulatory and accounting initiatives and off-balance-sheet structures on the financial statements. Management and the audit committee should discuss pending technical and regulatory matters that could affect the financial statements. The audit committee should be updated on management's plans to implement new technical or regulatory guidelines. The review

of off-balance sheet structures should be a recurring item on the agenda, and may be done as part of the committee's review of management's discussion and analysis in the annual and quarterly reports. The frequency will depend on the company's operations and inclination to use those structures. The audit committee should consider reviewing off-balance-sheet structures, or at least material ones, before they are executed.

**SEC requirements.** Discussions regarding internal controls and special audit steps to address significant deficiencies also may be guided by SEC certification requirements for the principal executive officer and the principal financial officer in Item 307 of Regulation S-K.

The audit committee may consider having management identify recurring issues related to financial reporting, including significant accounting policies, estimates, and judgments. A standard quarterly analysis may be useful for these meetings, and management should tailor the analysis to include new or unusual items that arose during the quarter. Because Regulation S-X, Rule 2-07 requires the independent auditor to discuss the effects of alternative GAAP methods on the financial statements, the information presented by management should be corroborated by the independent auditor.

**Review of related-party transactions.** The NASDAQ and NYSE listing standards each contemplate that the audit committee of a listed company, or another independent body of the board, will review all related-party transactions.

## Questions for audit committees to consider

The following questions may help the audit committee assess its process for fulfilling its responsibility for approving related-party transactions:

- ▶ What process will the committee follow in reviewing and approving related-party transactions? Is this process documented?
- ▶ Will special meetings be called as potential transactions arise?
- ▶ What information does the committee need to make an informed judgment about the appropriateness of a transaction?
- ▶ Who will be responsible for presenting this information?

For each transaction brought for approval, the committee may consider asking:

- ▶ What are the business reasons for the transaction? Are these reasons in line with the company's overall strategy and objectives?
- ▶ How will investors view the transaction when it is disclosed?
- ▶ Which insiders could benefit from the transaction and in what way?
- ▶ What impact will the transaction have on the financial statements?
- ▶ Are any outside advisers needed to help understand the implications of the transaction?



## Relevant PCAOB guidance



The SEC approved the PCAOB's proposed rule to adopt Auditing Standard No. 18, *Related Party Transactions, Significant Unusual Transactions, and Financial Arrangements with Executive Officers*, in October 2014. The standard strengthens auditor performance requirements for identifying, assessing, and responding to the risks of material misstatement associated with a company's relationships and transactions with its related parties. It requires that auditors discuss related-party transactions, significant unusual transactions, and other amendments with the appropriate board committee, and ensure that transactions are authorized and approved properly.



## Fraud and internal control over financial reporting

In conjunction with risk oversight, the audit committee should determine that the company has programs and policies in place to prevent and identify fraud. It should work with management to oversee the establishment of appropriate controls and antifraud programs and to take the necessary steps when fraud is detected. The audit committee should also be satisfied that the organization has implemented an appropriate ethics and compliance program and established a complaint hotline. See the [Code of ethics](#) and [Complaint helpline/hotline procedures](#) sections later in the document for more information.

Audit committee members should be aware of three main areas of fraud:

- Financial statement fraud, which includes intentional misstatements in or omissions from financial statements
- Asset misappropriation, which may include check forgery, theft of money, inventory theft, payroll fraud, or theft of services
- Corruption, which may include schemes such as kickbacks, shell companies, bribes to influence decision-makers, or manipulation of contracts.

Although the audit committee should be concerned with all three types of fraud, financial statement fraud should be its primary focus. Although this type of fraud occurs least frequently, it is often the most costly.

One way the audit committee can help oversee the prevention and detection of financial statement fraud is by monitoring management's assessment of internal control over financial reporting (ICFR). To oversee ICFR successfully, the audit committee must be familiar with the processes and controls management has put in place and understand whether they were designed

effectively. The audit committee should work with management, the internal auditors, and the independent auditor to gain the knowledge needed to provide appropriate oversight.

The audit committee should also have an awareness of the U.S. Foreign Corrupt Practices Act and other non-U.S. anticorruption laws that may be applicable (e.g., the U.K. Bribery Act of 2010). The committee should understand the company's responsibilities regarding these anticorruption laws as well as the policies and practices in place related to compliance. The audit committee may also ask management where the highest risks of an infraction exist and what the company's plans are should a violation occur. The committee should be made aware of any actual violations, including management's response.

**2013 COSO framework.** On May 14, 2013, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued its updated *2013 Internal Control — Integrated Framework*. Under COSO's transition guidance, the 2013 COSO framework superseded the original 1992 COSO framework as of December 15, 2014.

The 2013 COSO framework provides a more formal structure for the design and evaluation of the effectiveness of internal control. The updated framework emphasizes the role of the board of directors—and, by delegation or regulation, the role of the audit committee—in overseeing internal control, which remains an essential aspect of effective governance. In particular, the framework highlights:

- The board's role in the control environment, including clarification of expectations for integrity and ethics, conflicts of interest, adherence to codes of conduct, and other matters

- The board’s assessment of the risk of management override of internal control and careful consideration of the possibility that management may override such controls
- The establishment and maintenance of open lines of communication between management and the board and the provision of separate lines of communication, such as whistleblower hotlines.

Refer to [Appendix A](#) for additional details regarding the new requirements. In addition, for more information regarding considerations for audit committees in overseeing the implementation of the 2013 COSO framework, refer to Deloitte’s [September 5, 2014, Heads Up: Challenges and Leading Practices of Implementing COSO’s Internal Control—Integrated Framework](#), and [March 2014, Audit Committee Brief: The 2013 COSO Framework and the Audit Committee](#).

## Tools and resources



The [Antifraud Programs and Controls](#) and [Internal Control over Financial Reporting](#) sections of the [Center for Corporate Governance website](#)

provide resources to assist board and audit committee members. Additionally, the Anti-Fraud Collaboration released a report titled [The Fraud-Resistant Organization](#) that identifies three central themes critical to fraud deterrence and detection. The Anti-Fraud Collaboration consists of the Center for Audit Quality, the Institute of Internal Auditors, Financial Executives International, and the National Association of Corporate Directors.

## Review of earnings press releases and use of non-GAAP financial measures

The audit committee should consider how it will oversee earnings press releases and the financial information and earnings guidance provided to analysts and ratings agencies. It is common for the full audit committee to review each individual earnings release.

The audit committee should confirm that an appropriate legal review has been completed to verify the accuracy and completeness of disclosures, including any obligation to report on trends. This legal review should also consider compliance with the company's policies on forward-looking statements and the completeness of any related disclaimers.

The committee should consider the SEC's rules regarding the use of non-GAAP financial measures in Regulation G and Item 10(e) of Regulation S-K.

Under Regulation G, disclosure of any material information containing non-GAAP financial measures must include the most directly comparable GAAP financial measures, as well as a reconciliation of the two.

The NYSE listing standards require the audit committee charter to address the committee's responsibility to discuss earnings press releases and the financial information and guidance provided to analysts and ratings agencies. The commentary to the listing standards indicates that this discussion may be in general terms, and the audit committee may discuss the type of information disclosed and the type of presentation made. The commentary also indicates that the discussion should pay particular attention to any pro forma or adjusted non-GAAP financial information. In addition, the SEC requires registrants to furnish earnings releases or similar announcements on Form 8-K.

## Questions for audit committees to consider

The audit committee should discuss earnings guidance provided to analysts and ratings agencies with management. Questions to consider include:

- ▶ When did management last evaluate its approach to providing earnings guidance? Is a change in approach warranted as a result of the current economic environment and other circumstances facing the company?
- ▶ How can pressures to meet expectations in the short term influence the quality of the company's reported financial results? How could these influence management behavior?
- ▶ What practices do the company's competitors follow with respect to earnings guidance and other forward-looking information?
- ▶ What are management's reasons for providing or not providing EPS targets and other types of forward-looking information?
- ▶ How confident is management in its ability to forecast earnings accurately? Is the disclosure of a range of earnings estimates preferable to a specific target? Should the time frame for which estimates are provided be modified or are more frequent updates necessary?
- ▶ What are the company's long-term value drivers? What is the specific quantitative and qualitative information—be it financial or nonfinancial in nature—that best reflects these drivers? Is this information provided to investors and analysts on a forward-looking basis?
- ▶ Has management considered seeking input directly from shareholders regarding the types of forward-looking information they would find meaningful?
- ▶ Do current circumstances warrant enhanced audit committee review of earnings estimates and other forward-looking information before it is made public?
- ▶ If the company changes its approach to the provision of earnings guidance and forward-looking information, should the audit committee modify its practices for reviewing that information?



## Questions for audit committees to consider



The audit committee should ask questions of management on the use of non-GAAP and pro forma financial measures in earnings press releases, SEC filings, and other public releases. Questions may include:

- ▶ Does management have a policy for determining non-GAAP or pro forma financial measures?
- ▶ What non-GAAP or pro forma financial measures are used?
- ▶ Does management have effective internal controls over the development of non-GAAP measures?
- ▶ Why are non-GAAP or pro forma financial measures used?
- ▶ Does management believe the non-GAAP measure provides useful information to investors?
- ▶ Are the non-GAAP or pro forma measures consistent with those used by peers in the industry?
- ▶ Are all non-GAAP financial measures reconciled to appropriate GAAP measures?
- ▶ Are the GAAP financial measures at least as prominent as the non-GAAP financial measures?
- ▶ What is the difference in earnings per share under the GAAP and non-GAAP financial measures?
- ▶ Did the company meet analysts' expectations for earnings per share using non-GAAP or pro forma financial measures but not using GAAP financial measures?
- ▶ If the company received an SEC comment letter regarding non-GAAP financial measures, was it cleared?
- ▶ Does the company post a net loss when GAAP financial measures are used but net income when non-GAAP or pro forma financial measures are used?
- ▶ Has management only included non-GAAP adjustments that increase income? If so, are there non-GAAP adjustments that would decrease income that should be highlighted to prevent the financial information from being misleading and to provide appropriate balance?
- ▶ Can management confirm that no material facts have been omitted or misrepresented?
- ▶ Do the non-GAAP or pro forma financial measures change from period to period? If so, do these changes enhance non-GAAP or pro forma adjusted earnings for the current period?
- ▶ Are non-GAAP or pro forma measures disclosed in the financial statements consistent with those used by management during road shows and conferences?

## Interaction with the internal auditors

“When I regularly speak to the chief audit executive, I ask a few consistent questions: What’s going on? Do you have the right people? Do you have enough people? Are there any problems or accounting issues to discuss?”

*Audit committee chairman*

An effective relationship between the audit committee and the internal auditors is fundamental to the success of the internal audit function. It is important for audit committees to assess whether internal audit’s priorities are aligned with the audit committee’s, such as monitoring critical controls and identifying and addressing emerging risks.

**NYSE requirements.** The NYSE listing standards require audit committees to oversee the internal audit function and to note this responsibility in their charters. Specific requirements include:

- The audit committee charter must include oversight of the internal audit function as one of its purposes
- The audit committee’s regular report to the board of directors should include issues involving the performance of the internal audit function
- The audit committee must meet separately with the internal auditors.

**NASDAQ requirements.** The audit committee oversees the accounting and financial reporting processes of the company. Note that oversight of internal audit is often one component in meeting this requirement.

**Common practices and considerations.** The specific expectations for internal audit functions vary by organization, but may include:

- Objectively monitor and report on the health of financial, operational, and compliance controls
- Provide insight into the effectiveness of risk management
- Offer guidance regarding effective governance
- Become a catalyst for positive change in processes and controls
- Deliver value to the audit committee, executives, and management in the areas of controls, risk management, and governance to assist in the audit committee’s assessment of the efficacy of programs and procedures
- Coordinate activities and share perspectives with the independent auditor.

In support of these expectations, audit committees should take several steps to facilitate a mutually beneficial relationship with the internal auditors:

- Hold regular private sessions with the internal auditors (required for NYSE-listed companies)
- Be available when contacted by the chief audit executive (CAE)
- Engage in discussions regularly; make the reporting relationship both substantive and communicative
- Actively participate in discussing goals and evaluating the performance of the CAE; these responsibilities should not be delegated solely to the CFO or CEO

- Challenge the CAE and the internal audit department by setting high expectations, communicating those expectations clearly, and holding the department accountable for meeting them
- See that the internal auditors have appropriate stature and respect and are visibly supported by senior management throughout the organization
- Understand and approve the annual internal audit plan and determine if the CAE has sufficient resources to execute against it
- Support the CAE, providing guidance if needed and assistance when he or she reports potential management lapses.

Through effective communication, the audit committee can help the CAE fully understand and achieve what is expected. Several questions help assess the current or prospective CAE's ability to perform at a consistently high level:

- Was the audit committee involved in selecting the CAE?
- Was the bar set high enough to select the caliber of candidate needed?
- Does the CAE have the right mix of experience and capabilities, including industry knowledge and business acumen, to understand the company's risks?
- Does the CAE have a professional certification, such as certified internal auditor, and participate in relevant continuing education programs?
- Does the internal audit function have a quality improvement program?

In addition to these suggestions, a leading practice of the audit committee is to review and evaluate the status of the enterprise-wide risk assessment and the alignment of risks identified to the internal audit plan. The audit committee should evaluate the progress and results of the internal audit plan against the original plans and any significant changes made subsequently.

The Institute of Internal Auditors' (IIA) Standards for Professional Practice of Internal Auditing mandate that the internal auditors maintain a certain level of independence from the work they audit. This means that an internal auditor should have no personal or professional involvement with the area being audited and should maintain an impartial perspective on all engagements. Internal auditors should have access to records and personnel when necessary, and they should be allowed to employ appropriate investigative techniques without impediment.

When the internal audit function's direct reporting line is to the audit committee, it allows the internal auditors to remain structurally separate from management and enhances objectivity. This also encourages the free flow of communication on issues and promotes direct feedback from the audit committee on the performance of the CAE.

There are several ways the audit committee can oversee the internal audit function. The IIA provides the following 10-point checklist of considerations for audit committees in overseeing the internal auditors:

1. The audit committee engages in an open, transparent relationship with the CAE.
2. The audit committee reviews and approves the internal audit charter annually.
3. As a result of discussions with the CAE, the audit committee has a clear understanding of the strengths and weaknesses of the organization's internal control and risk management systems.
4. Internal audit is sufficiently resourced with competent, objective professionals to carry out the internal audit plan, which has been reviewed and approved by the audit committee.
5. Internal audit is empowered to be independent by its appropriate reporting relationships to executive management and the audit committee.
6. The audit committee addresses with the CAE all issues related to internal audit independence and objectivity.
7. Internal audit is quality-oriented and has in place a quality assurance and improvement program.
8. The audit committee regularly communicates with the CAE about the performance and improvement of the CAE and internal audit.
9. Internal audit reports are actionable, and audit recommendations and/or other improvements are satisfactorily implemented by management.
10. The audit committee meets periodically with the CAE without the presence of management.

## Questions for audit committees to consider



- ▶ Does internal audit have a clearly articulated strategy that is reviewed periodically and approved by the audit committee?
- ▶ Does internal audit have a clear set of performance expectations that are aligned with the success measures of the audit committee, and that are measured and reported to the audit committee?
- ▶ Does internal audit have a charter that is periodically reviewed and approved by the audit committee? Does internal audit operate in accordance with its charter?
- ▶ Is the internal audit plan aligned to the primary risks of the organization and other assurance activities? Is internal audit's risk assessment process appropriately linked to the company's enterprise risk management activities?
- ▶ In delivering the internal audit plan, is internal audit flexible and dynamic in promptly addressing new risks and the needs of the audit committee?
- ▶ Does internal audit organize or perform peer reviews or self-assessments of its performance and report the results to the audit committee?
- ▶ Is internal audit appropriately funded and staffed?
- ▶ Is internal audit staffed with the appropriate mix of professionals to achieve its objectives?
- ▶ Do members of the internal audit department participate in continuing education programs?
- ▶ Is internal audit sufficiently independent of management?
- ▶ Is the CAE respected as an adviser to the audit committee and management on emerging risks?
- ▶ Is internal audit highly regarded and respected in the organization?
- ▶ Is the level of assurance provided by internal audit and its interaction with other assurance sources clear and appropriate for the audit committee?
- ▶ Does internal audit meet regularly with the independent auditor to discuss risk assessments, the scope of procedures, or opportunities to achieve greater efficiencies and effectiveness in the company's audit services?
- ▶ Does internal audit report issues in a timely manner and address them with management?
- ▶ Are issues identified and reported by internal audit appropriately highlighted to the audit committee, and is the remediation progress tracked and reported?
- ▶ Are reports and other communications from internal audit to the audit committee of an appropriate standard and do they provide value?

## Tools and resources



Deloitte's [Center for Corporate Governance website](#) provides a number of resources to help audit committees understand the internal audit function and their oversight responsibilities, including the [September/October 2014, Audit Committee Brief: Internal Audit: Moving beyond Sarbanes-Oxley Compliance](#).

The IIA's [The Audit Committee: Purpose, Process, Professionalism](#) provides insight into the audit committee's interaction with the internal audit function and a list of questions for audit committees to consider.

## Risk assessment and oversight

“Risk management is one of the biggest concerns of the audit committee today, and it is tough to get your arms around it.”

*Fortune 500 company  
audit committee chairman*

Risk oversight has taken on increased importance for boards. Many boards are reconsidering the risk governance structure and which committees have the expertise to oversee particular risks.

The SEC requires disclosure regarding the board’s role in risk oversight. Examples include whether the entire board is involved or whether risk oversight is executed by a particular committee, and whether the employees responsible for risk management report directly to the board. The SEC considers risk oversight a key responsibility of the board, and this disclosure will improve investors’ and shareholders’ understanding of this role.

Audit committees are responsible for overseeing the process for identifying and addressing financial risks. However, the responsibility for overseeing other risks may be moved to other board committees that have the appropriate expertise; for example, human resource and compensation risks can be overseen by the compensation committee. Nonetheless, the full board has the ultimate responsibility for risk oversight and should discuss the organization’s most material risks regularly.

The NYSE listing standards require the audit committee to discuss the the company’s financial risk assessment and financial risk management policies with management. The commentary clarifies that although it is the responsibility of senior management to assess and manage the company’s risks, the audit committee should focus on areas of major financial risk exposure and discuss the guidelines and policies for addressing these areas.

Consequently, financial risk oversight has been on the agenda of audit committees for a number of years.

The requirement relates specifically to financial risks, but these risks are often a consequence of other sources of risk, such as those disclosed in the company’s Forms 10-K and 10-Q. These may include strategy, operations, and compliance with environmental, health, safety, legal, and regulatory requirements.

Deloitte offers six distinct actions that can help enable a **risk-intelligent governance** approach:

1. Define the board’s risk oversight role.
2. Foster a risk-intelligent culture.
3. Understand and approve an appropriate risk appetite.
4. Help management incorporate strategic risk thinking into strategy.
5. Assess the “maturity of the risk” governance process.
6. Make sure the organization discloses the risk story to stakeholders.

## Dodd-Frank impact



The Dodd-Frank Wall Street Reform and Consumer Protection Act requires certain bank holding companies, and certain other non-bank financial companies, to have a separate risk committee that must include at least one risk management expert, as defined in the act. The Federal Reserve Board issued its notice of proposed rulemaking, which will require U.S. banks and bank holding companies with greater than \$50 billion in assets, those with greater than \$10 billion in assets that are publicly traded, and non-bank financial companies designated as systemically important to establish a board risk committee with a formal written charter approved by the company’s board of directors.

Companies need to consider how risk oversight is managed, as the full board remains accountable for risk oversight and other committees may still play a significant role; for example, the audit committee’s role in overseeing financial risks.





## Questions for audit committees to consider

When the audit committee is considering the effectiveness of the company's enterprise risk management—the process of planning, organizing, leading, and controlling activities to minimize the effect of downside risk on the organization—it may consider asking the following questions:

- ▶ What are the company's policies and processes for assessing and managing major financial risk exposures on an integrated, enterprise-wide basis?
- ▶ Has management identified the significant risks, vulnerabilities, and plans to address them?
- ▶ Has the company defined its risk appetite with the board's input and approval?
- ▶ How capable is the company of preparing for and responding to major financial risk exposures?
- ▶ How do the various board committees oversee risk? Is there appropriate coordination and communication?
- ▶ Is the full board participating in risk oversight and discussing the most material risks and how they are being monitored?
- ▶ Does the board consider the relationship between strategy and risk?
- ▶ Does management provide the board the information needed to effectively oversee the risk management process?
- ▶ Does the scenario planning include both individual and aggregate financial risk views?
- ▶ What mechanisms does management use to monitor emerging financial risks? What are the early warning mechanisms, and how effective are they? How, and how often, are they calibrated?
- ▶ Which framework has management selected for the financial risk management program? What criteria were used to select it?
- ▶ What is the role of technology in the risk management program? How was it chosen, and when was it last evaluated?

## The audit committee's potential role in cybersecurity

It is highly challenging for even the most tech-savvy leaders in organizations to keep up with the scope and pace of developments related to big data, social media, cloud computing, IT implementations, cybersecurity, and other technology issues. Such developments carry with them a complex set of risks, the most serious of which can compromise sensitive information and significantly disrupt business processes. Cybersecurity is often at the top of agendas for both management and boards at companies of all sizes and industries, since the pervasiveness of cyber issues increasingly affects financial information concerns and internal controls. Oversight of a successful program of cybersecurity requires proactive engagement and is most frequently the responsibility of the full board of directors. In some organizations some level of oversight may have been delegated to a specific risk committee or to the audit committee.

In companies where some level of responsibility for cybersecurity has been delegated to the audit committee, the committee should first obtain a clear understanding of the specific oversight for which it has responsibility. In those organizations, the audit committee, in its capacity of overseeing financial risk management activities and monitoring management's policies and procedures, may have the expertise and be asked to play a significant strategic role in monitoring management's preparation for and response to cyber threats, coordinating cyber risk initiatives and policies, and confirming their efficacy. As such, those audit committees may take the lead with regard to awareness of cybersecurity trends, regulatory developments, and major threats to the company. Other responsibilities may include setting expectations and accountability for management, as well as assessing the adequacy of resources, funding, and focus for cybersecurity activities.

Additionally, for those audit committees charged with this oversight, engaging in regular dialogue with the CIO and other technology-focused organizational leaders can help the committee better understand where attention should be devoted. The audit committee chairman can be a particularly effective liaison with other groups in enforcing and communicating expectations regarding security and financial risk mitigation. While cybersecurity topics are frequently on full board agendas, the audit committee may also receive a briefing on related topics if the potential financial risk is significant and/or material.



## Tools and resources



The [Risk Oversight](#) section of the [Center for Corporate Governance website](#) provides a number of tools and resources to assist board and audit committee members with risk oversight, such as Deloitte's [Risk Committee Resource Guide for Boards](#) and [Risk Intelligent Governance: Lessons from State-of-the-Art Board Practices](#).

## Code of ethics

A culture that embraces the importance of ethics and compliance can be established only if employees, officers, and directors understand the requirements of the code of ethics.

The SEC, the NYSE, and NASDAQ all require a code of ethics or a code of conduct. There are similarities between the requirements, but there are also differences.

**SEC requirements.** The SEC requires registrants to disclose whether they have written codes of ethics that apply to their principal executive officers, principal financial officers, principal accounting officers or controllers, or individuals performing similar functions. If they do not, they must explain why not. Companies must promptly disclose amendments to, and waivers from, codes of ethics relating to any of those people.

The SEC rule defines a code of ethics as a written standard that is reasonably designed to deter wrongdoing and to promote:

- Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest in personal and professional relationships
- Full, fair, accurate, timely, and understandable disclosure in reports and documents that a registrant files with the SEC and in other public communications
- Compliance with applicable laws, rules, and regulations
- The prompt internal reporting of violations to parties identified in the code
- Accountability for adherence to the code.

Companies must include these disclosures in their annual reports filed on Forms 10-K, 10-KSB, 20-F, or 40-F. A company must make its code of ethics available to the public through one of the following methods:

- File a copy of its code of ethics with the SEC as an exhibit to its annual report
- Post the code of ethics on its website, provided that the website address and the intention to provide disclosure in this manner are set forth in its annual report
- Indicate in its annual report that it will provide a copy of its code of ethics to any person, without charge, on request.

U.S. registrants must disclose any changes to, or waivers from, the code of ethics that apply to the CEO or senior financial officers. A company that chooses to provide the disclosure on Form 8-K must do so within four business days after it amends its code of ethics or grants a waiver.

**NYSE requirements.** The NYSE listing standards require a code of conduct that covers not only senior financial officers, but all employees. Specifically, the websites of NYSE-listed companies must disclose the code of conduct applicable to employees, directors, and officers. Companies can determine their own policies, but the code must contain the items listed below, only some of which are required by the SEC. Waivers of the code's requirements for executive officers or directors must be disclosed in a Form 8-K within four business days.

- Treatment of conflicts of interest
- Prohibition from taking advantage of personal opportunities arising through the use of corporate property, information, or position
- Prohibition from conducting business that competes with that of the company
- Treatment of confidential information
- Fair behavior in interactions with the company's customers, suppliers, competitors, and employees

- Protection and proper use of the company's assets
- Compliance with laws, rules, and regulations, including insider-trading laws
- Encouragement to report any illegal or unethical behavior
- Compliance standards and procedures to facilitate effective operation of the code and to allow prompt and consistent action against violation
- A requirement that waivers of the code for executive officers or directors be granted only by the board or a committee of the board and be disclosed to shareholders in a timely manner

**NASDAQ requirements.** The NASDAQ listing standards require public disclosure of a code of conduct applicable to all employees, officers, and directors. NASDAQ's criteria for the code of conduct are consistent with the SEC's requirements.

In addition, each code of conduct must provide for prompt and consistent enforcement, protection for individuals who report questionable behavior, clear and objective standards for compliance, and a fair process for determining violations. Any waiver for executive officers or directors must be made only by the board and be disclosed to shareholders promptly, along with the reasons for the waiver. Waivers of the code's requirements for executive officers or directors must be disclosed in a Form 8-K within four business days (with certain exceptions for foreign private issuers).

Both the NYSE and NASDAQ listing standards permit companies to have more than one code of conduct as long as all directors, officers, and employees are covered by a code.

**Common practices and considerations.** As highlighted by the U.S. federal sentencing guidelines for organizations, executives and boards of directors have special responsibilities for the oversight and management of ethics and compliance programs, an important component of which is a robust code of ethics or conduct.

The board and the audit committee should consider whether the audit committee should be involved in this aspect of corporate governance.

Those responsible for overseeing ethics and compliance should work with management to determine that the company's code of ethics or conduct complies with the applicable requirements. Companies may update the code in response to new issues or situations. When appropriate, legal counsel should be consulted on modifications to the code.

The NYSE listing standards require the audit committee to oversee legal and regulatory compliance, so in many cases the audit committee will be involved in oversight of the code of ethics.

Communication and training are critical to fostering an ethical culture. The code should be available to everyone in the organization, perhaps through inclusion on the company's intranet site and in the orientation manual. Some companies require individuals to sign an annual representation noting that they have read and understand the requirements of the code.

If an employee refuses to sign the code of ethics, committees should encourage companies to use serious discipline, up to and including termination. Communication of disciplinary actions taken in response to code violations is recommended as a means of reassuring employees that violations are being handled seriously.

Board members or members of the committee that oversees compliance should have a thorough understanding of the waiver definition and disclosure requirements. The responsible members should also consider requiring all board members to acknowledge that they will comply with the code's requirements.

Any decision to grant waivers should be considered carefully. A company may want to consider if a requirement to seek preapproval for a conflict described within the code obviates the need for a waiver. Those responsible for overseeing ethics and compliance should work with management to establish a process for reporting and addressing violations promptly.

## Questions for audit committees to consider



To the extent the audit committee is charged with the responsibility to oversee ethics and compliance:

- ▶ Does the audit committee hear directly from the person who has day-to-day responsibility for ethics and compliance matters?
- ▶ Does the ethics and compliance governance framework (or organizational structure and reporting lines) provide sufficient independence to best execute its responsibilities (e.g., chief ethics and compliance officer does not report to the CFO or CAE)?
- ▶ Does the ethics and compliance officer have an adequate budget for talent, technology, and resources to do an effective job?
- ▶ Does the company regularly and systematically scrutinize the sources of ethics and compliance failures and react appropriately?
- ▶ How does management take action on reports? Is there evidence of employees being disciplined appropriately and consistently?
- ▶ Does the reporting process keep the audit committee informed of ethics and compliance issues, as well as the actions taken to address them? Is ethics and compliance a regular item on the committee's agenda?
- ▶ What type of ongoing monitoring and auditing processes are in place to assess the effectiveness of the ethics and compliance program?

## Tools and resources



The [Ethics and Compliance](#) section of the [Center for Corporate Governance website](#) offers additional information on establishing codes of ethics and robust ethics and compliance programs.

## Complaint helpline/hotline procedures

Companies use helplines/hotlines as a mechanism to report a range of ethics and compliance issues, including potential violations of the code of ethics. A thorough, independent, and objective process should be established by management and the audit committee for investigating complaints. Companies use various procedures, but the most common method of receiving tips from inside and outside the organization is through a telephone and Web-based helpline/hotline administered by an internal department or a third party.

SEC regulations and the securities market listing standards require the audit committees of listed companies to establish procedures for:

- Receiving, retaining, and addressing complaints regarding accounting, internal accounting controls, or auditing matters, whether from internal or external sources, as well as reporting a range of compliance matters, including violations of the code of conduct
- The confidential, anonymous submission of employee concerns regarding questionable accounting or auditing matters.

The audit committee should work with management to confirm that the company is aware of questions or complaints received from third-party vendors, in email, or through other reporting vehicles. Responsibility for investigating questions or concerns and reporting back to the audit committee often falls on individuals in the ethics and compliance, internal audit, legal, or risk management departments. Complaints should be categorized and analyzed by root cause, and recommendations should be made to the audit committee on how to reduce similar violations in the future.

The audit committee also should receive a regular analysis of the progress of complaint resolution. Periodic reports should be given to the audit committee in accordance with standing

instructions. Some complaints may warrant immediate communication to the audit committee, such as those involving senior management and significant dollar amounts. The audit committee should establish a schedule for reporting to the board of directors.

A helpline/hotline monitored by an independent third party is preferred. However, if the hotline is administered internally, operators should have specific training on where to direct questions or complaints, including those related to human resources, as well as the ability to provide coverage 24 hours a day, 365 days a year and include an anonymous reporting option. Employees can be informed of reporting channels in the code of ethics, the employee handbook, human resources orientation, and ethics training. Instructions for submitting questions or complaints can be posted in company facilities and on intranet sites.

The company's public website is a natural vehicle for communicating the procedures to individuals outside the organization. As discussed in the code of ethics section, the NYSE listing standards require companies to adopt codes of ethics and disclose them on their websites. NASDAQ-listed companies also must adopt and disclose codes of ethics, and many have chosen to post their codes on their websites. Information on the code of ethics and the complaint hotline often is linked from the home page under a section called "Ethics" or an equivalent. Telephone operators working in customer service and investor relations should be prepared to answer questions on how to submit concerns and complaints regarding financial reporting.

Under the SEC’s whistleblower programs, employees with knowledge of potential securities fraud who report original information to the government or a self-regulatory organization can receive a minimum of 10 percent and as much as 30 percent of monetary sanctions if the enforcement action results in fines of at least \$1 million.

Whistleblowers are not required to report issues first through internal company channels; however, those choosing to do so are still eligible for the reward if the company reports the problem to the government or if the whistleblower does so within 120 days of notifying the company.

It is important for the audit committee to work with management and internal audit to understand:

- Opportunities to enhance internal whistleblowing systems and promote reporting mechanisms to all personnel
- The potential value of transaction monitoring tools to help promptly identify potential securities fraud issues such as bribery or financial statement fraud.

## Common features of complaint helpline/hotline systems



- ▶ Operation by an independent third party.
- ▶ Staffing by trained interviewers rather than fully automated systems.
- ▶ A dedicated phone number that is available at all times, along with other reporting means such as fax, the company’s website, email, and regular mail.
- ▶ Multilingual systems and operators.
- ▶ Complainants should be allowed to call back at a later time, and they should be given the option to file complaints anonymously.
- ▶ Complainants must be protected from any retaliation as a result of reporting.
- ▶ Protocols should be in place to allow complaints to be channeled to the appropriate individual, and complaints involving senior management should go directly to the audit committee.
- ▶ Complaints must be handled in a confidential manner and resolved as quickly as possible.
- ▶ Complaint procedures should be well known to all employees, vendors, and other interested parties.

## Tools and resources



Deloitte’s resources to address ethics and compliance issues are discussed in the [Code of ethics](#) section of this document as well as in the [Ethics and Compliance](#) and [Antifraud Programs and Controls](#) sections of the [Center for Corporate Governance website](#).

Section Four

# Interaction with the independent auditor

Auditor communications

Auditor independence

Fee disclosure

Evaluation of the independent auditor

## Section Four

# Interaction with the independent auditor

Audit committees of listed companies are directly responsible for the appointment, compensation, and oversight of the independent auditor, including the resolution of any disagreements with management. It is optimal for the audit committee, management, the internal auditors, and the independent auditor to work together in a spirit of mutual respect and cooperation.

The audit committee and the independent auditor typically meet at least quarterly and engage in thorough discussion. Private sessions with the independent auditor are a way to maintain open communication and identify concerns. Periodic private sessions are required for NYSE-listed companies.

The audit committee should have a process for overseeing management's resolution of significant issues raised by the independent auditor.

## Auditor communications

*"I always ask the independent auditor to tell me something I'm not smart enough to ask. What were the close calls? Can you provide insight and color around your dialogue with management?"*

*Fortune 500 company audit committee chairman*

The following is a summary of communications required by the PCAOB, the SEC, and the NYSE and NASDAQ listing standards.

**PCAOB requirements.** Auditing Standard No. 16 (AS 16), *Communications with Audit Committees*, and amendments to

other PCAOB standards were effective for public company audits of fiscal periods beginning after December 15, 2012.

Unless otherwise specified, the auditor should communicate to the audit committee orally or in writing in a timely manner and prior to issuance of the auditor's report. Under AS 16, the auditor is required to communicate with the audit committee about the following:

- Significant issues discussed with management prior to the initial appointment or retention of the auditor
- An understanding of the terms of the audit engagement—outlined annually in an engagement letter—including the objective of the audit and the responsibilities of the auditor and management
- Whether the audit committee is aware of matters relevant to the audit, including, but not limited to, violations of laws or regulations
- An overview of the overall audit strategy, timing, and significant risks, including (i) the nature and extent of specialized skills necessary to perform planned audit procedures, (ii) the extent to which the independent auditor plans to rely on work performed by the company's internal audit function or others in the audits of the financial statements and internal control over financial reporting, (iii) the names, locations, and anticipated responsibilities of any firm or personnel performing audit work in the current period but not employed by the auditor, (iv) the auditor's rationale for serving as principal auditor if significant parts of the work are performed by others, and (v) any significant changes to the original strategy or significant risks and the reasons for such changes



- Significant accounting policies and practices, including (i) management's initial selection of, or changes in, significant accounting policies or the application of such policies in the current period, and (ii) the effect on financial statements or disclosures of significant accounting policies in controversial areas or areas for which there is a lack of authoritative guidance or consensus, or diversity in practice
- All critical accounting policies and practices to be used, including (i) the reasons certain policies and practices are considered critical, and (ii) how current and anticipated events might affect the determination of whether certain policies and practices are considered critical
- Critical accounting estimates, including (i) a description of the process management used to develop critical accounting estimates, (ii) management's significant assumptions used in critical accounting estimates that have a high degree of subjectivity, (iii) any significant changes management made to the processes used to develop critical accounting estimates or significant assumptions, a description of management's reasons for the changes, and the effects of the changes on the financial statements
- Significant unusual transactions, including (i) significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature, and (ii) the policies and practices management used to account for significant unusual transactions
- The auditor's evaluation of the quality of the company's financial reporting, including (i) qualitative aspects of significant accounting policies and practices, (ii) assessment of critical accounting policies and practices, (iii) conclusions regarding critical accounting estimates, (iv) the business rationale for significant unusual transactions, (v) financial statement presentation, including the related disclosures, (vi) management's anticipated application of new accounting pronouncements that might have significant effects in future periods, and (vii) alternative accounting treatments
- The auditor's responsibility, including any related procedures performed and the results of such procedures under PCAOB rules and standards when other information is presented in documents containing audited financial statements
- Matters that are difficult or contentious for which the auditor consulted outside the engagement team and that the auditor reasonably determined are relevant to the audit committee's oversight of the financial reporting process
- Management's consultation with other accountants about significant auditing or accounting matters when the auditor has identified a concern regarding such matters
- Evaluation of the company's ability to continue as a going concern, including (i) any conditions and events that the auditor has identified that indicate substantial doubt about the company's ability to continue as a going concern for a reasonable period of time, (ii) the auditor's conclusion about management's plans to alleviate substantial doubt about the company's ability to continue as a going concern, (iii) the effects, if any, on the financial statements and related disclosure, as well as the auditor's report, if substantial doubt remains about the company's ability to continue as a going concern for a reasonable period of time
- A schedule of uncorrected misstatements related to accounts and disclosures, as well as those corrected misstatements (unless clearly trivial) that related to accounts and disclosures that might not have been detected except through the auditing procedures performed and the implication of these misstatements on the company's financial reporting
- Other material written communications between the auditor and management
- Departures from the auditor's standard report, including (i) the reasons for modifying and the wording to be used when the auditor expects to modify the opinion, and (ii) the reasons for the explanatory language or paragraph and the wording to be used when the auditor expects to include explanatory language or an explanatory paragraph

- Any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report
- Any significant difficulties encountered during the audit, including, but not limited to, (i) significant delays by management, the unavailability of company personnel, or an unwillingness by management to provide information needed for the auditor to perform his or her audit procedures, (ii) an unreasonably brief time within which to complete the audit, (iii) unexpected extensive effort required by the auditor to obtain sufficient appropriate audit evidence, (iv) unreasonable management restrictions encountered by the auditor on the conduct of the audit, and (v) management's unwillingness to make or extend its assessment of the company's ability to continue as a going concern when requested by the auditor
- Other matters arising from the audit that are significant to the oversight of the company's financial reporting process, including complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters.
- PCAOB Ethics and Independence Rule 3526, *Communication with Audit Committees Concerning Independence*, requires the independent auditor to provide, at least annually, a formal written statement delineating all relationships between the independent auditor and the company, including individuals in financial reporting oversight roles at the company, that reasonably can be thought to bear on independence. The company and the auditor should engage in an active dialogue with respect to any disclosed relationships or services that may affect the objectivity and independence of the auditor.

Standards of the PCAOB (including AU 380, AU 325, or AS 5, as applicable) require the independent auditor to communicate all material weaknesses and significant deficiencies identified during the audit to the audit committee, in writing. In addition, if the independent auditor concludes that the audit committee's oversight of the company's external financial reporting and internal control over financial reporting is ineffective, the auditor is required to inform the board of directors.

## Required communications

### Communications required by AS 16

- ▶ Significant issues discussed with management before the auditor's appointment or retention
- ▶ Establishing an understanding of the terms of the audit
- ▶ Obtaining information relevant to the audit
- ▶ Overview of the audit strategy, timing of the audit, and significant risks
- ▶ Results of the audit, including:
  - Significant accounting policies and practices
  - Critical accounting policies and practices
  - Critical accounting estimates
  - Significant unusual transactions
- ▶ Auditor's evaluation of the quality of the company's financial reporting
- ▶ Other information in documents containing audited financial statements
- ▶ Difficult or contentious matters about which the auditor consulted
- ▶ Management consultations with other accountants
- ▶ Going-concern matters
- ▶ Uncorrected and corrected misstatements
- ▶ Material written communications
- ▶ Departure from the auditor's standard report
- ▶ Disagreements with management
- ▶ Difficulties encountered in performing the audit
- ▶ Other matters

### Communications required by other PCAOB standards or rules

- ▶ Material weaknesses and significant deficiencies in internal control
- ▶ Representations of management
- ▶ Fraud and illegal acts
- ▶ Communications in connection with interim reviews
- ▶ Preapproval of services
- ▶ Independence matters



**SEC requirements.** Regulation S-X, Rule 2-07, *Communication with Audit Committees*, requires the independent auditor to communicate the following to the audit committee:

- Critical accounting policies and practices used by the issuer
- Alternative accounting treatments within U.S. GAAP for accounting policies and practices related to material items that have been discussed with management during the current audit period, including the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the independent auditor
- Material written communications between the independent auditor and management of the issuer
- All nonaudit services provided to any entity in an investment company complex if the audit client is an investment company, as defined in 210.2-01(f)(14), that were not preapproved by the registered investment company's audit committee pursuant to 210.2-01(c)(7).

The SEC stated in its rule release that it expects these discussions to occur prior to filing Form 10-Q or Form 10-K.

SEC rules also require companies to include an audit committee report in their proxy statements. In the report, the audit committee must state whether it has:

- Reviewed and discussed the audited financial statements with management
- Discussed with the independent auditor all matters required under applicable auditing standards
- Received required independence disclosures from the independent auditor.

Based on this review and discussion, the report must also include a statement of whether the audit committee recommended to the board that the audited financial statements be included in the annual report to be filed with the SEC.

**NYSE requirements.** The NYSE listing standards require the audit committee to communicate with the independent auditor in the following ways:

- Meet to review and discuss with the independent auditor the company's annual audited financial statements and quarterly financial statements, including disclosures in management's discussion and analysis
- Periodically, meet separately with the independent auditor, management, and the internal auditors
- Obtain a formal written communication from the independent auditor regarding independence and other matters annually
- Review with the independent auditor any audit problems or difficulties and management's response
- Set clear hiring policies for employees or former employees of the company's independent auditor.

**NASDAQ requirements.** The NASDAQ listing standards require the audit committees of listed companies to obtain a formal written statement from the independent auditor, consistent with PCAOB Ethics and Independence Rule 3526, *Communication with Audit Committees Concerning Independence*.

## Audit committee reporting

The Center for Audit Quality, along with several governance organizations, formed the Audit Committee Collaboration<sup>1</sup>, which released a report titled *Enhancing the Audit Committee Report: A Call to Action* in November 2013 to encourage enhanced audit committee disclosures. In December 2014 the CAQ, along with Audit Analytics, published the *Audit Committee Transparency Barometer*, which presents findings from an analysis of 2014 audit committee disclosures in proxy statements, measuring the robustness of these disclosures among S&P Composite 1500 companies. The report measures the content of proxy statement disclosures in certain key areas, including auditor oversight and audit committee scope of duties.

The calls for increased transparency in key audit committee duties, including the oversight of the independent auditor, will likely continue to grow. Audit committees can respond by providing more meaningful disclosures that increase awareness of their responsibilities and how individual committees carry them out. For more information, read the [February 2014 Audit Committee Brief: A New Era in Audit Committee Reporting](#).

<sup>1</sup> The following groups are members of the Audit Committee Collaboration: Association of Audit Committee Members, Inc.; Center for Audit Quality; Corporate Board Member/NYSE Euronext; The Directors' Council; Independent Directors Council; Mutual Fund Directors Forum; National Association of Corporate Directors; and Tapestry Networks.

## Auditor independence

The SEC and PCAOB rules govern the independence of accountants who audit or review financial statements and prepare attestation reports filed with the SEC. The rules recognize the critical role of audit committees in financial reporting and their unique position in monitoring auditor independence.

The SEC independence rules address the following issues related to registrants:

- Relationships between the auditor and its audit client arising from:
  - Financial interests
  - Employment
  - Business dealings other than the audit and nonaudit services
- Nonaudit services provided by auditors
- Contingent fees and commissions
- Partner rotation
- The audit committee’s administration of the audit engagement
- Compensation of audit partners.

**Financial interests.** The rule states that independence is impaired if the audit firm or certain of its people have a direct or material indirect financial interest in an audit client. Examples of prohibited financial interests include an investment in the audit client’s debt or equity securities, loans, deposits not fully insured by the Federal Deposit Insurance Corporation, broker-dealer account balances not fully insured by the Securities Investor Protection Corporation, and certain individual insurance products.

**Employment relationships.** The rule states that independence is impaired if a current partner, principal, shareholder, or professional employee of the independent auditor has an employment relationship with, or serves as a

member of the board of directors or similar management or governing body of, the audit client. Former partners, principals, shareholders, or professional employees of the independent auditor cannot be employed in an accounting role or financial reporting oversight role—one who exercises more than minimal influence over the contents of accounting records or prepares them—at an audit client unless they are fully separated from the independent auditor, financially and otherwise. Even if this separation is achieved, former members of the audit engagement team for an issuer cannot take a financial reporting oversight role for the issuer before completion of one annual audit subsequent to the engagement period when the individual was a part of the engagement team. Employment restrictions also apply to certain close family members of the independent auditor’s personnel.

**Business relationships.** The rule prohibits an independent auditor from having a direct or material indirect business relationship with an audit client, or with persons associated with the audit client in a decision-making capacity, such as an audit client’s officers, directors, or substantial stockholders. This prohibition does not preclude the independent auditor from providing permissible services to the audit client or purchasing goods or services from the audit client as a consumer in the ordinary course of business.

**Nonaudit services provided by auditors.** The SEC’s rule sets forth 10 categories of services that impair the independent auditor’s independence if provided to an audit client. The rule permits an auditor to provide other nonaudit services to an issuer if the services are preapproved by the audit committee; however, the nonaudit fee does not have to be approved by the audit committee. Permissible nonaudit services include due diligence for mergers and acquisitions, internal control reviews, and tax services that are not prohibited by the PCAOB.

In certain limited circumstances, the independent auditor may provide bookkeeping, design, and implementation of financial information systems; appraisal or valuation services; actuarial services; and internal audit outsourcing to a non-client affiliate of an audit client if “it is reasonable to conclude that the results of these services will not be subject to auditing procedures during an audit of the audit client’s financial statements.” This is referred to as the “not-subject-to-audit” exception.

Prohibited services:

1. Bookkeeping or other services related to the accounting records or financial statements of the audit client
2. Design and implementation of financial information systems
3. Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
4. Actuarial services
5. Internal audit outsourcing
6. Management functions
7. Human resources
8. Broker-dealer, investment advisory, or investment banking services
9. Legal services
10. Expert services

In addition to the SEC’s 10 categories of prohibited services, the PCAOB also has discretion to prohibit any other service that it determines, by regulation, to be impermissible. To date, the PCAOB has issued rules prohibiting the independent auditor from:

- Providing a service or product to an audit client for a contingent fee or commission
- Marketing, planning, or opining in favor of the tax treatment of a confidential or aggressive tax transaction

- Providing tax services to persons in a financial reporting oversight role for an audit client.

**Partner rotation.** The SEC’s rule requires the lead audit and engagement quality review partners to rotate after five years, at which time they are subject to a five-year “time-out” period. Audit partners who are significantly involved with senior management or the audit committee or who are responsible for decisions on accounting matters that affect the financial statements, as well as advisory partners, must rotate after seven years and are subject to a two-year time-out period. This includes audit partners who serve as the lead partner for significant subsidiaries. Significant subsidiaries are defined as those accounting for greater than 20 percent of an issuer’s revenues or assets. Specialty partners, such as tax partners, are not required to rotate.

**The audit committee’s administration of the audit engagement (preapproval).** The audit committee must preapprove permissible audit and nonaudit services to be provided to the issuer and its subsidiaries. Preapproval can be obtained directly or based on policies and procedures that are detailed as to the type of service. These policies and procedures do not circumvent the need to inform the audit committee of the service, and the committee cannot delegate its preapproval responsibilities to management. It can, however, delegate preapprovals to one or more members of the committee if the preapprovals are reported at the next scheduled meeting of the full committee.

Further, the PCAOB rules provide that an audit firm seeking preapproval of tax services or nonaudit services related to internal control over financial reporting must:

1. Describe, in writing, the scope of the service. For tax services, the audit firm must describe, in writing, (i) the fee structure for the engagement, any side letter or other amendment to the engagement letter, or any other agreement between the firm and the audit client relating to the service; and (ii) any compensation arrangement or other agreement between the registered public accounting firm or an affiliate and any person other than the audit client with respect to promoting, marketing, or recommending a transaction covered by the service.
2. Discuss with the audit committee of the issuer the potential effects of the services on the independence of the firm.

**Compensation of audit partners.** Under the SEC’s rule, an auditor is not independent if, at any point during the audit and professional engagement period, any audit partner other than a specialty partner receives compensation from selling engagements to provide the audit client with any services other than audit, review, or attest services.

For the purpose of this restriction, the SEC defines the term “audit partner” as the lead and concurring partners and other partners on the engagement team who have responsibility for making decisions on significant auditing, accounting, and reporting matters that affect the financial statements or who maintain regular contact with management or the audit committee. This includes all audit partners serving the client at the issuer or parent, with the exception of specialty partners, as well as the lead partner at subsidiaries whose assets or revenues constitute at least 20 percent of the consolidated assets or revenues.

## Tools and resources



For additional information, read Deloitte’s *Appointing, Assessing, and Compensating the Independent Auditor: The Role of the Audit Committee*.

## Fee disclosure

The SEC's rule that implemented the Sarbanes-Oxley Act expanded on the requirements to disclose fees paid to the auditor, and many companies have opted to provide even more information. For instance, many companies subtotal the audit and audit-related fees so shareholders can easily quantify the portion of services that are audit and audit-related in nature.

Because certain institutional investors and investor advisers, such as Institutional Shareholder Services (ISS), have guidelines for proxy-vote recommendations, many companies disclose not only the nature of services in the fee categories but also the amounts associated with specific services in a particular category. For example, it is not uncommon for companies to bifurcate the disclosed tax fees into one amount for tax compliance services and another for tax planning services. Issuers should consult with legal counsel to determine the content of the fee disclosure.

1. **Audit fees** are fees for services that normally would be provided in connection with statutory and regulatory filings or engagements, including the audit of internal control over financial reporting. This category also may include services that only the independent auditor reasonably can provide, such as comfort letters, statutory audits, attest services, consents, and assistance with documents filed with the SEC. Audit fees may include certain services provided by specialists who assist in the audit, such as tax specialists needed to audit the tax provision or valuation specialists needed to audit a fair-value assertion; certain accounting consultations in connection with the audit; and similar items that are not billed as audit services and that only the independent auditor reasonably can provide.
2. **Audit-related fees** are for assurance and related services that are performed by the independent auditor, such as audits of employee benefit plans, due diligence related to mergers and acquisitions, accounting consultations and audits in connection with acquisitions, internal control reviews (not the audit of internal control over financial

reporting, which is part of audit fees), attest services that are not required by statute or regulation, and consultation concerning financial accounting and reporting standards (to the extent that such consultation is not necessary to complete the GAAS audit).

3. **Tax fees** include all tax services performed except those related to the audit (such as review of the tax provision, which would be included in audit fees). Typically, tax fees cover tax compliance, tax planning, and tax advice. Tax compliance generally involves preparation of original and amended tax returns, refund claims, and tax-payment planning services. Tax planning and tax advice encompass a diverse range of services, including assistance with tax audits and appeals, tax advice related to mergers and acquisitions, employee benefit plans, and requests for rulings or technical advice from tax authorities. The provision of tax services is subject to certain restrictions, among which are that company personnel must make all management decisions and perform all management functions, and that services cannot be provided for an employee with a financial oversight role.
4. **All other fees** include all fees paid to the independent auditor for services other than audit, audit-related, or tax services.

The SEC rule requires disclosure of fees paid to the independent auditor for the current year and the prior year, as well as a description of the services included in all categories, other than for audit fees, for both years. The audit committee's preapproval policies and procedures must be disclosed in a detailed description or by including the policy itself, along with disclosure of any services that were initially missed and later approved under a de minimis exception present in the SEC's rule. Disclosures are required in the issuer's annual report as well as the proxy statement, but companies are allowed to incorporate the information into their Form 10-K from their proxy statement.

## Evaluation of the independent auditor

Because there is no formal guidance regarding the evaluation of the independent auditor and needs and preferences vary by company and audit committee, practices for evaluating the independent auditor range from highly formalized processes with extensive documentation to more informal processes. Factors the audit committee may consider in developing an evaluation process include:

- **Frequency and timing of the evaluation.** Many audit committees perform the evaluation annually, immediately following the issuance of the Form 10-K.
- **Parties involved in the assessment.** Although the SEC does not explicitly require the audit committee to formally evaluate the independent auditor, many committees conduct some form of evaluation to make decisions on the auditor's initial appointment or annual reappointment. As noted previously, the SEC established the audit committee's responsibility for the appointment, compensation, and oversight of the independent auditor. However, it may not be practical for the audit committee to oversee and coordinate the entire evaluation. In many instances, the audit committee delegates the coordination responsibility to the internal audit department or another group in the company. The party responsible for coordinating the evaluation should obtain information not only from the audit committee, but from senior financial management and the internal auditors. Depending on the size and structure of the company, it may be appropriate to obtain input from the management of significant operating locations or business units.
- **Form and nature of the assessment.** Some independent auditors have assessment questionnaires for evaluating client service. Audit committees can use these questionnaires, tailor them to fit their needs, or create their own. The assessment can be done by having the relevant parties complete the questionnaire in writing or by holding interviews. They may

also have a discussion about the experience the audit committee and others at the company have had in working with the independent auditor.

- **Assessment criteria.** The criteria for evaluating the independent auditor vary. Common criteria specific to the engagement team include technical competence; industry knowledge; frequency and quality of communication; cohesiveness as a team; demonstrated independence, objectivity, and professional skepticism; and the level of support provided to the audit committee in fulfilling its responsibilities. Audit committees may consider information about the characteristics of the audit firm itself, such as size, financial strength and stability, presence in key markets, approach to professional development, technological capabilities, nature of the audit approach, quality of thought leadership, and eminence in the marketplace. The results of the PCAOB inspection process and peer reviews may also be considered in the evaluation.

The NYSE listing standards require the audit committee to review a report by the independent auditor describing its quality controls, results of investigations, and independence. The commentary accompanying this listing standard states that after reviewing the report and the independent auditor's work throughout the year, the audit committee will be in a position to evaluate the auditor's qualifications, performance, and independence.

The commentary also specifies that the "evaluation should include the review and evaluation of the lead partner of the independent auditor," and "should take into account the opinions of management and the company's internal auditors (or other personnel responsible for the internal audit function)."

## Tools and resources



A group of leading governance organizations<sup>1</sup> and the Center for Audit Quality released a tool, *Audit Committee Annual Evaluation of the External Auditor*, to help audit committees evaluate the external auditor as part of its annual reappointment process.

The PCAOB issued *Information for Audit Committees about the PCAOB Inspection Process*, which is intended to assist audit committees in better understanding the PCAOB's inspection process and gathering information from their audit firms about inspections.

<sup>1</sup> Association of Audit Committee Members, Inc.; Corporate Board Member/NYSE Euronext; Independent Directors Council; Mutual Fund Directors Forum; National Association of Corporate Directors; Tapestry Networks.



Section Five

# Education and evaluation

Board education

Audit committee performance evaluation

## Section Five

# Education and evaluation

## Board education

*“It is really important for audit committee members to commit to education. Chairmen should encourage members to refresh their skills and keep current with what’s going on.”* Audit committee member

The NYSE listing standards require board education to be addressed in the company’s corporate governance guidelines. Boards and audit committees should use a needs-based approach to determine the specific topics in a continuing education program.

With the enhanced focus on the responsibilities of boards and audit committees, continuing education for directors is an area of increasing importance. There are many options; for instance, public forums on corporate governance are offered by many professional services firms, universities, and not-for-profit organizations. Benefits include the opportunity to meet with peers and share experiences, and these programs can be invaluable for gaining knowledge from experts on trends in corporate governance. These forums often feature speakers who would not be available otherwise. However, boards should be careful not to rely completely on public programs designed for a broad audience, because they may not address the dynamics of a specific company and its industry.

An increasingly popular option is a customized program of continuing education focusing on topics such as roles and responsibilities, risk oversight, industry expertise, and financial literacy. Customized courses can address subjects relevant to the company’s needs and incorporate company-specific policies, processes, and objectives.

When designing a program of continuing education, the board should identify risks and complex issues facing the organization.

Directors can then evaluate their knowledge in these areas. This self-assessment can help the board gain a better picture of the issues it should include in the program. Depending on the organization’s size and complexity, the board may want to enlist the internal auditors or outside consultants in the self-assessment process.

For the audit committee, the focus is more specific, centered on financial reporting and accounting issues such as revenue recognition, pensions and other post-employment benefits, financial instruments, critical accounting policies, and internal controls.

Once a curriculum is set, the board, the audit committee, and management can assess the resources available to create and deliver the program. The program could be developed using a mix of individuals—some with company knowledge and others with an external perspective.

In addition to continuing education, the company should consider orientation programs for new directors and audit committee members. Materials may include information on the company’s history and operations, corporate governance, recent SEC filings, industry trends, accounting policies and practices, company policies and the code of ethics, and major business and financial risks.

Audit committees also benefit from periodically inviting subject-matter specialists to participate in audit committee meetings to enhance the committee’s knowledge and effectiveness. For example, specialists in cybersecurity, international tax, governance, or a particular industry could provide valuable insight in addressing risks or new requirements. Independent auditors or outside consultants can assist in identifying appropriate specialists.

## Audit committee performance evaluation

“I’ve seen improvements made as a result of a self-assessment. That is the beauty of doing one and having candid discussions about it during an executive session.”

*Fortune 500 company  
audit committee chairman*

The NYSE listing standards require audit committees to perform an annual performance evaluation, and this responsibility must be set forth in the audit committee’s charter. The SEC does not require audit committees to assess their performance, but the legislation itself may be the strongest argument for a robust evaluation process.

Performance assessments also provide information that the audit committee can use to improve processes. The following factors are often considered when evaluating the audit committee’s effectiveness:

- Independence of the audit committee members from management
- Clarity with which the audit committee’s responsibilities are articulated and the degree to which they are understood by management and the audit committee
- Interaction of the audit committee and the independent auditor, the internal auditors, and senior financial executives
- Whether the audit committee raises the right questions with management and the independent auditor, including questions that indicate the audit committee’s understanding of critical accounting policies and judgments and that challenge management’s judgments and conclusions
- Whether the audit committee has been responsive to issues raised by the independent auditor.

Because there are no specific requirements for how to assess an audit committee’s performance, members and directors have the benefit and the burden of collaborating on an appropriate

process. When advisable, this can be done in consultation with legal counsel.

There are several considerations in shaping the assessment process. First, there are various parties that may lead the assessment: the audit committee, the entire board or its nominating/governance committee, or the general counsel/corporate secretary. Some audit committees have found it useful to engage an objective third party to assist with the evaluation process.

A combination of these may prove optimal. For example, a committee may choose to engage an external adviser every two or three years, and facilitate the process internally in the other years.

The format of the evaluation is another consideration. In the case of a self-assessment, audit committee members may complete a questionnaire collectively or individually. If general counsel, the board, or management conducts the assessment, the format may consist of evaluation forms, interviews, or both. The party leading the evaluation may consider soliciting information from individuals who have significant interaction with the audit committee. The committee may want to consider changing the process periodically to keep it fresh.

Documentation is another significant factor, and the advice of corporate counsel is important in this matter. Regardless of the level of documentation in the evaluation process, the audit committee should identify and address opportunities for improvement.

Additionally, as part of its internal control over financial reporting procedures, the independent auditor must take into account the effectiveness of the audit committee’s oversight of financial reporting. The audit committee’s self-assessment process can support those procedures.

Developing and executing a plan of action for improvement is the ultimate objective of the assessment. A performance evaluation may highlight the need to examine issues such as the audit committee's composition and qualifications, information related to critical financial reporting areas, members' understanding of complex accounting and financial reporting issues, and meeting agendas.

A well-crafted performance assessment process can provide a number of benefits to the audit committee, including:

- Prioritizing the audit committee agendas and meeting structure to focus on the most critical issues
- Shifting compliance oversight into the time between live meetings
- Considering the committee's composition in the context of its current and future needs and challenges
- Revisiting the timing, level of detail, and quality of materials provided by management
- Identifying topics for continuing education.

## Tools and resources



For additional information, visit the [Board Evaluations, Education, and Development](#) section of the [Center for Corporate Governance website](#).

The [Performance Evaluations](#) section of Deloitte's [Center for Corporate Governance](#) website provides tools and resources, including a questionnaire that can be used for self-assessment.

Section Six

# Additional responsibilities

## Section Six

# Additional responsibilities

The NYSE and NASDAQ listing standards include responsibilities for audit committee members beyond those discussed previously. The SEC also grants additional authority to the audit committee.

The NYSE, NASDAQ, and the SEC all authorize the audit committee to engage and compensate independent counsel and advisers. In addition, the NYSE requires the audit committee to meet privately with management, the independent auditor, and the internal auditors periodically.

The audit committee may use the same counsel and advisers as management, but circumstances may warrant otherwise. Lawyers are the outside advisers most often engaged by audit committees. The primary reasons audit committees engage counsel are legal proceedings, corporate governance issues, whistleblower inquiries, fraud concerns, and SEC matters. The services may be investigative, or they may be used to identify potential process improvements. Audit committees may also consider engaging outside advisers to assist with their annual performance evaluations and continuing education.

# Appendices

- Appendix A      Sample audit committee charter
- Appendix B      Planning tool: Audit committee calendar of activities
- Appendix C      Audit committee performance evaluation

## Appendix A

# Sample audit committee charter

*This sample audit committee charter is based on observations of selected companies and the requirements of the SEC, the NYSE, and NASDAQ. The information presented can and will change; we are under no obligation to update such information<sup>1</sup>.*

*This template is designed for U.S. public companies; exceptions to the requirements noted below may apply for certain issuers, including investment companies, small-business issuers, and foreign private issuers. Many of the items presented here are not applicable to voluntary filers. All companies should consult with legal counsel regarding the applicability and implementation of the various requirements identified.*

## Audit committee of the board of directors—charter

### I. Purpose and authority

The audit committee is established by and among the board of directors for the primary purpose of assisting the board in:

- Overseeing the integrity of the company's financial statements [NYSE Corporate Governance Rule 303A.07(b)(i)(A)] and the company's accounting and financial reporting processes and financial statement audits [NASDAQ Corporate Governance Rule 5605(c)(1)(C)].
- Overseeing the company's compliance with legal and regulatory requirements [NYSE Corporate Governance Rule 303A.7(c)(i)(A)].
- Overseeing the registered public accounting firm's (independent auditor's) qualifications and independence [NYSE Corporate Governance Rule 303A.7(c)(i)(A) and NASDAQ Corporate Governance Rule 5605(c)(1)(b)].
- Overseeing the performance of the company's independent auditor [NYSE Corporate Governance Rule 303A.7(c)(i)(A) and NASDAQ Corporate Governance Rule 5605(c)(1)(b)] and internal audit function [NYSE Corporate Governance Rule 303A.7(c)(i)(A)].
- Overseeing the company's systems of disclosure controls and procedures, internal controls over financial reporting, and compliance with ethical standards adopted by the company.

The audit committee should encourage continuous improvement, and should foster adherence to the company's policies, procedures, and practices at all levels. The audit committee should also provide for open communication among the independent auditor, financial and senior management, the internal audit function, and the board of directors.

The audit committee has the authority to conduct investigations into any matters within its scope of responsibility and obtain advice and assistance from outside legal, accounting, or other advisers, as necessary to perform its duties and responsibilities [Section 10A(m)(5) of the Exchange Act, NYSE Corporate Governance Rule 303A.06, and NASDAQ Corporate Governance Rule 5605(c)(3)].

In carrying out its duties and responsibilities, the audit committee also has the authority to meet with and seek any information it requires from employees, officers, directors, or external parties.

<sup>1</sup> Deloitte LLP makes no representations as to the sufficiency of these tools for your purposes, and by providing them, we are not rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. These tools should not be viewed as a substitute for such professional advice or services, nor should they be used as a basis for any decision that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional adviser. Deloitte LLP does not assume any obligations as a result of your access to or use of these tools.



The company will provide appropriate funding, as determined by the audit committee, for compensation to the independent auditor, to any advisers that the audit committee chooses to engage, and for payment of ordinary administrative expenses of the audit committee that are necessary or appropriate in carrying out its duties [Section 10A of the Exchange Act, NYSE Corporate Governance Rule 303A.06, and NASDAQ Corporate Governance Rule 5605(c)(3)].

The audit committee's principal responsibility is one of oversight. The fundamental responsibility for the company's financial statements and disclosures rests with management and the independent auditor [General commentary to NYSE Corporate Governance Rule 303A.07(b)].

## II. Composition and meetings<sup>1</sup>

The audit committee will comprise three or more directors as determined by the board [NYSE Corporate Governance Rules 303A.06 and .07(a) and NASDAQ Corporate Governance Rule 5605(c)(2)(A)].

Committee members will be appointed by the board at the annual organizational meeting of the board to serve until their successors are elected. Unless a chairman is elected by the full board, the members of the committee may designate a chairman by majority vote.

Each audit committee member will meet the applicable standards of independence and the determination of independence will be made by the board and as defined by applicable standards listing [Section 10A of the Exchange Act, NYSE Corporate Governance Rules 303A.06 and .07(a) and NASDAQ Corporate Governance Rule 5605(c)(2)(A)].

All members of the committee must comply with all financial literacy requirements of the securities exchanges on which the company is listed. To help meet these requirements, the audit committee will provide its members with annual continuing education opportunities in financial reporting and other areas relevant to the audit committee<sup>2</sup>. At least one member will qualify as an "audit committee financial expert" as defined by the SEC and determined by the board and appropriate disclosure will be made [Item 407(d)(5) of Regulation S-K, NYSE Corporate Governance Rule 303A.07(a), and NASDAQ Corporate Governance Rule 5605(c)(2)(A)]<sup>3</sup>.

The board will determine that a director's simultaneous service on multiple audit committees will not impair the ability of such member to serve on the audit committee<sup>4</sup>.

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<sup>1</sup> Consideration also should be given to the amount of time members of the audit committee can devote to the role. While there are currently no regulations limiting the number of public-company audit committees on which an individual may serve, some companies have included such limitations in the audit committee charter. Furthermore, the NYSE required disclosures state: "If an audit committee member simultaneously serves on the audit committee of more than three public companies, the board must determine that such simultaneous service would not impair the ability of such member to effectively serve on the listed company's audit committee and disclose such determination either on or through the listed company's website or in its annual proxy statement, or if the company does not file an annual proxy statement, in its annual report on Form 10-K filed with the SEC."

<sup>2</sup> Although the existence of a continuing education program for the board and audit committee is not a requirement, NYSE Corporate Governance Rule 303A.09 requires companies to adopt and disclose guidelines for corporate governance that address their policies for directors' continuing education.

<sup>3</sup> NYSE Corporate Governance Rule 303A.07(a) requires all audit committee members to be "financially literate" as interpreted by the business judgment of the company's board, or to become financially literate within a reasonable period after being appointed to the committee. In addition, at least one member must have "accounting or related financial management expertise" as interpreted by the board. NASDAQ Corporate Governance Rule 5605(c)(2)(A) requires all audit committee members to be able to read and understand financial statements at the time of their appointment to the committee and requires at least one audit committee member to be "financially sophisticated." The SEC requires an issuer to disclose whether at least one audit committee financial expert serves on the audit committee or whether it does not have an audit committee financial expert serving on its audit committee [Item 407 (d)(5)(i)(A)(1) and (2) of Regulation S-K].

<sup>4</sup> The disclosure requirement of NYSE Corporate Governance Rule 303A.07(a) requires that if an audit committee member simultaneously serves on the audit committees of more than three public companies, the board must determine that such simultaneous service does not impair the ability of such member to effectively serve on the listed company's audit committee and must disclose such determination either on or through the listed company's website, in its annual proxy statement, or, if the listed company does not file an annual proxy statement, in its annual report on Form 10-K filed with the SEC.

The committee will meet at least quarterly, or more frequently as circumstances dictate. The committee chairman will approve the agenda for the committee's meetings and any member may suggest items for consideration. Briefing materials will be provided to the committee as far in advance of meetings as practicable.

Each regularly scheduled meeting will conclude with an executive session of the committee absent members of management. As part of its responsibility to foster open communication, the committee will meet periodically with management, the director of the internal audit function, and the independent auditor in separate private sessions [NYSE Corporate Governance Rule 303A.07(b)(iii)(E)].

### III. Responsibilities and duties

To fulfill its responsibilities and duties, the audit committee will engage in the following activities.

#### Documents/reports/accounting information review

1. Review this charter at least annually and recommend to the board of directors any necessary amendments [NASDAQ Corporate Governance Rule 5605(c)(1)].
2. Meet with management [Item 407(d)(3)(i)(A) of Regulation S-K] and the independent auditor to review and discuss the company's annual financial statements and quarterly financial statements (prior to the company's Form 10-K and 10-Q filings or release of earnings), including the company's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations" [Item 303 of Regulation S-K and NYSE Corporate Governance Rule 303A.07(b)(iii)(B)] and all internal control reports (or summaries thereof). Review other relevant reports or financial information submitted by the company to any governmental body or the public, including management certifications as required in Item 601(b)(31) of Regulation S-K and relevant reports rendered by the independent auditor (or summaries thereof).
3. Discuss earnings press releases, including the type and presentation of information, paying particular attention to any pro forma or adjusted non-GAAP information. Such discussions may be in general terms (i.e., discussion of the types of information to be disclosed and the type of presentations to be made) [NYSE Corporate Governance Rule 303A.07(b)(iii)(C)].
4. Discuss financial information and earnings guidance provided to analysts and ratings agencies. Such discussions may be in general terms (i.e., discussion of the types of information to be disclosed and the type of presentations to be made) [NYSE Corporate Governance Rule 303A.07(b)(iii)(C)].
5. Review the regular internal reports to management (or summaries thereof) prepared by the internal audit function, as well as management's response.

#### Independent auditor

6. Appoint (and recommend that the board submit for shareholder ratification, if applicable), compensate, retain, and oversee the work performed by the independent auditor retained for the purpose of preparing or issuing an audit report or related work [Section 10A(m)(2) of the Exchange Act, NYSE Corporate Governance Rule 303A.06, and NASDAQ Corporate Governance Rule 5605(c)(3)]. Review the performance and independence of the independent auditor and remove the independent auditor if circumstances warrant. The independent auditor will report directly to the audit committee and the audit committee will oversee the resolution of disagreements between management and the independent auditor if they arise [Section 10A(m)(2) of the Exchange Act].
7. Review and preapprove (which may be pursuant to preapproval policies and procedures<sup>1</sup>) both audit and nonaudit services to be provided by the independent auditor [Section 10A(g) and (h) of the Exchange Act]. The authority to grant preapprovals may be delegated to one or more designated members of the audit committee, whose decisions will be presented to the full audit committee at its next regularly scheduled meeting [Section 10A(i) of the Exchange Act].

<sup>1</sup> Any policy under which audit or nonaudit services are preapproved needs to be detailed as to the particular services and the audit committee needs to be informed of each service [Rule 2-01(c) of Regulation S-X].

8. Consider whether the auditor's provision of permissible nonaudit services is compatible with the auditor's independence [Rule 2-01(c) of Regulation S-X]. Actively engage in dialogue with the independent auditor with respect to any disclosed relationships or services that may affect the independence and objectivity of the auditor and take appropriate actions to oversee the independence of the independent auditor [NASDAQ Corporate Governance Rule 5605(c)(1)(B)].
9. Discuss with the independent auditor the matters required to be discussed under the standards of the PCAOB [Item 407(d)(3)(i)(B) of Regulation S-K].
10. Review with the independent auditor any problems or difficulties and management's response [NYSE Corporate Governance Rule 303A.7(c)(iii)(F)].
11. Hold timely discussions with the independent auditor regarding the following:
  - All critical accounting policies and practices.
  - All alternative treatments of financial information within generally accepted accounting principles related to material items that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditor.
  - Other material written communications between the independent auditor and management, including, but not limited to, the management letter and schedule of unadjusted differences [Rule 2-07(a)(3) of Regulation S-X].
12. At least annually, obtain and review a report by the independent auditor describing:
  - The independent auditor's internal quality-control procedures [NYSE Corporate Governance Rule 303A.07(b)(iii)(A)].
  - Any material issues raised by the most recent internal quality control review or peer review, or by any inquiry or investigation by governmental or professional authorities within the preceding five years with respect to independent audits carried out by the independent auditor, and any steps taken to deal with such issues [NYSE Corporate Governance Rule 303A.07(b)(iii)(A)].
  - All relationships between the independent auditor and the company [NYSE Corporate Governance Rule 303A.07(b)(iii)(A)], addressing the matters set forth in PCAOB Rule 3526 [Item 407(d)(3)(i)(C) of Regulation S-K].
13. Use this report to evaluate the independent auditor's qualifications, performance, and independence. Further, the committee will review the experience and qualifications of the lead partner each year and determine that all partner rotation requirements, as promulgated by applicable rules and regulations, are executed. The audit committee should present its conclusions to the full board [Commentary to NYSE Corporate Governance rule 303A.07(b)(iii)(A)].
14. Assess whether the independent auditor is consistently demonstrating objectivity and skepticism in the performance of its work.
15. Set policies, consistent with governing laws and regulations, for hiring personnel of the independent auditor [NYSE Corporate Governance Rule 303A.07(b)(iii)(G)]<sup>1</sup>.

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<sup>1</sup> Such policy should take into consideration the one-year "cooling-off period" for individuals in a financial reporting oversight role, such as the CEO, CFO, controller, CAO, or the equivalent, as well as other prohibited relationships under the related rules of the SEC.

## Financial reporting processes, accounting policies, and internal control structure

16. In consultation with the independent auditor and the internal audit function, review the integrity of the company's financial reporting processes (both internal and external).
17. Understand the scope of the independent auditors' review of internal control over financial reporting.
18. Receive and review any disclosure from the company's CEO and CFO made in connection with the certification of the company's quarterly and annual reports filed with the SEC of: a) significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize, and report financial data; and b) any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal controls.
19. Review major issues regarding accounting principles and financial statement presentations, including any significant changes in the company's selection or application of accounting principles; major issues as to the adequacy of the company's internal controls; and any special audit steps adopted in light of material control deficiencies [General commentary to NYSE Corporate Governance Rule 303A.07(b)].
20. Review analyses prepared by management and the independent auditor setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements [General commentary to NYSE Corporate Governance Rule 303A.07(b)].
21. Review the effect of regulatory and accounting initiatives, as well as off-balance-sheet structures, on the financial statements of the company [General commentary to NYSE Corporate Governance Rule 303A.07(b)].
22. Review and approve all related-party transactions, defined as those transactions required to be disclosed under Items 404(a) and (b) of Regulation S-K, NYSE Rule 314.00, and NASDAQ Corporate Governance Rule 5630. Discuss with the independent auditor its evaluation of the company's identification of, accounting for, and disclosure of its relationships with related parties as set forth under the standards of the PCAOB.
23. Establish and oversee procedures for the receipt, retention, and treatment of complaints regarding accounting, internal accounting controls, or auditing matters, including procedures for confidential, anonymous submissions by company employees regarding questionable accounting or auditing matters [Section 10A(m)(4) of the Exchange Act, NYSE Corporate Governance Rule 303A.06, and NASDAQ Corporate Governance Rule 5605(c)(3)].

## Internal audit<sup>1,2</sup>

24. Review and advise on the selection and removal of the internal audit director.
25. Review the activities and organizational structure of the internal audit function, as well as the qualifications of its personnel.
26. Annually, review and recommend changes (if any) to the internal audit charter.
27. Periodically review, with the internal audit director, any significant difficulties, disagreements with management, or scope restrictions encountered in the course of the function's work.
28. Periodically review, with the independent auditor, the internal audit function's responsibility, budget, and staffing [Commentary to NYSE Corporate Governance Rule 303A.07(b)(iii)(F)].

## Ethical compliance, legal compliance, and risk management<sup>3</sup>

29. Oversee, review, and periodically update the company's code of business conduct and ethics<sup>4</sup> and the company's system to monitor compliance with and enforce this code.
30. Review, with the company's counsel, legal compliance and regulatory matters that could have a significant impact on the company's financial statements [Commentary to NYSE Corporate Governance Rule 303A.07(b)(iii)(H)].
31. Discuss policies with respect to risk assessment and risk management, including appropriate guidelines and policies to govern the process, as well as the company's major financial risk exposures and the steps management has undertaken to control them [NYSE Corporate Governance Rule 303A.07(b)(ii)(D)].
32. Consider the risk of management's ability to override the company's internal controls.

## Reporting

33. Report regularly to the board regarding the execution of the audit committee's duties, responsibilities, and activities, as well as any issues encountered and related recommendations [NYSE Corporate Governance Rule 303A.07(b)(iii)(H)].
34. Recommend to the board of directors that the audited financial statements be included in the company's annual report on Form 10-K [Item 407(d)(3)(i)(D) of Regulation S-K].

## Other responsibilities

35. Review, with management, the company's finance function, including its budget, organization, and quality of personnel.
36. Conduct an annual performance assessment relative to the audit committee's purpose, duties, and responsibilities outlined herein [NYSE Corporate Governance Rule 303A.07(b)(ii)].
37. Perform any other activities consistent with this charter, the company's bylaws, and governing laws that the board or audit committee determines are necessary or appropriate.

<sup>1</sup> Though not required, many companies have a process in place by which the internal and independent auditors evaluate each other on an annual basis. Should the audit committee choose to include the responsibility to review any such evaluations, the following language may be used: "Review the results of the annual evaluation of the internal audit function by the independent auditor and the review of the independent auditor by the internal audit function. Recommend improvements as necessary."

<sup>2</sup> NYSE Corporate Governance Rule 303A.7(d) requires each listed company to have an internal audit function. The NYSE commentary indicates that this function does not have to be a separate department and may be outsourced if the company chooses. Language regarding the internal audit function should be reviewed and modified, if necessary, to reflect the nature and composition of such function at a given company.

<sup>3</sup> The audit committee charter should include the items 30 through 33 if the audit committee, rather than another committee, assumes responsibilities with respect to ethical compliance.

<sup>4</sup> NYSE Corporate Governance Rule 303A.10 and NASDAQ Corporate Governance Rule 5610 require listed companies to maintain a code of business conduct and ethics. Although the rules do not require the audit committee to be responsible for establishing, maintaining, and overseeing enforcement of this code, the rules do require the audit committee to oversee legal compliance, which, in many cases, includes the code of conduct.

## Supplement for the 2013 COSO framework

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) released an updated version of its *Internal Control — Integrated Framework* in May 2013. Under COSO’s transition guidance, the 2013 framework superseded the original 1992 COSO framework as of December 15, 2014.

The table below lists the role of the board of directors—and, by delegation or regulation, the role of the audit committee—emphasized by the 2013 framework. This COSO supplement contains responsibilities related to the board and audit committee. These are not changes to any of the listing requirements set forth under existing guidance.

### 2013 COSO Framework

| Oversight activities of the board   | Principle <sup>1</sup>   |
|---|--|
| <b>CONTROL ENVIRONMENT</b>  |  |
| Work with management to demonstrate the importance of integrity and ethical values to support the functioning of the system of internal control (i.e., helping to set the tone at the top).   | <b>1</b> Demonstrates commitment to integrity and ethical values |
| Oversee the definition of and apply the standards of conduct of the organization (and ensure that deviations are addressed in a timely manner).   |  |
| Oversee management’s design, implementation, and conduct of internal control.   | <b>2</b> Exercises oversight responsibility                      |
| Commission board oversight effectiveness reviews and address opportunities for improvement (defining and identifying oversight responsibilities); define, maintain, and periodically evaluate the skills and expertise needed among board members.                    |  |
| Demonstrate the independence of board members from management requirements.   |  |
| Exercise fiduciary responsibilities to shareholders or other owners and due care in oversight (e.g., prepare for and attend meetings, review the entity’s financial statements and other disclosures).  |  |
| Challenge senior management by asking probing questions about the entity’s plans and performance and require follow-up and corrective actions, as necessary (e.g., questioning transactions that occur repeatedly at the end of interim or annual reporting periods). |  |
| Provide oversight of the structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.  | <b>3</b> Establishes structure, authority, and responsibility    |
| Work with management to evaluate competence across the organization and with outsourced service providers in accordance with established policies, practices, and acts to address shortcomings.   | <b>4</b> Demonstrates commitment to competence                   |
| Work with senior management to develop succession plans.  |  |
| Establish expectations and evaluate the performance, integrity, and ethical values of the CEO or equivalent role.   | <b>5</b> Enforces accountability                                 |
| Work with management to establish performance measures, incentives, and rewards appropriate for all levels of the entity that align with the fulfillment of responsibilities.   |  |
| Work with management to evaluate and adjust pressures on the board, the audit committee, and management.  |  |

<sup>1</sup> Principle 6 (“specifies suitable objectives”) and principle 13 (“uses relevant information”) are focused on management responsibilities and are excluded from this supplement.

## 2013 COSO Framework

| Oversight activities of the board   | Principle   |
|---|---|
| <b>RISK ASSESSMENT</b>  |   |
| Consider internal and external factors that pose significant risks to the achievement of objectives; identify issues and trends (e.g., sustainability implications of the entity's business operations).  | <b>7</b> Identifies and analyzes risk                           |
| Challenge management's assessment of risks to the achievement of objectives, including the potential impact of significant changes (e.g., risks associated with entering a new market) and fraud or corruption.   | <b>8</b> Assesses fraud risk                                    |
| Evaluate how proactively the organization assesses risks related to innovations and changes, such as those triggered by new technology or economic and geopolitical shifts.   | <b>9</b> Identifies and analyzes significant change             |
| <b>CONTROL ACTIVITIES</b>   |   |
| Consider internal and external factors that pose significant risks to the achievement of objectives; identify issues and trends (e.g., sustainability implications of the entity's business operations).  | <b>10</b> Selects and develops control activities               |
|   | <b>11</b> Selects and develops general controls over technology |
|   | <b>12</b> Deploys through policies and procedures               |
| Oversee senior management in its performance of control activities.   | <b>10</b> Selects and develops control activities               |
|   | <b>11</b> Selects and develops general controls over technology |
|   | <b>12</b> Deploys through policies and procedures               |
| <b>INFORMATION AND COMMUNICATION</b>  |   |
| Communicate direction and tone at the top.  | <b>14</b> Communicates internally                               |
| Obtain, review, and discuss information relating to the entity's achievement of objectives.   | <b>14</b> Communicates internally                               |
|   | <b>15</b> Communicates externally                               |
| Scrutinize information received and present alternative views.  | <b>14</b> Communicates internally                               |
|   | <b>15</b> Communicates externally                               |
| Review disclosures to external stakeholders for completeness, relevance, and accuracy.  | <b>15</b> Communicates externally                               |
| Allow for and address upward communication of issues.   | <b>14</b> Communicates internally                               |
|   | <b>15</b> Communicates externally                               |
| <b>MONITORING ACTIVITIES</b>  |   |
| Assess and oversee the nature and scope of monitoring activities and management overrides of controls, and management's evaluation and remediation of deficiencies.   | <b>16</b> Conducts ongoing and/or separate evaluations          |
|   | <b>17</b> Evaluates and communicates deficiencies               |
| Engage with management, internal and external auditors, and others, as appropriate, to evaluate the level of awareness of the entity's strategies, specified objectives, risks, and control implications associated with evolving business, infrastructure, regulations, and other factors. | <b>16</b> Conducts ongoing and/or separate evaluations          |

## Planning tool: Audit committee calendar of activities

Audit committees can use this tool to help plan their annual activities and meeting agendas. It considers the requirements for the audit committees of U.S. public companies, including NYSE- and NASDAQ-listed companies, as well as common practices in the marketplace, and it is subject to change if additional guidance is issued. The “Results From:” section indicates if the action or responsibility results from a requirement of SEC rule-making, the NYSE, NASDAQ, or a common or emerging practice. The action or responsibility, as described, may not be an explicit legislative or regulatory requirement or proposal, but may be an action that logically results from other legislative or regulatory requirements or proposals. The “Suggested Frequency” section offers a benchmark for how often the activity could be performed, while the “Meeting Month” section provides an area where the audit committee can mark the months in which an activity should be performed. The audit committee can use this tool in conjunction with the “Sample Audit Committee Charter” and tailor it to reflect the responsibilities in the company’s audit committee charter.

This document is not an all-inclusive list of activities that an audit committee should or must execute. The planning tool contains general information only and does not constitute, and should not be regarded as, legal or similar professional advice or service<sup>1</sup>.

The information presented can and will change; we are under no obligation to update such information. Deloitte LLP makes no representations as to the sufficiency of these tools for your purposes, and, by providing them, we are not rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. These tools should not be viewed as a substitute for such professional advice or services, nor should they be used as a basis for any decision that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional adviser. Deloitte LLP does not assume any obligations as a result of your access to or use of these tools.

This planning tool is designed for U.S. public companies; exceptions to the requirements noted below may apply for certain issuers, including investment companies, small-business issuers, and foreign private issuers. Many of the items presented here are not applicable to voluntary filers. All companies should consult with legal counsel regarding the applicability and implementation of the various activities identified.

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<sup>1</sup> Deloitte LLP does not accept any responsibility for any errors this publication may contain, whether caused by negligence or otherwise, or for any losses, however caused, sustained by any person that relies on it.



| Action/responsibility                    | Results from:   |                        |                          |                 | Suggested frequency | Meeting month                |          |       |       |     |      |      |        |           |         |          |          |  |  |
|--|---|------------------------|--------------------------|-----------------|---------------------|------------------------------|----------|-------|-------|-----|------|------|--------|-----------|---------|----------|----------|--|--|
|  | SEC requirement   | NYSE listing standards | NASDAQ listing standards | Common practice |                     | January                      | February | March | April | May | June | July | August | September | October | November | December |  |  |
| General responsibilities                 | Monitor audit committee members' compliance with applicable independence rules and regulations.   | ■                      | ■                        | ■               |                     | Ongoing                      |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | As necessary, engage outside legal, accounting, or other advisers and provide funding to compensate those advisers.   | ■                      | ■                        | ■               |                     | As needed                    |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Report regularly to the board of directors regarding the execution of duties and responsibilities.  |                        | ■                        |                 |                     | Each board meeting           |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Review the financial literacy and expertise of all audit committee members. Determine audit committee financial expert status and determine that members are in compliance with applicable rules and regulations.   | ■                      | ■                        | ■               |                     | Annually                     |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Disclose in the Form 10-K (or equivalent annual filing) whether at least one member of the audit committee has been determined to be an "audit committee financial expert," as defined by the SEC. If the board determines that someone on the audit committee meets the definition, disclose his/her name and whether he/she is independent. If more than one audit committee member is determined to fulfill the definition, determine if the names and independence of those individuals will be disclosed. If there is not an audit committee financial expert, disclose why not. | ■                      |                          |                 |                     | Annually                     |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Conclude each regular audit committee meeting with an executive session of the committee, without members of management.  |                        |                          |                 | ■                   | Each audit committee meeting |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Periodically, meet with management privately to discuss any necessary matters.  |                        | ■                        |                 |                     | Quarterly                    |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Consider and plan for succession of audit committee members.  |                        |                          |                 | ■                   | Annually                     |          |       |       |     |      |      |        |           |         |          |          |  |  |
| Review of financial/controls information | Review, with management, the company's finance function, including its budget, organization, and quality of personnel.  |                        |                          |                 | ■                   | Annually                     |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Review and discuss with management and the independent auditor the company's annual financial statements and quarterly financial statements prior to filing, including the company's disclosure under "Management's Discussion and Analysis of Financial Condition and Results of Operations."  | ■                      | ■                        |                 |                     | Quarterly                    |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Recommend to the board of directors whether the financial statements should be included in the annual report on Form 10-K.  | ■                      |                          |                 |                     | Annually                     |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Review the internal controls report.  |                        |                          |                 | ■                   | Annually                     |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Review management certifications required by the SEC.   | ■                      |                          |                 |                     | Quarterly                    |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Review other reports rendered by the independent auditor and submitted by the company to any governmental body or the public.   | ■                      |                          |                 |                     | As needed                    |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Discuss earnings press releases, including the type and presentation of information, paying particular attention to any pro forma or adjusted non-GAAP information. This discussion may be in general terms.  |                        | ■                        |                 |                     | Quarterly                    |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Discuss the financial information and earnings guidance provided to analysts and ratings agencies. This discussion may be in general terms.   |                        | ■                        |                 |                     | Annually                     |          |       |       |     |      |      |        |           |         |          |          |  |  |
|  | Review the regular internal reports to management prepared by the internal audit function and management's response.  |                        |                          |                 |                     | Semiannually                 |          |       |       |     |      |      |        |           |         |          |          |  |  |

| Action/responsibility   | Results from:   |                        |                          |                 | Suggested frequency                      | Meeting month |          |       |       |     |      |      |        |           |         |          |          |
|---|-----------------|------------------------|--------------------------|-----------------|--|---------------|----------|-------|-------|-----|------|------|--------|-----------|---------|----------|----------|
|   | SEC requirement | NYSE listing standards | NASDAQ listing standards | Common practice |  | January       | February | March | April | May | June | July | August | September | October | November | December |
| Appoint the independent auditor.  | ■               | ■                      | ■                        |                 | Annually                                 |               |          |       |       |     |      |      |        |           |         |          |          |
| Compensate, retain, and oversee the work of the independent auditor for the purpose of preparing or issuing an audit report or related work.  | ■               | ■                      | ■                        |                 | Ongoing                                  |               |          |       |       |     |      |      |        |           |         |          |          |
| Review the qualifications and performance of the independent auditor, including the lead audit partner. Ensure that partners are rotated in accordance with applicable requirements.  |                 | ■                      |                          |                 | Annually                                 |               |          |       |       |     |      |      |        |           |         |          |          |
| Preapprove audit and nonaudit services provided by the independent auditor.   | ■               |                        |                          |                 | In accordance with policy (as necessary) |               |          |       |       |     |      |      |        |           |         |          |          |
| Consider the independence of the auditor, including engaging in dialogue with the independent auditor with respect to any disclosed relationships or services that may affect the independence, objectivity, and professional skepticism of the auditor, and take appropriate actions to oversee independence.  |                 |                        | ■                        |                 | Annually and as needed                   |               |          |       |       |     |      |      |        |           |         |          |          |
| Oversee the resolution of disagreements between management and the independent auditor if they arise.   | ■               |                        |                          |                 | As needed                                |               |          |       |       |     |      |      |        |           |         |          |          |
| Review with the independent auditor any problems or difficulties encountered in the course of the audit and management's response.  |                 | ■                      |                          |                 | Annually                                 |               |          |       |       |     |      |      |        |           |         |          |          |
| Understand the scope of the independent auditor's review of internal control over financial reporting.  |                 |                        |                          | ■               | Annually                                 |               |          |       |       |     |      |      |        |           |         |          |          |
| Prior to filing periodic financial statements, receive the report from the independent auditor required by Rule 2-07(a)(3) of Regulation S-X. This report includes: <ul style="list-style-type: none"> <li>– Critical accounting policies and practices</li> <li>– Alternative treatments of financial information within GAAP related to material items that have been discussed with management, the ramifications of using these alternative disclosures and treatments, and the treatment preferred by the independent auditor</li> <li>– Other material written communications between the independent auditor and management, including (but not limited to) the management letter and schedule of unadjusted differences.</li> </ul> | ■               |                        |                          |                 | As reported by the independent auditor   |               |          |       |       |     |      |      |        |           |         |          |          |
| Discuss with the independent auditor the matters required to be discussed under the standards of the PCAOB.   | ■               |                        |                          |                 | As reported by the independent auditor   |               |          |       |       |     |      |      |        |           |         |          |          |
| Periodically, meet privately with the independent auditor to discuss any necessary matters.   |                 | ■                      |                          | ■               | Quarterly                                |               |          |       |       |     |      |      |        |           |         |          |          |
| Review hiring policies for personnel of the independent auditor.  |                 | ■                      |                          | ■               | As needed                                |               |          |       |       |     |      |      |        |           |         |          |          |
| Obtain and review a report by the independent auditor describing: <ul style="list-style-type: none"> <li>– The independent auditor's internal quality-control procedures</li> <li>– Any material issues raised by the most recent internal quality-control review, peer review, or any inquiry or investigation by governmental or professional authorities, within the preceding five years, with respect to independent audits carried out by the independent auditor, and any steps taken to deal with such issues</li> <li>– All relationships between the independent auditor and the company.</li> </ul>  |                 | ■                      |                          |                 | Annually                                 |               |          |       |       |     |      |      |        |           |         |          |          |

| Action/responsibility   | Results from:   |                        |                          |                 | Suggested frequency | Meeting month             |           |       |       |     |      |      |        |           |         |          |          |  |  |  |
|---|---|------------------------|--------------------------|-----------------|---------------------|---------------------------|-----------|-------|-------|-----|------|------|--------|-----------|---------|----------|----------|--|--|--|
|   | SEC requirement   | NYSE listing standards | NASDAQ listing standards | Common practice |                     | January                   | February  | March | April | May | June | July | August | September | October | November | December |  |  |  |
| Financial reporting processes, accounting policies, and internal control                                    | In consultation with the independent auditor and the internal audit function, review the integrity of the company's financial reporting processes (both internal and external) and the internal control structure (including disclosure controls and procedures and internal control over financial reporting).   |                        |                          |                 | ■                   | Quarterly                 |           |       |       |     |      |      |        |           |         |          |          |  |  |  |
|   | Meet with representatives of the disclosure committee to discuss any anomalies encountered in the management certification process.   |                        |                          |                 | ■                   | Quarterly                 |           |       |       |     |      |      |        |           |         |          |          |  |  |  |
|   | Review with management major issues regarding accounting principles and presentation of the financial statements, including any significant changes in the company's selection or application of accounting principles, major issues as to the adequacy of the company's internal controls, and any special audit steps adopted in response to material control deficiencies. |                        | ■                        |                 |                     |                           | Quarterly |       |       |     |      |      |        |           |         |          |          |  |  |  |
|   | Review management's analyses of financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements.  |                        | ■                        |                 |                     |                           | Quarterly |       |       |     |      |      |        |           |         |          |          |  |  |  |
|   | Review with management the effect of regulatory and accounting initiatives, as well as off-balance-sheet structures, on the financial statements of the company.  |                        | ■                        |                 |                     |                           | As needed |       |       |     |      |      |        |           |         |          |          |  |  |  |
|   | Review and approve all related-party transactions.  | ■                      | ■                        | ■               |                     |                           | Quarterly |       |       |     |      |      |        |           |         |          |          |  |  |  |
|   | Review the adequacy of procedures for the receipt, retention, and treatment of complaints regarding accounting, internal accounting controls, or auditing matters, including procedures for confidential, anonymous submissions by company employees.   | ■                      | ■                        | ■               |                     |                           | Annually  |       |       |     |      |      |        |           |         |          |          |  |  |  |
| Receive and review reports or complaints of questionable accounting, auditing, or internal control matters. |   |                        |                          | ■               |                     | Semiannually or quarterly |           |       |       |     |      |      |        |           |         |          |          |  |  |  |
| Internal audit activities   | Review and advise on the selection or removal of the internal audit director.   |                        |                          |                 | ■                   | As needed                 |           |       |       |     |      |      |        |           |         |          |          |  |  |  |
|   | Meet with the director of the internal audit function privately to discuss any necessary matters.   |                        | ■                        |                 |                     | Quarterly                 |           |       |       |     |      |      |        |           |         |          |          |  |  |  |
|   | Review with the internal audit director any significant difficulties, disagreements with management, or scope restrictions encountered in the course of the function's work.  |                        |                          |                 | ■                   | Annually                  |           |       |       |     |      |      |        |           |         |          |          |  |  |  |
|   | Review the activities and organizational structure of the internal audit function, as well as the qualifications of its personnel.  |                        |                          |                 | ■                   | Annually                  |           |       |       |     |      |      |        |           |         |          |          |  |  |  |
|   | Review the internal audit charter and recommend any necessary changes.  |                        |                          |                 | ■                   | Annually                  |           |       |       |     |      |      |        |           |         |          |          |  |  |  |
|   | Discuss, with the independent auditor, the internal audit function's responsibilities, budget, and staffing.  |                        | ■                        |                 |                     |                           | Annually  |       |       |     |      |      |        |           |         |          |          |  |  |  |

| Action/responsibility                                     |  | Results from:   |                        |                          |                 | Suggested frequency                   | Meeting month |          |       |       |     |      |      |        |           |         |          |          |  |
|---|--|-----------------|------------------------|--------------------------|-----------------|---------------------------------------|---------------|----------|-------|-------|-----|------|------|--------|-----------|---------|----------|----------|--|
|   |  | SEC requirement | NYSE listing standards | NASDAQ listing standards | Common practice |                                       | January       | February | March | April | May | June | July | August | September | October | November | December |  |
| Ethical compliance, legal compliance, and risk management | Review the company's code of ethical conduct and the company's systems to monitor compliance and enforce this code. Determine whether the code is in compliance with applicable rules and regulations. |                 |                        |                          | ■               | Annually                              |               |          |       |       |     |      |      |        |           |         |          |          |  |
|   | Receive and review reports of code violations and how they were identified and treated.  |                 |                        |                          | ■               | Quarterly                             |               |          |       |       |     |      |      |        |           |         |          |          |  |
|   | In consultation with the company's legal counsel, review legal compliance and legal and regulatory matters that could have a significant impact on the organization's financial statements.            |                 | ■                      |                          |                 | Semiannually, or more often as needed |               |          |       |       |     |      |      |        |           |         |          |          |  |
|   | Discuss with management significant risk exposures, including major financial and accounting risk exposures, and the steps taken by management to control them.  |                 | ■                      |                          |                 | Annually                              |               |          |       |       |     |      |      |        |           |         |          |          |  |
| Other responsibilities                                    | Review the audit committee charter; recommend to the board of directors any necessary amendments, as conditions dictate.   |                 |                        | ■                        |                 | Annually                              |               |          |       |       |     |      |      |        |           |         |          |          |  |
|   | Review, with the independent auditor, the internal audit function, and management, the extent to which changes or improvements in financial or accounting practices have been implemented.             |                 |                        |                          | ■               | As needed                             |               |          |       |       |     |      |      |        |           |         |          |          |  |
|   | Participate in appropriate continuing education.   |                 |                        |                          | ■               | As needed                             |               |          |       |       |     |      |      |        |           |         |          |          |  |
|   | Assess performance relative to the audit committee's purpose, duties, and responsibilities.  |                 | ■                      |                          |                 | Annually                              |               |          |       |       |     |      |      |        |           |         |          |          |  |

## Appendix C


# Audit committee performance evaluation

The following questionnaire is based on emerging and leading practices to assist in the self-assessment of an audit committee's performance. It is not intended to be all-inclusive.

When completing the performance evaluation, consider the following process:

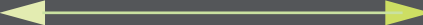
- Select a coordinator and establish a timeline for the process.
- In addition to audit committee members completing the form as a self-evaluation, ask individuals who interact with the audit committee members to provide feedback.
- Ask each audit committee member to complete an evaluation by selecting the rating that most closely reflects the audit committee's performance related to each practice.
- Consolidate the results into a summarized document for discussion and review by the committee.

For each of the following statements, select a number between 1 and 5, with 1 indicating that you strongly disagree and 5 indicating that you strongly agree with the statement. Leave blank if the point is not applicable or you do not have enough information to rank the organization's audit committee on a particular statement.


| <b>Composition and quality</b>   | <i>Strongly disagree</i> ←  <i>Strongly agree</i> |   |   |   |   |
|--|--|---|---|---|---|
|  | 1  | 2 | 3 | 4 | 5 |
| 1. Qualified audit committee members are identified by sources independent of management (e.g., independent board members assisted by an outside search firm).   | 1  | 2 | 3 | 4 | 5 |
| 2. Audit committee members have the appropriate qualifications to meet the objectives of the audit committee's charter, including appropriate financial literacy.  | 1  | 2 | 3 | 4 | 5 |
| 3. The audit committee demonstrates integrity, credibility, trustworthiness, active participation, an ability to handle conflict constructively, strong interpersonal skills, and the willingness to address issues proactively. | 1  | 2 | 3 | 4 | 5 |
| 4. The audit committee demonstrates appropriate industry knowledge and includes a diversity of experiences and backgrounds.  | 1  | 2 | 3 | 4 | 5 |
| 5. Members of the audit committee meet all applicable independence requirements.   | 1  | 2 | 3 | 4 | 5 |
| 6. The audit committee participates in a continuing education program to enhance its members' understanding of relevant accounting, reporting, regulatory, auditing, and industry issues.  | 1  | 2 | 3 | 4 | 5 |
| 7. The audit committee monitors compliance with corporate governance regulations and guidelines.   | 1  | 2 | 3 | 4 | 5 |
| 8. The audit committee reviews its charter annually to determine whether its responsibilities are described adequately and recommends changes to the board for approval.   | 1  | 2 | 3 | 4 | 5 |
| 9. New audit committee members participate in an orientation program to educate them on the company, their responsibilities, and the company's financial reporting and accounting practices.                                     | 1  | 2 | 3 | 4 | 5 |
| 10. The audit committee chairman is an effective leader.   | 1  | 2 | 3 | 4 | 5 |
| 11. The audit committee, in conjunction with the nominating committee (or its equivalent), creates a succession and rotation plan for audit committee members, including the audit committee chairman.                           | 1  | 2 | 3 | 4 | 5 |

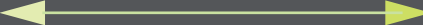
## Understanding the business, including risks

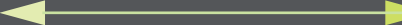

|  | <i>Strongly disagree</i> ← |   |   |   | → <i>Strongly agree</i> |
|--|----------------------------|---|---|---|-------------------------|
| <p>12. The audit committee considers or knows that the full board or other committees take into account significant risks that may directly or indirectly affect financial reporting. Examples include:</p> <ul style="list-style-type: none"> <li>• Regulatory and legal requirements</li> <li>• Concentrations (e.g., suppliers and customers)</li> <li>• Market and competitive trends</li> <li>• Financing and liquidity needs</li> <li>• Financial exposures</li> <li>• Business continuity</li> <li>• Company reputation</li> <li>• Financial strategy execution</li> <li>• Financial management’s capabilities</li> <li>• Management override</li> <li>• Fraud control</li> <li>• Company pressures, including “tone at the top”</li> </ul> | 1                          | 2 | 3 | 4 | 5                       |
| 13. The audit committee considers, understands, and approves the process implemented by management to effectively identify, assess, and respond to the organization’s risks.   | 1                          | 2 | 3 | 4 | 5                       |
| 14. The audit committee understands and approves management’s fraud risk assessment and has an understanding of identified fraud risks.  | 1                          | 2 | 3 | 4 | 5                       |
| 15. The audit committee considers the company’s performance versus that of its peers in a manner that enhances comprehensive risk oversight by using reports provided directly by management to the audit committee or at the full board meeting. These may include benchmarking information comparing the company’s financial performance and ratios with industry competitors and peers, industry trends, analyst estimates, and budget analysis with explanations for areas where significant differences are apparent.   | 1                          | 2 | 3 | 4 | 5                       |

| Process and procedures   | <i>Strongly disagree</i> ←  <i>Strongly agree</i> |   |   |   |   |
|--|--|---|---|---|---|
| 16. The audit committee reports its proceedings and recommendations to the board after each committee meeting.   | 1  | 2 | 3 | 4 | 5 |
| 17. The audit committee develops a calendar that dedicates the appropriate time and resources needed to execute its responsibilities.  | 1  | 2 | 3 | 4 | 5 |
| 18. Audit committee meetings are conducted effectively, with sufficient time spent on significant or emerging issues.  | 1  | 2 | 3 | 4 | 5 |
| 19. The level of communication between the audit committee and relevant parties is appropriate; the audit committee chairman encourages input on meeting agendas from committee and board members, management, the internal auditors, and the independent auditor. | 1  | 2 | 3 | 4 | 5 |
| 20. The audit committee sets clear expectations and provides feedback to the full board concerning the competency of the organization's CFO and senior financial management.   | 1  | 2 | 3 | 4 | 5 |
| 21. The audit committee has input into the succession planning process for the CFO.  | 1  | 2 | 3 | 4 | 5 |
| 22. The agenda and related information (e.g., prior meeting minutes, press releases, financial statements) are circulated in advance of meetings to allow audit committee members sufficient time to study and understand the information.                         | 1  | 2 | 3 | 4 | 5 |
| 23. Written materials provided to audit committee members are relevant and concise.  | 1  | 2 | 3 | 4 | 5 |
| 24. Meetings are held with enough frequency to fulfill the audit committee's duties and at least quarterly, which should include periodic visits to company locations with members of management.  | 1  | 2 | 3 | 4 | 5 |
| 25. Regularly, audit committee meetings include separate private sessions with management and the internal and independent auditors.   | 1  | 2 | 3 | 4 | 5 |
| 26. The audit committee maintains adequate minutes of each meeting.  | 1  | 2 | 3 | 4 | 5 |
| 27. The audit committee and the compensation committee regularly review management incentive plans to consider whether the incentive process is appropriate.   | 1  | 2 | 3 | 4 | 5 |
| 28. The audit committee meets periodically with the committee responsible for reviewing the company's disclosure procedures.   | 1  | 2 | 3 | 4 | 5 |
| 29. The audit committee respects the line between oversight and management of the financial reporting process.   | 1  | 2 | 3 | 4 | 5 |
| 30. Audit committee members come to meetings well prepared.  | 1  | 2 | 3 | 4 | 5 |



| <b>Oversight of the financial reporting process, including internal controls</b>   | <i>Strongly disagree</i> ←  <i>Strongly agree</i> |   |   |   |   |
|--|--|---|---|---|---|
| 31. The audit committee considers the quality and appropriateness of financial accounting and reporting, including the transparency of disclosures.  | 1  | 2 | 3 | 4 | 5 |
| 32. The audit committee reviews the company's significant accounting policies.   | 1  | 2 | 3 | 4 | 5 |
| 33. The audit committee understands and approves the process used by management to identify and disclose related-party transactions.   | 1  | 2 | 3 | 4 | 5 |
| 34. The audit committee has a process for reviewing quarterly and annual earnings releases, including pro forma or non-GAAP information and other significant financial information or earnings guidance, with management and the independent auditor.   | 1  | 2 | 3 | 4 | 5 |
| 35. The audit committee oversees the organization's external financial reporting and internal control over financial reporting. This oversight includes a process for reviewing Forms 10-Q and 10-K (including management's discussion and analysis), proxies, and other filings before they are issued and providing comments to management and the independent auditor when applicable.        | 1  | 2 | 3 | 4 | 5 |
| 36. The audit committee reviews the processes related to financial statement certifications made by the CEO and the CFO.   | 1  | 2 | 3 | 4 | 5 |
| 37. The audit committee receives sufficient information to assess and understand management's process for evaluating the organization's system of internal controls (e.g., financial reporting and disclosure controls, operation controls, compliance controls) and also believes that management's scope of internal control testing adequately supports its internal control assessment.      | 1  | 2 | 3 | 4 | 5 |
| 38. The audit committee understands and gives appropriate consideration to the internal control testing conducted by management, the internal auditors, and the independent auditor to assess the process for detecting internal control issues or fraud. Any significant deficiencies or material weaknesses that are identified are addressed, reviewed, and monitored by the audit committee. | 1  | 2 | 3 | 4 | 5 |
| 39. The audit committee makes inquiries of the independent auditor, internal auditors, and management on the depth of experience and sufficiency of the company's accounting and finance staff.  | 1  | 2 | 3 | 4 | 5 |
| 40. The audit committee reviews the management recommendation letters written by the independent and internal auditors and monitors the process to determine that all significant matters are addressed.   | 1  | 2 | 3 | 4 | 5 |
| 41. The audit committee oversees that management takes action to achieve resolution when there are repeat comments from auditors, particularly those related to internal controls.   | 1  | 2 | 3 | 4 | 5 |
| 42. Adjustments to the financial statements that resulted from the audit are reviewed by the audit committee, regardless of whether they were recorded by management.  | 1  | 2 | 3 | 4 | 5 |
| 43. The audit committee is consulted when management is seeking a second opinion on an accounting or auditing matter.  | 1  | 2 | 3 | 4 | 5 |

| <b>Oversight of audit functions</b>   | <i>Strongly disagree</i> ←  <i>Strongly agree</i> |   |   |   |   |
|---|--|---|---|---|---|
| 44. The audit committee understands the coordination of work between the independent and internal auditors and clearly articulates its expectations of each.  | 1  | 2 | 3 | 4 | 5 |
| 45. The audit committee regularly reviews the adequacy of the internal audit function (e.g., the charter; audit plan; budget; compliance; and number, quality, and continuity of staff).                          | 1  | 2 | 3 | 4 | 5 |
| 46. The audit committee oversees the role of the internal audit director from selection to termination (e.g., appointment, evaluation, compensation, and retention) and provides feedback at least annually.      | 1  | 2 | 3 | 4 | 5 |
| 47. The internal audit reporting lines established with the audit committee promote an atmosphere where significant issues that might involve management will be brought to the attention of the audit committee. | 1  | 2 | 3 | 4 | 5 |
| 48. The audit committee appropriately considers internal audit reports, management’s responses, and steps toward improvement.   | 1  | 2 | 3 | 4 | 5 |
| 49. The audit committee oversees the role of the independent auditor from selection to termination and has an effective process to evaluate the independent auditor’s qualifications and performance.             | 1  | 2 | 3 | 4 | 5 |
| 50. The audit committee considers the independent audit plan and provides recommendations.  | 1  | 2 | 3 | 4 | 5 |
| 51. The audit committee reviews the audit fees paid to the independent auditors.  | 1  | 2 | 3 | 4 | 5 |
| 52. The audit committee comprehensively reviews management’s representation letters to the independent auditor, including making inquiries about any difficulties in obtaining the representations.               | 1  | 2 | 3 | 4 | 5 |
| 53. The audit committee preapproves all audit and nonaudit services provided by the independent auditor and considers the scope of the nonaudit services provided.  | 1  | 2 | 3 | 4 | 5 |
| 54. The audit committee reviews other professional services that relate to financial reporting (e.g., consulting, legal, and tax strategy services) provided by outside consultants.                              | 1  | 2 | 3 | 4 | 5 |
| 55. The audit committee monitors the process to determine that the independent auditor’s partners are rotated in accordance with applicable rules.  | 1  | 2 | 3 | 4 | 5 |
| 56. The audit committee has private sessions with management and the internal and independent auditors that result in candid discussion of pertinent issues.  | 1  | 2 | 3 | 4 | 5 |

| <b>Ethics and compliance</b>  | <i>Strongly disagree</i> ←  <i>Strongly agree</i> |   |   |   |   |
|---|--|---|---|---|---|
| 57. Audit committee members oversee the process and are notified of communications received from governmental or regulatory agencies related to alleged violations or areas of noncompliance.   | 1  | 2 | 3 | 4 | 5 |
| 58. The audit committee oversees management’s procedures for enforcing the company’s code of conduct.   | 1  | 2 | 3 | 4 | 5 |
| 59. The audit committee determines that there is a senior-level person designated to understand relevant legal and regulatory requirements.   | 1  | 2 | 3 | 4 | 5 |
| 60. The audit committee oversees the organization’s hotline or whistleblower process, reviews the log of incoming calls that relate to possible fraudulent activity, and understands the procedures to prohibit retaliation against whistleblowers. | 1  | 2 | 3 | 4 | 5 |
| <b>Oversight of audit functions</b>   | <i>Strongly disagree</i> ←  <i>Strongly agree</i> |   |   |   |   |
| 61. An annual performance evaluation of the audit committee is conducted and any matters that require follow-up are resolved and presented to the full board.   | 1  | 2 | 3 | 4 | 5 |
| 62. The company provides the audit committee with sufficient funding to fulfill its objectives and engage external parties for matters requiring external expertise.  | 1  | 2 | 3 | 4 | 5 |

## For more information:

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