

## Audit Committee Resource Guide

April 2018

Center *for*  
**Board Effectiveness**



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# Message from Deloitte's Center for Board Effectiveness

The expectations of audit committees are higher than ever. Shareholders rely on audit committees to maintain oversight while keeping up with increasingly complex financial reporting requirements and a changing regulatory landscape. Setting the appropriate tone at the top has never been more important for audit committees and boards as a whole.

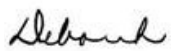
As an audit committee member, your judgment is critical to management and the shareholders who depend on you to execute your governance responsibilities. Success requires a clear understanding of the committee's charter, NYSE and NASDAQ listing requirements, and the rules set by the SEC and the PCAOB.

Responsibilities vary by organization, but an audit committee's obligations typically include oversight of financial reporting, risk, internal and independent auditors, and ethics and compliance programs. To lead in these areas, it is important for the audit committee to build strong relationships with a variety of internal and external stakeholders who have an impact on the company's risk profile and ability to create value.

Our work with audit committees suggests there is some consistency in the issues and challenges they face. One is to set the right tone at the top and foster and model a culture of compliance; another is to monitor growing cyber risk while overseeing those responsible for risk management. Audit committees should also stay apprised of new accounting and regulatory requirements and consider the increasing demand for greater transparency in external communications and disclosures. Organizations also look to the audit committee to build relationships and oversee finance talent and succession planning. To rise to these challenges, it is critical for audit committees to stay informed as the pace of change accelerates.

The *Audit Committee Resource Guide* offers practical considerations and resources to help audit committee members execute their responsibilities by outlining regulatory requirements, questions to consider, and tools and resources available from [Deloitte's Center for Board Effectiveness](#) and other governance organizations. We hope this guide is valuable as you raise the bar on performance individually and as a full committee.

Kind regards,



**Deb DeHaas**  
**Vice Chairman and**  
**National Managing Partner**  
Center for Board Effectiveness  
Deloitte



**Henry Phillips**  
**Vice Chairman and**  
**National Managing Partner**  
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# Preface

The *Audit Committee Resource Guide* presents an overview of audit committee requirements, leading practices, and considerations for US public companies. The guide is a reference for both seasoned and new committee members. Please note that the guide is not a comprehensive examination of all audit committee requirements. Companies should review applicable SEC and NYSE or NASDAQ exchange regulations and consult a qualified professional adviser to understand their full compliance needs.



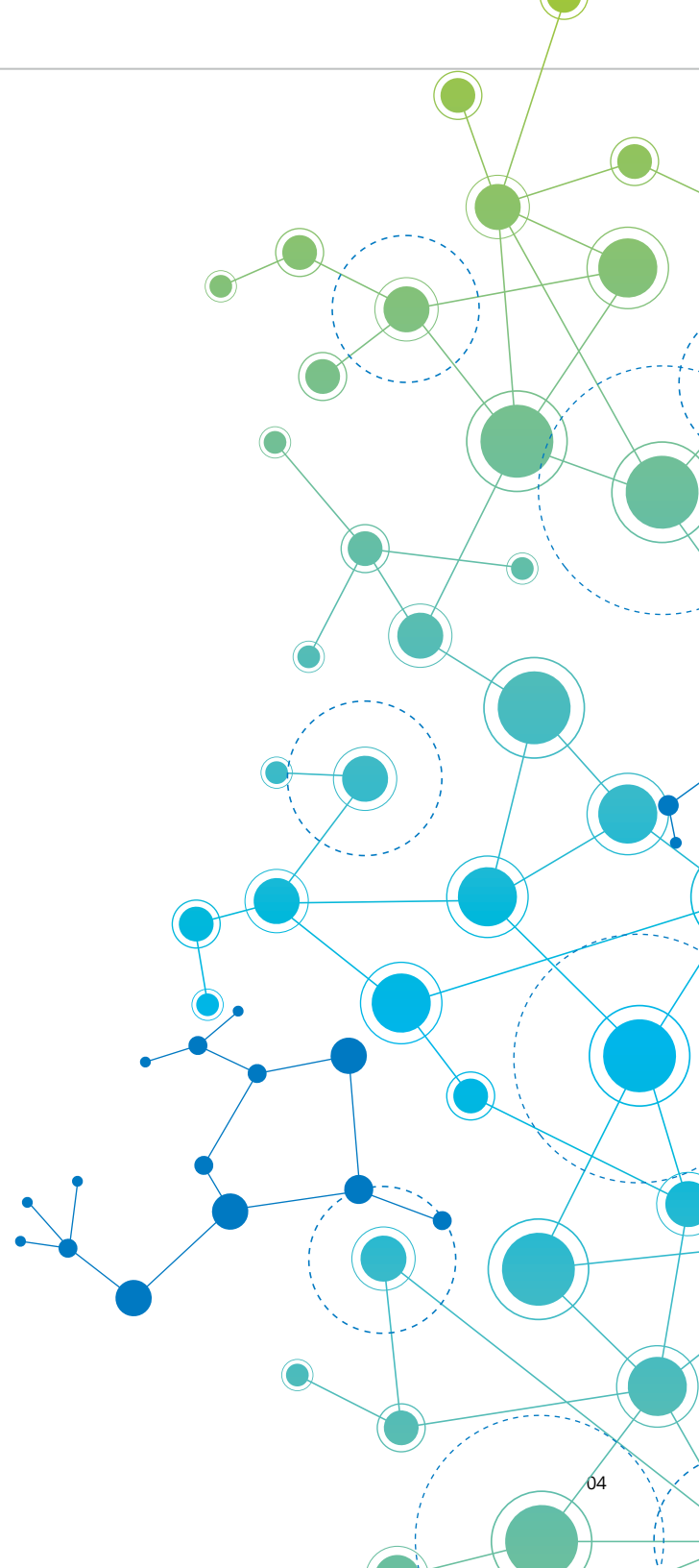
If you have any questions or comments about this guide, please contact Deloitte's Center for Board Effectiveness at [centerforboardeffectiveness@deloitte.com](mailto:centerforboardeffectiveness@deloitte.com).



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Additional resources for boards and audit committees can be found at Deloitte's Center for Board Effectiveness page at: [www.deloitte.com/us/en/pages/center-for-board-effectiveness/topics/center-for-board-effectiveness.html](http://www.deloitte.com/us/en/pages/center-for-board-effectiveness/topics/center-for-board-effectiveness.html)





# Audit committee requirements and governance topics

Composition

Charter

Meetings

Evaluation and self-assessment

Education

# Audit committee requirements and governance topics

Audit committees of publicly traded US companies are subject to SEC rules and listing standards of the exchange on which the company's securities are listed (i.e., the NYSE or NASDAQ). Some of these rules and standards relate to committee composition, the charter, committee evaluations, and member education. These topics, as well as advice on how to run effective audit committee meetings, are covered in this section.

## Composition

The audit committee should consist of three or more directors who are "independent," as determined by the board based on the requirements discussed below. All members must comply with the financial literacy requirements of the relevant securities exchange. Although audit committees are not required to include an "audit committee financial expert," as defined by the SEC, it is considered beneficial for at least one member to qualify as an expert to avoid having to disclose the reasons why there is none.

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

## Independence and qualifications of members

Audit committee members must be independent directors, and their independence should be continuously maintained and reviewed at least annually. Listed companies should have policies in place to allow timely identification of changing relationships or circumstances that may affect the independence of



audit committee members. Companies generally require directors to complete questionnaires when joining the board and each year 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.

*Having appropriate and relevant skills on the audit committee is increasingly important. I'm constantly challenging the composition. Do we have the right competencies on the audit committee? Are there skills we need to add?*

#### **Audit Committee Chairman**

**SEC requirements.** [Section 10A of the Securities Exchange Act of 1934](#) specifies general criteria for audit committee independence. Under these criteria, an audit committee member is permitted to receive compensation such as director fees, retainers, and meeting fees for serving on the board, the audit committee, or another committee, but may not:

- Accept any other consulting, advisory, or compensatory fee from the company or any subsidiary
- Be affiliated with the company or any subsidiary, as discussed below.

Prohibited compensation includes that received 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. Prohibited compensation also includes payments to spouses, minor children or stepchildren, and adult children or stepchildren who share a home with the audit committee member.

Whether a person is “affiliated” with the company or a subsidiary depends on the circumstances. Under the SEC rules, a person will be affiliated if he or she is an executive officer or both a director and employee, general partner, or managing member of a company or another entity that controls, is controlled by, or is under common control with the company. “Control” is defined as “the power to direct or cause the direction of...management and policies..., whether through the ownership of voting securities, by contract, or otherwise.” Under the SEC rule, a director is considered independent

to serve on an audit committee if he or she is neither an executive officer nor a holder of 10 percent or more of the entity's shares. The rule provides limited exceptions.

**NYSE and NASDAQ requirements.** The NYSE and NASDAQ listing standards incorporate the SEC's independence requirements, but each has its own additional requirements.

NYSE listing standards state that an audit committee member is not independent if any of the following applies:

- He or she is an employee or an immediate family member<sup>1</sup> is or was an executive officer of the company during the past three years.
- He or she or an immediate family member received more than \$120,000 in direct compensation from the company in any 12-month period during the previous three years, except for director fees and other permitted payments.
- He or she or an immediate family member is a current partner of the company's internal or independent auditor; he or she is a current employee of such a firm; he or she has an immediate family member who is a current employee of such a firm and personally works on the company's audit; he or she or an immediate family member was, but is no longer, a partner or employee of such a firm and personally worked on the company's audit during the previous three years.
- He or she 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

<sup>1</sup> A person's spouse, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters-in-law, brothers- and sisters-in-law, and anyone other than domestic employees who shares such person's home. ([NYSE listing standards](#))

services in an amount that, in any one of the previous three fiscal years, was in excess of the greater of \$1 million or 2 percent of the other company's consolidated gross revenues.

NASDAQ listing standards state that an audit committee member is not independent if any of the following applies:

- He or she is an employee or a family member is or was an executive officer of the company during the previous three years.
- He or she or a family member<sup>1</sup> accepted compensation in excess of \$120,000 from the company in any 12-month period during the previous three years, except for director fees and other permitted payments.
- He or she or a family member is a partner of the company's independent auditor or was a partner or employee of the company's independent auditor and worked on the company's audit during the previous three years.
- He or she 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).

**Director qualification disclosure requirements.** The SEC requires proxy disclosures about the qualifications of directors and the nomination process. The disclosure includes information about the experience, qualifications, and attributes considered in the

nomination process and the reasons why individuals should serve on the company's board. Disclosures regarding individual board committee qualifications are not required, but companies may want to consider including such qualifications as a part of the overall board qualification disclosure.

### Financial literacy and expertise

**SEC requirements.** The SEC requires an issuer to disclose whether at least one "audit committee financial expert" serves on the audit committee, and if so, the name of the expert and whether he or she is independent of management. The SEC defines the term as an individual who the board determines to possess all the following attributes:

- An understanding of financial statements and generally accepted accounting principles (GAAP)
- An ability to assess the general application of GAAP in connection with accounting for estimates, accruals, and reserves
- 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 company's financial statements, or experience actively supervising those engaged in such activities
- An understanding of internal control over financial reporting
- An understanding of the audit committee's functions.

The rule indicates that the attributes may be acquired by any of the following:

- 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.

Disclosure of whether at least one audit committee member is an audit committee financial expert is required in the annual report, usually by reference to the proxy statement. If the committee does not have at least one audit committee financial expert, the company must explain why it does not. The SEC also requires disclosure of the financial expert's name and whether he or she is independent of management. The company may choose to disclose whether more than one audit committee member is an audit committee financial expert, but the names of any additional experts need not be disclosed.

The SEC rule states that designation as a financial expert 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.

<sup>1</sup> A person's spouse, parents, children and siblings, whether by blood, marriage, or adoption, or anyone residing in such person's home. ([NASDAQ listing standards](#))



**NYSE requirements.** The NYSE requires all audit committee members to be “financially literate” as interpreted by 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 a financial expert, a person who satisfies the SEC’s definition also satisfies the NYSE requirement.

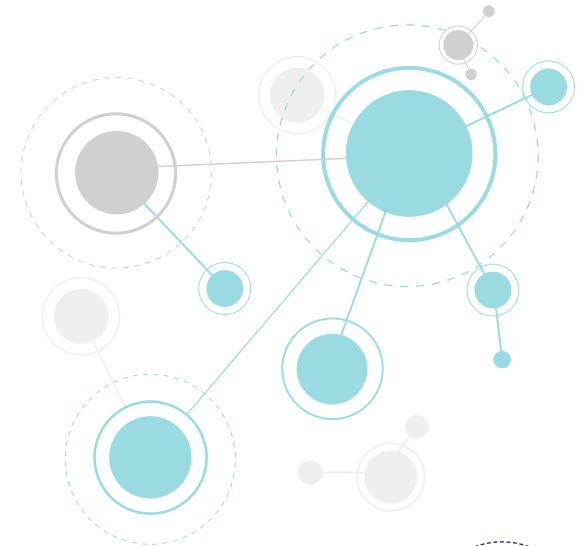
**NASDAQ requirements.** NASDAQ listing standards require all audit committee members to be able to read and understand financial statements at the time of their appointment to the committee. NASDAQ also requires at least one audit committee member to be “financially sophisticated.” Financial sophistication 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 a financial expert on the audit committee, but if the board determines an individual to be a financial expert, he or she will also be deemed financially sophisticated.

**Common practices and considerations.** In designating an audit committee financial expert, the board should abide by the SEC rules and applicable listing requirements noted above, and may wish to consult with legal counsel when doing so. Given the complex issues audit committees often address, many are choosing to have more than one financial expert.

According to Deloitte’s latest proxy statement analysis, [Audit Committee Disclosure in Proxy Statements – 2017 Trends](#), 86 percent of the S&P 100 disclosed that their audit committees have more than one financial expert. In making this determination, the board 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 financial expert status does not change over time, it is important that audit committee members invest the effort 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 financial expert designation periodically. It is also important for the board and

the audit committee to consider financial literacy and expertise during succession planning.



## Questions for audit committees to consider

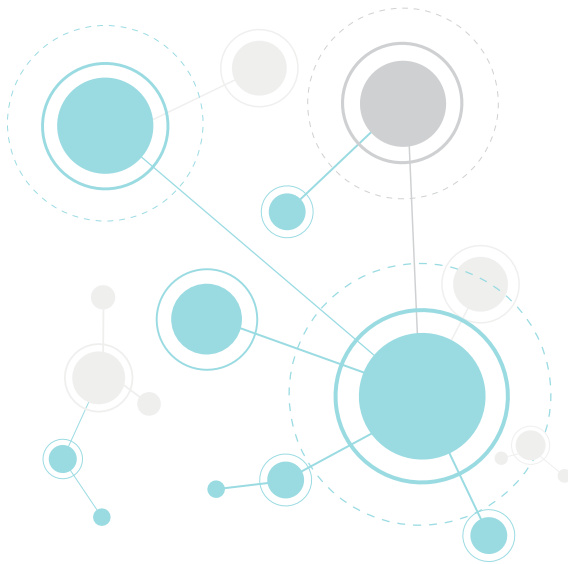


### Composition

- Does the nominating and governance committee maintain a matrix that incorporates the skills and attributes needed on the audit committee?
- Does the audit committee periodically assess its composition to confirm its members collectively have the skills and experience (e.g., industry, business, leadership) needed to fulfill the committees’ duties? Are any gaps discussed with the nominating and governance committee chairman?
- When assessing committee composition, does the committee consider attributes such as diversity, tenure, and experience?
- Do the audit committee members meet the requirements for financial expertise and financial literacy?
- Are training and education programs available to help audit committee members maintain their financial knowledge?

*One of the audit committee's biggest challenges is to keep discussions relevant to their responsibilities and leave broader topics for the full board. Without the charter's guideposts, the committee may lose its way.*

**Audit Committee Chairman**



## Charter

Both the NYSE and NASDAQ outline minimum requirements for the content of the audit committee charter. Additional detail on these responsibilities is included in the sample audit committee charter template in **Appendix A**.

**NYSE requirements.** 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.

Charters of NYSE-listed companies also 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 executive sessions with management, internal audit personnel, 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 ([NYSE 303A.07](#)).

**NASDAQ requirements.** Under NASDAQ standards, the charter should include the audit 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 those responsibilities, including structure, processes, and membership requirements. The responsibilities in the charter must include all of the following:

- 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.

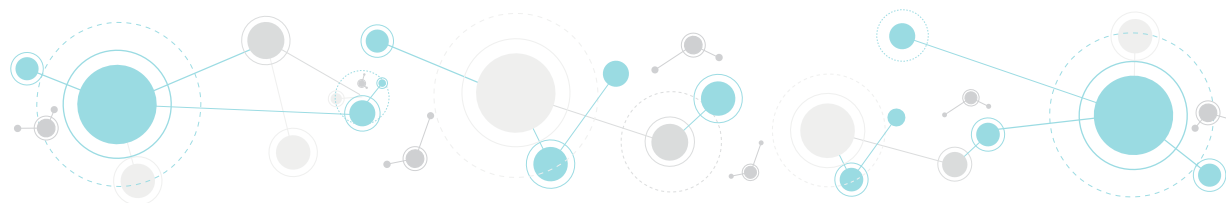
**Common practices and considerations.** An annual review of the charter is recommended for all audit committees and is required for NASDAQ-listed entities. Some factors that may render updates necessary are:

- 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 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 audit committee wants to formalize and include among its responsibilities.

In addition to addressing responsibilities prescribed by rules and listing standards, the charter should set forth the audit committee's recurring responsibilities, as well as its responsibility for overseeing significant transactions and unusual events. The charter should allow the committee to meet outside the official calendar when needed. Concurrent with the charter review, the committee can examine its calendar of meetings and consider if modifications are needed.

When updating the charter and calendar, it may be helpful to consult with legal counsel, management, the internal auditors, and the independent auditor.

SEC rules require the proxy statements of public companies to disclose whether the board has adopted a written charter for the audit committee. If so, the statement must disclose whether a copy of the charter is available on the company's website and provide the address.



### Tools and resources



Deloitte has developed a template for an audit committee charter based on those of a variety of companies and the requirements of the SEC, the NYSE, and NASDAQ. See **Appendix A** for a sample audit committee charter for US public companies. The charter can be used with the calendar planning tool in **Appendix B**.

### Right to engage independent counsel



The NYSE, NASDAQ, and the SEC all authorize the audit committee to engage and compensate independent counsel and advisers. 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 and may be engaged to advise on areas such as 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.

## Meetings

Audit committees should consider ways to implement or enhance practices that will help them conduct effective meetings. Each committee should consider what is most effective for its circumstances, but certain practices are valuable for most.

**Calendar.** As noted above, audit committees can use the charter to create a calendar outlining what will be covered during each meeting over the course of a year. This can help confirm that required matters are addressed and allow the chairman to determine whether meetings are frequent and long enough to cover the necessary topics.

**Meeting agendas.** Once the annual calendar is established, the chairman and management can create meeting agendas that focus on critical risks and priority areas. The agendas should be flexible enough to address any issues that may arise during the year and allow time for critical discussion by committee members. The chairman should consider how to prioritize agenda items so the committee allocates appropriate time to high-priority topics. A well-planned and -managed agenda will help the committee stay focused.

Consider allocating time on the agenda for educational topics or more in-depth discussions to help committee members stay informed of risks and issues affecting the company. These educational sessions can be led by management or involve external specialists.

**Meeting materials.** As the demands on audit committees increase, it is important for meeting materials to contain information that facilitates discussion and effective decision making. Advance materials should be provided to the audit committee well ahead of meetings and include executive summaries that

help members understand risks and issues. Materials should clearly identify the actions to be taken by the committee.

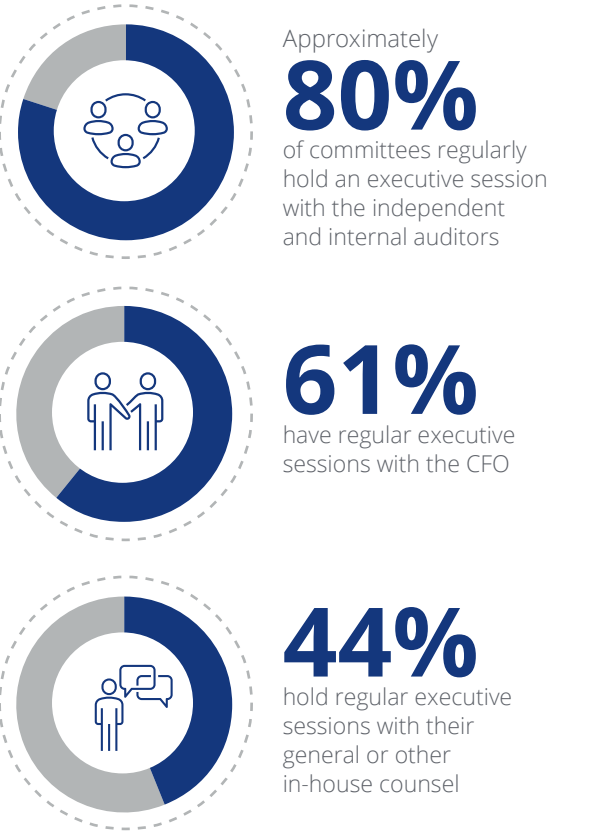
**Meeting attendees and discussions.** The chairman should work with management to determine who should attend each meeting. Although it is important to have the right subject-matter resources in attendance, the chairman should keep the meetings small enough to encourage candid discussions. Each attendee should have a role and contribute to the overall goals of the meeting.

Critical discussion and engagement in meetings should be encouraged by the chairman and members should come prepared, having read all advance materials and prepared questions for management. The chairman should keep the discussion focused on important topics and reprioritize the agenda if necessary.

**Executive sessions.** Executive sessions allow the audit committee to meet privately with key members of executive management (e.g., the CEO and CFO), the independent auditor, the internal auditors, and the general counsel or chief legal officer. They provide an opportunity to discuss sensitive issues that may not be appropriate in a larger meeting. Executive sessions often occur after regular business portion of the meeting and should be held even if there are no specific topics to discuss. This practice helps keep the lines of communication open between the audit committee and its stakeholders. Some audit committees also meet privately in advance of meetings, to discuss the agenda and priorities, and after meetings and executive sessions to debrief, outline actions, and consider future agenda topics.

Average director time commitment for the audit committee:	
Number of in-person meetings per year	5.5
Average in-person meeting length (hours)	2.6
Number of meetings conducted remotely via telephone or other electronic means	3.2

Source: 2017–18 NACD Public Company Governance Survey, National Association of Corporate Directors



Source: Deloitte 2016 Board Practices Report

## Evaluation and self-assessment

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 and NASDAQ listing standards do not require audit committees to assess their performance, but all audit committees should consider how performance assessments could provide information they can use to enhance their performance and processes.

Factors often considered when evaluating the audit committee's effectiveness include:

- Independence of the audit committee members from management
- Fulfillment of the audit committee's role, including what is outlined in its charter
- Articulation of the committee's responsibilities and the degree to which they are understood by management, the independent and internal auditors, and the committee
- Interaction among the committee and the independent auditor, the internal auditors, and senior financial executives
- Whether the committee raises the right questions with management and the independent and internal auditors, including questions that indicate the committee's understanding of critical accounting policies and judgments and that challenge management's judgments and conclusions
- Whether the committee has been responsive to issues raised by the independent and internal auditors.

Because there are no specific requirements for how to assess an audit committee's performance, directors have the benefit and the burden of collaborating on an appropriate process. This can be done in consultation with legal counsel, the independent auditor, or third-party facilitators. There are several considerations in shaping the assessment process.

**Conducting the assessment.** The assessment can be led by a variety of parties, including the committee itself, the entire board or its nominating/governance committee, or the general counsel or corporate secretary. Some audit committees find it useful to engage an objective third party to assist with the evaluation process, or a combination of these options may prove optimal. For example, a committee may choose to engage a third party every two or three years and facilitate the process internally in other years.

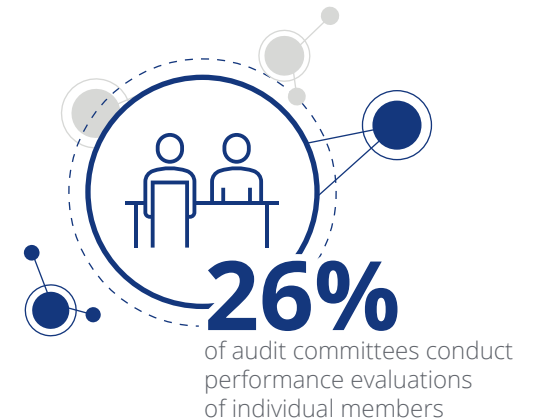
**Format and documentation.** The format may consist of evaluation forms, interviews, or both. The party leading the evaluation may also consider soliciting information from individuals who have significant interaction with the audit committee, including management. The committee may want to consider changing the process periodically to keep it fresh.

Because the evaluation may contain information that is critical of the committee or its practices, committees should consult with counsel about the level of documentation that should be provided and retained.

**Addressing the results.** The results should be presented in a private session limited to audit committee members. This allows the committee to discuss the findings and develop a plan for improvement, which 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.

As part of its procedures to test internal control over financial reporting, the independent auditor considers the effectiveness of the audit committee's oversight of financial reporting. The results of the audit committee's self-assessment can support those procedures.



Source: Deloitte 2016 Board Practices Report

## Benefits of conducting an annual performance evaluation



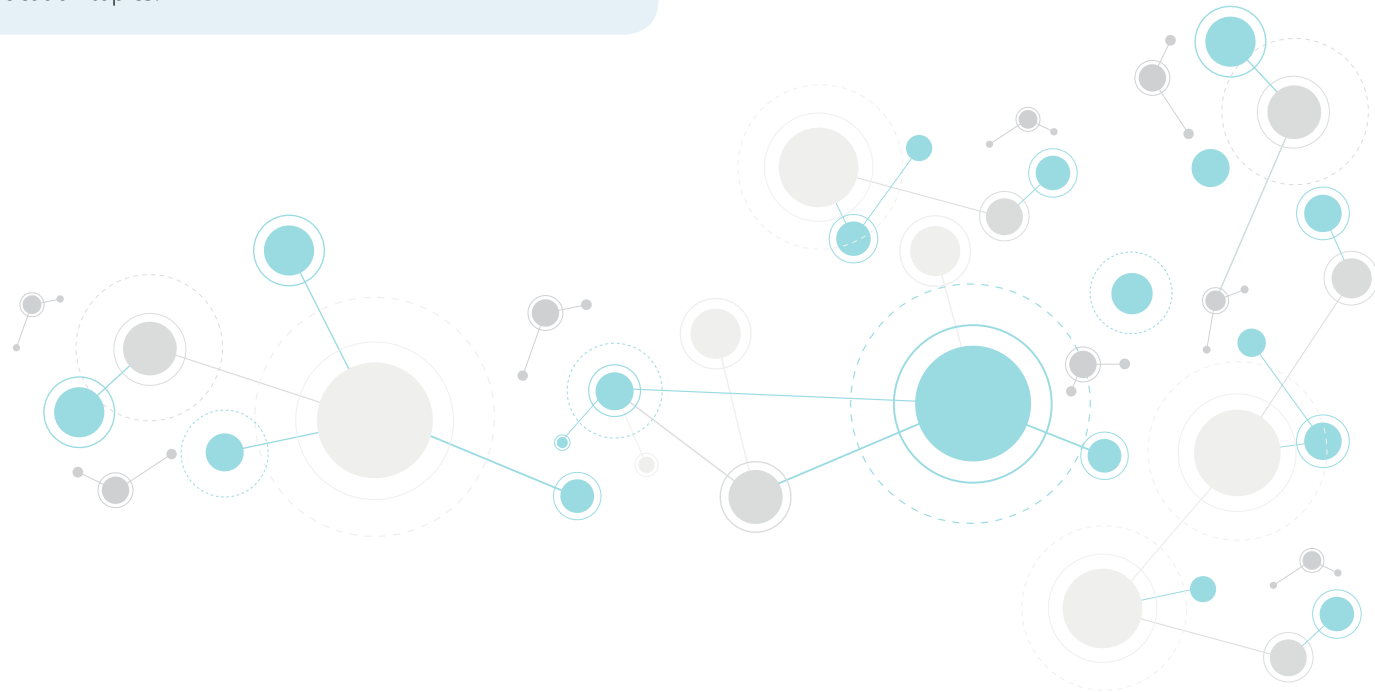
A well-crafted performance assessment process can provide a number of benefits to the audit committee, including:

- Prioritizing agendas and the meeting structure to focus on the most critical issues
- Considering the committee's composition in the context of its current and future needs and challenges
- Revisiting the timing of delivery, level of detail, and quality of materials provided by management
- Identifying future agenda items and continuing education topics.

## Tools and resources



See **Appendix C** for a sample self-assessment that audit committees can use to evaluate their performance.



## Education

NYSE listing standards require board education to be addressed in the company's corporate governance guidelines. The audit committee should embrace a continuing education program to address emerging issues, knowledge gaps, and leading practices using a needs-based approach to determine the content, nature, and frequency. Various types of education programs can be implemented:

- **Public forums on corporate governance.** These programs are offered by many professional services firms, universities, and not-for-profit organizations. Public forums offer 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. 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.
- **Customized continuing education program.** An increasingly popular option is a customized program of continuing education focused on topics relevant to the audit committee, the specific company, or its industry. These topics could encompass audit committee roles and responsibilities, including internal control over financial reporting and risk oversight; accounting issues such as revenue recognition, pension and other post-retirement employment benefits, and critical accounting policies; industry trends and developments; and regulatory updates. Customized sessions can address subjects relevant to the company's needs and incorporate company-specific policies, processes, and objectives.

*It is important for audit committee members to participate in activities that help them stay educated on relevant trends and developments. We find it helpful to include different educational topics on the agendas one to two times per year.*

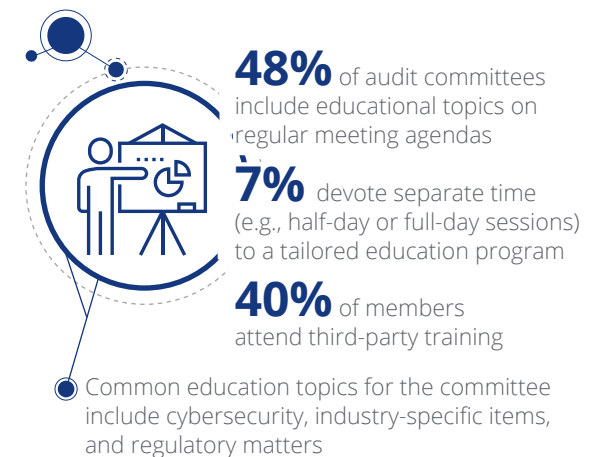
### Audit Committee Chairman

When designing an education program, management and the audit committee should consider the risks and complex issues facing the organization. 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 can feature a mix of individuals: some within the organization and others who can provide an external perspective. Sessions can be delivered during regularly scheduled audit committee meetings or in special sessions.

As part of this program, audit committees often benefit from periodically inviting subject-matter specialists to participate in audit committee meetings to enhance the members' knowledge. For example, specialists in cyber risk, international tax, governance, or a particular industry can provide valuable insight in identifying and addressing risks or new requirements. Independent auditors or outside consultants can assist in identifying appropriate specialists.

**New member onboarding.** In addition to continuing education, the board, in collaboration with management, may consider conducting one or more onboarding sessions for new audit committee members. Sessions can be tailored to the new member's background and experience but can include an overview of the company, including its history and operations; company policies and the code of ethics; major business and financial risks; corporate governance requirements and practices; audit committee responsibilities, including oversight of

accounting policies and practices; and industry trends. Onboarding sessions may include other audit committee members, the CEO, the finance team, internal audit, and the independent auditors.



Source: Deloitte 2016 Board Practices Report

## Tools and resources



Deloitte's [Board and Audit Committee Director Development](#) publication provides a list of education topics that can be customized for audit committees seeking additional education.



# The role of the audit committee

Oversight of financial reporting and related internal controls

Review of filings and earnings releases

Risk oversight

Oversight of the independent auditor

Ethics and compliance

Oversight of internal audit

Other interactions with management and the board

Audit committee external communications



# The role of the audit committee

As an audit committee member, it is important to understand the rules relevant to your role. This section provides an overview of an audit committee's responsibilities in overseeing financial reporting and related internal controls, risk, and ethics and compliance. It also discusses the committee's role in overseeing the internal and independent auditors, as well as how the committee may interact with other members of management and external stakeholders. Finally, it highlights the committee's responsibilities with respect to disclosures in the proxy statement.

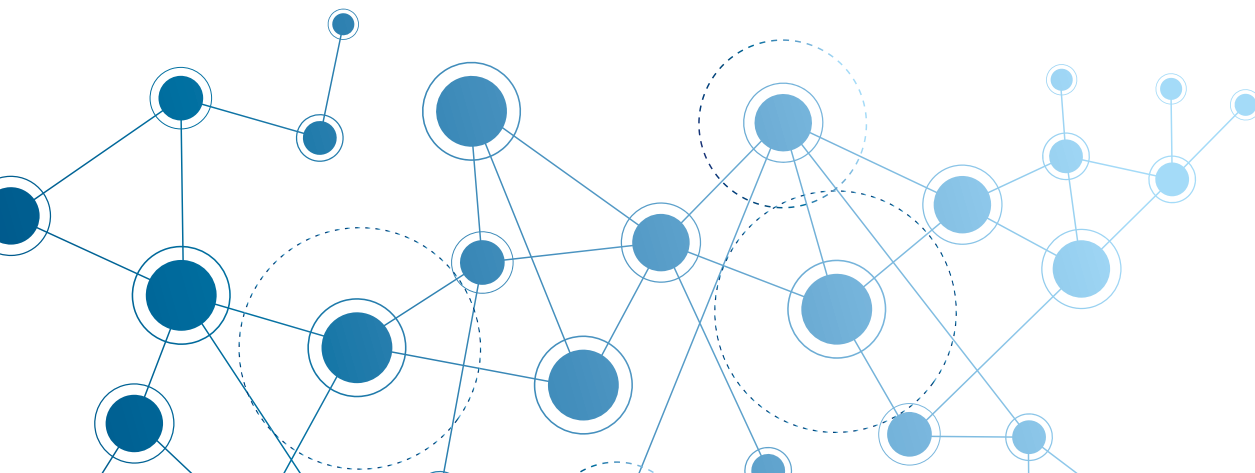
SEC, PCAOB, NYSE, and NASDAQ rules are highlighted where relevant, and we have noted leading practices, tools, and resources to help audit committee members execute their responsibilities.

## Oversight of financial reporting and related internal controls

The audit committee, management, and the independent auditor all have distinct roles in financial reporting. Management is responsible for preparing the financial statements, establishing and maintaining adequate internal control over financial reporting (ICFR), and evaluating the effectiveness of ICFR. The independent auditor is responsible for expressing an opinion on the fairness with which the financial statements present, in all material respects, the financial position, the results of operations, and cash flows in conformity with GAAP, and, when applicable, evaluating the effectiveness of ICFR.

To oversee ICFR successfully, the audit committee should be familiar with the processes and controls management has put in place and understand whether those processes and controls are designed and operating effectively. The audit committee should work with management, the internal auditors, and the independent auditor to gain the knowledge needed to provide appropriate oversight of this area.

Likewise, the audit committee is responsible for overseeing the entire financial reporting process. To do so effectively, it should be familiar with the processes and controls that management has established and determine whether they were designed effectively.



The audit committee's role is one of oversight and monitoring, and in carrying out this responsibility, the committee may rely on management, the independent auditor, and any advisers the committee might engage, provided its reliance is reasonable.

The audit committee should consider having management identify and discuss any significant accounting policies, estimates, and judgments made. A quarterly analysis of these areas may be useful to prepare for these discussions, and management should tailor the analysis to highlight changes and include new or unusual items. 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.

**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 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 can be held, generally with management, 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 may also be held during the review of the quarterly financial statements. The audit committee also should review the effects of regulatory and accounting initiatives, as well as off-

balance-sheet transactions, on the financial statements. For example:

- Management and the audit committee should discuss pending technical and regulatory matters that could affect the financial statements, and 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 also be a recurring agenda item, and may be conducted as part of the committee's review of management's discussion and analysis in the annual and quarterly reports. The exact frequency of these discussions will depend on the company's operations and preferences. Finally, the audit committee should consider reviewing off-balance-sheet transactions, or at least material ones, before they are executed.

**NASDAQ requirements.** NASDAQ requires disclosure of the audit committee's purpose, as set out in its charter, of overseeing accounting and financial reporting processes of the company and audits of the financial statements. See the **audit committee charter** section of this guide for details.

### Fraud risk

In conjunction with risk oversight, the audit committee should be satisfied 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 antifraud controls and 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 reporting hotline. See the **ethics and code of conduct** and **reporting hotline procedures** sections later in this guide for more information.

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

- 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.

One way the audit committee can help oversee the prevention and detection of financial statement fraud is by monitoring management's assessment of ICFR.

The audit committee should also have an awareness of the US Foreign Corrupt Practices Act (FCPA) and other non-US anticorruption laws that may be applicable (e.g., the UK Bribery Act). As the SEC and Department of Justice note in the [Resource Guide to the FCPA](#), anticorruption compliance "begins with the board of directors and senior executives setting the proper tone for the rest of the company." To that end, the audit committee should:

- Understand the company's obligations and responsibilities regarding anticorruption laws to which it is subject
- Determine whether the company has dedicated appropriate oversight, autonomy, and resources to its anticorruption compliance program; depending on the company's size, this could involve assigning an individual who is specifically charged with anticorruption compliance and has a direct reporting line to the committee

- Understand specific policies and procedures in place to identify and mitigate corruption-related risks
- Discuss with management specific corruption-related risks that have been identified, including allegations of corruption that may have been received through the company's monitoring and reporting mechanisms, as well as management's plans for responding to such risks
- Monitor any actual violations, including management's response.

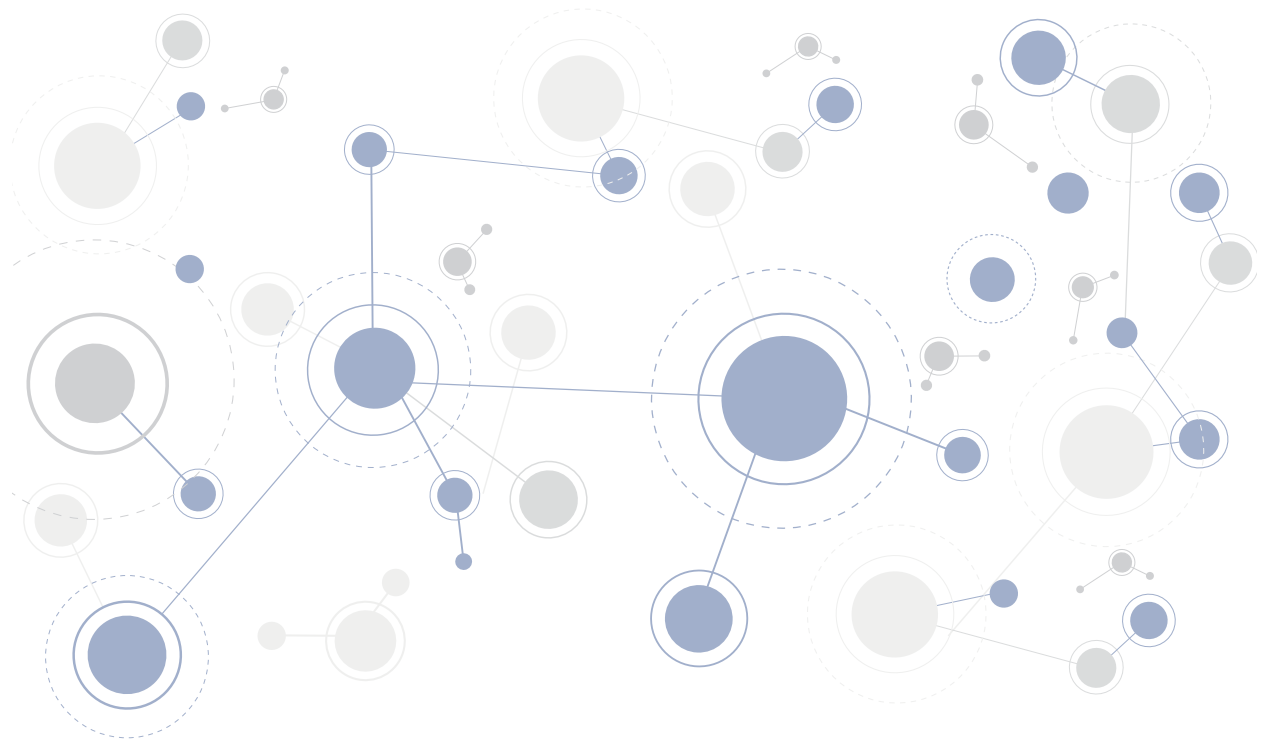
## Tools and resources



The [Anti-Fraud Collaboration](#) released a report titled [The Fraud-Resistant Organization](#) that identifies three central themes critical to fraud deterrence and detection.

**2013 COSO framework.** The 2013 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) provides a formal structure for designing and evaluating the effectiveness of internal control. It emphasizes the role of the board—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 that management could override internal controls 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.



## Review of filings and earnings releases

The audit committee generally reviews earnings releases, SEC filings containing financial information, and other financial information and earnings guidance provided to analysts, ratings agencies, and others. The committee should consider how it will execute these responsibilities to satisfy itself that all information is presented fairly and in a transparent manner. This should include a focus on consistency of information, tone, and messaging across all financial communications.

The audit committee should confirm that an appropriate legal review has been completed to verify the 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.

**NYSE requirements.** NYSE listing standards require that the audit committee meet to discuss the company's annual audited financial statements and quarterly financial statements with management and the independent auditor. They also 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.

Note that SEC rules require the audit committee to recommend to the board that the audited financial statements be included in the company's annual report on Form 10-K.



**Two-thirds** of audit committees meet via conference call to discuss earnings releases, while **22%** review earnings releases at in-person meetings

Source: Deloitte 2016 Board Practices Report

## Questions for audit committees to consider



### Earnings guidance

The audit committee should discuss earnings guidance 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 and 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 earnings-per-share 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



### Non-GAAP measures

The SEC rules regarding the use of non-GAAP financial measures require, among other things, that disclosure of any material information containing non-GAAP financial measures must include the most directly comparable GAAP financial measures, that the GAAP measures must be disclosed with equal or greater prominence, and that the GAAP and non-GAAP measures must be reconciled. The SEC has recently taken a hard look at non-GAAP measures in response to concerns about their increased use and prominence. As a result, companies and audit committees should consider re-examining their use of non-GAAP measures and related controls and the disclosure of those measures. The audit committee should consider asking the following questions:

- Is the measure misleading or prohibited?
- Is the measure presented with the most directly comparable GAAP measure and with no greater prominence than the GAAP measure?
- Is the measure defined and described appropriately and clearly labeled as non-GAAP?
- Does the reconciliation between the GAAP and non-GAAP measure clearly label and describe the nature of each adjustment, and is each adjustment appropriate?
- Is there transparent and company-specific disclosure of the substantive reasons why management believes that the measure is useful for investors and the purpose for which management uses the measure?
- Is the measure prepared consistently from period to period in accordance with a defined policy, and is it comparable to that of the company's peers?
- Is the measure balanced (e.g., does it adjust not only for nonrecurring expenses but also for nonrecurring gains)?
- Does the measure appropriately focus on material adjustments and not include immaterial adjustments that would not seem to be a focus of management?
- Do the disclosure controls and procedures address non-GAAP measures?
- Does the audit committee oversee the preparation and use of non-GAAP measures?
- Does the audit committee have a clear understanding how non-GAAP measures impact compensation? Are the audit and compensation committees aligned on this?

## Tools and resources



Deloitte's publications [\*A Chance to Self-Correct: SEC Urges Companies to Take a Fresh Look at Their Non-GAAP Measures\*](#) and [\*A Roadmap to Non-GAAP Financial Measures\*](#) provide additional information, including ways for a company to assess the appropriateness of its non-GAAP measures and control considerations.

Additionally, in March 2018, the Center for Audit Quality issued [\*Non-GAAP Measures: A Roadmap for Audit Committees\*](#), a guide intended to help audit committees enhance their oversight of these measures used by company management. The roadmap provides key considerations for audit committees, including leading practices to assess whether a company's non-GAAP metrics present a balanced representation of the company's performance.

## Questions for audit committees to consider



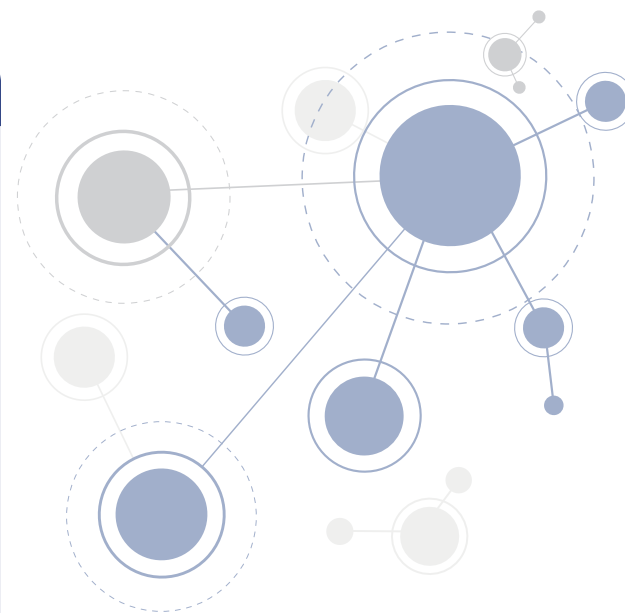
### Related-party transactions

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. In some instances, this responsibility is assigned to the audit committee. The following questions may help the audit committee assess its process 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, or is there a process to review transactions between scheduled meetings?
- 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?
- When and how will the transaction have to be disclosed? 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?



## Risk oversight

Given the dynamic business environment, which creates an ever-changing risk landscape, boards should make sure the risk oversight function is well defined and effective. The board plays a critical role in understanding and influencing management's processes for identifying, assessing, and continually monitoring risks. The board should clearly define which risks the full board should discuss regularly versus the risks that can appropriately be delegated primarily to a board committee. While many boards have a defined risk governance structure in place, it is important to continually assess the structure as companies face new risks.

A leading practice is for management to maintain a list of all enterprise-wide risks, which are then mapped to specific board committees with the expertise to oversee them. For example, human resource and compensation risks may be delegated to the compensation committee for oversight, and the audit committee should have a key role in overseeing financial risks. In many instances, the full board takes direct responsibility for and regularly discusses the company's most strategic risks, which include risks that could disrupt and materially impact the company's business strategy. Committee charters should be updated to align with the defined risk governance structure.

For companies outside the financial services industry, where many companies have separate board risk committees, any risks not assigned to a specific committee during this process are often delegated to the audit committee. While it may be appropriate for the audit committee to take responsibility for reviewing the guidelines, processes, and policies management has in place to identify, assess, and manage risk, boards should take care not to overburden the audit committee

## Questions for audit committees to consider



### Risk oversight

When the board or 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 the following questions:

- Which board committees are responsible for various aspects of risk governance? Has the risk governance structure been defined?
- How do the various board committees oversee risk? Is there appropriate coordination and communication between all relevant stakeholders?
- Does the board consider the relationship between strategy and risk? What are the potential internal and external risks to the success of the strategy?
- Does management provide the board with the information needed to oversee the risk management process effectively?
- What are the company's policies and processes for identifying, assessing, and continually monitoring the major financial risk exposures on an integrated, enterprise-wide basis?
- Has management assigned owners for each risk that has been identified?
- How might the company's compensation programs encourage inappropriate focus on short-term financial performance? Are the audit committee and compensation committee aligned on such risks?
- 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?
- Is cyber risk receiving adequate time and focus on the audit committee agenda?

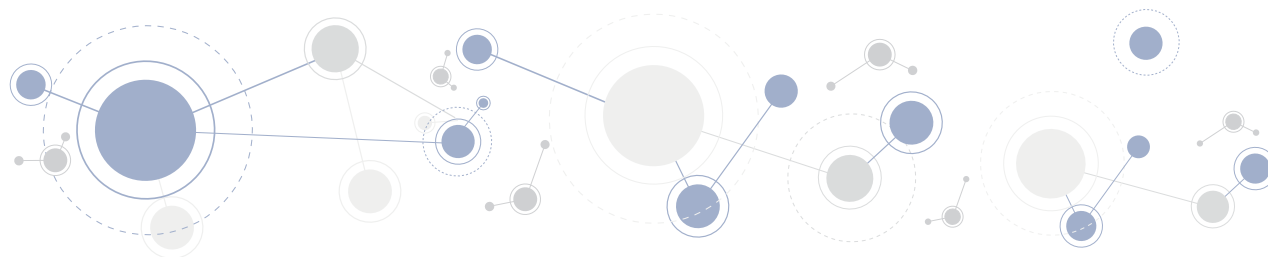


with risk oversight responsibilities. The NYSE listing standards further define the audit committee's role in discussing policies with respect to risk assessment and risk management:

While it is the job of the CEO and senior management to assess and manage the listed company's exposure to risk, the audit committee must discuss guidelines and policies to govern the process by which this is handled. The audit committee should discuss the listed company's major financial risk exposures and the steps management has taken to monitor and control such exposures. The audit committee is not required to be the sole body responsible for risk assessment and management, but, as stated above, the committee must discuss guidelines and policies to govern the process by which risk assessment and management is undertaken. Many companies, particularly financial companies, manage and assess their risk through mechanisms other than the audit committee. The processes these companies have in place should be reviewed in a general manner by the audit committee, but they need not be replaced by the audit committee.<sup>1</sup>

The SEC considers risk oversight a primary responsibility of the board and requires disclosure of its role in this area. Disclosures include whether the entire board is involved in risk oversight; whether certain aspects are executed by individual board committees; and whether the employees responsible for risk management report directly to the board. Such disclosures informs shareholders' understanding of the board's process for overseeing risk.

<sup>1</sup> NYSE listing standards, [303A.07 Audit Committee Additional Requirements](#).



## Tools and resources



Deloitte's publications, [Risk Committee Resource Guide for Boards](#); [Risk Intelligent Governance: Lessons from State of the Art Board Practices](#); and [Bank Board Risk Governance: Driving Performance through Enhanced Risk Oversight](#), provide additional information for boards and audit committee members on risk oversight.



### The audit committee's potential role in overseeing cyber risk

It is often challenging for even the most tech-savvy business leaders to keep up with the scope and pace of developments related to big data, social media, cloud computing, IT implementations, cyber risk, and other technology matters. These developments carry a complex set of risks, the most serious of which can compromise sensitive information and significantly disrupt business processes. Cyber risk is often at the top of the agenda for management and boards at companies of all sizes and industries. The pervasiveness of cyber risk significantly increases concerns about financial information; internal controls; and a wide variety of risks, including the reputational risks that can result from a cyber incident. Oversight of a successful cyber risk management program requires proactive engagement and is most frequently the responsibility of the full board. In some organizations, a level of oversight may be delegated to a risk committee or the audit committee.

In companies where the audit committee holds some responsibility for cyber risk management, the committee should first obtain a clear understanding of the specific areas it is expected to oversee. In those organizations, the audit committee, in its capacity of overseeing financial risks and monitoring management's policies and procedures, may have expertise and be asked to play a significant strategic role in monitoring management's preparation for and response to cyber threats, coordinating cyber risk management initiatives and policies, and confirming their efficacy. Those audit committees may take the lead in monitoring cyber threat 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 on cyber risk management activities.

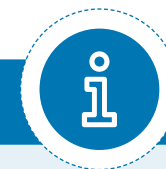
For those audit committees charged with this oversight, engaging in regular dialogue with the chief information officer, chief information security officer, and other technology-focused leaders can help the committee determine where attention should be focused. Although cyber risk is frequently on the full board's agenda, audit committees are increasingly receiving regular updates from relevant technology leaders, with some technology risk-related topic on almost every meeting agenda. The audit committee chairman can be a particularly effective liaison with other groups in enforcing and communicating expectations regarding cyber and financial risk mitigation.

*We need to arm corporate boards with a mechanism to thoughtfully assess management's assertions about the design and effectiveness of their organizations' cyber defenses.*

**Sarah Bloom Raskin, Former Deputy Secretary of the US Department of Treasury, at the PCAOB's 10th annual International Institute on Audit Regulation event in Washington, DC**

To which groups has the board allocated the majority of tasks connected to the following areas of risk oversight? (Respondents could select multiple groups for each risk.)							
	The "big" picture	Reputational risks	Financial stability risk	Cyber risks	Compliance risks	Talent risks	Incentive risks
The full board	96%	86%	47%	41%	22%	46%	21%
Audit committee	5%	9%	51%	51%	69%	2%	5%

Source: 2016–2017 NACD Public Company Governance Survey, National Association of Corporate Directors



## Cybersecurity risk management

In April 2017, the AICPA released its cybersecurity risk management attestation reporting framework, which is intended to expand cyber risk reporting to address the marketplace need for greater stakeholder transparency. This reporting framework establishes a standardized reporting mechanism to provide a broad range of users with useful information about an entity's cybersecurity risk management program to support informed and strategic decision making. It consists of the following components:

- Management's description of the entity's cybersecurity risk management program
- Management's assertion on the presentation of the description and the operating effectiveness of the controls to achieve the cybersecurity objectives
- Practitioner's report on the presentation of the description and the operating effectiveness of the controls to achieve the cybersecurity objectives.

Leveraging a unified approach for performing and reporting on an entity's cyber risk management program and related controls could help boards and audit committees effectively execute their oversight responsibilities with respect to cyber risk.

See Deloitte's [Cybersecurity risk management assessment](#) page.



## Enhanced cybersecurity disclosure guidance

The SEC issued interpretive guidance on February 21, 2018, that largely refreshes the SEC's 2011 staff guidance related to cybersecurity disclosure obligations. The [latest guidance](#) does not establish any new disclosure obligations but rather presents the SEC's views on how its existing rules should be interpreted in connection with cybersecurity threats and incidents. It also expands on the initial concepts discussed, concentrating more heavily on cybersecurity policies and controls, most notably those related to cybersecurity escalation procedures and the application of insider trading prohibitions. The guidance also addresses the importance of avoiding selective disclosure, as well as considering the role of the board of directors in risk oversight. The release applies to public operating companies, including foreign private issuers, but does not address the specific implications of cybersecurity for other regulated entities under the federal securities laws, such as registered investment companies, investment advisers, brokers, dealers, exchanges, and self-regulatory organizations.

The new guidance clarifies the SEC's view on the role of the board of directors in overseeing cybersecurity risk. If the risk is material to a company's business, the discussion of the board of directors' role in the risk oversight function should include the nature of its responsibilities for overseeing the management of this risk. The SEC believes that "disclosures regarding a company's cybersecurity risk management program and how the board of directors engages with management on cybersecurity issues allow investors to assess how a board of directors is discharging its risk oversight responsibility in this increasingly important area."

For more information about the latest guidance, refer to Deloitte's *Heads Up: [In the Spirit of Full Cybersecurity Disclosure](#)*.



## The audit committee's role in M&A

The audit committee has an important role in M&A, both before and after a transaction.

### **Before the deal is done: Due diligence**

Although due diligence is largely management's responsibility, the audit committee can provide critical oversight in areas such as risk analysis, internal controls, and even the basic financial information on which the terms are based. Weakness in a target's internal control systems can create unpleasant surprises that, in the absence of due diligence, may not be discovered until it is too late. This could be a critical factor when management is required to evaluate the post-integration controls in accordance with the Sarbanes-Oxley Act. While target financial information may be prepared with the best of intentions, and may even be audited, audit committee oversight can provide greater comfort that the financial information is accurate and complete. Other areas of due diligence oversight include tax, insurance, and Foreign Corrupt Practices Act compliance.

Audit committees can and should satisfy themselves that the due diligence process is thorough and that the board is fully informed of related risks before the transaction is approved. They can do this in much the same way they address day-to-day matters: ask questions, identify areas of risk to consider, and provide guidance on how to solve problems.

### **Post-merger integration oversight**

While post-merger integration is sometimes overlooked in the excitement of closing a deal, it can be critical to the success or failure of the transaction. The audit committee has a vital role to play here, too.

One area of audit committee focus is the melding of internal control systems and processes so they are stable on Day 1 or as soon as possible thereafter. SEC rules adopted under the Sarbanes-Oxley Act require public companies to integrate disclosure controls as well as controls over financial reporting. Failure to do so can have significant consequences. Even when both parties have high-quality systems, processes that do not work well together may create control problems, leading to reportable deficiencies or even material weaknesses.

Other areas of audit committee responsibility include oversight of talent integration in the financial and accounting areas and monitoring that computer systems and technology platforms can communicate with each other from the outset.

For additional information, read Deloitte's [\*On the Board's Agenda: Post-Merger Integration\*](#).



## Special requirements for financial institutions

Following the enactment of the Dodd-Frank Act in July 2010, the Federal Reserve Board issued a new regulation setting forth enhanced prudential standards for large banking organizations, including risk committee requirements. Specifically, all bank holding companies (BHCs) with total consolidated assets of \$10 billion or more are required to maintain a risk committee that approves and periodically reviews the risk management policies of the BHC's global operations and oversees the operation of the BHC's global risk management framework. More stringent requirements apply to BHCs with total consolidated assets of \$50 billion or more. The corporate governance requirements state that the risk committee must:

- Have a formal, written charter that is approved by the BHC's board of directors
- Meet at least quarterly, or more frequently if needed, and fully document and maintain records of its proceedings, including risk management decisions.

Moreover, the risk committee at each BHC with total consolidated assets of \$50 billion or more is required to:

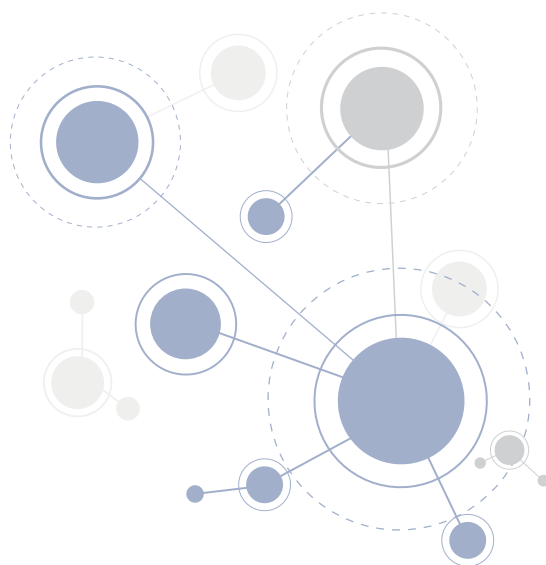
- Be an independent committee of the board of directors that has, as its sole and exclusive function, responsibility for the risk management policies of the BHC's global operations and oversight of the operation of the BHC's global risk management framework
- Report directly to the BHC's board of directors
- Receive and review regular reports not less than quarterly from the BHC's chief risk officer.

See the [Federal Reserve's final rule](#) and [Deloitte's practical guide](#) to the rule for additional requirements and guidance.

Soon after the Federal Reserve Board finalized its EPS framework, the Office of the Comptroller of the Currency (OCC) issued heightened standards applicable to national banks, insured federal savings associations, insured federal branches of foreign banks with total consolidated assets of \$50 billion or more, and OCC-regulated institutions with total consolidated assets of less than \$50 billion if that institution's parent company controls at least one other covered institution.

Among other things, each covered institution is required to establish and adhere to a formal, written risk governance framework that is designed by independent risk management and approved by the board of directors or the board's risk committee.

See the OCC's [heightened standards](#) for additional requirements and guidance.



## Oversight of 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 to thoroughly discuss a wide variety of matters, including the company's financial reporting, internal controls, and the audit, from planning to conclusion of the audit. These discussions should also include educational and evaluative topics. Executive sessions with the independent auditor are a way to maintain open communication and identify concerns, and they are required for NYSE-listed companies.

### Auditor communications

The NYSE, NASDAQ, and PCAOB outline communications that are required between the audit committee and the independent auditor. Many of these communications are focused on the responsibility of the audit committee to oversee the independent auditor.

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

- Meet with the independent auditor to review and discuss 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.** 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.](#)

**PCAOB requirements.<sup>1</sup>** Some communications between the auditor and the audit committee are driven by standards the auditor must follow in conducting the audit. There are a number of PCAOB standards that require communications with the audit committee. The primary one is [Auditing Standard No. 1301 \(AS 1301\), Communications with Audit Committees](#). The communications under this standard can be oral or written, but must be made in a timely manner and prior to issuance of the auditor's report. The standard addresses communications relevant to different phases of the audit, from the auditor's engagement through the issuance of the auditor's report. It also requires communications relevant to various aspects of the company's accounting and reporting, as well any disagreements between the auditor and management.

<sup>1</sup> The PCAOB requirements encompass the items the independent auditor is required to communicate to the audit committee by [SEC's Regulation S-X, Rule 2-07, Communication with Audit Committees](#). The SEC stated in its release adopting this rule that it expects these discussions to occur prior to filing Form 10-Q or Form 10-K.

## Summary of PCAOB required communications

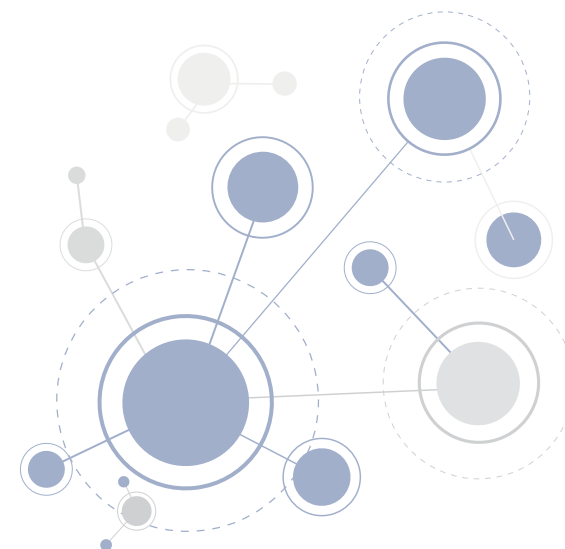


### Communications required by [AS 1301](#)

- Significant issues discussed with management before the auditor's appointment or retention
- An understanding of the terms of the audit
- 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 ([AS 2201](#))
- Representations of management ([AS 2201](#))
- Fraud and illegal acts ([AS 2401](#) and [2405](#))
- Communications in connection with interim reviews ([AS 4105](#))
- Preapproval of services ([Rules 3524](#) and [3525](#))
- Independence matters ([Rule 3526](#))
- Related parties ([AS 2410](#))
- Auditing fair-value measurements and disclosures ([AS 2502](#))



### PCAOB adopts changes to the auditor's report

The SEC approved the standard requiring changes to the auditor's report on October 23, 2017. In a statement announcing its approval of this standard that significantly modifies the auditor's reporting model, Chairman Jay Clayton stated his strong support for the objective of the rule, namely for the auditors to provide investors with meaningful insights into the audit. Chairman Clayton highlighted the important role of the audit committee and noted that the SEC and PCAOB will monitor the results of the new standard's implementation, including consideration of any unintended consequences.

The new auditor reporting standard will significantly modify the auditor's reporting model while retaining the current "pass/fail" opinion of the existing auditor's report. The primary changes include:

- Standardized ordering and inclusion of section headers, with the opinion section appearing first
- Enhanced descriptions of the auditor's role and responsibilities, including a statement regarding independence requirements
- Communication of critical audit matters (CAMs)
- Disclosure of auditor tenure—the year in which the auditor began serving consecutively as the company's auditor.

A CAM is defined as a matter communicated, or required to be communicated, to the audit committee that:

- Relates to accounts or disclosures that are material to the financial statements
- Involves especially challenging, subjective, or complex auditor judgment.

The new requirements will be phased in, with CAM disclosure effective for large accelerated filers for audits of fiscal years ending on or after June 30, 2019, and for all other audits to which the requirement applies for fiscal years ending on or after December 15, 2020. The remaining changes apply to auditor reports issued for fiscal years ending on or after December 15, 2017.

Although the standard will be implemented in accordance with phased-in effective dates, management and audit committees will most likely want to start to consider the implications of the new requirements and discuss them with their auditors. Potential questions regarding CAMs may include:

- What matters could be CAMs?
- How will management and the audit committee engage with the auditor as CAMs are identified and the auditor's descriptions of the CAMs are developed and finalized?
- How will the timing of auditor communications with management and the audit committee accommodate the discussion of CAMs?
- How do the auditor's statements regarding CAMs compare to management's disclosures regarding the same matters?

Deloitte's [Heads Up](#) provides additional information on the new rule.

*I strongly support the objective of the rule to provide investors with meaningful insights into the audit from the auditor. CAMs are designed to provide investors and other financial statement users with the auditor's perspective on matters discussed with the audit committee that relate to material accounts or disclosures and involve especially challenging, subjective, or complex auditor judgment. Investors will benefit from understanding more about how auditors view these matters.*

**Jay Clayton, SEC Chairman**

### 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, their unique position in monitoring auditor independence, and their direct responsibility for the oversight of the independent auditor. Although most audit firms are rigorous in monitoring and enforcing these independence requirements, it is important that audit committee members be aware of them as well.

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

**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, certain 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 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, commonly known as a vendor business relationship.

**Nonaudit services provided by auditors.** The rule sets forth 10 categories of services that impair the 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. 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 nonclient 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.

The following nonaudit services are prohibited to the independent auditor:

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

**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 established by the audit committee 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:

- 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.
- Discuss with the audit committee of the issuer the potential effects of the services on the independence of the firm.

**Contingent fees and commissions.** The rule states that independence is impaired if the independent auditor provides any service or product to an audit client for a contingent fee or a commission, or receives a contingent fee or commission from an audit client. The PCAOB also has discretion to prohibit any other service that it determines, by regulation, to be impermissible. In addition to prohibiting the independent auditor from providing a service or product to an audit client for a contingent fee or commission, the PCAOB has issued rules prohibiting the independent auditor from:

- 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 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 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. Other specialty partners, such as tax partners, are not required to rotate.

**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 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.

#### Evaluation of the independent auditor

Inherent in the audit committee’s duty to appoint, compensate, and oversee the independent auditor is the idea that the audit committee will do some form of evaluation of the auditor.

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 to this standard 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).”

Practices for evaluating the independent auditor range from highly formalized processes with extensive documentation to more informal assessments. 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 and in conjunction with their decision to reappoint the independent auditor.
- **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. While the audit committee is responsible for the appointment, compensation, and oversight of the independent auditor, 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 internal

audit, the legal department, or another group in the company. The party responsible for coordinating the evaluation should obtain information not only from the audit committee, but also 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.

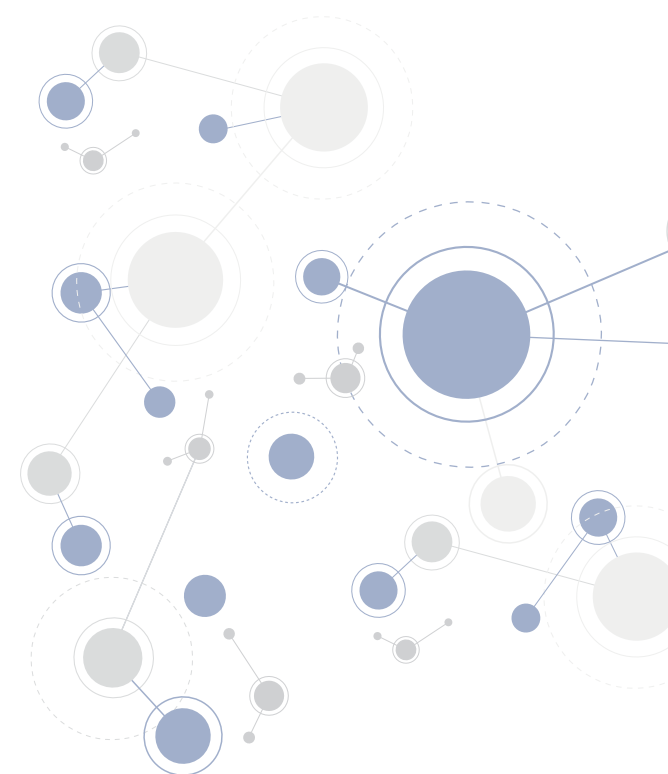
## Tools and resources

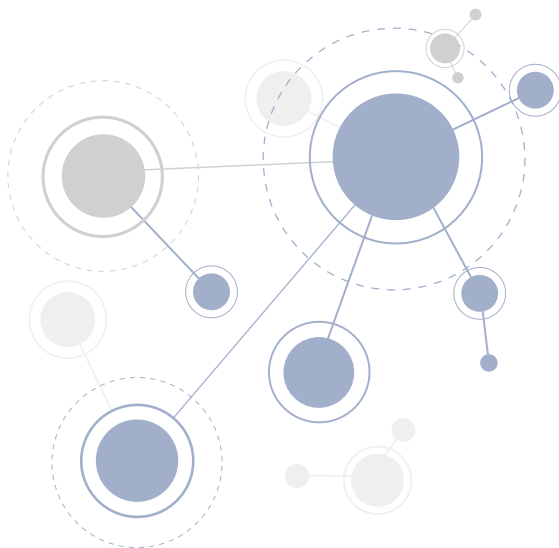


For additional information, read Deloitte's [\*Appointing, Assessing, and Compensating the Independent Auditor: The Role of the Audit Committee\*](#).

The Audit Committee Collaboration, a partnership of the Center for Audit Quality and US corporate governance and policy organizations, has issued an [\*External Auditor Assessment Tool\*](#) for audit committees. The tool assists audit committees in carrying out their responsibility of appointing, overseeing, and determining compensation for the independent auditor.

The PCAOB issued [\*Information for Audit Committees about the PCAOB Inspection Process\*](#) to help audit committees better understand the PCAOB's inspection process and how to gather information from their audit firms about inspections.





## Questions for audit committees to consider

### **Audit innovation**

With advances in technology, auditors are turning to innovation to enhance quality and drive value into the audit. In understanding how the independent auditor is using innovation, the audit committee may consider the following questions:

- How is the independent auditor leveraging innovation to enhance audit execution?
- What investments is the independent auditor making in audit innovation, and how do those investments translate to enhanced audit quality and value for the company?
- What insights is the independent auditor able to provide about the company and its financial and internal controls processes through the audit and with the use of new technologies, including audit analytics?
- What are some of the emerging technologies that the independent auditor is exploring for use in the audit? How may the company benefit from the independent auditor's use of these emerging technologies?
- With respect to innovation, how is the independent auditor differentiating itself from competitors to add value to the audit?

## Ethics and compliance

As highlighted by several court rulings and the US 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 should consider the audit committee's role in overseeing the company's ethics and compliance programs, noting that NYSE-listed companies are required to have the audit committee oversee legal and regulatory compliance.

### Ethics and code of conduct

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 among 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. A company registered in the United States must disclose any changes to, or waivers from, the code of ethics that apply to the CEO or senior financial officers, generally within four business days after it amends its code of ethics or grants a waiver. The NYSE and NASDAQ listing standards have the same four-day rule.

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 the company's SEC filings and 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 and must make the code of ethics available to the public through one of the methods listed in [Item 406 of Regulation S-K](#).

**NYSE requirements.** 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 in [NYSE 303A.10](#), only some of which are required by the SEC.

**NASDAQ requirements.** 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.



# 86%

of audit committees receive a report on internal tips from a hotline or other reporting mechanism at least once a year



# 26%

of audit committees receive these reports at every committee meeting

Source: Deloitte 2016 Board Practices Report

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 addressing violations.

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. For example, some companies have developed a separate code for directors, whose roles and responsibilities differ from those of officers and other employees.

**Common practices and considerations.** 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. Legal counsel should be consulted on modifications to the code.

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 employee orientation program and manual. Some companies require individuals, including directors, to sign an annual certification noting that they have read, understood, and complied with the code. If an employee refuses to sign the certification, committees should encourage companies to take prompt and appropriate disciplinary action, up to and including termination. Communication of disciplinary actions taken in response to code violations is a common way of communicating to employees that violations are taken seriously.

## Questions for audit committees to consider



### Ethics and compliance

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

- Does the committee hear directly from the person who has day-to-day responsibility for ethics and compliance matters? Does this person have the ability to hold these discussions in an executive session?
- Do the ethics and compliance governance framework, organizational structure, and reporting lines provide sufficient independence for the audit committee to execute its responsibilities (e.g., does the chief ethics and compliance officer report directly or indirectly to the audit committee)?
- Does the ethics and compliance officer have adequate staff, technology, and other 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 promptly, 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?
- Is the company's risk culture encouraging the right type of behaviors?

## Tools and resources



Deloitte's ethics and compliance resources offer additional information on establishing codes of ethics and robust ethics and compliance programs, including [Building World-Class Ethics and Compliance Programs: Making a Good Program Great](#), and [In Focus: Compliance Trends Survey](#), a collaboration between Deloitte and Compliance Week.

### Reporting hotline procedures

Companies often use 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 hotline administered by an internal department or a third party.

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

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

The audit committee should work with management to confirm that the appropriate members of management are aware of questions or complaints received from internal sources and third parties, including vendors, through the various reporting methods available. 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.

The audit committee should also establish expectations with respect to the type of complaints that will be reported to them and how they will be communicated. Some complaints may warrant immediate communication, such as those involving senior management and significant dollar amounts. In addition to these immediate reporting situations, the audit committee should receive a regular analysis of the complaints received, including a root-cause analysis; their resolution; and the steps taken to avoid similar violations in the future. The audit committee should also determine which complaints warrant a discussion with the board.

A telephone and Web-based hotline monitored by an independent third party is common. 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, ethics training, and periodic communications. 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, 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. 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 who 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:

- How hotlines are evaluated, tested, and audited to ensure calls are received, recorded, and managed in a consistent, confidential, accurate, and timely manner
- 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.

Companies with operations in different countries should be careful to comply with those countries' laws, as they may impose requirements, restrictions, and prohibitions different from those applicable in the United States.

*Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It can help an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control, and governance processes.*

#### Institute of Internal Auditors

## Oversight of internal audit

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, such as monitoring critical controls and developing an audit plan focused on risks identified in the enterprise risk management program, are aligned with those of the audit committee. At some companies, internal audit evaluates and considers suggestions to improve operations and processes.

When the internal audit function reports to the audit committee directly, 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 chief audit executive.

**NYSE requirements.** The NYSE listing standards require companies to have an internal audit function. Audit committees are required 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 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. Although NASDAQ companies are not required

to have an internal audit function, for those that do, oversight of internal audit is often one component of overseeing accounting and financial reporting.

**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 internal/compliance controls
- Act as a catalyst for positive change in processes and controls
- Deliver value to the audit committee, other directors, and management in the areas of controls and risk management 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, the audit committee and the chief audit executive (CAE) should have a strong relationship characterized by open communication. The audit committee should challenge the CAE and the internal audit department by setting high expectations, communicating those expectations clearly, and holding the department accountable for meeting them. The CAE should be candid in raising concerns with the audit committee when they arise.

It is important for the audit committee to see that the internal auditors have appropriate independence and



stature and are visibly supported by senior management throughout the organization. They should support the CAE, providing guidance and assistance when he or she reports potential management lapses.

In addition to making themselves available when contacted by the CAE, members of the audit committee should engage with the CAE regularly to maintain a reporting relationship that is both substantive and communicative. Holding regular executive sessions with the CAE is common and is required for NYSE-listed companies. The audit committee should actively participate in discussing goals and evaluating the performance of the CAE; these responsibilities should not be delegated solely to the CFO or CEO.

The audit committee should understand and approve the annual internal audit plan and determine if the CAE has a sufficient budget and related resources to execute against it. In determining that resources are adequate, audit committees often consider whether the CAE and his or her staff are adequately compensated. As part of this review, they should review and evaluate the status of the enterprise-wide risk management program and the alignment of risks to the internal audit plan. The audit committee should also evaluate the progress and results of the internal audit plan against the original plans and any significant changes made subsequently.

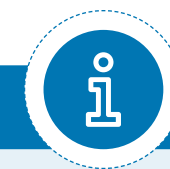
[The International Standards for Professional Practice of Internal Auditing](#) established by the Institute of Internal Auditors (IIA) require internal auditors to maintain a certain level of independence from the work they audit. This means that an internal auditor should have no personal or professional 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.

Internal audit departments should also employ quality processes with a focus on continuous improvement. These processes should be periodically reviewed through self-assessment and/or external reviews. The IIA's standards require external assessments to be

conducted by a qualified, independent party at least once every five years. The CAE should discuss the form and frequency of the external assessment, as well as the qualifications and independence of the external assessor, with the audit committee.

## Oversight of internal audit



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

- The audit committee engages in an open, transparent relationship with the CAE.
- The audit committee reviews and approves the internal audit charter and internal audit plan annually.
- 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.
- 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.
- Internal audit is empowered to be independent by its appropriate reporting relationships to executive management and the audit committee.
- The audit committee addresses with the CAE all issues related to internal audit independence, objectivity, and resources.
- Internal audit is quality-oriented and has a quality assurance and improvement program in place.
- The audit committee regularly communicates with the CAE about the performance and improvement of the CAE and internal audit.
- Internal audit reports are actionable, and audit recommendations and other improvements are implemented by management satisfactorily.
- The audit committee meets periodically with the CAE without the presence of management.





## Questions for audit committees to consider

### Interactions with internal audit

- Does internal audit have a clearly articulated strategy that is reviewed and approved by the audit committee periodically?
- Does internal audit have a clear set of performance expectations that are aligned with the success measures of the audit committee and measured and reported to the audit committee?
- Does internal audit have a charter that is reviewed and approved by the audit committee periodically? 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 linked to the company's enterprise risk management activities appropriately?
- Is internal audit flexible and dynamic in addressing new risks promptly and meeting the needs of the audit committee?
- Is internal audit effective in using advanced technologies, such as data analytics, to improve audit quality?
- Does internal audit organize or perform peer reviews or self-assessments of its performance and report the results to the audit committee?
- 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?
- Is internal audit funded and adequately and staffed with the appropriate mix of professionals needed to achieve its objectives?
- Does internal audit's reporting structure within the organization ensure sufficient independence and respect from management and other employees?
- Is the level of assurance provided by internal audit and its interaction with other assurance sources clear and appropriate for the audit committee?
- Does the internal audit function have and demonstrate the level of independence needed to execute its responsibilities properly?
- Does internal audit meet with the independent auditor regularly 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 highlighted to the audit committee appropriately, and is the progress of remediation tracked and reported?
- Are reports and other communications from internal audit to the audit committee of an appropriate standard and do they provide value?

## Other interactions with management and the board

In executing their governance responsibilities, audit committees frequently interact with other stakeholders, in addition to the internal and independent auditors.

### Interactions with the finance organization

The finance function's leaders and professionals can have a direct impact on a company's risk profile, value creation, and return on investment for investors and other stakeholders. The audit committee relies significantly on the finance function and needs to maintain an open and effective relationship with them. Their oversight can contribute to the finance organization's interest in having the right resources available to support the quality and reliability of financial accounting, reporting, and related controls. Audit committees may also provide input on the assessment and compensation of finance professionals who they interact with regularly.

The audit committee can help monitor and strengthen finance talent initiatives, in particular the succession plans for leaders and finance professionals in roles of critical importance, through regular discussions with the CEO, CFO, and other finance executives, as well as regular oversight of issues related to finance talent.

**Common practices and considerations.** Interactions with the finance organization vary, but may include the following practices:

- To foster open communication, meet periodically with management, the director of the internal audit function, and the independent auditor in separate executive sessions ([NYSE Corporate Governance Rule 303A.07\(b\)\(iii\)\(E\)](#)).
- Provide input on the performance of key finance executives, including the CFO and CAO.
- Provide input into management's goal-setting process.
- Hold annual discussions of succession planning for the finance organization with the CEO and CFO and regular discussions of the finance organization's bench strength.
- Invite succession candidates to present during audit committee meetings to develop a firsthand view of their potential.
- 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.
- Visit company locations and meet with members of management periodically.

## Questions for audit committees to consider



### Finance organization talent

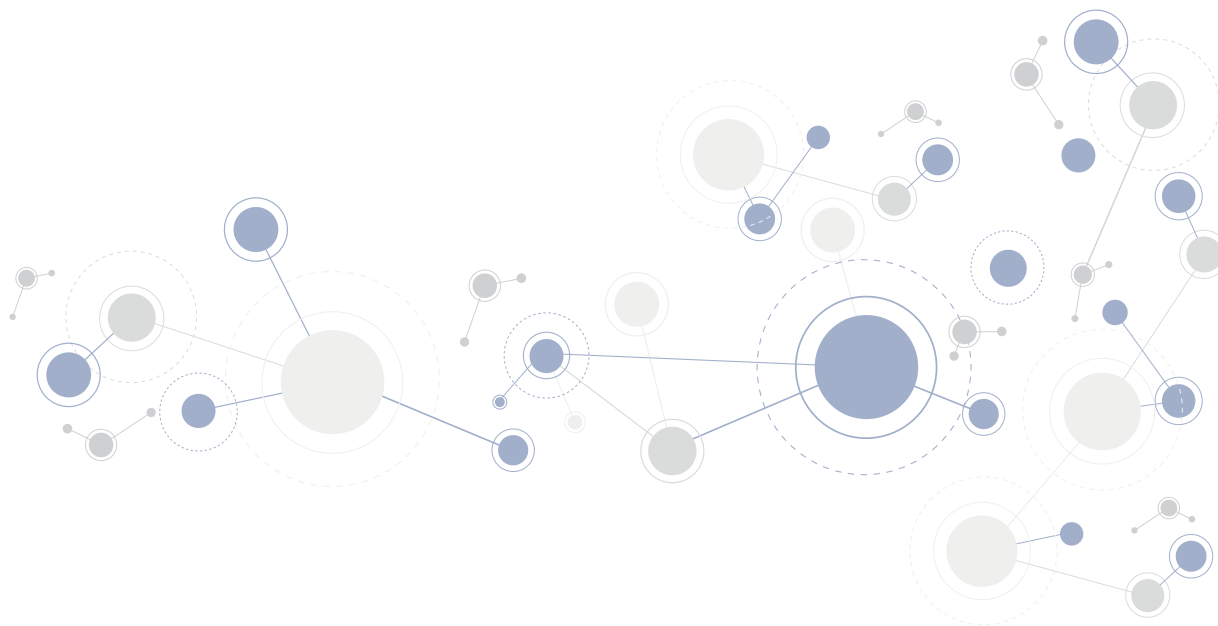
- Do you have adequate personnel, both in numbers and quality, to fulfill your responsibilities with respect to the financial statements and internal control over financial reporting?
- What is the succession plan for key finance positions?
- Are there finance professionals in the pipeline of potential leaders that the audit committee should meet? Are succession candidates given an opportunity to meet with the audit committee?
- What plans are in place to respond to unexpected turnover in finance roles? Is someone ready to begin immediately, and if not, what are the backup plans to hire temporary resources?
- What formal training and development programs are in place to keep finance professionals up to date with the latest developments and requirements? Do professionals receive training on advanced technologies that could enhance the effectiveness of the finance organization?
- How does the audit committee participate in the evaluation of the CFO? What kind of evaluation criteria are important to the audit committee?

### Interactions with the board and other committees

As the audit committee seeks to align its structure with the company's strategic priorities, it should consider the coordination required among other board committees and the full board to facilitate the optimal allocation and coverage of topics that affect more than one group and to reduce the likelihood of something falling through the cracks. The audit committee should understand the roles and responsibilities of other board committees and consider whether they could benefit from periodic joint meetings to discuss areas of common interest and significant matters.

It is particularly important for the audit committee to coordinate with the compensation committee as it considers the risk that compensation policies have on the financial statements and internal controls. The audit committee should understand management and general employee compensation plans and how related metrics may affect fraud risks. Additionally, as companies increasingly use non-GAAP metrics to determine compensation, the audit committee should understand how those metrics may impact risk and may need to be addressed in the reconciliation between non-GAAP and GAAP information.

The audit committee chairman should also coordinate with the nominating and governance committee as it considers board candidates. The chairman should communicate the skills and experiences needed from members to effectively carry out the audit committee's responsibilities.



## Audit committee external communications

Investors, policymakers, and regulators are continuing to show interest in more detailed disclosure about audit committees, their activities, and their oversight of the relationship with independent auditors. As these external parties request additional clarification about the roles and responsibilities, audit committees should consider whether they should enhance disclosures in the proxy statement.

Various SEC rules and exchange listing requirements address audit- and audit committee-related information that must be disclosed in the proxy statement, including the audit committee report, and on company websites.

SEC rules require companies to disclose the name of each audit committee member and 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.

Proxy statements must disclose whether the board has adopted a written charter for the audit committee, and if so, include a copy of the charter as an appendix to the proxy statements at least once every three years.

## Audit committee reporting



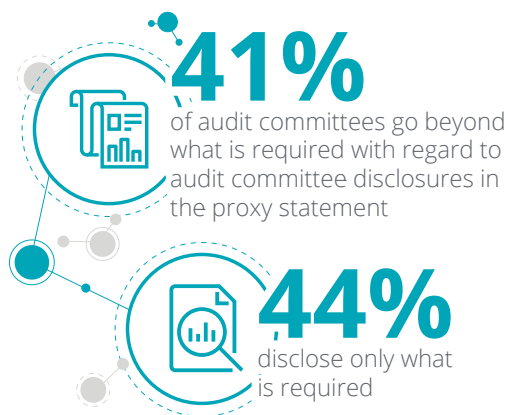
Over the past several years, investors and other governance groups and investors have sought expanded disclosures on how audit committees execute their duties. As recently as November 2016, the United Brotherhood of Carpenters' Pension Fund announced that it would send letters to 75 companies encouraging their audit committees to enhance auditor independence disclosures in 2017 proxy statements—a request they have been making since 2013. The SEC weighed in on the discussion when it issued a request for public comment in a July 2015 concept release titled [Possible Revisions to Audit Committee Disclosures](#).

Deloitte's latest proxy statement analysis, [Audit Committee Disclosure in Proxy Statements – 2017 Trends](#), indicates that companies have generally increased voluntary disclosures about the role and activities of audit committees over the past several years. While it is not necessary, or possible, to disclose everything an audit committee does each year in fulfilling its duties, additional insight into the structure and activities of the audit committee can help increase investor confidence in both the committee and the company as a whole.

The Center for Audit Quality (CAQ) and Audit Analytics published the [Audit Committee Transparency Barometer](#) in November 2016, which presents findings from an analysis of audit committee disclosures in proxy statements and measures the robustness of these disclosures among S&P Composite 1500 companies. The report measures the content of proxy statement disclosures in areas that include auditor oversight and scope of duties. The CAQ joined with several governance organizations in 2013 to form 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.

The calls for increased transparency into audit committee duties, including the oversight of the independent auditor, are expected to 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 [July 2015 Audit Committee Brief: SEC Issues Concept Release Concerning Audit Committee Reporting Requirements](#).

<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.



Source: Deloitte 2016 Board Practices Report

Companies whose securities are quoted on NASDAQ or listed on the NYSE must disclose whether the audit committee members are independent as defined in the applicable listing standards, as well as certain information regarding any director on the audit committee who is not independent.

Regulators continue to solicit views of audit committees with respect to industry- and company-specific knowledge and experience. Taking the time to engage in formal or informal communication with regulators, industry groups, or the independent auditor on these topics can have a substantive impact on the development of standards and rules.

### Fee disclosure

The SEC rule requires disclosure of fees paid to the independent auditor for the current and prior years, 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 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.

The SEC's rule that implemented the Sarbanes-Oxley Act expanded 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 proxy advisers, such as Institutional Shareholder Services, have guidelines for proxy-vote recommendations related to audit fees, many companies disclose not only the nature of services in the fee categories but also the amounts associated with specific services. Issuers should consult with legal counsel to determine the content of the fee disclosure. The SEC's four fee categories are:

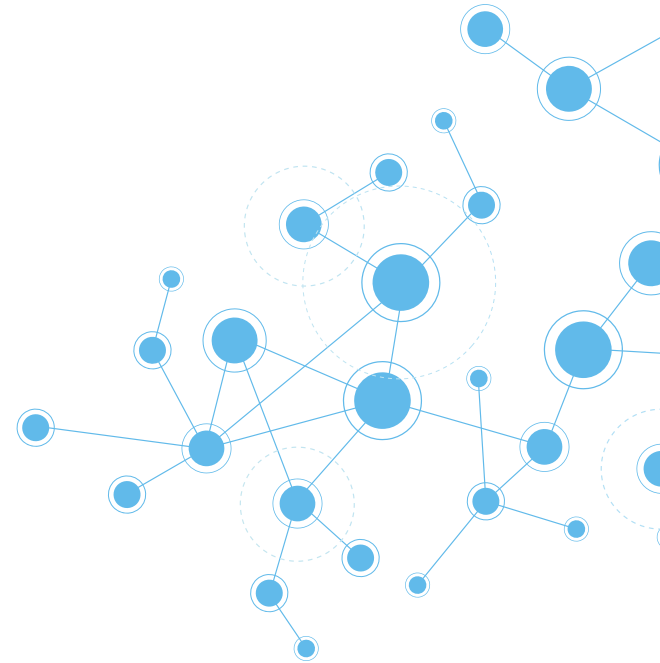
- **Audit fees** are fees for services that normally would be provided in connection with statutory and regulatory filings or engagements, including the audit of internal control over financial reporting. This category also may include services that only the independent auditor reasonably can provide, 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.
- **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, although 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.
- **Tax fees** include all tax services 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, planning, and advice. Tax compliance generally involves preparation of original and amended tax returns, refund claims, and planning services related to tax payments. 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.
- **All other fees** include all fees paid to the independent auditor for services other than audit, audit-related, or tax services.



# Audit committee leading practices and trends

# Audit committee leading practices and trends

Audit committees have full agendas and require careful planning to focus on critical priorities. In addition to the requirements and recommendations noted in the previous sections, audit committees often implement practices to help them stay on track and execute their oversight responsibilities more effectively. Some of the leading practices implemented by audit committees are outlined below. The list is not all-inclusive, and certain activities may be the responsibility of the full board or another committee.



## Committee composition and effectiveness

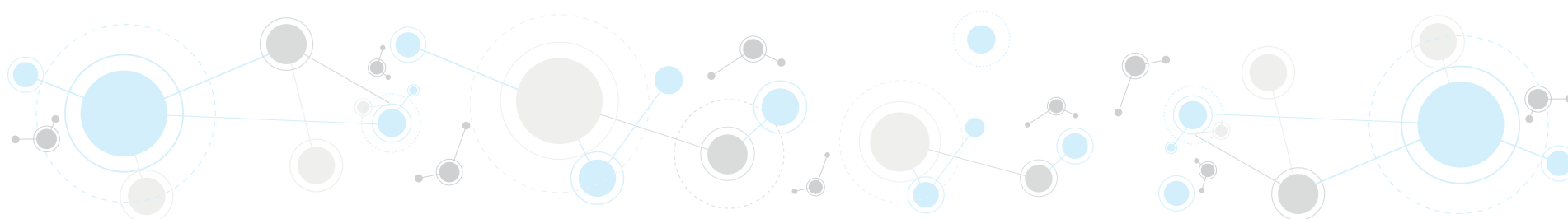
- Focus on committee composition, including members' independence, financial literacy, and expertise.
- Focus on having the right skills and experience on the audit committee, such as financial, industry, risk management, business, and leadership experience.
- Limit the number of audit committee members to four or five to optimize effectiveness.
- Consider rotating audit committee members periodically, including the chairman.
- Develop a succession plan for audit committee members and a rotation plan for the chairman, in coordination with the nominating committee.
- Review and approve the audit committee charter and align activities with a calendar that sets forth required activities and allows flexibility for additional topics.
- Perform a robust self-assessment annually.
- Discuss the results of the self-assessment with the audit committee in an executive session and develop tactical plans to address findings.

### Meeting effectiveness

- Review and approve the audit committee charter and develop a calendar that incorporates required activities and allows flexibility for additional topics.
- Develop meeting agendas in consultation with management; resist the urge to reuse past agendas without discussion.
- Align audit committee meeting materials and agendas with priority areas.
- Distribute briefings and other materials well in advance of meetings.
- Include executive summaries to reports that highlight issues and critical discussion points and allow discussion versus presentation during meetings.
- Consider a regular “watch list” to report on ongoing topics even when they are not the focus of a particular meeting.
- Foster an environment where open dialogue and candid discussions are encouraged.
- Hold executive sessions at every meeting with the CFO, internal auditors, and independent auditors; consider having the committee meet after the executive sessions to discuss the effectiveness of the meeting and future agenda items.

### 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 in a way that is consistent with NYSE listing standards.
- Include educational topics on the agendas once or twice a 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, such as specialized industry matters, new regulations, operations, and emerging topics such as cyber risk.





### Oversight of internal controls and financial reporting

- Understand risk areas as assessed by management, the internal auditors, and the independent auditor, as well as related controls. Also understand any prior internal control issues and how they have been resolved.
- Understand the design and components of the company's antifraud and anticorruption compliance programs and confirm that those programs have sufficient oversight, autonomy, and resources.
- Understand complex accounting and reporting areas and how management addresses them.
- Understand significant judgments and management estimates and their impact on the financial statements.
- Consider conducting a periodic analytic review of balance sheet items, focused on key underlying assumptions and potential vulnerabilities.
- Be aware of any uncertain tax positions taken by the company and their potential impact on financial reporting.
- Stay abreast of pending financial reporting and regulatory developments and understand how they may affect the company.
- Understand the issues raised in SEC comment letters received by the company, as well as management's response.
- Consider the nature of SEC comment letters issued to companies in similar industries.
- Consider levels of authority and responsibility in areas such as pricing and contracts, acceptance of risk, commitments, and expenditures.

### 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 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 that may influence the financial statements.
- Periodically visit company locations and meet with local management.
- 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 response.
- Understand the company's strategy for managing tax risk, tax controversy, and volatility in the effective tax rate.
- Consider potential reputational risks associated with tax positions.

### Ethics and compliance

- Focus on the tone at the top, culture, ethics, and hotline monitoring.
- Provide oversight of compliance with the company's code of ethics and compliance.
- Initiate internal or independent investigations on matters within the committee's scope of responsibility.
- Understand the risk and mitigation mechanisms with regard to management override of controls.
- Periodically meet with those responsible for overseeing ethics and compliance matters in executive sessions.

### Interaction with the internal auditors

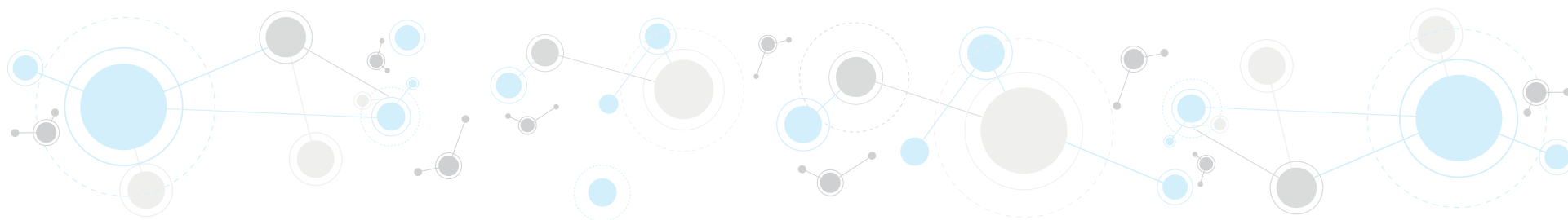
- Provide the internal auditors with direct access to the audit committee.
- Consider having internal audit report directly to the audit committee and administratively to senior management.
- Play an active role in determining the highest and best use of internal audit, as well as the appropriate structure 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 beyond audit committee meetings.
- Provide formal evaluations and regular feedback.

### Coordination and communication with the full board and its other committees

- Understand areas of risk and responsibilities delegated to other committees.
- Coordinate with the compensation committee on incentive goals for the talent pool.
- Coordinate with the compensation committee to establish the financial metrics used in incentive compensation plans.
- 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.
- Coordinate with the nominating committee to develop succession plans for audit committee members and the chairman.





# Appendices

**Appendix A: Sample audit committee charter**

**Appendix B: Planning tool: Audit committee calendar of activities**

**Appendix C: Audit committee performance evaluation**

# 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 US 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.07(b)(i)(A)]
- Overseeing the registered public accounting firm's (independent auditor's) qualifications and independence [NYSE Corporate Governance Rule 303A.07(b)(i)(A) and NASDAQ Corporate Governance Rule 5605(c)(1)(B)]
- Overseeing the performance of the company's independent auditor and internal audit function [NYSE Corporate Governance Rule 303A.07(b)(i)(A)]
- Overseeing the company's systems of disclosure controls and procedures
- Overseeing the company's internal controls over financial reporting
- Overseeing the company's compliance with ethical standards adopted by the company.

<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 audit committee should encourage continuous improvement and should foster adherence to the company's policies, procedures, and practices at all levels. 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 when necessary to perform its duties and responsibilities [Rule 10A-3(b)(4) 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 has the authority to engage outside legal, accounting, or other advisers [Rule 10A-3(b)(4) of the Exchange Act, NYSE Corporate Governance Rule 303A.06, and NASDAQ Corporate Governance Rule 5605(c)(3)], and to seek any information it requires from employees, officers, and directors.<sup>1</sup>

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. [Rule 10A-3(b)(5) of the Exchange Act, NYSE Corporate Governance Rule 303A.06, and NASDAQ Corporate Governance Rule 5605(c)(3)].

The 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>2</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. 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

<sup>1</sup> NYSE Corporate Governance Rule 303A.09 requires companies to adopt and disclose guidelines for corporate governance that address their policies for directors' access to management and independent advisers.

<sup>2</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."

Corporate Governance Rule 303A.07(a), and NASDAQ Corporate Governance Rule 5605(c)(2)(A)].<sup>1</sup> 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>

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>3</sup> 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 executive sessions [NYSE Corporate Governance Rule 303A.07(b)(iii)(E)].

### III. Responsibilities and duties

To fulfill its responsibilities and duties, the audit committee will:

#### **Documents/reports/accounting information review**

Review this charter at least annually and recommend any necessary amendments to the board of directors [NASDAQ Corporate Governance Rule 5605(c)(1)].

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)]. Review internal control reports (or summaries thereof), other relevant reports or financial information submitted by the company to any governmental body or the public, and relevant reports rendered by the independent auditor (or summaries thereof).

Review internal control reports (or summaries thereof), other relevant reports or financial information submitted by the company to any governmental body or the public, and relevant reports rendered by the independent auditor (or summaries thereof).

Discuss the listed company's earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies, 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)].

Review the regular internal reports to management (or summaries thereof) prepared by the internal audit function, as well as management's response.

<sup>1</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 or not at least one audit committee financial expert serves on the audit committee. (Item 407 (d)(5)(i)(A)(1) and (2) of Regulation S-K).

<sup>2</sup> While the existence of a continuing education program for the board and audit committee is not a requirement, the 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> The disclosure requirement of NYSE Corporate Governance Rule 303A.07(a) states 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.

## Independent auditor

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, including the resolution of disagreements between management and the independent auditor regarding financial reporting [Rule 10A-3(b)(2) of the Exchange Act, NYSE Corporate Governance Rule 303A.06, and NASDAQ Corporate Governance Rule 5605(c)(3)]. Review the qualifications and independence of the independent auditor and remove the independent auditor if circumstances warrant. The independent auditor will report directly to the audit committee [Rule 10A-3(b)(2) of the Exchange Act].

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]. Consider whether the auditor's provision of permissible nonaudit services is compatible with the auditor's independence [Rule 2-01(c) of Regulation SX]. 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)].

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].

Review with the independent auditor any problems or difficulties encountered during the course of the audit, including any restrictions on the scope of the independent auditor's activities or on access to requested information, and any significant disagreements with management, together with management's response [NYSE Corporate Governance Rule 303A.07(b)(iii)(F)].

Hold timely discussions with the independent auditor regarding the following:

- All critical accounting policies and practices [Rule 2-07(a)(1) of Regulation S-X]
- 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 [Rule 2-07(a)(2) of Regulation S-X]
- 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].

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].

<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].



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)].

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>

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

In consultation with the independent auditor and the internal audit function, review the integrity of the company's internal and external financial reporting processes.

Understand the scope of the audit plan, including the independent auditors' review of internal control over financial reporting. 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 [Rules 13A-14(a) and 15d-14(a) of the Exchange Act].

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)].

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)].

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)].

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.

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 [Rule 10A-3(b)(3) of the Exchange Act, NYSE Corporate Governance Rule 303A.06, and NASDAQ Corporate Governance Rule 5605(c)(3)].

<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.

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

Review and advise on the selection and removal of the internal audit director.

Review the activities and organizational structure of the internal audit function, as well as the qualifications of its personnel.

Annually, review and recommend changes (if any) to the internal audit charter.

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.

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>**

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 enforcement of this code.

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)].

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)(iii)(D)].

Consider the risk of management's ability to override the company's internal controls.

**Reporting**

Report regularly to the board regarding the execution of the audit committee's duties, responsibilities, and activities, any issues encountered, and related recommendations [NYSE Corporate Governance Rule 303A.07(b)(iii)(H)].

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].

<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 items 43 through 46 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.

Provide a report of the audit committee, which contains certain required disclosures, in the company's annual proxy [Item 306 of Regulation S-K and Item 7(e)(3) of schedule 14A].

**Other responsibilities**

Review, with management, the company's finance function, including its budget, organization, and quality of personnel.

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)].

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.

# 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 US 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 following headings are included in the tool to guide audit committees in their planning:

- **Action or responsibility:** This 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.
- **Source:** This indicates if the action or responsibility results from a requirement of SEC rule making, the NYSE, NASDAQ, or a common or emerging practice.
- **Suggested frequency:** This offers a benchmark for how often the activity could be performed.
- **Meeting month:** This outlines the months in which an activity could 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.

<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 who relies on it. This planning tool is designed for US 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.

Action or responsibility		Source:				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, with management, the company's finance function, including its budget, organization, and quality of personnel.				●	Annually												
Review of financial/controls information	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 or responsibility	Source:				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
Independent auditor relationship	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: – Critical accounting policies and practices – 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 – Other material written communications between the independent auditor and management, including (but not limited to) the management letter and schedule of unadjusted differences.	●			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: – The independent auditor's internal quality-control procedures – 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 – All relationships between the independent auditor and the company.		●		Annually												

		Source:				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 internal and external financial reporting processes 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 chief audit executive.				●	As needed												
	Meet with the director of the internal audit function privately to discuss any necessary matters.		●			Quarterly												
	Review with the chief audit executive 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												

		Source:				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
<b>Action or responsibility</b>	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											
<b>Other responsibilities</b>		Review the audit committee charter; recommend to the board of directors any necessary amendments, as conditions dictate.			●		Annually											
		Provide the audit committee report required to be included in the company's proxy statement.	●				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											



# 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. Leave blank if the statement is not applicable or you do not have enough information to rank the audit committee on that particular item.

Composition and quality	Strongly disagree				Strongly agree
01. 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
02. 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
03. 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
04. The audit committee demonstrates appropriate industry knowledge and includes a diversity of experiences and backgrounds.	1	2	3	4	5
05. Members of the audit committee meet all applicable independence requirements.	1	2	3	4	5
06. 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
07. The audit committee monitors compliance with corporate governance regulations and guidelines.	1	2	3	4	5
08. 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
09. 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
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#### Additional Notes:

Understanding the business, including risks	Strongly disagree					Strongly agree
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: <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	
AVG						

**Additional Notes:**

Process and procedures	Strongly disagree				Strongly agree
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
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**Additional Notes:**

Oversight of the financial reporting process, including internal controls	Strongly disagree				Strongly agree
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

Continued on next page


Oversight of the financial reporting process, including internal controls (continued)	Strongly disagree				Strongly agree
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
AVG					

**Additional Notes:**


Oversight of audit functions	Strongly disagree					Strongly agree
		2	3	4	5	
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	

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**Additional Notes:**

Ethics and compliance	Strongly disagree				Strongly agree
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

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Monitoring activities	Strongly disagree				Strongly agree
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

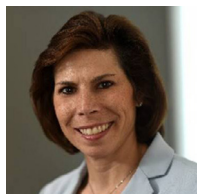
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**Additional Notes:**



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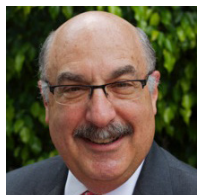
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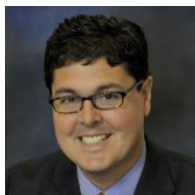
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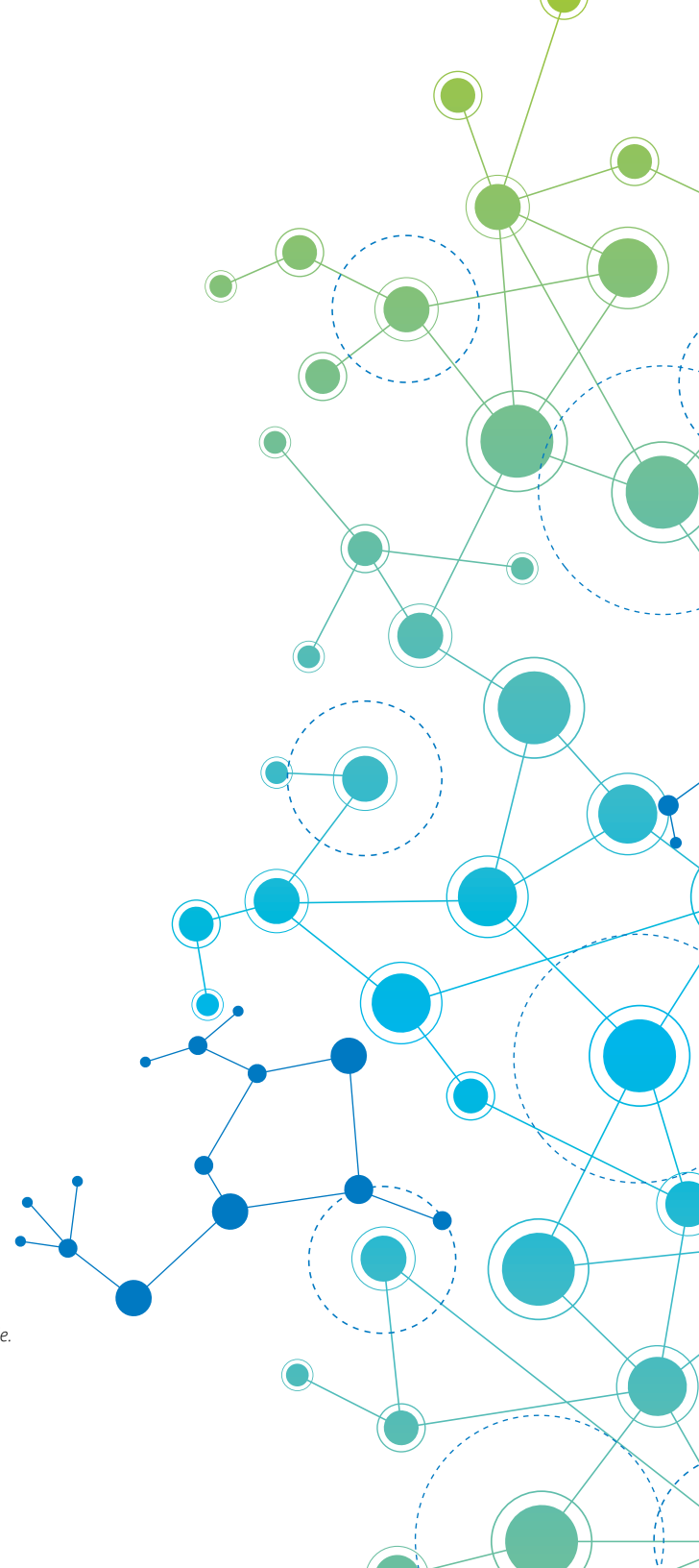
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