Audit Committee Guide

2021 Edition

KPMG Audit Committee Institute

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About the KPMG Audit Committee Institute

As part of the KPMG Board Leadership Center, the Audit Committee Institute (ACI) provides audit committee and other board members with practical insights, resources, and peer-exchange opportunities focused on strengthening oversight of financial reporting and audit quality, and the array of challenges facing boards and businesses today—from risk management and emerging technologies to strategy, talent, and global compliance. Learn more about ACI at **kpmg.com/us/aci**.

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Using this guide

The KPMG Audit Committee Guide (the Guide) draws on insights from our interactions with thousands of audit committee members, audit and governance professionals, and business leaders across the country and around the world.

The Guide is intended to be a practical, user-friendly reference for both new and seasoned audit committee members, and for the management and audit teams who work with the audit committee. To that end, the Guide covers the fundamentals—e.g., basic requirements and responsibilities and key areas of oversight—and offers insights into the current challenges and leading practices shaping audit committee effectiveness today. It is written for the needs of companies listed on a U.S. stock exchange (NYSE or Nasdaq) and can also serve as a resource—to the extent applicable—for audit committee members of private companies, non-U.S. companies, and nonprofits.

Some of the issues covered in the Guide—e.g., risk oversight, cybersecurity and the impact of emerging technologies, long-term performance, shareholder activism, and environmental, social, and governance (ESG) issues—are clearly matters that require the full board's attention. These and other broader issues are included, however, as the audit committee may have an important role to play in helping to ensure that key issues—particularly those related to risk and compliance—are being addressed appropriately.

Of course, no one size fits all; the practices discussed in this Guide should be considered in the context of each audit committee's needs and circumstances. In the appendices, we provide examples of various audit committee materials—including a sample audit committee charter, annual agenda calendar, and audit committee and auditor assessment tools—for consideration and tailoring as appropriate.

Maintaining the committee's effectiveness requires strong leadership, prioritizing the committee agenda, monitoring its oversight processes, and periodically reassessing its skills and composition. The audit committee, in discussion with the full board, should also periodically reconsider whether its risk oversight responsibilities still make sense as the risk landscape evolves.

Our hope is that this Guide will help audit committees continue to fine-tune their oversight and governance processes and drive robust conversations as they help guide their companies forward.

— KPMG Audit Committee Institute

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Audit committee's role and responsibilities—An overview

In these times of rapid change and increased uncertainty, the need for the oversight role that audit committees play is as critical as ever. The most effective audit committees are engaged, executing their responsibilities with diligence, and this engagement significantly enhances the financial reporting output.

—Sagar Teotia, SEC Chief Accountant

The audit committee is a standing committee of the board of directors, charged with overseeing the company's financial reporting processes and internal control over financial reporting (ICFR) and the audits of the company's financial statements. Given the crucial role that the committee plays in the corporate governance process—which is the cornerstone of shareholder protection—the committee must be independent of management.

Aside from the general fiduciary responsibilities of directors set forth in state law, a number of federal laws and regulations—Sarbanes-Oxley Act, Dodd Frank Wall Street Reform and Consumer Protection Act, and U.S. Securities and Exchange Commission (SEC) rules—as well as stock exchange listing rules prescribe the audit committee's purpose and responsibilities. The New York Stock Exchange (NYSE) requires significantly more detail in audit committee charters than the Nasdaq Stock Market (Nasdaq).

In the subsequent chapters of this Audit Committee Guide, we discuss in more detail the committee's responsibilities and, importantly, how audit committees carry out these responsibilities—including leading practices we see audit committees employing.

In general, and at a minimum, the audit committee must assist the board in its oversight of the following:

— The company's financial reporting processes and ICFR

— The independent auditors

— The company's internal audit function

— The company's compliance with legal and regulatory requirements, including the establishment and monitoring of whistle-blower processes.

In addition (as discussed in Chapter 5), most boards delegate to the audit committee a number of responsibilities for oversight of risk management—which is consistent with the NYSE listing standards. We also discuss how boards are allocating responsibility for risk oversight among the full board and its standing committees, including the audit committee, and emphasize that the audit committee's role can vary widely depending on a number of factors, including the size and complexity of the business and the industry.

The focus by investors and regulators on how the audit committee carries out its oversight responsibilities and related demands for disclosure continue to intensify. This increasing scrutiny—along with the growing complexity of the business and risk environment—is prompting audit committees (and boards) to take a hard look at the committee's workload and activities as well as its composition and leadership—all of which we discuss at some length in this Audit Committee Guide.

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Composition, onboarding, and role of the chair

The NYSE and Nasdaq listing rules require that an audit committee have a minimum of three directors—on average, audit committees have three to five members—and each director must be "independent" and meet certain financial literacy requirements.

Given the audit committee's demanding role and responsibilities—and significant time commitment—the NYSE discourages directors from serving on too many audit committees. Under the NYSE listing rules, 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 would not impair that member's ability to effectively serve on the listed company's audit committee, and must disclose such determination in the company's proxy statement.

Independence

The NYSE and Nasdaq have adopted detailed rules as to who can qualify as an "independent" director. In general, a director is "independent" only if the board determines that there is no material relationship with the company (NYSE) and no relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director (Nasdaq). Each stock exchange also sets forth "bright line disqualification standards." The board must review all relevant relationships and make a determination.

In addition to meeting the stock exchange requirements for independence, each audit committee member must also satisfy the SEC's "enhanced" definition of audit committee independence:

— The director generally may not receive any compensation from the company—such as consulting or advisory fees—other than director fees

— The director may not be an "affiliated person" of the company or any subsidiary.

Many companies incorporate the audit committee independence criteria into the criteria applicable to all independent directors to avoid having different levels of independence.

Financial literacy and expertise

The stock exchanges require that all audit committee members be financially literate. The NYSE leaves the interpretation of financial literacy to the board, while the Nasdaq defines financial literacy as the ability to read and understand fundamental financial statements, including the company's balance sheet, income statement, and cash flow statement.

In addition, the NYSE requires that at least one member of the audit committee have accounting or related financial management expertise—as interpreted by the board. Under the Nasdaq rules, at least one member of the audit committee must have a specified background or experience that results in financial sophistication.

The SEC rules require a company to disclose whether any member of its audit committee qualifies as an "audit committee financial expert" (ACFE). The SEC rules defining ACFE require, among other things, that an ACFE possess all of the following attributes:

— An understanding of generally accepted accounting principles (GAAP) and financial statements

— The ability to assess how GAAP applies to accounting for estimates, accruals, and reserves

— Experience preparing, auditing, analyzing or evaluating financial statements with a comparable breadth and level of complexity or experience actively supervising people who do so

— An understanding of ICFR

— An understanding of audit committee functions.

These attributes must be acquired by certain types of experiences specified in the SEC rules.

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In practice, many audit committees have more than one ACFE. According to an analysis of proxy statement disclosures by the KPMG Board Leadership Center (BLC), 43 percent of Russell 3000 companies disclosed having one ACFE, while 34 percent disclosed that three or more audit committee members were ACFEs.[1] In its Governance Quality Score and U.S. voting policy, proxy advisor Institutional Shareholder Services includes a factor for how many financial experts serve on the audit committee.

Onboarding

Whether directors are joining their first audit committee or their fifth, the stronger the onboarding process, the more quickly a new audit committee member will be able to add value. Some boards assign new directors with the required background to the audit committee to provide them with a deeper understanding of the company. The onboarding process should be designed to help the new audit committee member quickly get up to speed on:

- The role and responsibilities of the committee
- The business—its strategy, financial status, operations, leadership, and key opportunities and risks—as well as unique industry issues and trends
- Financial reporting issues, including any specific to the company's industry
- The culture and dynamics of the committee and the board
- Background on current and emerging issues.

For directors joining their first audit committee, an orientation regarding the core role and responsibilities of the audit committee—including a review of the legal duties of loyalty and care applicable to directors generally—is essential.

While every audit committee of a public company has the same core set of responsibilities, there is significant variation among audit committees regarding the scope of the committee's involvement in oversight of risk. And the number and types of risks overseen by audit committees, such as culture, continue to increase. For both new and experienced directors, the audit committee onboarding process should help the director understand the scope of the audit committee's role in the oversight of risk. Although this may be described in the committee charter or the company's public filings, often these documents are too general to be helpful on this point, and the corporate secretary or committee chair should be consulted.

Onboarding should also cover the basics—what the company does, how it makes money, where it is headed, its significant opportunities and risks, and its control environment. How much information a new audit committee member needs will, of course, vary depending on the complexity of the company and the director's knowledge about the company and its industry. Meetings with the leaders of each of the company's key businesses and others—the chief financial officer (CFO), chief information officer, general counsel, chief compliance officer, chief risk officer, head of investor relations, head of internal audit, and external auditor—can help new audit committee members gather valuable information about the company.

To the extent that new audit committee members have not reviewed them as part of their due diligence prior to joining the board, the following materials are essential reading as part of any onboarding process:

- The company's SEC filings during the past two years—annual and quarterly financial reports, proxy statements, and other disclosures
- Other public communications containing financial disclosures and/or projections, including quarterly earnings calls (the Q&A as well as the script), presentations made to groups of analysts or shareholders, press releases, media interviews
- Audit committee meeting minutes and materials
- Materials relevant to company strategy, including the current and previous strategic plan as well as scorecards or other materials that are used to track progress against the plan
- Materials relevant to risk, including the company's enterprise risk management activities or program (if it has one), how risk oversight is allocated among the board's standing committees, risk reports or analyses as applicable, summaries of the company's business continuity, and crisis management plans
- Materials relevant to compliance, including:
  - The code of conduct and whistle-blower procedures
  - A summary of whistle-blower complaints and how they were handled
  - Contacts by regulators, including SEC comment letters
  - Significant investigations and litigation
- Internal audit plan for the current year and report for the prior year
- External auditor reports and written communications.
- Information on the company's use of non-GAAP and nonfinancial measures, such as those relating to ESG.

[1] Analysis of 2019 proxy statement disclosures by 2,948 Russell 3000 companies based on Equilar data

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In order to develop a well-rounded understanding of the company, new audit committee members should include information from external sources as part of their onboarding. In addition to information provided by the external auditor, a new director may find valuable insight into the company's risks by reviewing stock analyst reports, social media chatter, research on consumer perception of brand value, and public disclosures that discuss risks faced by other companies in the same industry. And go beyond the corporate headquarters—visit factories, retail outlets, and offices out in the field. The key is to obtain information that will show the company from a number of different vantage points, including perspectives of the company's critics as well as its fans. Also see New audit committee/director onboarding from the KPMG BLC.

Finally, if there is a new committee chair, in addition to any other onboarding activities, consider whether the transition of committee chairs presents an opportunity for the new chair to use the onboarding period to gather information relevant to the effectiveness of the committee itself, to look at the committee with fresh eyes, and to make changes as appropriate to ensure that the committee is keeping pace. In addition, the onboarding of a new chair is a good time for the committee to review its succession plan.

Continuing education

NYSE listing rules require companies to address director orientation and continuing education in their corporate governance guidelines. Audit committees may want to consider offering members access to education programs to help them keep current on recent developments, emerging issues, leading practices, or any gaps in their knowledge. Universities, corporate governance and industry groups, nonprofits, and professional services providers offer a variety of programs that can be customized to the committee's requirements.

Role of the chair

Beyond the committee's qualifications and responsibilities set forth in the listing standards and legal/regulatory requirements, the audit committee chair's leadership—in setting the committee's tone, work style, and agenda—is vital to the committee's effectiveness and accountability, and cannot be overstated.

In our experience, the most effective audit committee chairs are fully engaged—recognizing that the position may require their attention at any time and beyond regularly scheduled meetings; they set clear expectations for committee members, management, and auditors; and they ensure that the right resources are being employed to support quality financial reporting.

To provide effective leadership, the audit committee chair must have a clear understanding of the committee's duties and responsibilities, be able to commit the necessary time (which will vary depending on the size and complexity of the business), be readily available on urgent matters and in times of crisis and have the requisite business, financial, communication, and leadership skills.

In particular, the audit committee chair should play a proactive leadership role in:

— Setting the tone: dedicated, informed, probing, and independent—willing to challenge management, when appropriate

— Keeping the committee focused on what is important—quality accounting and financial reporting and effective internal controls

— Making sure the audit committee has the information, resources, and support to do its job and to handle the expanding portfolio of issues it is being asked to manage

— Periodically reviewing and refining the audit committee's charter, including working with the board chair and committee chairs to reallocate responsibilities if the audit committee's workload is out of balance

— Ensuring that all committee members are engaged

— Promoting communications—both formal and informal—between audit committee members

— Spending time between meetings working with management and auditors to ensure that all relevant issues are identified and addressed by the committee

— Helping ensure the finance organization has the talent and resources to maintain quality financial reporting

— Setting clear expectations for external and internal auditors

— Leading annual committee performance evaluations and self-assessments (required by NYSE listing rules)

— Assessing the tone at the top and throughout the organization

— Assessing whether members have the expertise to oversee the additional risks delegated to the audit committee and getting input from experts as appropriate.

For more, also see The role of the audit committee chair.

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Oversight of financial reporting and internal control over financial reporting (ICFR)

Quality financial reporting starts with the CFO and finance organization. Management is responsible for the preparation of the company's financial statements and related disclosures, as well as maintaining effective ICFR and disclosure controls and procedures. The audit committee has oversight responsibility for these areas and is actively engaged in the financial reporting process, including:

— Reviewing financial communications, including financial statements and disclosures, earnings releases, and earnings guidance

— Overseeing management's system of ICFR and its disclosure controls and procedures.

Under SEC rules, the audit committee is required to report in the proxy whether it has recommended to the board of directors that the audited financial statements be included in the company's annual report.

Reviewing financial communications

There is little in law or regulation regarding the audit committee's responsibility to oversee financial communications; however, under NYSE listing rules, the audit committee is required to:

— Assist the board in overseeing the integrity of the company's financial statements

— Review and discuss the company's annual and quarterly financial statements, including disclosures in the management's discussion and analysis (MD&A), with management and the external auditor

— Discuss the company's earnings releases, financial information and earnings guidance provided to analysts and rating agencies.

10-K and 10-Q

The size and complexity of financial reports today makes reviewing these documents—often more than 100 pages for the 10-Q and 200–300 for the 10-K, with entire pages devoted to complex, technical issues—a formidable task, even for the most seasoned audit committees. Given this challenge, the audit committee's review should be grounded in the following:[2]

— Understanding the purpose of the audit committee's review—which is not to edit the 10-K, but to satisfy itself, from an oversight perspective, that the report is fairly presented

— Insisting that management provide a summary of key areas the audit committee needs to evaluate

— Allowing adequate time to review the SEC filings. Particularly in the case of the 10-K, audit committee members should be prepared to devote the time needed to review and comment

— As an aid to reviewing the SEC filings, requesting that management provide the committee with a summary of key areas it needs to evaluate, including new matters.

In addition to the issues identified in management's summary (as noted above), the audit committee's review of the 10-K should also include:

— New accounting pronouncements being applied for the first time during the most recent reporting period. The audit committee should be informed of the initial application and should understand the process for implementation

— The MD&A and disclosures regarding critical accounting policies, judgments, and estimates, and risk factor disclosures

— Other significant accounting, auditing, and reporting matters, including matters that the external auditors brought to the attention of the audit committee or referred to the firm's national office.

[2] National Association of Corporate Directors (NACD), Report of the NACD Blue Ribbon Commission on the Audit Committee, 2010.

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The audit committee should discuss key elements of the 10-K and 10-Q with the CFO, general counsel, external auditor, and the head of internal audit, focusing on the issues that management has highlighted, as well as other significant accounting and disclosure issues that arose during the process. To this end, the audit committee chair may find it helpful to develop a list of issues to discuss with the external auditor and a separate list with internal auditors each year.

A robust discussion of the 10-K and 10-Q should:

— Challenge the assumptions that underlie management's critical accounting judgments and estimates. Understand what has been disclosed about these assumptions in the past, how these assumptions have been impacted by recent events and economic conditions, and the likelihood that materially different amounts would be reported under different conditions or using different assumptions

— Assess whether the company's critical accounting policies, judgments, and estimates are consistent with others in the industry? Are they more aggressive? Less aggressive? And how have they changed?

— Discuss potential critical audit matters (CAMs) that have been identified by the external auditor

— Probe management and auditors about significant or unusual transactions, estimates, and decisions related to areas involving a risk of material misstatement or large and imprecise dollar implications

— Obtain a briefing from management's disclosure committee (whether verbally or from a committee report) regarding its review of disclosures contained in the 10-K or 10-Q (as well as related disclosures in press releases, shareholder correspondence, and presentations to analysts and rating agencies)

— Review disclosures regarding related-party transactions

— Tap the external auditor's expertise across industries and segments—and its experience in dealing with different business transactions and arrangements—to help put issues into context.

Note that there are a number of required communications—largely codified by Public Company Accounting Oversight Board (PCAOB) AS 1301, "Communications with Audit Committees"—that the external auditor must make to the audit committee about important financial reporting issues, such as critical accounting policies, significant unusual transactions, disagreements with management, etc. While these "required communications" (many of which occur during the normal course of the audit) are essential, it is critical for the audit committee and external auditor to maintain robust, two-way communications about a range of financial reporting, control, and risk-related issues that may have implications for the company's financial statements and disclosures.

We should emphasize the increasing focus by regulators, investors, audit committees, and boards on disclosures. Different investors have different expectations for disclosures, with varying appetites for the level of disclosure they want. Generally, however, investors want to have an understanding of the state of the business—"what's important?"—as well as some sense of "what's going on in the boardroom." An ongoing consideration for every audit committee and board is whether disclosures can be improved—perhaps going beyond what is required—to better tell the company's story, as well as the audit committee's/board's governance story. The Center for Audit Quality's annual Audit Committee Transparency Barometer documents the increased level of disclosure relating to the work of the audit committee among S&P 1500 companies.

Internal control over financial reporting and disclosure controls and procedures

Internal control over financial reporting

ICFR is a process designed by management to provide "reasonable assurance" regarding the reliability of the company's financial reporting and preparation of financial statements in accordance with GAAP.

Under Section 404 of the Sarbanes-Oxley Act, for certain issuers, management is required to annually evaluate ICFR and report on its effectiveness, and the external auditor must conduct an audit of ICFR as part of its integrated audit. Under Sarbanes-Oxley Section 302, the CEO and CFO are required to make quarterly certifications regarding the effectiveness of ICFR, as well as the company's "disclosure controls and procedures."

The audit committee has oversight responsibility and must satisfy itself that management has established an appropriate system of ICFR, a process to monitor, test, and assess ICFR and to certify as to its adequacy—as well as responsibility to oversee the external auditor's integrated audit. Under PCAOB AS 2201, the external auditor must provide written communication to the audit committee regarding all material weaknesses and significant deficiencies in ICFR.

ICFR is an area of continued focus by the PCAOB and SEC. The audit committee should have periodic discussions with management and external and internal auditors regarding the status of the company's ICFR, including the status of audits and certification processes. During periods of budget and workforce reductions, the audit committee should carefully probe management and auditors regarding the impact of these reductions on the company's ICFR.

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COSO frameworks

The Committee of Sponsoring Organizations of the Treadway Commission's (COSO) Internal Control-Integrated Framework (2013) describes five components of internal control—the control environment, risk assessment, control activities, information and communications, and monitoring activities—as well as 17 "principles" and "points of focus" for each principle to help companies better understand and evaluate the effectiveness of internal control. The COSO 2013 Framework also emphasizes the role of the board—and by delegation, the audit committee—in overseeing internal control.

In COSO's 2015 Leveraging COSO Across the Three Lines of Defense, building on COSO's Internal Control-Integrated Framework, the first line (frontline operating management) owns and manages risk and control; the second line (risk, control, and compliance functions put in place by management) monitors risk and control in support of management; and the third line (internal audit) provides independent assurance to the board and senior management concerning the effectiveness of management risk and control.

Non-GAAP financial measures

In light of the increased use of non-GAAP measures, the audit committee should discuss the selection and use of non-GAAP measures and other key operating metrics with management. Questions may include:

- Does the company have a policy regarding the use and disclosure of non-GAAP measures?
- How does the company decide whether and which non-GAAP financial measures and other key operating metrics to present?
- Who drives the process?
- What is the role of management's disclosure committee?
- What is the role of the audit committee?
- Is the audit committee satisfied that non-GAAP financial measures and key operating metrics presented improve transparency?
- How frequently does management reassess the adequacy of the company's disclosure controls and procedures around non-GAAP measures and other key operating metrics?

Financial reporting red flags and fraud risk factors

The pressures on management and employees to engage in financial reporting fraud vary both in kind and intensity, depending on a number of factors. The audit committee must be vigilant and maintain a healthy skepticism about the risk of financial reporting fraud throughout the organization. To this end, the audit committee should have a general understanding of the incentives and pressures that may encourage management to engage in financial reporting fraud, and some of the common red flags. Pressure points for organizations often include:

- Meeting analysts' earnings estimates
- Meeting business plan and budget targets
- Complying with debt covenants
- Meeting incentive compensation targets
- Managing significant and often stressful organizational changes, such as job cuts, acquisitions, divestitures, etc.
- Managing a crisis.

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Disclosure controls and procedures

SEC rules define "disclosure controls and procedures" to mean controls and other procedures that are designed to ensure that information required to be disclosed in SEC reports is recorded, processed, summarized, and reported within the mandated time frames.

Disclosure controls and procedures is a broader category of controls than ICFR. As noted on page 9, in their 302 certifications, the CEO and CFO must make disclosures regarding the effectiveness of the company's disclosure controls and procedures.

Quarterly earnings pressure is always on the radar—it has to be. The audit committee's first priority is the integrity of our financials, so if there's pressure that could affect the integrity of the company's financials, the audit committee needs to be aware of that and on top of it. At the end of the day, financial integrity is our number one mission—and the only way to stay on top of that is to be actively engaged and really integrated into the rhythm of the organization.

—Audit committee chair

The SEC has recommended that companies have a management-level "disclosure committee," tasked with considering the materiality of information and determining the company's disclosure obligations on a timely basis. Disclosure committees, comprising company officers and senior managers, typically report to the CEO or CFO and play a lead role in maintaining the company's disclosure controls and procedures and in preparing and reviewing disclosures contained in the company's periodic filings with the SEC. Some disclosure committees also review sustainability reports.

An important role of the audit committee is to understand the workings of the disclosure committee and stay apprised of its activities and output:

- What is the disclosure committee's composition and role, and how does it identify and evaluate information that may need to be disclosed?
- Given their responsibility for the company's disclosure controls and procedures, how are the CEO and CFO kept up to date on the disclosure committee's activities and thinking?
- What is (or should be) the nature of the disclosure committee's communications with the audit committee and others?

Many audit committees receive copies of minutes of disclosure committee meetings or other reports from the disclosure committee, and some audit committee chairs occasionally attend disclosure committee meetings to see how the committee operates and to support its initiatives.

Earnings releases and other financial communications

In addition to its review of the 10-K and 10-Q, the audit committee should pay close attention to the company's other financial communications. The NYSE corporate governance rules require the audit committee to discuss the company's earnings press releases, as well as financial information and earnings guidance that is provided to analysts and rating agencies—and to that end, we offer several important considerations:

- **Earnings releases**, which have become important communications for the investor community, can present particular challenges. Unlike the 10-Q or 10-K, earnings releases often contain important business information that is not generated by the company's financial reporting system, is not audited, and may not be subject to ICFR. The audit committee should pay particular attention to the overall tone, as well as to any non-GAAP financial information, and discuss the process used to develop non-GAAP financial information and the controls around that information. The audit committee should review the earnings release before it is issued. Also see the discussion of non-GAAP financial measures on p.10.
- **Earnings guidance**. Companies vary in their approach to guidance—whether they provide guidance at all, and if they do, what metrics they use, whether their guidance specifies an exact number or a broad range, the time horizon of the guidance, and how frequently it is communicated (for example, some companies provide annual guidance but discuss progress against the guidance every quarter). The pros and cons of providing guidance—and the various approaches that can be taken—should be considered carefully, and any changes to the company's approach to providing guidance should be clearly communicated to investors and the marketplace.
- **Information provided to analysts**. The audit committee should also consider listening to the company's conference calls with the analyst community—again, focusing on consistency and tone—and may want to review management's talking points in advance of the call. Directors can gain valuable insight into the way others view the company by hearing the questions that are asked after management's prepared remarks as well as management's responses.

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Accuracy and consistency across all financial communications is essential. Maintain a "big picture" perspective of the company's financial communications (i.e., are tone, messages, and information consistent across the 10-K, earnings releases, analyst calls, and other communications, and do they position the company appropriately?).

Short-term results and long-term value

Companies and boards are sharpening their focus on the company's drivers of long-term value creation. And while financial health is vital—cash flow, growth in revenues and profits, are key—these short-term measurements may provide little, if any, insight about the company's likelihood of achieving long-term growth and returns. As a result, more companies and directors are putting greater emphasis on key measures relevant to the long-term health and performance of their organizations, including those related to ESG.

Every company needs to identify the drivers of long-term value based on its particular strategy, risk profile, strengths, and weaknesses. These drivers may be quantitative and qualitative, financial and nonfinancial.

A number of questions and considerations can help audit committees and boards sharpen the company's focus on its key long-term metrics, including:

- Do we understand the key drivers of long-term value for the enterprise?
- What are the measures that will best help us track progress against long-term goals?
- Are we focused on enhancing alignment between short-term measures and long-term goals?
- How do performance management and incentive compensation balance the short term and the long term?
- How do we communicate those drivers to investors and other stakeholders?

In short, a key role for the audit committee and board is to help align short- and long-term considerations—by setting the right tone, focusing on the right metrics, and ensuring that the company is communicating its long-term focus to its stakeholders.

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Oversight of external and internal auditors

Because external and internal auditors play a vital role in the financial reporting process, effective oversight of auditors is at the core of the audit committee's responsibilities.

External auditor

One of the most important Sarbanes-Oxley reforms was to assign to the audit committee direct responsibility for oversight of the external auditor. For all U.S. public companies today, the audit committee is "directly responsible for the appointment, compensation, and oversight" of the external auditor, including "resolution of disagreements between management and the auditor" regarding financial reporting matters. The external auditors "report directly to the audit committee." In short, the audit committee should expect to be treated as the external auditor's "client."

The laws and regulations governing the audit committee's relationship with the external auditor—Sarbanes-Oxley requirements, SEC and PCAOB rules, stock exchange listing rules, and auditing standards—are extensive.

Generally, the audit committee's oversight responsibilities for the external auditor include:

— Appointment, retention, evaluation, and compensation of the external auditor

— Monitoring the external auditor's independence—including rotation of audit partners and preapproval of audit and nonaudit services, which are strictly limited under SEC regulations and therefore require a clear preapproval policy and process. (See Appendix D: Sample audit and nonaudit services preapproval policy.)

— Overseeing the strategy, scope, progress, and results of the external audit of financial statements and audit of ICFR

— Overseeing the auditor's interim review procedures.

NYSE corporate governance rules also require that the audit committee hold executive sessions with the external auditor.

In our experience, the following practices (developed in collaboration with the NACD's Blue Ribbon Commission on the Audit Committee) can help the audit committee carry out its oversight responsibilities and build a strong relationship with the external auditor:

Build a strong working relationship between the audit committee chair and the lead audit engagement partner. A good working relationship between the audit committee chair and the lead audit engagement partner is essential—both to the audit committee's effectiveness and to the effectiveness of the engagement team. From preparing committee agendas and walking through the premeeting materials together, to discussing important developments on a real-time basis, informal conversations between the audit committee chair and the lead audit engagement partner are critical to the effectiveness of the audit committee.

The audit committee chair plays an important role in maintaining the effectiveness and accountability of the audit committee. Likewise, the lead audit engagement partner plays a similar role for the engagement team. A strong relationship—of trust and confidence—between the chair and the audit partner lays the foundation for productive communications between the engagement team and the audit committee as a whole.

Get to know the firm's engagement partners as well as its national office partners who may be involved in the engagement. Given the complexity of accounting and auditing standards today, it's no surprise that external auditors are consulting their national offices more frequently on technical accounting and other matters. To gain a better understanding of the consultation process, consider having a national office partner of the firm meet with the audit committee periodically to discuss current issues and developments, as well as the role of the national office. Get to know their technical accounting experts, industry leaders, and thought leaders. Also develop relationships with other partners involved in the engagement—the engagement quality review partner, the relationship partner, as well as other partners on the engagement team (such as the tax partner, IT partner, and partners in foreign countries, if the company has international operations). Audit committees should know the partners they are dealing with and relying on.

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> **Let the external auditor know that you're serious about their objectivity. We need it and we want it. I mean, we (the audit committee) need them, and we hire them. Hopefully we never have to fire them, but it's our responsibility to have a strong relationship so that if we start feeling that there are any issues with the support we're getting from an audit or technical perspective, we can have a productive and professional dialogue to address the concerns.**
>
> —Audit committee chair

Develop a clear plan for audit partner rotations, as well as rotations for key members of the engagement team. Lead audit engagement and engagement quality review partners must be rotated every five years, and certain other engagement partners must be rotated every seven years.[3] In order to provide continuity and avoid disruptions, audit committees should ensure that the audit firm has developed a clear schedule and timeline for partner rotations—in effect, a succession plan—as well as a process to identify new partners to assume these positions.

Make sure the right people are working on the audit. This requires advance planning, particularly in connection with the rotation of the lead audit engagement partner. For example, many audit committees develop the qualities and characteristics the committee seeks in the next engagement partner. The audit firm then proposes a candidate—or perhaps several candidates, depending on the size and nature of the engagement. This can be a significant challenge, particularly for a company in a specialized industry such as banking or energy. The audit committee and financial management interview the candidate(s), and the audit committee, with management's input, then approves the firm's final selection of the new lead audit engagement partner.

Give the external auditor clear performance objectives and evaluate the auditor against those objectives. Work with the external auditor to develop clear performance objectives against which the committee will evaluate the auditor's performance in the coming year, and then evaluate the auditor accordingly. (See Additional resources, CAQ External, Auditor Assessment Tool.)

Consider how the audit committee can most effectively carry out its "direct responsibility" for oversight of the external auditor given management's extensive interactions with the engagement team, often on a daily basis. For example, what should be the role of the audit committee versus management in negotiating audit fees? Depending on the unique facts and circumstances, management may be able to help the audit committee during fee negotiations; but in all cases, the audit committee—not management—has direct and final responsibility for determining the auditor's fees. Financial management might initially develop a fee estimate in concert with the external auditor and then propose an overall plan to the audit committee for its consideration. Of course, the audit committee needs to consider and balance management's inherent bias to reduce the auditor's time and fees, and the external auditor's bias to increase audit fees. If this is a concern, the audit committee might take a more active role in the process.

Similarly, the audit committee should consider its role (versus financial management's) in other key areas, such as evaluating the auditor's performance, partner rotation, and reviewing audit plans. In all of these areas, management works closely with the engagement team, and certainly has important insights and knowledge that can help the audit committee carry out its direct responsibility for oversight of the external auditor.

Audit quality initiatives

In recent years, investors, regulators, and other the stakeholder have continued to focus on the quality of financial statement audits. The PCAOB continues to focus on ICFR as well as various projects to enhance audit quality and auditor independence, objectivity, and professional skepticism, including changes to the auditor's reporting model, communication of CAMs, audit quality indicators, and others.

Audit committees should stay apprised of these initiatives, and consider sharing their views with regulators, as appropriate, and understand the implications for the company's audit (including multinational audit activities) and the audit committee's oversight role and interaction with auditors. The audit committee should always take the lead in helping to ensure audit quality.

[3] Sarbanes-Oxley, Section 203, "Audit Partner Rotation"

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Changes to the auditor's report

On October 23, 2017, the SEC adopted the changes to the auditor's report proposed by the PCAOB. The most significant change was a requirement for large accelerated filers to include CAMs in the auditor's report for fiscal years-ended June 30, 2019 and after. The effective date for all other filers was December 15, 2020. Under this mandate, auditors are to disclose matters that are communicated to the audit committee, relate to material accounts or disclosures, and that proved to be especially challenging, subjective, or complex and how the auditor addressed them in their audit.

The most frequent categories of CAMs are goodwill and intangibles, revenue, business combinations, and—for financial services companies—the allowance for loan and lease losses. For the majority of companies, the number of CAMs communicated in the auditors' report has been either one or two, with an average of 1.7.[4]

Internal audit

Under NYSE listing rules, the audit committee must oversee the internal audit function (whether in-house or outsourced), including:

- Reviewing with the external auditor the responsibilities, staffing, and budget of the internal audit function
- Holding executive sessions with the internal auditor.

As part of their responsibilities, audit committees typically also review the internal audit plan and results of internal audit's work. Beyond these requirements, there are few mandates prescribing the audit committee's responsibility for oversight of internal audit. However, as audit committees have come to rely on internal audit (and the head of internal audit) as one of their primary resources in the oversight of financial reporting and risk management processes, a number of leading practices for oversight of internal audit have evolved. Today, many audit committees play an important role in three key areas:

- Helping to define or clarify internal audit's role and helping to ensure that it has the skills and resources to be successful
- Defining the reporting relationships for internal audit
- Working with the chief audit executive to help identify the risks that pose the greatest threat to the company's reputation, strategy, and operations and helping to ensure that internal audit is focused on these key risks and related controls.

Internal audit's role and resources

At a time when audit committees are wrestling with heavy agendas—and issues like cybersecurity and global compliance are putting risk management to the test—internal audit should be an indispensable resource to the audit committee and a crucial voice on risk and control matters.

This often means focusing not just on financial reporting and compliance risks, but critical risks to the business—key operational and technology risks, and related controls. Does internal audit have the stature—and a direct line to the audit committee—to ensure that its voice is heard and valued? "High-performing departments stand apart in their mindset and how they approach their work," says one seasoned internal audit executive. "They grasp the importance of delivering value, and they are seen by stakeholders as an indispensable resource."

As noted above, an important role for the audit committee is to help clarify and define the role of internal audit in the organization. Do the internal auditor, CEO, CFO, and audit committee have a shared view of the role of internal audit in the organization? Recognize that there are competing demands on internal audit—from the CEO, CFO, business unit leaders, and risk and IT officers—and that the lack of a shared view can undermine internal audit's effectiveness.

Clarify internal audit's role in connection with risk management—which is not to manage risk, but to provide added assurance regarding the adequacy of risk management processes. To this end, are internal audit plans focused on the most significant risks to the business, including strategic and operational risks? Do we have the right controls around these risks? Are the controls functioning properly? Is the audit committee obtaining assurances regarding mitigation of the strategic and operational risks?

The audit committee can help internal audit add value to the organization by:

- **Making sure internal audit has the necessary skills**. Given its evolving responsibilities, internal audit may require different staffing and/or skills, including operational knowledge (supply chain, shared services, outsourcing), IT experience, cross-cultural training for global organizations, knowledge of emerging markets, risk management and evaluation, cybersecurity, blockchain, data analytics, fraud detection, local language skills, and more.

[4] KPMG, Critical Audit Matters – Auditors' report snapshot, March 11, 2020

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Cosourcing of internal audit

Many organizations do not have internal audit professionals with the technical skills and/or industry experience to meet the demands of the business; or they may not have a large enough staff—with language skills and knowledge of local cultures—to meet the audit-related needs of a company operating internationally. As a result, they may cosource internal audit services to support specific areas of the internal audit function.

In these cases, the audit committee should be involved in any proposal to cosource internal audit activities and should continue to provide oversight of the cosourced services. The audit committee should ensure that the company's head of internal audit has management responsibility for the cosourced function—including adequate resources to manage the cosourced services effectively—and that there are appropriate controls around the cosourced function.

- **Reinforcing internal audit's stature within the organization and its accountability to the audit committee**. As internal audit becomes more involved in helping the organization manage risk and achieve strategic objectives, there is a greater need for the audit committee to help ensure the objectivity of the internal audit function. Direct and open lines of communication between the audit committee and the head of internal audit become more important. Also, leverage internal audit as a barometer of the company's financial and operational health—helping the audit committee understand the quality of financial and operational controls, processes, and people.

Reporting relationships for internal audit

There's an inherent tension in the internal auditor's role: the head of internal audit is an important member of the company's management team, while at the same time responsible for reviewing management's conduct and performance. This is a difficult position, and the challenge for the audit committee is to establish a relationship that helps the head of internal audit and internal audit staff operate effectively in its dual management/monitoring role.

The Institute of Internal Auditors (IIA) and others suggest that internal audit report "functionally" to the audit committee and "administratively" to executive management, creating a direct line of communications between the chief audit executive (CAE) the CEO or other C-level executive—e.g., the CFO, general counsel, or other C-level—who can effectively serve as the "internal audit champion."

What is the role of the audit committee versus management in this reporting relationship—e.g., reviewing and approving internal audit's plan, budget, and resources; hiring or firing the head of internal audit; conducting a performance review and determining compensation? Each organization will need to structure the head of internal audit's reporting relationships and oversight roles according to its unique needs and circumstances; however, in many cases it will make sense for both the audit committee and the internal audit champion to be jointly responsible for overseeing internal audit.

Management is in a good position to review the internal auditor's audit plans, budget, and resources and to recommend appropriate compensation and hiring or terminating the head of internal audit. All of these issues, however, should be subject to the audit committee's approval—a "review and consent" model.

Under no circumstances should internal audit's findings and reports be "filtered" before they are presented to the audit committee, and the audit committee should set a clear expectation for the internal auditor to report any concerns regarding sensitive matters, including issues involving senior management, directly to the audit committee. A relationship built on trust and confidence is essential to ensuring that internal audit will bring important, sometimes controversial, issues to the audit committee's attention without hesitation.

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Oversight of risk—Considering the audit committee's role

Regulators and investors are keenly focused on what boards of directors are doing to oversee risk management. The SEC rules require disclosure about the board's role in risk oversight, including a description of how the board and its committees administer oversight. In its commentary, the SEC stated that "disclosure about the board's involvement in the oversight of the risk management process should provide important information to investors about how a company perceives the role of its board and the relationship between the board and senior management in managing the material risks facing the company."

The Dodd-Frank Act requires certain public companies subject to Federal Reserve jurisdiction to establish a board-level risk committee that is responsible for the oversight of a company's enterprise-wide risk management practices. For companies not subject to this requirement, views differ on whether a separate risk committee is appropriate. Risk oversight should be a full board function, with various aspects of risk allocated among the standing committees. Clearly, the audit committee has responsibility for oversight of financial reporting risk; beyond that, however, there is little in law or regulation that addresses this question. The NYSE corporate governance standards require the audit committee "to discuss policies with respect to risk assessment and risk management;" yet, the standards also make clear that the audit committee is "not the sole body responsible for risk."

Risk management processes

Oversight of the company's risk processes can be a significant undertaking, which generally requires an understanding of the company's processes to identify, assess, mitigate, manage, and communicate about risk throughout the enterprise. While risk oversight is a full board responsibility, some boards task their standing committees with oversight of specific risks. For example, in addition to financial reporting risk, the audit committee may also oversee cybersecurity risk. Among the questions to be addressed:

- How rigorous are management's processes to identify and assess the risks to the business? Who is involved? How far down in the organization does it go? Where/who does the information come from?
- Is there a good understanding of the risks inherent in the company's strategy, and a process in place to monitor changes in the environment that might alter key assumptions?
- Is the organization taking the "right" amount of risk?
- Does the company have the right controls around risk? Are controls reassessed based on changes in the risk environment?
- Does internal audit provide added assurance regarding the adequacy of risk management systems?

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The NACD's Blue Ribbon Commission on Risk Governance contains important recommendations for how boards—and their committees—should oversee risk. The Commission's report summarizes its recommendations as follows: "While there is no one-size-fits-all solution, the Commission believes that, as a general rule, **the full board should have primary responsibility for risk oversight, with the board's standing committees supporting the board by addressing the risks inherent in their areas of oversight**. It is rare that any one committee—such as the audit committee or a risk committee—would have the time, resources, and expertise to oversee the full range of risks facing a company. Moreover, the critical link between strategy and risk points to the need for the full board—rather than any one committee—to have responsibility for risk."[5] While proxies and surveys indicate that boards are increasingly taking on primary responsibility for risk oversight, many audit committees continue to say they have primary oversight responsibility for a host of risks beyond financial reporting—from operational and compliance risks posed by globalization and the extended organization (partners, suppliers, vendors, etc.), to cybersecurity, emerging technologies, and financial risks (if the board does not have a finance committee)—as well as the company's overall risk management processes. Perhaps not surprisingly, in recent surveys, many audit committee members tell us that it is increasingly difficult for them handle the array of risks on their plate: The audit committee's "core" duties—overseeing financial reporting and controls, as well as external and internal auditors—are a substantial undertaking and time commitment. All of this points to the importance of having a robust boardroom discussion about what does and does not belong on the audit committee's plate, and what is realistic—particularly as the risk environment becomes more complex and faster-paced.

A key question for every board and audit committee is whether the audit committee's portfolio of risk oversight responsibilities is appropriate, realistic, and aligned with the audit committee's competencies—for today and tomorrow. As directors consider this question, we recommend three areas of focus:

— **How does the board allocate among its committees the responsibility for oversight of the major substantive areas of risk—as well as responsibility for oversight of the company's risk management processes?** How rigorous is the allocation process? Who is involved? What factors are considered? What is the logic behind the allocation? How frequently is the process revisited? Has the board solicited feedback on the effectiveness of the process as part of its annual self-evaluation? Do the committee chairs meet, including to discuss potential gaps and overlap in risk oversight?

— **How have board governance and oversight processes changed—and advanced—as the business and risk environment has become more complex?** Are the roles of the board, audit committee, and other committees clear? Periodically review whether changes to committee structure or reallocation of risk oversight responsibilities are needed. Do directors have a shared view as to the three, four, or five most significant risks facing the company? Are we allocating adequate board and committee time to these risks? Do we have the right people—who understand the business and strategy, and are willing and able to ask the right questions? How effective are our board and committees in coordinating and communicating their risk oversight activities?

— **Given the time required to carry out its core responsibilities—oversight of financial reporting and controls and oversight of external and internal auditors—what risk oversight responsibilities are appropriate for the audit committee?** How much time can or should the audit committee devote to these risk oversight responsibilities? Does the committee have the necessary expertise and skill sets in these areas? Is there a need for an additional committee—such as a risk committee, a technology committee, a compliance committee, or a finance committee? And if so, does the board have members with the necessary background and expertise to serve on such a committee?

Audit committees can also refer to the COSO 2017 Framework, *Enterprise Risk Management—Integrating with Strategy and Performance, and the related 2020 guidance Creating and Protecting Value: Understanding and Implementing Enterprise Risk Management*, for further insight into how ERM can help create and retain value, and how ERM links to the company's strategy. The guidance will also help audit committees determine how the board can structure its governance around risk management oversight.

In 2018, COSO published *Enterprise Risk Management: Applying enterprise risk management to environmental, social and governance-related risks*, providing guidance on how to apply its ERM framework to ESG risks. The publication, prepared in collaboration with the World Business Council for Sustainable Development, explains ESG risks and gives guidance on how to manage and disclose these risks.

[5] National Association of Corporate Directors, Report of the NACD Blue Ribbon Commission on Risk Governance: Balancing Risk and Reward, 2009

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What risk oversight responsibilities are appropriate for the audit committee? In our experience, the answer to this question varies from company to company, based on the unique needs of the business and industry. In general, in addition to financial statement and disclosure risks, the audit committee may focus on one or more of the following risks:

- *Legal/regulatory compliance, including Foreign Corrupt Practices Act risk.* The NYSE listing rules require that the audit committee assist the board in oversight of the company's compliance with legal and regulatory requirements, and many audit committees monitor compliance with the company's code of ethics. In addition, under Sarbanes-Oxley, the audit committee is required to establish procedures for the receipt, retention and treatment of complaints regarding accounting, internal controls, and auditing matters and confidential, anonymous submission by company employees of concerns about questionable accounting or auditing matters. Dodd-Frank and its implementing rules provide significant monetary incentives and protections for whistle-blowers. As companies move to capitalize on opportunities in global markets, leveraging technologies and data, and engaging with vendors and third parties across longer and more complex supply chains, a key role for the audit committee is to monitor whether the company's ethics and compliance programs—including Foreign Corrupt Practices Act (FCPA) and antibribery programs—are keeping pace with the vulnerabilities to fraud and misconduct.

- *Tax risk.* An important role for the audit committee is to understand the company's domestic and international tax positions and risks—both tax compliance risks and related financial reporting risks. Of particular concern for audit committees of companies with global operations are coordinated global policy initiatives to address profit shifting and establish minimum levels of taxation, increase transparency and reporting in tax matters, and facilitate tax information exchange among governments. In addition, increasingly tax is being incorporated as a component of sustainability and ESG agendas. In general, the audit committee should understand how the company's tax director and executives deal with significant tax risks and how they coordinate their activities with risk management generally. In particular, consideration should be given to the following:

- *Does the company have a tax strategy, including an internal tax code of conduct?* What controls are in place to ensure adherence to the company's strategy or tax code of conduct? What are the processes management uses to identify, measure, and manage the company's significant tax risks—such as uncertain tax positions; significant judgments and estimates; internal controls; federal, state, and global enforcement activities; taxation of major transactions, etc.?

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- *How is the company tracking and ensuring compliance with tax mandatory disclosure rules across multiple jurisdictions?*
- *What is the company's position on voluntary tax disclosure?*
- *Do the company's tax decisions take into account reputational risks and not simply whether the company has technically complied with tax laws?*
- *Finally, how is the company considering tax matters in connection with broader sustainability and ESG agendas?*

In short, tax is no longer simply an expense to be managed. Fundamental changes in public attitudes about responsible tax behaviors, increasing expectations and demands for greater transparency, growing disclosure obligations, and the intersection of tax and ESG objectives have heightened the need to prioritize consideration of tax risks on audit committee agendas.

- *Finance, liquidity, and capital structure risks.* If the board does not have a finance committee, the audit committee often assumes many of the responsibilities of a finance committee. It is critical here that the board clarify the role of the board versus the audit committee in this area.
- *Code of conduct, ethics.* Positive culture and ethical conduct of companies, their officers, and boards have come under even more scrutiny by investors and the public. Companies should consider the role of audit committees in ensuring the organizations internal culture is consistent with its code of conduct. NYSE and Nasdaq listing rules require companies to adopt and disclose a code of conduct or ethics code for directors, officers, and employees. The SEC also mandates disclosing whether a company has adopted a code of conduct for CEOs, CFOs, and chief accounting officers/controllers.
- *Risks posed by culture and the tone at the top.* The audit committee, working with auditors and overseeing ethics and compliance and the whistle-blower hotline, can provide a different line of sight into cultural issues and risks. Audit committees are well positioned to help focus internal audit on risks posed by incentives—and to spot-check and question results that seem too good to be true.
- *Cybersecurity, data privacy, and other IT-related risks.* More boards are enhancing oversight of the range of IT-related risks—including cybersecurity and data privacy. These issues moved to the forefront of the board's agenda, as emphasized by the AICPA's 2017 Cybersecurity Risk Management Reporting Framework, the SEC's 2018 Guidance on Public Company Cybersecurity Disclosures (Releases 33-10459 and 34-82746), the European Union's 2018 General Data Protection Regulation (GDPR), and the California Consumer Privacy Act of 2018. Boards that are in the forefront oversee these issues as part of overall risk oversight and as business issues, rather than as a narrow question of technology. Has management assessed the highest risks to the company? Have employees been properly trained, and are there plans in place to handle problems as they occur? The "home" for these discussions—full board, audit committee, another committee, or multiple committees—varies by company. However the board allocates these oversight responsibilities, the pace of technology change and the escalating and persistent threat of cyber attacks have pushed IT and privacy risk steadily higher on board agendas. Audit committees can play a pivotal role in helping to ensure robust discussions around IT and privacy risk generally, and cybersecurity in particular. The chief information security officer should provide regular reports to the board on these risks in business terms and using language that is not overly technical.

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Audit committee effectiveness

Effective oversight by strong, active, knowledgeable and independent audit committees significantly furthers the collective goal of providing high-quality, reliable financial information to investors and our markets.

—SEC Chairman Jay Clayton, Chief Accountant Sagar Teotia, and Division of Corporation Finance Director William Hinman Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities, December 30, 2019

The audit committee's "core" duties—overseeing financial reporting and controls, as well as external and internal auditors—are a substantial undertaking and time commitment. In addition, many audit committees have oversight responsibilities for a range of other risks that have become increasingly complex and challenging—from operational and compliance risks posed by globalization and the extended organization (partners, suppliers, vendors, etc.) to culture, cybersecurity, data privacy, and other risks related to emerging technologies. Prioritizing this heavy audit committee workload is a challenge for most audit committees.

We see audit committees meeting this oversight challenge by focusing on ways to improve their effectiveness and efficiency—refining their agendas and oversight processes and reassessing their skills and composition. Keeping pace requires agendas that are manageable (what risk oversight responsibilities are realistic given the audit committee's time and expertise?); focusing on what is most important (starting with financial reporting and audit quality); allocating time for robust discussion (including new and emerging issues) while taking care of "must do" compliance activities. And, perhaps most importantly, understanding the tone, culture, and rhythm of the organization by spending time outside of the boardroom—visiting company facilities, interacting with employees and customers, and hearing outside perspectives.

Here are some guiding principles that seasoned audit committee chairs have told us are critical to keeping their audit committee's "eye on the ball":

Focus on those few things with the greatest impact. The audit committee needs to determine what really matters and make sure the committee focuses on those issues and devotes the proper time and attention to them. As one audit committee chair told us, "If you try to focus on everything equally, you'll just get overwhelmed." The audit committee should focus on the areas that are of most importance to the company.

Make sure the committee is getting information, not just data—from business and functional leaders as well as internal and external auditors. With meaningful information, the committee will be in a position to discuss and provide insight regarding the critical issues facing the business, and probe whether everyone at the table understands the risks, how the risks are being mitigated, what controls are in place, and whether the controls are working.

Consider how the committee might improve its efficiency and make the most of its meetings. To streamline committee meetings and allow more time for discussion and questions, insist on quality premeeting materials that highlight issues for consideration and expect them to be read. Limit management presentations and the use of PowerPoint. Conclude (and sometimes begin) each meeting with an executive session so that members have an opportunity to discuss important matters privately.

Understand that it can't all be done at the formal committee meetings; "between meeting" work is essential. Today, the depth and breadth of audit committee engagement has made oversight a much more time-consuming job, particularly at larger, more complex, global companies. As one audit committee chair said, "To be truly effective, the audit committee needs to get up and out of the corporate headquarters, seeing things and talking to people in their own offices and workplaces. It is entirely appropriate and even desirable for audit committee members—particularly the chair—to meet with members of management and the outside auditor between regularly scheduled meetings, to have more in-depth discussions on some of the issues that are developing."

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Reinforce the right audit committee culture and dynamics. The audit committee's effectiveness hinges on a number of critical factors—including the knowledge, experience, commitment, and independence of its members; the committee's dynamics and chemistry; the quality of the committee's interactions with management and auditors (internal and external); and perhaps most importantly, the committee's leadership. The signs of a healthy committee culture are easy enough to spot: The committee encourages open discussion and debate; committee members question and probe management; dissenting and contrarian views are encouraged and actively sought out; and committee members speak their minds, listen fully, and work toward consensus.

Take a hard look at the audit committee's performance. Effective self-assessments aren't easy—but they're essential. For many audit committees, the annual self-assessment process (required by the NYSE listing standards) has not been particularly productive, and there is work to be done to ensure that the process accomplishes its objectives. As a first step, get the buy-in of all committee members—a commitment to making the most of the self-assessment process. Then engage the necessary resources and expertise to develop a self-assessment process that works for the audit committee—and follow through on findings and conclusions. The self-assessment process should not be static. It may be helpful to alternate the format periodically. For instance, alternating interviews with questionnaires. (See Appendix C: Sample Audit Committee Evaluation.)

> **Aside from the results of the self-evaluation, I would say that at the end of the day, our effectiveness as a committee is best measured by controllership and compliance within the company. Is controllership well managed? We're always going to have compliance problems, but are we informed of them? Do we understand them? Do we investigate them promptly and fully? Do we take action when we find something we don't like?**
>
> —Audit committee chair

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Audit committee mechanics and practical considerations

Underlying the guiding principles noted above are some practical mechanics, which we describe here in some detail. Of course, no one size fits all, and each audit committee needs to apply these mechanics based on its own needs and circumstances.

Setting the agenda

To help the audit committee stay focused and efficient, a leading practice is to create a formal "responsibilities checklist and calendar" for the coming year—aligned with the audit committee's charter—as well as a strawman agenda for each audit committee meeting scheduled in the year ahead. (See Appendix B: Sample Audit Committee Meeting Planner.)

Given the array of issues that will need to be addressed at each meeting—e.g., the company's financial reports and disclosures, control environment, risks, audit processes, whistle-blower complaints, and legal and regulatory compliance—the audit committee chair should prepare a focused agenda that devotes sufficient time to the company's key financial reporting risks, as well as other items that require the audit committee's attention. The agenda should also have the flexibility to address other matters that may arise.

The audit committee should be proactive in setting its agendas. While input from management and the internal and external auditors is essential, the audit committee should not merely react to an agenda developed by management. In our experience, the following considerations can help the committee develop an effective agenda:

— Have someone in management who serves as the audit committee's primary support—such as the CFO, controller, head of internal audit, or corporate secretary—draft an initial agenda as a starting point.

— Discuss the agenda with the CFO, the lead audit engagement partner, the head of internal audit—and perhaps others—to obtain their suggestions on key issues and topics for the agenda, including the time allotted to each item, and who should participate in the discussion of each topic.

— Share a draft agenda with audit committee members for their input (and encourage them to suggest agenda and follow-up items for future committee meetings).

— Ensure that the agenda allocates sufficient time to the issues that will most likely require the most discussion and then address any other required items.

We recommend that the audit committee structure its annual calendar so that time is allocated to a focused look at each of the company's major issues that are within the scope of the committee's responsibilities. Taking a deep dive into a key issue—e.g., accounting judgments and estimates, tax, cybersecurity (if allocated to the audit committee)—can help deepen the audit committee's understanding and oversight of management's approach to the risks facing the company.

Above all, the audit committee's agenda should dedicate sufficient time to the committee's primary focus: financial reporting risk. The audit committee chair should remain acutely sensitive to "mission creep" and be ready to discuss (with the board and other committee chairs) the practicality of reallocating certain risk oversight responsibilities to better balance the workload.

In my view, the audit committee has to develop a high level of comfort with both management and the external auditor that the basic mechanics of the company's financial reporting and controls are, in fact, under control. And while we don't want to give short shrift to that part of it, we want to be in a position that I would call 'process routine,' so that we can apply most of our work capacity and our focus as a committee to those things which could be more material and important to the fate of the company going forward. But this approach means that you have to have good processes in place and the right people in the finance function. You need to feel confident about that.

—Audit committee chair

Making the most of meetings

The efficiency and effectiveness of audit committee meetings hinges largely on the preparation and engagement of committee members, as well as on the dynamics among committee members and other participants in the meeting. Generally, we have found the following practices to be helpful, if not essential, to making the most of the audit committee's time together:

— Insist on quality premeeting materials that highlight issues for consideration and expect them to be read in advance of the meeting.

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- Consider using a "consent agenda" to address items that are routine and do not require discussion—for example, approval of meeting minutes (assuming all members agree). This approach allows for more meeting time to be allocated to issues that would benefit more from discussion.
- Take time at the beginning of every committee meeting to review the agenda. Based on the committee members' review of meeting materials, does the amount of time allocated to each agenda item still seem appropriate?
- Consider addressing the most difficult issues first, so that they get the appropriate airtime.
- Allow time for forward-looking discussions on strategy and risk, rather than solely focusing on retrospective matters.

Updates between meetings can help streamline committee meetings. To help alleviate some of the pressure on the audit committee's agenda, some audit committee members—usually the chair—will communicate informally with management and auditors to stay up to date and deepen their understanding of certain issues and developments.

We caution, however, that an efficient meeting does not necessarily equate to an effective, quality meeting. Regardless of the agenda topics or time allocations, audit committee meetings should foster an atmosphere of openness and transparency and provide the time and opportunity for committee members, management, and auditors to pose questions and express their views.

Executive sessions

Even in the most transparent corporate cultures—where frank discussion is encouraged and expected—a full boardroom may not always be conducive to complete candor. Executive sessions, which are standard fare for audit committees, provide an important opportunity for auditors, management, and audit committee members themselves to share their views privately and fully.

As noted in the NYSE corporate governance rules, executive sessions serve as a "check on management" by promoting open discussion among the audit committee members without members of management present and by providing an opportunity for the audit committee to have private conversations with individual members of management and with internal and external auditors. (The NYSE corporate governance rules require the audit committee to hold periodic, separate, private sessions with management, external auditors, and internal audit.)

To make the most of executive sessions, the audit committee should consider:

- Holding executive sessions as a matter of routine. If this is not done, the calling of an executive session may lead to speculation and concern by those not in the room
- Having private, one-on-one discussions in executive session with various individuals, including the lead audit engagement partner, the head of internal audit, and executives of the company—the CFO, CEO, general counsel, compliance, and/or risk officers
- Providing executive session participants (management and auditors) with questions in advance if a thorough response may require research and forethought. As one seasoned director has suggested, "Executive sessions shouldn't be a game of 'gotcha'"
- Dedicating a portion of the executive session for audit committee members only, to help surface concerns or work toward consensus on particularly challenging or sensitive issues.

Be sure to communicate with management or auditors any issues discussed during the executive session that may require their attention or follow up. The chair should also report to the board (or lead director) on executive session topics, as needed, and confer with the corporate secretary or general counsel regarding what, if anything, should be documented in the committee minutes.

Gaining exposure to key management and others

Audit committee meetings provide a valuable opportunity to see the company's talent "in action"—including members of the CFO's team (treasurer, tax director, chief accounting officer, controller, head of investor relations, et al.) as well as the chief information/technology/security officer and managers a level or two below these executives. The challenge here is two-fold: providing the audit committee with exposure to numerous individuals without having committee meetings become unnecessarily large and ensuring that there is a clear purpose for their attendance at the meeting. To this end, the audit committee chair should work with the CFO, the head of internal audit, and others to develop a schedule and cadence that makes sense.

Reports to the board

The audit committee's report to the full board is often the primary method to keep the board apprised of the audit committee's activities and, importantly, to help ensure the coordination of the audit committee's activities with other committees of the board.

The NYSE corporate governance rules and related commentary require the audit committee to report

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regularly to the board of directors: "The audit committee should review with the full board any issues that arise with respect to the quality and integrity of the company's financial statements, the company's compliance with legal or regulatory requirements, the performance and independence of the company's independent auditors, and the performance of the internal audit function."

Some audit committee chairs will take the extra step of communicating periodically with other committee chairs to provide each other with a fuller understanding of the issues, concerns, and activities of the committees—particularly with respect to oversight of risk.

Typically allocated 10 to 15 minutes on the board agenda (including time for Q&A), the audit committee chair's report should inform directors about the committee's work and, importantly, help them focus on key issues and recommendations that may benefit from their input and perspective. The audit committee chair may look to the corporate secretary or CFO to draft an outline, for their reference, of the important issues discussed in the committee meeting.

Meeting minutes and documentation

The audit committee's meeting minutes are essential to documenting the processes the committee followed in carrying out its oversight responsibilities. How much detail should be included in the minutes is a matter of debate. Some attorneys recommend more detail, some less. The audit committee should seek the advice of counsel regarding the content and level of detail that is appropriate. As with other board committees, the minutes of audit committee meetings should be maintained by the company's corporate secretary and distributed to the full board on a timely basis.

Given the sensitivity of the information addressed in audit committee meetings, many companies advise directors to avoid or minimize note-taking (before or during meetings). The company may also limit the number of copies of materials distributed at the meeting and will dispose of paper and electronic notes and materials after the meeting, in line with the company's record retention policies and applicable law. Companies using board portals may disable the note-taking function or delete notes promptly after meetings as part of their regular processes.

In addition, directors should consult corporate counsel regarding the potential electronic trails that may be discoverable in the event of litigation. (For example, if board materials are distributed electronically, there may be a request to produce evidence regarding the amount of time the director spent reviewing the materials online before the meeting or electronic evidence that a director was not engaged during discussion of a critical topic at the meeting, for example, by showing the committee member was sending or receiving unrelated emails at the time.)

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Appendices

Appendix A

Sample audit committee charter

Explanatory note

Sidley Austin LLP provides this information for educational purposes only. It should not be construed or relied upon as legal advice. Given the complexities of law, regulation and practice in this area and the variety of company-specific factors that need to be considered, the sample audit committee charter provided herein should not be used unless tailored by an attorney experienced in this area of law for the specific corporation based on applicable law, regulation and listing rules as well as factors such as organizational structure and lines of business.

Sample audit committee charter

Although the sample audit committee charter was designed for a public company subject to SEC and stock exchange requirements, a private company may adopt a similar charter for its audit committee as a matter of best practice.

Companies listed on the New York Stock Exchange (the NYSE) or The NASDAQ Stock Market (NASDAQ) are generally required (subject to limited exceptions) to have an audit committee comprised of at least three members of the board of directors that qualify under heightened standards of director independence. The audit committee must function under a written charter that addresses:

- Committee authority and responsibilities required by Rule 10A-3 under the Securities Exchange Act of 1943, which generally include:
  - appointing, compensating and retaining any registered public accounting firm (Section 202 of the Sarbanes-Oxley Act of 2002 requires audit committee approval of all audit services and generally (subject to limited exceptions) prohibits the independent auditor from providing any permissible nonaudit services without audit committee prior approval);
  - overseeing the work of such firms in preparing or issuing any audit report (and related work), including resolving any disagreements between management and such firms regarding financial reporting;
  - establishing procedures for the receipt, retention and treatment of complaints from company employees on accounting, internal accounting controls or auditing matters, as well as for confidential, anonymous submissions by company employees of concerns regarding questionable accounting or auditing matters; and
  - authority to engage independent counsel and other advisers as it determines necessary, with appropriate funding as it determines for payment of:
    - compensation to the independent auditor and advisers to the committee; and
    - ordinary administrative expenses that are necessary or appropriate to the committee in carrying out its duties.
- Committee purpose and other matters required by the NYSE and NASDAQ listing rules in varying levels of detail.

For NYSE listed companies, the audit committee charter must address its purpose, which must include:

- Assisting the board in oversight of:
  - The integrity of the company's financial statements;
  - Company compliance with legal and regulatory requirements;
  - Independent auditor qualifications, independence and performance; and
  - Performance of the company's internal audit function.
- Preparing disclosure required by Securities and Exchange Commission Regulation S-K Item 407(d)(3)(i), which relates to the audit committee report that must be included in the company's annual proxy statement.

In addition, the charter must address the following committee responsibilities, in addition to those described above for all listed company audit committees:

- Receipt and review at least annually of a report from the independent auditor that describes:
  - the auditor's internal quality control procedures;
  - any material issues raised by the auditor's most recent internal quality control review or peer review of the firm, or by any inquiry or investigation by governmental or professional authorities within the preceding 5 years, respecting one or more independent audits carried out by firm, and steps taken to deal with any such issues; and

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- all relationships between the independent auditor and the company for evaluation of auditor independence.

— Setting clear hiring policies for employees or former employees of the independent auditor.

— Review and discussion of annual audited financial statements and quarterly financial statements in meetings with management and the independent auditor, including review of "Management's Discussion and Analysis of Financial Condition and Results of Operations."

— Discussion of earnings press releases and financial information and earnings guidance given to analysts and rating agencies.

— Discussion of policies with respect to risk assessment and risk management.

— Meeting separately, from time to time, with management, with internal auditors and with independent auditors.

— Review with the independent auditor of:

  - any audit problems or difficulties; and
  - management's response to such issues.

— Regular reports to the board of directors.

— Annual evaluation of the committee.

For NASDAQ listed companies, the audit committee charter must address:

— Its purpose—overseeing the company's accounting and financial reporting processes and financial statement audits.

— Scope of committee responsibilities, including those described above for all listed company audit committees, and how it carries out its responsibilities, including structure, processes and membership requirements.

— Specified responsibility for:

  - ensuring receipt from the outside auditor of a written statement that describes all relationships between auditor and company;
  - actively engaging in dialogue with the outside auditor about any disclosed relationships or services that may impact auditor objectivity and independence; and
  - taking, or recommending that full board take, appropriate action to oversee outside auditor independence.

The committee must also review the charter annually.

[Company name]
Audit committee charter

As adopted by the Board of Directors, effective [ ]

The purpose of the Audit Committee (the Committee) of the Board of Directors (the Board) of [COMPANY NAME] (the Company) is to assist the Board in fulfilling its oversight responsibilities relating to [(i) [[the integrity][1]/[the Company's accounting and financial reporting processes and the audit][2]] of the Company's financial statements, (ii) the Company's compliance with legal and regulatory requirements, (iii) the qualifications and independence of the Company's external auditor (the Independent Auditor) and (iv) the performance of the Company's internal auditing function ("Internal Audit") and the Independent Auditor.][3]

The Committee shall be comprised of three or more directors appointed by the Board,[4] each of whom (i) meets the independence requirements of the [[New York Stock Exchange (the NYSE)][5]/The NASDAQ Stock Market (NASDAQ)]][6] [and the Company's corporate governance guidelines][7] and (ii) otherwise satisfies the applicable requirements for audit committee service imposed by the Securities Exchange Act of 1934, as amended (together with the rules and regulations promulgated thereunder, (the Exchange Act), and [[the NYSE]/[NASDAQ]][8] [; provided that the Board may elect to take advantage of any exception from such requirements provided in the NASDAQ rules][9].

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1 §303A.07(b)(i)(A) of the NYSE Listed Company Manual (the "NYSE Rules").

2 §5605(c)(1)(C) of the NASDAQ Listing Standards (the "NASDAQ Rules").

3 Items (i)—(iv) above are consistent with §303A.07(b)(i) of the NYSE Rules, which sets forth the minimum requirements for the stated purpose of the audit committee. For NASDAQ companies, the equivalent is §5605(c)(1)(C) of the NASDAQ Rules, under which item (i) above is sufficient.

4 §303A.07(a) of the NYSE Rules and §5605(c)(2)(A) of the NASDAQ Rules.

5 §§303A.07(a) and 303A.02 of the NYSE Rules.

6 §§5605(c)(2)(A) and 5605(a)(2) of the NASDAQ Rules. The NASDAQ Rules provide a cure procedure for permitting a director who ceases to be independent to remain on the committee until the next annual meeting. The NASDAQ Rules also provide that if a company fails to comply with the NASDAQ Rules due to a vacancy on the audit committee, the company will have until the earlier of the next annual shareholders meeting or one year from the vacancy to comply. §5605(c)(4) of the NASDAQ Rules.

7 Many companies adopt categorical standards of independence and include them in their corporate governance guidelines.

8 Rule 10A-3(b)(1) under the Exchange Act, commentary to §303A.07(a) of the NYSE Rules and §5605(c)(2)(A)(iv) of the NASDAQ Rules.

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At least one member of the Committee shall be an "audit committee financial expert" in accordance with the rules of the Securities and Exchange Commission[10][, and at least one member (who may also serve as the audit committee financial expert) shall have past employment experience in finance or accounting, requisite professional certification in accounting or other comparable experience or background that leads to financial sophistication][11]. All other Committee members shall be [[financially literate, as required by the NYSE][12]/[able to read and understand fundamental financial statements, including the Company's balance sheet, income statement and cash flow statement, as required by NASDAQ][13]]. Committee members shall not simultaneously serve on the audit committees of more than [two][14] other public companies unless the Board determines that such simultaneous service would not impair the ability of such director to serve effectively on the Committee. [No Committee member shall have participated in the preparation of the Company's or any of its subsidiaries' financial statements at any time during the past three years.][15]

The Committee shall meet with such frequency and at such intervals as it determines necessary to carry out its duties and responsibilities. The Committee shall meet separately and periodically with management, Internal Audit [(or other Company personnel responsible for the internal audit function)][16] and the Independent Auditor.[17] Minutes of Committee meetings and actions taken without a meeting shall be kept in accordance with the Company's bylaws.

While the Board has delegated to the Committee oversight duties and responsibilities pursuant to this Charter, the fundamental responsibility for the accuracy of the Company's financial statements and disclosures, and the quality of the Company's accounting and financial reporting processes, remains with management and the Independent Auditor.[18]

In furtherance of its purpose, the Committee shall:

Independent Audit, Financial Statements and Internal Controls

1. Be directly responsible for the appointment, compensation, retention, oversight of the work and termination of the Independent Auditor and any other independent registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Company. The Committee shall also be responsible for the resolution of disagreements between management and the Independent Auditor, or any other such firm, regarding accounting and financial reporting. The Independent Auditor and any other such firm shall report directly to the Committee.[19]
2. Obtain and review, at least annually, a report by the Independent Auditor describing: (i) the Independent Auditor's internal quality control procedures, (ii) any material issues raised by the most recent internal quality control review or peer review of the Independent Auditor, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years respecting one or more independent audits carried out by the Independent Auditor, (iii) any steps taken to deal with any such issues, (iv) all relationships between the Independent Auditor and the Company and (v) any other information pertaining to the independence of the Independent Auditor. Discuss with the Independent Auditor any issues or relationships disclosed in such report that, in the judgment of the Committee, may have an impact on the competence or independence of the Independent Auditor.[20]

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[9] §5605(c)(2)(B) of the NASDAQ Rules. There is a limited exception to the complete independence requirement under the NASDAQ Rules under exceptional circumstances, as determined by the board of directors. Under this exception, one nonindependent director may be appointed to the audit committee as long as such individual meets the criteria set forth in Section 10A(m)(3) of the Exchange Act and is not a current executive officer or employee or a family member of an executive officer or employee of the company. Any such individual may not serve longer than two years and may not chair the audit committee.

[10] Item 407(d)(5)(ii) of Regulation S-K. Commentary to §303A.07(a) of the NYSE Rules indicates that at least one member of the audit committee must have accounting or related financial management expertise and that any person who qualifies as an "audit committee financial expert" will be presumed to have such expertise. Also IM-5605-4 of the NASDAQ Rules.

[11] §5605(c)(2)(A) of the NASDAQ Rules.

[12] Commentary to §303A.07(a) of the NYSE Rules.

[13] §5605(c)(2)(A) of the NASDAQ Rules.

[14] Disclosure requirement of §303A.07(a) of the NYSE Rules, which provides that if a member of the audit committee of a listed company serves on audit committees of more than three public companies, the Board must determine that the simultaneous service would not impair his or her ability to serve on the Company's audit committee.

[15] §5605(c)(2)(A)(iii) of the NASDAQ Rules.

[16] This parenthetical may be deleted if the Company has its own internal audit function (i.e., it has not outsourced internal audit, as permitted by the NYSE rules).

[17] §307A.07(b)(iii)(E) of the NYSE Rules.

[18] General Commentary to §303A.07(b) of the NYSE Rules.

[19] Rule 10A-3(b)(2) under the Exchange Act, §303A.07(b)(iii)(A), (E), and (F) of the NYSE Rules, including commentary, and §5605(c)(3) of the NASDAQ Rules.

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3. Review and evaluate the lead audit partner of the Independent Auditor (taking into account the opinions of management and Internal Audit) and assure the regular rotation of the lead audit partner, the concurring partner and other audit partners engaged in the Independent Auditor's annual audit of the Company's year-end financial statements (the Annual Audit), to the extent required by law.[21]
4. Discuss with Internal Audit and management their views as to the competence, performance and independence of the Independent Auditor.[22]
5. Preapprove all audit and permitted nonaudit and tax services to be provided to the Company by the Independent Auditor, in accordance with a preapproval policy adopted by the Committee.[23]
6. Meet to review and discuss the annual audited financial statements and quarterly financial statements with management and the Independent Auditor, including the annual and quarterly report disclosures under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations." The Committee shall make a recommendation to the Board as to whether the annual audited financial statements should be included in the Company's Annual Report on Form 10-K.[24]
7. Review and discuss earnings press releases as well as financial information and earnings guidance provided to analysts and ratings agencies.[25]
8. Review reports to management prepared by the Independent Auditor or Internal Audit and any responses by management.
9. Obtain and review annually, prior to the completion of the Annual Audit, a report from the Independent Auditor describing (i) all critical accounting policies and practices to be reflected in the Annual Audit, (ii) (a) all alternative treatments of financial information within generally accepted accounting principles (GAAP) for policies and procedures related to material items that have been discussed with management, (b) ramifications of the use of such alternative disclosures and treatments and (c) the treatment preferred by the Independent Auditor and (iii) other material written communications between the Independent Auditor and management, such as any management letter or schedule of unadjusted differences. Review any reports on such topics or similar topics prepared by management. Discuss with the Independent Auditor any material issues raised in such reports.[26]
10. Review the Company's financial reporting processes and internal controls in consultation with the Independent Auditor and Internal Audit. Such review shall include a consideration of 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 identified deficiencies. Review any analyses prepared by management and/or 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.[27]
11. Discuss with the Independent Auditor the Independent Auditor's judgment about the quality, not just the acceptability, of the accounting principles applied in the Company's financial reporting.[28]

[20] §303A.07(b)(iii)(A) of the NYSE Rules and §5605(c)(1)(B) of the NASDAQ Rules.

[21] Commentary to §303A.07(b)(iii)(A) of the NYSE Rules which also provides that, in addition to assuring the regular rotation of the lead audit partner as required by law, the Committee should also consider whether, to assure continuing auditor independence, there should be regular rotation of the audit firm itself. The Committee should present its conclusions with respect to the Independent Auditor to the full Board.

[22] Commentary to §303A.07(b)(iii)(H) of the NYSE Rules.

[23] Section 10A(i) of the Exchange Act.

[24] §303A.07(b)(i)(B) of the NYSE Rules (referencing Item 407(d)(3)(i) of Regulation S-K).

[25] §303A.07(b)(iii)(C) of the NYSE Rules and commentary.

[26] Section 10A(k) of the Exchange Act and Rule 2-07 of Regulation S-X.

[27] General Commentary to §303A.07(b) of the NYSE Rules.

[28] PCAOB Auditing Standard No. 1301 and commentary to §303A.07(b)(iii)(H) of the NYSE Rules.

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12. Review with the Independent Auditor any audit problems or difficulties and management's response thereto. Such review shall include a review of any difficulties the Independent Auditor encountered in the course of the audit work, including any restrictions on the scope of the Independent Auditor's activities or access to requested information, and any significant disagreements with management.[29]
13. Review with the Independent Auditor, Internal Audit and management the extent to which changes or improvements in financial or accounting practices and internal controls that were previously reviewed and/or approved by the Audit Committee have been implemented.
14. Review annually the effect of legal, regulatory and accounting initiatives on the Company's financial statements.[30]
15. Review annually the effect of off-balance sheet arrangements, if any, on the Company's financial statements.[31]
16. Review and discuss with the Independent Auditor any critical audit matter (CAM) addressed in the audit of the Company's financial statements and the relevant financial statement accounts and disclosures that relate to each CAM.[32]
17. Review and discuss with the Independent Auditor the matters required to be discussed by the applicable requirements of the Public Company Accounting Oversight Board and the Securities and Exchange Commission, including, but not limited to, review of the external audit plan and revisions thereto.[33]
18. Approve hiring policies for employees or former employees of the Independent Auditor and oversee the hiring of any personnel from the Independent Auditor in accordance with applicable law.[34]

Internal Audit

19. Review and assess the annual internal audit plan, the process used to develop the plan and the status of activities, significant findings, recommendations and management's response. Provide oversight of Internal Audit, including by reviewing and discussing with management reports and other communications prepared by Internal Audit.
20. Oversee Internal Audit's structure, objectivity, responsibilities, staffing, resources and budget. Discuss with the Independent Auditor the Independent Auditor's judgment about the competence, performance and cooperation of Internal Audit and management and Internal Audit's responsibilities, budget and staffing.[35] Recommend for Board approval (i) the appointment and, if appropriate, replacement of (A) the head of Internal Audit, where the head of Internal Audit is a Company employee, or (B) any third party service provider (other than the Independent Auditor) that is providing Internal Audit services to the Company, and (ii) the Internal Audit budgets.

Compliance and Risk Management

21. Review and approve any transaction between the Company and any related person (as defined in Item 404 of Regulation S-K) in accordance with the Company's related person transaction approval policy.[36]
22. Discuss policies with respect to risk assessment and risk management, the Company's major litigation and financial risk exposures and the steps management has taken to monitor and control such exposures.[37]

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[29] Section 303A.07(b)(iii)(F) of the NYSE Rules and commentary. The Committee may also consider reviewing: any accounting adjustments that were noted or proposed by the Independent Auditor but were "passed" (as immaterial or otherwise); any communications between the audit team and the audit firm's national office respecting auditing or accounting issues presented by the engagement; and any "management" or "internal control" letter issued, or proposed to be issued, by the audit firm to the Company.

[30] General Commentary to §303A.07(b) of the NYSE Rules.

[31] General Commentary to §303A.07(b) of the NYSE Rules.

[32] PCAOB Auditing Standard No. 3101.

[33] Item 407(d)(3)(i)(B) of Regulation S-K.

[34] §303A.07(b)(iii)(G) of the NYSE Rules. Section 206 of the Sarbanes-Oxley Act of 2002, which prohibits an auditing firm from providing audit services to a company whose CEO, CFO, controller or chief accounting officer (or any person serving in an equivalent position) was employed by the auditing firm and participated in the company's audit in any capacity within one year of initiating the audit. See Section 10A(l) of the Exchange Act, Rule 10A-2 under the Exchange Act and Rules 2-01(c)(2)(iii)(B) and 2-01(f)(3)(ii) of Regulation S-X.

[35] Section 303A.07(b)(iii)(F) of the NYSE Rules and commentary.

[36] §314 of the NYSE Rules and §5630 of the NASDAQ Rules. Alternatively, this responsibility can be given to the Company's Nominating and Corporate Governance Committee.

[37] §303A.07(b)(iii)(D) and commentary of the NYSE Rules.

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23. Establish procedures for (i) the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters and (ii) the confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters. Review periodically with management and Internal Audit these procedures and review all complaints received by the Company regarding accounting, internal controls or auditing matters.[38]
24. Recommend amendments to the Code of Business Conduct and Ethics to the Nominating and Corporate Governance Committee as appropriate for its consideration.
25. Review and grant, if deemed appropriate by the Committee, any requested waiver of the Code of Business Conduct and Ethics for an officer or a director. Any such waivers must be granted in writing.
26. Review periodically with the Company's chief legal officer, or appropriate delegates, the Company's compliance with legal and regulatory requirements.[39]

Committee Report, Evaluation and Charter

27. Prepare the report of the Committee required to be included in the Company's annual report and proxy statement.[40]
28. Report regularly to the Board on the activities of the Committee.[41]
29. Conduct an annual evaluation assessing the Committee's performance with respect to its purpose, duties and responsibilities set forth in this Charter and report the results of such evaluation to the Nominating and Corporate Governance Committee and the Board.[42]
30. Review the adequacy of this Charter [annually] [periodically] and recommend any proposed changes to the Board for approval.[43]
31. Perform such other duties and responsibilities as reasonably determined by the Committee to be consistent with its mandate (under this Charter, the Company's bylaws, governing law, the rules and regulations of [the NYSE/NASDAQ], the federal securities laws and such other requirements applicable to the Company) or as further delegated to the Committee by the Board. This includes the authority to conduct or authorize investigations into any matter, including, but not limited to, complaints relating to accounting, internal accounting controls or auditing matters within the scope of duties and responsibilities delegated to the Committee, as it deems appropriate.[44]

The Committee shall have authority to retain such outside counsel, experts and other advisors as the Committee may deem appropriate in its sole discretion. The Committee shall have sole authority to approve related fees and retention terms. The Committee shall receive appropriate funding from the Company, as determined by the Committee, for any expense related to any external advisors and for the ordinary administrative expenses of the Committee.[45]

The Committee shall have full, unrestricted access to Company books, records and facilities.

The Committee shall have the authority to delegate any of its responsibilities to subcommittees as the Committee may deem appropriate in its sole discretion.

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[38] Rule 10A-3(b)(3) under the Exchange Act, §303A.07(b)(iii) of the NYSE Rules and §5605(c)(3) and IM-5605-3 of the NASDAQ Rules.

[39] §303A.07(b)(i)(A) and commentary to §303A.07(b)(iii)(H) of the NYSE Rules.

[40] §303A.07(b)(i)(B) of the NYSE Rules and Item 407(d)(3)(i) of Regulation S-K.

[41] §303A.07(b)(iii)(H) of the NYSE Rules.

[42] §303A.07(b)(ii) of the NYSE Rules.

[43] §5605(c)(1) of the NASDAQ Rules. NASDAQ companies are required to review the charter annually.

[44] Rule 10A-3(b)(4)-(5) under the Exchange Act, §303A.07(b)(iii) of the NYSE Rules and §5605(c)(3) of the NASDAQ Rules.

[45] Section 10A(i) of the Exchange Act.

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Sample audit committee meeting planner

Explanatory note

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Audit committee meeting planner

The following meeting planner has been prepared for use by the chair of the audit committee (the Committee) of [______] (the Company). This meeting planner can be used to coordinate with members of the internal audit department, independent auditors and management.

Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
Financial management and reporting								
1.	Meet with management and the independent auditor to review and discuss Annual Report on Form 10-K and proxy statement, including MD&A. Review how reported results compared to budget and forecasts							
2.	Meet with management and the independent auditor to review and discuss Quarterly Reports on Form 10-Q, including MD&A. Review how reported results compared to budget and forecasts							
3.	Discuss the quarterly financial statement close process and how quarterly financial information is presented							
4.	Review and discuss earnings press releases, set earnings guidance and determine what other financial information will be shared with analysts and rating agencies							
5.	Review and discuss with management any non-GAAP measures used in SEC filings or earnings press releases							
6.	Review management's process for performing its certifications under Sarbanes-Oxley Act Section 302							
7.	Review management's certifications of quarterly and annual reports							

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Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
8.	Review the effect of legal, regulatory and accounting initiatives on the Company's financial statements							
9.	Review the effect of off-balance sheet arrangements, if any, on the Company's financial statements							
10.	Recommend to the Board whether the annual financial statements should be included in the Company's Annual Report on Form 10-K							
Accounting policies and controls								
11.	Evaluate management's plan to monitor and assess the effectiveness of the Company's internal control over its financial reporting under Sarbanes-Oxley Act Section 404							
12.	Review the results of management's internal control assessment. Discuss any identified material weaknesses and deficiencies as well as management's remediation plans							
13.	Discuss with management the materiality of any identified audit differences not corrected by management and consider whether uncorrected differences could be material in future periods; discuss the expectation that accounting errors should be recorded when identified							
14.	Review any new accounting and financial reporting requirements							
15.	Discuss all significant accounting estimates and judgments, and management's rationale for those judgments							
16.	Discuss any proposed significant, complex or unusual transactions. Review the business rationale, approval and monitoring of such transactions. Evaluate the impact of such transactions on the financial statements							
17.	Discuss any issues that management and the independent auditor propose to address through the SEC's preclearance process and responses to SEC comment letters							
18.	Review with the independent auditor, the internal audit department and management the extent to which any previously approved changes or improvements in financial or accounting practices and internal controls have been implemented							

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Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
Risk management								
19.	Discuss policies with respect to risk assessment and risk management, the Company's major litigation and financial risk exposures, and the steps management has taken to monitor and control such exposures (it being understood that it is the job of management to assess and manage the Company's exposure to risk and that the Committee's responsibility is to discuss guidelines and policies by which risk assessment and management are undertaken)							
20.	Review the Company's antifraud, antibribery, and anti-corruption programs and controls							
21.	Discuss any events, conditions or opportunities that could create a risk of fraud due to management overriding internal controls							
22.	Assess the risk of making a material misstatement in the Company's financials due to fraud and how the Company's management is responding to that risk							
Related person transactions[1]								
23.	Discuss the process for identifying related person transactions							
24.	Review and approve any transaction between the Company and any related person in accordance with the Company's related person transaction policy							
General business planning								
25.	Hold executive session with management and evaluate management's overall effectiveness							
26.	Discuss responsibilities, communication procedures, and performance expectations between management and the Committee							
27.	Assess the Company's business continuity plan							

[1] Alternatively, this responsibility can be given to the Nominating and Corporate Governance Committee.

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Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
28.	Understand management's compensation structure							
29.	Understand how management has reacted to changes in the Company's business environment							
30.	Meet with other management below the executive level to obtain their perspectives on the business							
31.	Evaluate corporate culture and environment							
32.	Discuss information systems matters							
33.	Discuss tax matters							
34.	Review changes to the Company's compliance and ethics programs and receive reports from management related to monitoring of programs and responses to issues							
35.	Review the Company's compliance with legal and regulatory requirements							
Independent auditor								
36.	Hold executive session with the independent auditor and evaluate the auditor's overall performance							
37.	Discuss responsibilities, deliverables, communication procedures and performance expectations							
38.	Evaluate the audit team's credentials, expertise, experience, and ability to perform a high-quality audit. Consider the continuity of the team from prior audits							
39.	Review and sign the audit engagement letter							

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Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
40.	Discuss business and industry risk considerations							
41.	Discuss key accounting and auditing developments							
42.	Obtain and review a report from the independent auditor describing (i) the independent auditor's internal quality control procedures, (ii) any material issues raised by the most recent internal quality control review, or peer review, of the independent auditor, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the independent auditor, (iii) any steps taken to deal with any such issues, (iv) all relationships between the independent auditor and the Company and (v) any other information pertaining to the independence of the independent auditor							
43.	Discuss with the independent auditor any issues or relationships disclosed in the above report that, in the judgment of the Committee, may have an impact on the competence or independence of the independent auditor							
44.	Discuss the independence of the independent auditor and understand its process for determining its continued independence in relation to the Company							
45.	Review and evaluate lead audit partner of independent auditor							
46.	Consider a plan for audit partner rotation, including the lead audit partner, concurring partner and other audit partners engaged in the annual audit, to the extent required by law							
47.	Discuss the scope and timing of the annual audit and all interim reviews							
48.	Determine what audit fees are appropriate to perform a quality audit							
49.	Review the results of the annual audit and quarterly reviews, including all required communications							

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Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
50.	Confirm with the independent auditor that the audit was conducted in a manner consistent with Section 10A of the Securities Exchange Act of 1934							
51.	Review a summary of any unadjusted audit differences							
52.	Review any critical accounting policies and all material alternative accounting treatments that the independent auditor discussed with management							
53.	Review and discuss with the independent auditor any critical audit matter (CAM) addressed in the audit of the Company's financial statements and the relevant financial statement accounts and disclosures that relate to each CAM							
54.	Discuss the characterization of any deficiencies in internal control over the Company's financial reporting as well as any differences between management's assessment and that of the independent auditor							
55.	Review other material written communications that the independent auditor discussed with management and any responses to the same by management							
56.	Discuss and review any updates to the scope of the audit							
57.	Understand areas of emphasis in the audit							
58.	Preapprove all audit and nonaudit services (specifically preapprove internal control-related services and receive certain disclosure, documentation and discussion of non-prohibited tax services from the independent auditor)							
59.	Discuss the quality, not just the acceptability, of the accounting principles applied in the Company's financial reporting							
60.	Discuss the independent auditor's observations related to the effectiveness of the Committee							
61.	Discuss any significant deficiencies and material weaknesses in the Company's internal controls and the adequacy of management's plans for remediation							

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Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
62.	Review disclosures related to material weaknesses, if any noted							
63.	Discuss the independent auditor's judgment about the competence, performance and cooperation of the Company's internal audit department and management							
64.	Discuss the resolution of any disagreements between management and the independent auditor regarding accounting and financial reporting							
65.	Discuss any identified or suspected fraud and other illegal acts involving senior management and other employees							
66.	Consider areas that require special attention							
67.	Set clear hiring policies for employees or former employees of the independent auditor within the hiring restrictions of the Sarbanes-Oxley Act of 2002							
68.	Oversee the hiring of any personnel from the independent auditor into positions within the Company							
69.	To the extent not covered above, review and discuss with the independent auditor the matters required to be discussed by the applicable requirements of the Public Company Accounting Oversight Board and the SEC							
Internal audit department								
70.	Hold executive session with the internal audit director							
71.	Review responsibilities, communication procedures and performance expectations							
72.	Review structure, objectivity, resources, expertise, the appropriateness of the internal audit department's staffing and the functional reporting of internal audit							
73.	Review scope of internal audit plan for upcoming year, including responsibilities, staffing and budget							

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Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
74.	Approve internal auditing costs (approving the budget and actual expenditures)							
75.	Discuss internal audit department's coordination and communication with independent auditor							
76.	Discuss with internal audit department and management their views as to the competence, performance and independence of the independent auditor							
77.	Discuss any identified or suspected fraud and other illegal acts involving senior management and other employees							
78.	Obtain and review results of a general compliance review of business conduct policies							
79.	Obtain and review results of general compliance review of director and executive officer perquisites and expense reimbursements							
80.	Discuss the general quality of the Company's control environment, including culture and emphasis on ethical behavior							
81.	Discuss any significant recommendations for improvements in internal controls and any other reports to management and the adequacy of management's response to the recommendations							
82.	Review any audit problems or difficulties and management's response thereto							
83.	Review summary of significant audit or review findings and any necessary adjustments to annual planning							
84.	Conduct and review the results of a periodic peer review, including the effectiveness and independence of the review and any action plan or next steps in response to the review							
85.	Review any personnel issues related to the internal audit director (appointment, replacement, reassignment or dismissal)							

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Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
Whistleblower procedures								
86.	Establish procedures for (i) the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters and (ii) the confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters							
87.	Review with management and internal audit department the above procedures and any significant complaints received							
88.	Review any other complaints received regarding accounting, internal accounting controls or auditing matters							
Other audit committee matters and governance								
89.	Report to the Board (activities of the Committee, issues that arise regarding the quality or integrity of the Company's financial statements, the Company's compliance with legal or regulatory requirements, the performance and independence of the independent auditor or the performance of the internal audit)							
90.	Appoint independent auditor							
91.	Review Committee charter, with particular attention to recent developments in securities regulations and listing standards							
92.	Recommend any proposed changes to Committee charter to the Board for approval							
93.	Prepare and review annual proxy statement Committee report and ensure that it accurately reflects the Committee's oversight							
94.	Evaluate Committee performance evaluation							

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		A	Q	P	Q1	Q2	Q3	Q4
95.	Evaluate the financial expertise of Committee members and identify financial experts							
96.	Evaluate management's process for determining the continued independence of the independent auditor							
97.	Evaluate any business relationships and independence of Committee members in relation to both the Company and the independent auditor							
98.	Evaluate the processes and procedures in place for preapproval of audit and nonaudit services of the independent auditor							
99.	Approve minutes of previous meeting							
100.	Hold executive session of Committee members							
101.	Plan and conduct orientation of new members and relevant continuing education for new and existing members of the Committee							
102.	Develop succession plans for the Committee's chair and financial expert(s)							
103.	Engage independent counsel and other advisors							
104.	Review and understand the Company's code of ethics and business conduct as they relate to the Committee's responsibilities and expectations of directors, senior management and employees							
105.	Receive updates from the Company's attorneys on legal and regulatory matters, including any formal communications from regulatory bodies							
106.	Approve Committee meeting planner for the upcoming year. Share expectations with management, the internal audit team and the independent auditors							

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Sample audit committee evaluation form

Explanatory note

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Audit committee evaluation is a best practice that has gained considerable traction in the last two decades, supported by New York Stock Exchange listing requirements that require boards of listed companies to address board evaluation in corporate governance guidelines and provide for annual evaluation of audit committees in committee charters. In addition, outside auditors generally expect audit committees to perform annual committee evaluations as a component of effective internal controls.

Undertaking a self-evaluation process provides the audit committee with the opportunity to consider the committee's culture, cohesiveness, processes and performance. It also provides an opportunity to remind members of their roles and responsibilities. Whatever evaluation process is used—whether based on surveys, interviews, a facilitated discussion or a combination of methods—the evaluation process should culminate in a discussions of ways in which the group can continuously improve.

Common topics addressed in evaluations (in addition to compliance with governance guidelines and committee charters) include the appropriateness, quality and/or efficiency of:

- Leadership
- Agenda formation and topics
- Information flow, materials and presentations
- Committee size, composition and independence
- Committee culture and cohesiveness
- Member preparedness
- Committee performance of responsibilities
- Relations between members and key members of management
- Relations with key advisors and experts including auditors
- Committee discussions
- Committee reports to the board.

Audit committee evaluation is usually undertaken as part of the broader board evaluation. A board committee or other entity or individual is delegated the task of developing an evaluation process (subject to board and/or committee approval) and implementing an evaluation process. The process typically involves obtaining member viewpoints about board and committee performance: (i) through use of survey forms and/or interviews (on topics along the lines outlined above), which are then digested into a written or oral report, followed by a full board/committee discussion of the results; or (ii) through a more simple, streamlined process involving a facilitated board/committee discussion. Self-assessment methodologies typically involve some or all of the following:

- **Written surveys** provide an efficient means of obtaining viewpoints while providing confidentiality. However, they may not elicit a full explanation of a point of view.
- **Interviews** take more time but provide opportunity to explore viewpoints more fully.
- **Facilitated discussion** provides opportunity for members to share viewpoints, discuss potential modifications to governance practices in response to concerns that are identified and reach consensus. Such discussion may also help clear the air concerning underlying tensions. While facilitated discussion can be stand-alone to streamline the entire process, if used without a survey or interview process it does not provide the opportunity for confidential input.

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Methods outlined above can be combined: for example, a survey or interview format may be used to obtain information in a manner that protects confidences, followed by a facilitated discussion, or a survey may be sent out with follow-up brief interviews, culminating in a facilitated discussion. If written surveys or reports are to be used, consideration should be given to the potential discoverability of such materials in litigation.

A third party is often relied on to assist in tailoring areas for inquiry, collecting and collating information from surveys and interviews, and facilitating discussion. Using an attorney may preserve the ability to argue at a later date that attorney-client communication protection attaches. However, the strength of this argument has not been tested, and boards and committees should not rely on such protections. This leads some boards and committees to rely solely on paperless facilitated discussions.

Whatever format is used, the goal should be to engage the full board and each committee in deliberation and discussion about how the board and the committees function. Deliberation and discussion is key to a productive evaluation.

If discussion leads to consensus about areas in which changes might be beneficial, appropriate follow-up is important. This may involve delegation of further study or other work and implementation to the governance committee as to changes in board processes or to another committee or management.

Minutes should reflect that the evaluation was undertaken and any clear action items decided, but need not reflect much else.

[Company name]
Audit committee evaluation form

Highly confidential

Note that documents prepared in connection with an evaluation process may be discoverable in litigation.

Name:[1] ____

Date: ____

The following evaluation form has been prepared for use in the annual evaluation of the Audit Committee of the Board of Directors of [________] (the Company). The results of this evaluation will be discussed by the Committee and by the Board. All responses to this evaluation form will be treated confidentially.

For each statement in the table, please check the box that best reflects your opinion. Please provide any additional comments or explanatory notes at the end of each section in the indicated space.

Please return completed forms by [_____] to [___________] at [________].

Thank you for your participation.

[1] If the evaluation will be submitted anonymously, the name and date block should be deleted in their entirety. Alternatively, each Committee member's name can be filled in above to facilitate the distribution as a cover page to be removed when the evaluation is returned.

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	Do you agree with the statement? Please indicate on a scale of 1 (strongly disagree, strongly negative) to 10 (strongly agree, strongly positive).									
	1	2	3	4	5	6	7	8	9	10
1. The Committee is effective in fulfilling the duties set forth in its charter. Comments:										
2. The scope and definition of the Committee's responsibilities are clear and appropriate. Comments:										
3. Committee meeting times are appropriately allocated between Committee discussion and management presentation and are conducted in a manner and on a schedule so as to allow adequate opportunity for deliberation. Comments:										
4. The Committee holds an adequate number of meetings during the year. Comments:										
5. The Committee has a positive culture and working environment supported by appropriate meeting processes to allow for varied viewpoints to be expressed, disagreement to be debated and consensus to be formed and supported. Comments:										

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	Do you agree with the statement? Please indicate on a scale of 1 (strongly disagree, strongly negative) to 10 (strongly agree, strongly positive).								
	1	2	3	4	5	6	7	8	9	10
6. The Committee agenda and the information provided to the Committee in advance of meetings are of a high quality and position the Committee for informed discussion of important issues. Comments:										
7. The volume of written materials provided to the Committee in advance of meetings is appropriate Comments:										
8. The Committee has a common understanding of the purpose and intent of executive sessions. Comments:										
9. The Committee Chair performs his or her role effectively. Comments:										
10. The Committee's processes support Board and Committee effectiveness and efficiency. Comments:										

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	Do you agree with the statement? Please indicate on a scale of 1 (strongly disagree, strongly negative) to 10 (strongly agree, strongly positive).									
	1	2	3	4	5	6	7	8	9	10
11. The Committee reports to the full Board are effective and informative. Comments:										
12. The composition of the Committee is appropriate. Comments:										

13. Please list below three to five items that the Committee should focus on as priorities for the upcoming year.

14. Do you have any additional suggestions for how the Committee can continue to improve its own effectiveness?

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Sample audit and nonaudit services preapproval policy

Explanatory note

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The Sarbanes-Oxley Act of 2002 and the rules of the Securities and Exchange Commission and the Public Company Accounting Oversight Board significantly limit the types of services that an independent auditor may provide to an audit client without impairing the auditor's independence. Audit committees must approve in advance all audit services provided by an independent auditor, either specifically or in accordance with established policy and procedures. Independent auditors may provide nonaudit services to audit clients that are not specifically prohibited, but only if such services are approved in advance by the audit committee, either specifically or in accordance with established policy and procedures. Rather than granting specific approvals on a case-by-case basis, audit committees typically establish preapproval policies and procedures setting forth the services the independent auditor is permitted to provide to the audit client.

An audit committee's use of preapproval through policies and procedures is subject to three requirements: (1) the policies and procedures must be detailed as to the particular services to be provided; (2) the audit committee must be informed about each service; and (3) the policies and procedures cannot result in the delegation of the audit committee's authority to management.

[Company name]

Audit and nonaudit services preapproval policy

Including appendices of preapproved services

As adopted by the audit committee, effective []

The Audit Committee of the Board of Directors of [COMPANY NAME] (the Company) is responsible for the appointment, compensation and oversight of the work of the Company's independent auditor.[1] As part of this responsibility, the Audit Committee is required to approve in advance (preapprove) the audit and permitted nonaudit services performed by the independent auditor, to ensure the auditor's independence would not be impaired by the provision of such services.[2] The Audit Committee may preapprove specific services on a case-by-case basis (specific preapproval) and may also preapprove services falling within a defined category on an annual or periodic basis (general preapproval). This Audit and Nonaudit Services Preapproval Policy (the Policy) sets forth the procedures the Audit Committee follows to preapprove services to be performed by the Company's independent auditor and, in the Appendices, sets forth the services the Audit Committee has preapproved on an annual or periodic basis.

Services Requiring Preapproval

Any service by the independent auditor to the Company or any of its subsidiaries requires preapproval by the Audit Committee as either (1) a service falling within a defined general category (general preapproval) or (2) a specific service (specific preapproval). The term of any preapproval is 12 months from the date of preapproval, unless the Audit Committee approves a different period.

Audit services

The Audit Committee has granted general preapproval to the audit services listed in Appendix A, including certain audit services that only the independent auditor reasonably can provide.

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[2] Section 301 of the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act), Section 10A(m)(2) and Rule 10A-3(b)(2) of the Securities and Exchange Act of 1934, as amended (the Exchange Act), Rule 2-01 of Regulation S-X, §303A.07(b)(i)(A) of the New York Stock Exchange Listed Company Manual and §5605(c)(3) of the NASDAQ Listing Standards.

Section 201(a) and 202 of the Sarbanes-Oxley Act and Section 10A(i) of the Exchange Act.

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Audit services require specific preapproval, as follows:

— The terms of the independent auditor's annual audit and quarterly reviews of the Company's financial statement and the audit of internal controls, on terms set forth in an engagement letter;

— Any proposed significant changes in terms of such engagement resulting from changes in audit scope, Company structure or other matters; and

— All other audit services not listed in Appendix A and not addressed in an engagement letter.

Audit-related services

The Audit Committee has granted general preapproval to the audit-related services listed in Appendix B, including assurance and related services that are reasonably related to the performance of the audit or review of the Company's financial statements and/or the Company's internal control over financial reporting.

Audit-related services not listed in Appendix B require specific preapproval.

Tax services

The Audit Committee has granted general preapproval to the tax services listed in Appendix C, including tax compliance, tax planning and tax advice services.

Tax services not listed in Appendix C require specific preapproval.

All other services

The Audit Committee may grant specific preapproval, on a case-by-case basis, to other permissible nonaudit services that it believes would not impair the independence of the auditor, including those that are routine and recurring services.

Prohibited nonaudit services

A list of prohibited nonaudit services is attached to this Policy as Exhibit 1. The Audit Committee shall not engage the independent auditor for, and the independent auditor shall not request preapproval of, such services under any circumstances.

Preapproval procedure

At least annually or more frequently as needed, upon consultation with the independent auditor and the Chief Financial Officer, the Audit Committee shall review and approve services for general preapproval and Appendices A, B and C shall be updated to reflect such general preapproval and shall serve as the record of Audit Committee preapproval of these services.

In addition, as need arises, the independent auditor and the Chief Financial Officer shall submit a request to provide services that require specific preapproval, including any significant changes to preapproved terms.

Consideration of services for general preapproval and any request for specific preapproval shall require that the Chief Financial Officer and the independent auditor provide a joint statement as to whether the request is consistent with the Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB) rules on auditor independence. See Exhibit 2 for the Company's specific preapproval form.

When deciding to preapprove on either a general or specific basis any service to be provided by the independent auditor, the Audit Committee shall consider whether such service is consistent with SEC and PCAOB rules and whether the provision of such service by the Company's independent auditor would impair the independent auditor's independence. The Audit Committee shall also be mindful of the relationship between fees for audit services and fees for nonaudit services.

The Audit Committee shall consider whether provision of nonaudit services by the independent auditor would:

— Create a mutual or conflicting interest between the Company and the independent auditor;

— Place the independent auditor in the position of auditing its own work;

— Result in the independent auditor acting as management or an employee of the Company;

— Place the independent auditor in the position of acting as an advocate for the Company;

— Present any other circumstances that the Audit Committee believes would impair auditor independence; and/or

— Place the independent auditor in the position where it is not capable of exercising objective judgment with respect to its audit work.

Delegation of specific preapproval authority

The Audit Committee hereby delegates to the Chair of the Audit Committee (the Chair) authority to grant specific preapproval on a case-by-case basis in accordance with this Policy[, subject to a dollar limit of $[•]]. The Chair shall report any preapproval decisions to the Audit Committee at or prior to its next scheduled meeting.

The Audit Committee and the Chair may not delegate to management the responsibility to preapprove any services performed by the independent auditor.

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Performance of services and fees

Management shall promptly inform the Audit Committee whenever management initiates with the independent auditor the provision of any of the general preapproval services listed in an Appendix to this Policy. Management shall also track the actual fees incurred against the preapproved limits set forth in the relevant Appendix or set forth in a specific approval, and promptly inform the Audit Committee upon the reasonable likelihood that such limits may be exceeded. Once a fee limit is reached, services in excess of the preapproved fee limit require Audit Committee approval prior to continued performance of the services and payment of the excess amount. Any request from management that the independent auditor provide services in excess of the preapproved fee limit shall include an explanation as to the reason for the overage.

Policy review

The Audit Committee shall review this Policy annually and shall update Appendices A, B and C at least annually or more frequently as general preapprovals are made.

Questions about this Policy should be directed to the Company's General Counsel.

List of appendices

Appendix A	Preapproved Audit Services
Appendix B	Preapproved Audit-Related Services
Appendix C	Preapproved Tax Services

List of exhibits

Exhibit 1	Prohibited Nonaudit Services
Exhibit 2	Specific Preapproval of Audit and Nonaudit Services Form

Appendix A

Preapproved audit services for fiscal year 20[•]

Approved by the audit committee on [•]

Service	**Preapproved limit**
Services associated with SEC filings (e.g., periodic reports) and assisting with responding to SEC comment letters	**$**
Services associated with SEC registration statements and other documents issued in connection with securities offerings (e.g., comfort letters, consents)	**$**
Statutory audits or financial audits for subsidiaries or affiliates of the Company	**$**
Consultations with Company management (not otherwise included as Audit-Related Services) as to the accounting or disclosure treatment of transactions or events and/or the actual or potential impact of financial or proposed rules, standards or interpretations by the SEC, PCAOB, FASB or other regulatory or standard-setting bodies[3]	**$**
Total preapproved fees for 20[•]	**$**

[3] Some consultations may be audit-related services rather than audit services, to be determined by the Audit Committee.

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Appendix B

Preapproved audit-related services for fiscal year 20[•]

Approved by the audit committee on [•]

Service	Preapproved limit
Due diligence services related to acquisitions/dispositions	$
Consultations with Company management (not otherwise included as Audit Services) as to the accounting or disclosure treatment of transactions or events and/or the actual or potential impact of financial or proposed rules, standards or interpretations by the SEC, PCAOB, FASB or other regulatory or standard-setting bodies[4]	$
Financial statement audits of employee benefit plans	$
Agreed-upon or expanded audit procedures related to accounting and/or billing records required to respond to or comply with financial, accounting or regulatory reporting matters	$
Attest services not required by statute or regulation	$
Total preapproved fees for 20[•]	$

Appendix C

Preapproved tax services for fiscal year 20[•]

Approved by the audit committee on [•]

Service	Preapproved limit
Review of U.S. federal, state, local and international income, franchise and other tax returns	$
U.S. federal, state and local tax planning and advice	$
U.S. federal, state and local tax compliance	$
International tax planning and advice	$
International tax compliance	$
Licensing or purchase of income tax preparation software from the independent auditor, as long as the functionality is limited to preparation of tax returns[5]	$
Total preapproved fees for 20[•]	

[4] Some consultations may be audit services rather than audit-related services, to be determined by the Audit Committee.

[5] Licensing or purchasing income tax preparation software is permissible as long as the functionality is limited to preparation of tax returns. If the software performs additional functions, each function should be evaluated for its potential effect on the auditor's independence.

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Exhibit 1

Prohibited nonaudit services[6]

— Bookkeeping or other services related to the Company's accounting records or financial statements*

— Financial information systems design and implementation*

— Appraisal or valuation services, fairness opinions or contribution-in-kind reports*

— Actuarial services that involve the determination of amounts recorded in the financial statements and related accounts, other than assisting Company personnel in understanding the methods, models, assumptions and inputs used in computing an amount*

— Internal audit outsourcing services*

— Management functions

— Human resources

— Broker-dealer, investment advisor or investment banking services

— Legal services

— Expert services unrelated to the audit

— Any services entailing a contingent fee or commission (not including fees awarded by a bankruptcy court when the Company is in bankruptcy)

— Tax services to an officer of the Company whose role is in a financial reporting oversight capacity or an immediate family member of such person (regardless of whether the Company or the officer or immediate family member pays the fee for the services)

— Planning or opining on the tax consequences of a "confidential" transaction, i.e., where tax advice is given under conditions of confidentiality (regardless of the fee to be paid)

— Planning or opining on a transaction based on an "aggressive interpretation" of tax laws and regulations, if the transaction was recommended by the auditor and a significant purpose of the transaction is tax avoidance, unless the proposed tax treatment is at least more likely than not to be allowed under current tax laws[7]

* Provision of these nonaudit services is permitted only if it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the Company's financial statements.[8]

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[6] Section 201(a) of the Sarbanes-Oxley Act, Rule 2-01(c)(4) of Regulation S-X and PCAOB Rules 3521, 3522 and 3523.

[7] With respect to transactions subject to U.S. tax laws, this prohibition includes, but is not limited to, any transaction that is a listed transaction within the meaning of Section 1.6011-4(b)(2) of the Internal Revenue Code, i.e. a tax avoidance transaction.

[8] Rule 2-01(c)(4) of Regulation S-X. There is a rebuttable presumption that prohibited services will be subject to audit procedures. Materiality is not a basis upon which to overcome that presumption in making a determination that it is reasonable to conclude that the results of the services will not be subject to audit procedures, because determining materiality is itself a matter of audit judgment. SEC Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence, Frequently Asked Questions, E. Nonaudit services, Question 3 (issued August 13, 2003).

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Exhibit 2

Specific preapproval of audit and nonaudit services form

The Audit Committee shall use this form to document specific preapproval of any service to be performed by the independent auditor that has not received general preapproval pursuant to the Audit and Nonaudit Services Preapproval Policy, as reflected in Appendices A, B or C.

Audit committee specific preapproval of services of the independent auditor

Type of service (check one):	
Audit services	
Audit-related services	
Tax services	
Other services	
Aggregate fees	$
Provide a detailed description of the service.*	

Discuss whether the request is consistent with the SEC's and PCAOB's rules on auditor independence.

___

___

___

Company Initiator of Service	___ Sign and date	___ Name and title
Independent auditor	___ Sign and date	___ Name and title
Audit committee approval	___ Sign and date	___ Name and title

* Attach engagement letter or other documentation supporting the services to be performed.

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Sample policy for reporting concerns

Explanatory note

Sidley Austin LLP provides this information for educational purposes only. It should not be construed or relied upon as legal advice. Given the complexities of law, regulation and practice in this area and the variety of company-specific factors that need to be considered, the sample policy for reporting concerns provided herein should not be used unless tailored by an attorney experienced in this area of law for the specific corporation based on applicable law, regulation and listing rules as well as factors such as organizational structure and lines of business. References to company policies, departments and reporting hotlines and websites used in the sample policy for reporting concerns should be tailored to the company as necessary.

[Company name]

Policy for reporting concerns

As adopted by the audit committee, effective [•]

[COMPANY NAME] (the Company) is committed to conducting business in accordance with applicable laws, rules and regulations and high standards of business ethics and to fostering an environment in which all employees, executive officers and directors of the Company are encouraged to raise in good faith concerns about any potential wrongdoing within the Company, free from fear of discrimination, harassment or other forms of retaliation.

This Policy for Reporting Concerns (this Policy) sets forth (a) the procedures for reporting and handling questions and concerns regarding potential, suspected or known violations of applicable law, regulation, rule or standard or Company policy[1] and (b) the Company's policy prohibiting retaliation against employees who report concerns in good faith.[2]

Applicability

This Policy applies to all employees, executive officers and directors of the Company and its subsidiaries (collectively referred to as "you").

Definitions

"**Concern**" means any question or concern about a potential, suspected or known violation that has occurred, may occur and/or is occurring of any applicable law, regulation, rule or standard, the Company's Code of Business Conduct and Ethics or any other Company policy.

"**Corrective Action**" means an action to be taken to address issues raised as part of a Concern and may include, for example, revision of policies and procedures, disciplinary action, regulatory reporting or recovery of the proceeds of fraud or other conduct that is in breach of applicable law, regulation, rule or standard, the Company's Code of Business Conduct and Ethics or any other Company policy.

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[1] As mandated by Section 301 of the Sarbanes-Oxley Act of 2002 and Section 10A(m)(1) of the Securities Exchange Act of 1934, the Securities and Exchange Commission adopted Exchange Act Rule 10A-3 which requires a public company's audit committee to establish procedures for the receipt, retention and treatment of complaints received by the company regarding accounting, internal accounting controls or auditing matters, including procedures for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

[2] Section 806 and 1107 of the Sarbanes-Oxley Act prohibit employers from retaliating against employees who report information about questionable accounting practices, fraud or other possible violations of law. As mandated by Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC adopted Exchange Act Section 21F(h)(1) which prohibits employers from terminating or discriminating against employees who report conduct that they reasonably believed violated federal securities laws. It also created a private right of action for employees who experience retaliation and gives the SEC enforcement authority for violations of the anti-retaliation provisions by employers.

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"**Investigation**" means the analysis and investigation of the factual, legal and ethical basis of a Concern, which may include interviews, review of documents and data, site visits and receipt of advice with respect to, but not limited to, the Concern and related Corrective Actions.

"**Investigator**" means any person or group of persons designated by Compliance pursuant to this Policy to coordinate and supervise the Investigation of a particular Concern.

Reporting concerns

Reporting: Concerns may be submitted in writing or orally by any person. No form is required to submit a Concern; however, if it is your intent to submit a Concern and you do so orally (other than through the Ethics Hotline), you should request a written acknowledgment that you have submitted a Concern. You may report a Concern by communicating it orally or in writing to any of the following:

- Your manager
- Compliance
- Human Resources
- Legal
- For accounting, auditing and financial disclosure related Concerns: Audit Committee, [COMPANY NAME], [COMPANY ADDRESS], Attention: Audit Committee Chair
- Ethics Hotline: [TELEPHONE NUMBER]
- Reporting website at [WEBSITE ADDRESS]

Receipt of a Concern reported orally should be acknowledged in writing to the person reporting the Concern.

Confidential reporting: You may request that your report of a Concern through any of the channels listed above be treated confidentially subject to the Company's interests in properly investigating the Concern and/or taking other action to protect the health and safety of individuals and the Company's interests. (All reported Concerns will be reviewed by Compliance.)

Anonymous reporting: You may also report a Concern anonymously to:

- For accounting, auditing and financial disclosure related Concerns: Audit Committee, [COMPANY NAME], [COMPANY ADDRESS], Attention: Audit Committee Chair
- Ethics Hotline: [TELEPHONE NUMBER]
- Reporting website at [WEBSITE ADDRESS]

If you choose to report anonymously, please ensure that you provide sufficiently detailed information to enable the Concern to be properly investigated (including, for example, details relating to the facts underlying the Concern and the person(s) involved). A third party contracted by the Company will take your initial report and handle gathering any follow up information. The initial report and any additional information are then communicated to the Company without disclosing any information about you. Accounting, auditing and financial disclosure related Concerns are specifically communicated to the Audit Committee Chair in the same confidential manner. The Ethics Hotline and Reporting Website are designed to provide you with a case number so that you may provide additional information and receive a response relating to the Concern. For more information about the Ethics Hotline and Reporting Website, please refer to the Employee Handbook.

While the Company encourages internal reporting to the Company of Concerns, nothing in this Policy restricts or limits your ability to report Concerns directly to a regulatory agency.

Protection for reporting concerns/antiretaliation policy

Certain laws and regulations prohibit retaliatory action against employees who report potential wrongdoing in certain circumstances. The Company prohibits retaliation against employees for reporting Concerns in good faith under this Policy or for participating in an Investigation. Making a report in "good faith" means that you have provided all the information you have and you reasonably believe there has been a possible violation of applicable law, regulation, rule or standard, the Company's Code of Business Conduct and Ethics or any other Company policy, even if your report turns out to be unsubstantiated. Retaliation includes any unfavorable job action (such as termination, demotion, suspension, discipline, reduced hours, transfer or adverse compensation action), threat, harassment or other discrimination in the terms and conditions of employment.

Retaliation is a violation of this Policy and the Company's Code of Business Conduct and Ethics and may also violate the law. Retaliation should be reported in accordance with this Policy.

Handling and Investigating Concerns

The recipient of any reported Concern shall promptly communicate such Concern to Compliance. Compliance shall promptly provide written confirmation to the reporter that such Concern has been received. If the report has been submitted anonymously, Compliance shall provide written confirmation to the extent possible.

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Compliance shall review within a reasonable timeframe each Concern reported through any of the mechanisms for reporting Concerns listed above. Compliance shall assign an identification number to enable tracking of the Concern and shall communicate the Concern to the appropriate Investigator for review and Investigation, if needed, with appropriate consideration regarding confidentiality concerns. Persons who have reported Concerns anonymously can use the identification number to provide additional information and receive a response relating to the Concern.

The Investigator will typically be from within the relevant business unit or corporate function but may be from within Compliance, Internal Audit, the Audit Committee or the Board of Directors depending on the nature of the Concern and the persons involved.

The Investigator shall prepare a plan of Investigation, which Compliance shall review and approve before the Investigation commences. A plan of Investigation should set forth the process and expected timing for conducting the Investigation, including persons to be interviewed, documents to be reviewed, reports to be prepared and the roles of Company personnel and outside advisors. Investigators may seek assistance in any Investigation from other Company personnel, including people outside the relevant business unit or corporate function. In addition, depending on the scope and nature of the Investigation, Investigators may require assistance from outside advisors (such as legal counsel, external auditors, accountants, fraud investigators, information technology experts, etc.) but shall obtain the prior approval of Compliance before approaching or retaining such advisors.

The person who is the subject of the Investigation shall be notified in a timely manner about the Investigation and involved in the Investigation as deemed necessary and appropriate.

You are expected to cooperate when your assistance, or the assistance of any person under your supervision, is sought with respect to any Investigation.

Compliance shall meet with the Investigator on a regular basis as determined by Compliance to provide oversight and receive updates on the progress of the Investigation.

Where the Concern implicates Compliance, Internal Audit shall perform the responsibilities of Compliance set forth in this Policy. Where the Concern implicates Compliance, such concerns shall be reported to the Audit Committee and the Audit Committee shall review the matter and take appropriate action, including appropriate Investigation or other appropriate action, within a reasonable period of time.

Investigations shall be treated as confidential to the extent possible and only discussed with those outside the investigation team on a need-to-know basis. You are required to keep confidential any information that you receive as part of an Investigation, including the existence of the Investigation, the persons involved and the factual, legal and ethical issues.

Corrective Actions

At the conclusion of an Investigation, the Investigator and/or Compliance may recommend that certain Corrective Actions be taken. Compliance shall monitor completion of any recommended Corrective Actions. Any Corrective Action that consists of discipline of any Company personnel shall be discussed in advance with Human Resources. Disciplinary action shall be consistent with applicable law and regulation and the guidelines for disciplinary action included in the Employee Handbook. Types of disciplinary action include, but are not limited to, reprimand (verbal or written), suspension, reduction in current or future salary or other compensation such as bonuses, demotion and termination.

Reporting relating to concerns, investigations and corrective actions

Compliance shall maintain a log of all Concerns and the status of any Investigations and Corrective Actions. Compliance shall report on Concerns, Investigations and Corrective Actions to the Audit Committee at least quarterly and more frequently as circumstances require. Company personnel who have raised a Concern shall be kept apprised of the status of their Concern where appropriate.

Policy review

The Audit Committee shall review this Policy periodically.

Questions about this Policy should be directed to Compliance.

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Oversight of external audit—Fundamental and leading practices

Considerations in the appointment of the external auditor

— Background and experience of principal members of the engagement team, including the lead engagement partner, tax partner, quality control review partner, senior manager(s), and any specialists (such as actuarial, valuation, and employee benefits specialists) who perform a significant role in connection with the audit.

— Audit firm's technology used in the audit, and expectations regarding the use of the work of the company's internal auditors and other third parties—and how this will impact the external auditor's work and fees.

— Audit firm's quality control system and how it is managed to provide reasonable assurance regarding consistent audit quality throughout the firm.

— Audit firm's other clients—as an indication of the audit firm's industry experience (including nonaudit services), experience with companies of similar size, as well as the audit firm's footprint of operations domestically and internationally.

— If the company has significant international operations, the extent and quality of audit resources outside the U.S. that will be used by the audit firm and whether the international resources are subject to the same audit approach and quality control standards as the audit firm.

Establish clear expectations for the external auditor

— Develop and maintain a rigorous, iterative process—involving the audit committee, management, and the external auditor—to establish clear expectations for the external auditor.

— Expectations should be company-specific, but likely include:

- – Audit requirements
- – Communications (with management and the audit committee)
- – Audit team resources, key roles, and the use of specialists
- – Issue resolution—process and use of national office
- – Progress reporting, audit coordination
- – Reasonableness of fee, given scope of audit
- – Other services, and preapproval process
- – Auditor's support of the audit committee
- – Benchmarking (e.g., comparison of company's audit committee, finance, and internal audit functions with those of the audit firm's similar clients).

— Be clear that audit committee will evaluate auditor performance against these expectations.

Discuss the external auditor's audit plan and monitor performance

— Review and discuss external auditor's audit plan, including:

- – Adequacy of audit scope to address financial reporting risks facing the company
- – Planned audit procedures and approaches to address these risks (given audit firm's knowledge of company and industry)
- – Use of specialists in such areas as taxation, valuation, pensions, etc.
- – Reporting processes for subsidiary audit teams
- – Control of overseas audits
- – Working relationship with internal audit.

— Engage in frequent dialogue throughout the course of the audit regarding the progress of the audit and any difficulties encountered by the auditor in executing the audit, including the reasonableness of the timeframe

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within which the audit must be completed, and any impact of the timing on the approach to the audit.

— At each audit committee meeting, discuss audit progress and significant issues and concerns, including:
  - Significant accounting, auditing, and internal control over financial reporting issues identified by the auditor, and how those issues may impact the quality of the company's financial reporting.
  - Critical accounting policies, judgments, and estimates—whether accounting treatment is conservative or aggressive
  - Other company, industry, and economic changes that may significantly impact the audit—e.g., the company's revenue generating activities, including new products; regulatory initiatives, including new taxes; supplier vulnerabilities; domestic and international trends and developments; accounting standard changes that impact company's financial reporting.

— Discuss audited and interim financial statements.

Maintain robust communications with the external auditor

— A strong relationship, including frequent, informal communications, between the audit committee chair and the lead engagement partner are critical.
  - Providing input on committee agendas, walking through premeeting materials, discussing developments on a real-time basis, and promoting an understanding of key matters from the perspective of the external auditor.

— Conduct an executive session with external auditor at each formal meeting—to gain insight into the strengths and weaknesses of the company's financial reporting and control processes.

— Maintain robust, two-way communications with external auditor about a range of financial reporting, internal control, and risk-related issues that may impact the company's financial reporting and internal controls.
  - Consider the audit firm's full range of capabilities.

— Determine audit firm's succession plans for key engagement team members (audit, tax, and specialists at both the partner and senior manager level).

Monitor the external auditor's independence

— Approve audit and nonaudit services

— At least annually, discuss with the engagement partner the external auditor's compliance with independence requirements.

Evaluate the external auditor's performance

— An ongoing process throughout the year—not simply an annual event.
  - Use periodic touchpoints—whether formal audit committee meetings and executive sessions or informal discussions between the engagement partner and the audit committee chair—as opportunities to provide feedback and discuss auditor performance.

— Develop a formal, structured process to evaluate external auditor's performance against expectations on an annual basis.
  - Obtain input from audit committee members, other directors, the CEO, finance executives, the internal auditor—as well as the external auditor.

— Discuss evaluation results with the audit engagement partner and other partners who may be involved in the audit.
  - How did the auditor perform against expectations? What are the auditor's views?
  - How can the external auditor improve?
  - How should expectations be changed for the coming year?

— Agree on a plan for external auditor's continuous improvement.

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Additional resources

Public Company Accounting Oversight Board Resources for Audit Committees

NYSE Listed Company Manual 303A.06 Audit Committee

NYSE Listed Company Manual 303A.07 Audit Committee Additional Requirements

Nasdaq Corporate Governance Requirements

CAQ External Auditor Assessment Tool: A Reference for US Audit Committees (April 2, 2019)

CAQ Audit Committee Issues

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About the KPMG Board Leadership Center

The KPMG Board Leadership Center (BLC) champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programs and perspectives—including the KPMG Audit Committee Institute, the WomenCorporateDirectors Foundation, and more—the BLC engages with directors and business leaders to help articulate their challenges and promote continuous improvement of public- and private-company governance. Drawing on insights from KPMG professionals and governance experts worldwide, the BLC delivers practical thought leadership—on risk and strategy, talent and technology, globalization and compliance, financial reporting and audit quality, and more—all through a board lens. Learn more at kpmg.com/us/blc.

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