



Audit Committee Guide

KPMG's Audit Committee Institute

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About KPMG's Audit Committee Institute

As part of the KPMG Board Leadership Center, the Audit Committee Institute (ACI) engages with audit committee chairs, board members, and business leaders to help articulate their challenges and promote continuous improvement. With a presence in more than 35 countries worldwide, ACI delivers actionable thought leadership—on financial reporting and audit quality, risk and compliance, talent and technology, and more—all through a board lens. Learn more about ACI's programs, resources, and insights for directors at kpmg.com/aci.

Contents

Foreword	2
Acknowledgements	3
About the guide	5
Chapter 1: Audit committee’s role and responsibilities – An overview	6
Chapter 2: Composition, onboarding, and role of the chair	7
Chapter 3: Oversight of financial reporting and internal control over financial reporting (ICOFR)	11
Chapter 4: Oversight of external and internal auditors	19
Chapter 5: Oversight of risk – Considering the audit committee’s role	26
Chapter 6: Audit committee effectiveness	29
Appendices	35

Foreword

Audit committees have, in many ways, run the gauntlet since KPMG's Audit Committee Institute (ACI) was founded in 1999—through the Enron and WorldCom scandals and expanded responsibilities under Sarbanes-Oxley, the dot-com bubble of the late 90s, the 2007–2008 financial crisis and subsequent Dodd-Frank¹ reforms, the Great Recession, corruption investigations in global companies, and the dramatic escalation and impact of cybersecurity attacks.

The insights gained and lessons learned have clearly set a high bar for audit committees (and boards), and the accelerating speed and complexity of doing business will, no doubt, keep pushing that bar higher. Technology and innovation, globalization and geopolitical turbulence, investor activism, and other disruptive forces are shaping a risk and regulatory landscape that few could have envisioned 15, 10, or even five years ago.

By and large, we see audit committees adapting to these changes and challenges—

refining their agendas and oversight processes and, in some cases, reassessing their skills and composition. But keeping pace will require agendas that are manageable (what risk oversight responsibilities are realistic given the audit committee's time and expertise?), focusing on what's most important (starting with financial reporting and audit quality), allocating time for robust discussion 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.

Our hope is that this *Audit Committee Guide* will help audit committees continue to sharpen their governance processes to keep pace, stay focused, and deliver not only effective oversight, but insight and foresight to help guide their companies forward.



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¹ Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Acknowledgements

The insights and practical suggestions in this *Audit Committee Guide* come from many sources—KPMG audit partners and subject matter professionals, leading audit committee chairs around the world, the National Association of Corporate Directors' Audit Committee Chair Advisory Council and Blue Ribbon Commission on the Audit Committee (2010), Sidley Austin LLP, the Center for Audit Quality, and many others who have shared their thoughts and leading practices with us over the years.

We gratefully acknowledge these thought leaders for their valuable, ongoing contribution to the audit committee dialogue.





About the guide

This *KPMG Audit Committee Guide* draws on insights and learnings from our interaction with thousands of audit committee members, audit and governance professionals, and business leaders across the country and around the world. It also builds on the 2010 *Report of the NACD Blue Ribbon Commission on the Audit Committee*, which KPMG's Audit Committee Institute played a prominent role in developing.

The *Audit Committee 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 that work with the audit committee. To that end, the *Audit Committee 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 *Audit Committee Guide*—e.g., cybersecurity and the impact of emerging technologies, long-term performance metrics, shareholder activism—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 (if simply as a catalyst) 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 *Audit Committee Guide* should be considered in the context of each audit committee's needs and circumstances. In the appendix, 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.

We welcome suggestions for refining future editions of the *Audit Committee Guide* (auditcommittee@kpmg.com) and invite you to visit KPMG's Audit Committee Institute Web site (www.kpmg.com/aci) for regular updates and insights into emerging issues affecting audit committee and board oversight.

Audit committee's role and responsibilities – An overview

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 (ICOFR) 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, and SEC rules—as well as stock exchange listing rules prescribe the audit committee's purpose and responsibilities. A noticeable difference between stock exchanges exists regarding the level of detail required in the charters; the NYSE requires significantly more detail than the 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 ICOFR

- The independent auditors
- The company's internal audit function
- The company's compliance with legal and regulatory requirements, including the establishment of whistle-blower processes.

In addition (as discussed in Chapter 5), most boards delegate to the audit committee some responsibility 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 continues 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*.

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 sets forth “bright line disqualification standards;” in addition, 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 “enhanced” definition of audit committee independence set forth in the SEC’s rules:

- 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.

While the enhanced criteria apply only to audit committee members, many companies incorporate the audit committee independence criteria into the criteria applicable to all independent directors in order to avoid having two 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, or evaluating financial statements or experience actively supervising people who do so
- An understanding of ICOFR
- An understanding of audit committee functions.

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

In practice, many audit committees have more than one ACFE. According to Shearman & Sterling’s 2014 Corporate Governance Survey of the Largest U.S. Public Companies, 42 percent disclosed that two or more of their audit committee members were ACFEs, and 25 percent disclosed that *all* audit committee members were ACFEs. In its Governance QuickScore formula, 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. 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
- The culture and dynamics of the committee and the board
- Background on any upcoming issues requiring attention.

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. 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 CFO, CIO, 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 a new audit committee member has 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
- 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), 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, contacts by regulators (including SEC comment letters) and the company's response, significant investigations, and litigation
- Internal audit plan for the current year and report for the prior year
- External auditor reports and written communications.

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, whistle-blower complaints, a summary of any significant legal issues or litigation, 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.

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.

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 overemphasized.

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—starting with financial reporting risk
- Making sure the audit committee has the information, resources, and support to do its job
- 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
- Supporting the CFO/finance organization's focus on long-term performance
- Setting clear expectations for external and internal auditors.

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

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 ICOFR 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 ICOFR 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 MD&A, with management and the external auditor
- Discuss the company's earnings releases and 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, how should the audit committee go about reviewing the 10-K and 10-Q? What's the process, and who should be involved? The NACD's Blue Ribbon Commission on the Audit Committee offers the following helpful recommendations:

- Understand 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
- Insist that management provide a summary of key areas the audit committee needs to evaluate

- Allow 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 filings, audit committees often request 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, the audit committee’s review of the 10-K should also include a sharp focus on:

- New accounting pronouncements that are being applied for the first time during the most recent reporting period (of which the audit committee should be kept apprised in advance of their initial application)
- Other significant accounting, auditing, and reporting matters
- The MD&A and disclosures regarding critical accounting policies, judgments, and estimates, and risk factor disclosures
- Matters that the external auditors brought to the attention of the audit committee or referred to the firm’s national office.

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 “standing list” of issues to discuss with the external auditor and a separate list with internal auditors.

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

- 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
- Are the company’s critical accounting policies, judgments, and estimates consistent with others in the industry? Are they more aggressive? Less aggressive?
- 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)
- 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 PCAOB Auditing Standard No. 16, “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.

Internal control over financial reporting and disclosure controls and procedures

Internal control over financial reporting

ICOFR 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 generally accepted accounting principles (GAAP).

Under Section 404 of the Sarbanes-Oxley Act, management is required to annually evaluate ICOFR and report on its effectiveness, and the external auditor must conduct an audit

of ICOFR as part of its integrated audit. (The Dodd-Frank Act amended section 404 to exempt nonaccelerated filers from the requirement for an external audit of ICOFR). Under Sarbanes-Oxley Section 302, the CEO and CFO are required to make quarterly certifications regarding the effectiveness of ICOFR, 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 ICOFR, a process to monitor, test, and assess ICOFR and to certify as to its adequacy—as well as responsibility to oversee the external auditor’s integrated audit. Under PCAOB Auditing Standard No. 5, the external auditor must provide written communication to the audit committee regarding all material weaknesses and significant deficiencies in ICOFR.

ICOFR is an increasing area of 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 ICOFR, 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 ICOFR.

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.

Sharpening financial disclosures and expanded audit committee reporting

Disclosure overload continues to be a thorn in the side for companies, investors, regulators, and audit committees, with boilerplate and repetition making it difficult to focus on what's important. Acknowledging that the heavy disclosure regime is likely to continue, investors have emphasized the vital role that audit committees play in ensuring the usefulness of financial statements. Views expressed at a meeting of the NACD's Audit Committee Chair Advisory Council were consistent with the general dialogue on the audit committee's role in this area:

- Setting high expectations regarding the quality of the numbers: *"The audit committee should be working closely with management to ensure the company's numbers are down the middle of the fairway."* One analyst observed, *"We hope audit committees are asking questions about operations in emerging markets. We definitely see a difference in quality of reporting in certain markets, and we don't always trust the numbers."*
- Advocating for transparency: *"Markets don't like surprises, so make sure key things aren't getting swept under the rug. If the company discloses something [in good times], they also need to disclose on the way down—when the news isn't great."*

- Rationalizing disclosures where possible: *"Writing a three-page report is much harder than 20 pages, but shorter is usually much better—so always press management on that."*
- Asserting the audit committee's authority where necessary. In the event of a change in auditors, for example, *"It's helpful to hear more from the audit committee about the reasons [for the change]. It clearly demonstrates that the audit firm works for the audit committee, not for management."* Investors and rating agencies also expect to hear directly from the audit committee in situations such as breakdowns in controls or financial restatements: *"The audit committee should communicate its point of view. Tell [us] what happened and why. Demonstrate that the audit committee is on top of the issue, and that there's a plan to address the problem in the future."*²

(Continued on page 15)

² NACD Audit Committee Chair Advisory Council – Summary of Proceedings, March 5, 2014

The audit committee should understand how management is addressing these organizational pressures and the steps being taken to help prevent and detect fraud. Committee members play an important role in helping to shape the culture and tone of the organization and helping to ensure that management is conducting business in a manner that drives integrity throughout the organization. The Center for Audit Quality's Anti-Fraud Task Force report is a valuable resource, providing examples of red flags and risk factors for fraudulent financial reporting, as well as recommendations to enhance the deterrence and detection of fraudulent financial reporting.

For starters, the following questions can shed important light on the risk of fraud:

- What is the style of management? How do they get things done? Are open and candid communications encouraged?
- Is there a commitment to competence—and sufficient resources—throughout the organization?
- How does senior management demonstrate its commitment to an appropriate corporate culture?
- Is there an effective process to facilitate information flow and promote transparency?

(Continued from page 14)

Investors have also suggested that companies can improve the usefulness of disclosures by providing expanded reporting at the business unit, segment, or geography level; including data that shows trends over multiple years; using more charts and visuals; and including more forward-looking disclosures.

Audit committee reports

Consider whether expanding the audit committee's report—in the proxy, annual report, online, or another channel—would provide investors with more insight into how the committee carries out its oversight responsibilities (see "Enhancing the Audit Committee Report" at www.thecaq.org). The SEC's concept release on audit committee reporting³ invites comment on potential revisions to current audit committee reporting requirements, including 11 possible new reporting topics focusing on the audit committee's oversight of the external auditor. Given the audit committee's critical oversight role, additional disclosure can provide

investors and other stakeholders with a better understanding of—and, ultimately, greater confidence in—the committee's work.

More broadly, consider the company's approach to shareholder engagement, particularly in light of stepped-up pressure by activist investors—often supported by pension funds and other institutional investors—for strategic, operational, capital allocation, and governance changes. Looking at the company through the eyes of the investor can provide important insights into the company's strengths and weaknesses. Though not specifically an audit committee responsibility, the audit committee can help prompt a robust boardroom discussion about how the company is preparing for activist investors and engaging with current shareholders and the investor community generally.

³ *Possible Revisions to Audit Committee Disclosures*, SEC Release No. 33-9862; 34-75344, issued July 1, 2015

- Are the company’s whistle-blower processes effective? Has there been an independent, third-party assessment of the processes?
- Does management use directors as a sounding board to test assumptions (or as a “rubber stamp”)?
- Are incentive compensation targets realistic? Is there a focus on long-term performance?
- Is management receptive to the work of the internal auditors? Are internal audit recommendations implemented in a timely manner, or are findings and recommendations repeatedly cited due to lack of implementation?
- What is management’s relationship with the external auditor? Are the external auditors repeatedly finding audit differences?

Auditors are also an important resource here. Audit committees should regularly hear the views of internal and external auditors on the risk of financial reporting fraud at the company, pressures on management, possible red flags, and the adequacy of the company’s fraud prevention, deterrence, and detection efforts.

COSO 2013 Framework

In May 2013, The Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued the Internal Control-Integrated Framework (2013), which updates the 1992 Framework to reflect changes in the business and risk environment—technology, globalization, and more. COSO’s five components of internal control—the control environment, risk assessment, control activities, information and communications, and monitoring activities—remain the same, but the COSO 2013 Framework adds “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.

Audit committees also play an important role in overseeing management’s implementation of the COSO 2013 Framework. COSO discontinued support of the earlier framework at the end of 2014; we expect that all registrants will complete the transition to COSO 2013 by their next assessment date, if they have not yet done so.

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 above, in their 302 certifications, the CEO and CFO must make disclosures regarding the effectiveness of the company’s disclosure controls and procedures.

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 disclosures contained in the company’s periodic filings with the SEC.

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.

“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**

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 ICOFR. 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. It is a leading practice for audit committees to discuss the earning release (whether by phone or in person) *before* it is issued.
- **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.

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.

Every company needs to translate the drivers of long-term value—whether it is innovation, operational efficiency, or talent management—into more tangible or specific drivers of value

based on its particular strategy and risk profile, strengths and weaknesses, and a broad range of external factors shaping the business and risk environment. Such external factors can include emerging technologies and social media, globalization, sustainability of natural resources, disruptive business models and the interests of key stakeholders—all of which may have a direct impact on the company's long-term value.

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? Customer satisfaction? Investment in R&D? Early adoption of new technology?
- 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 the alignment of long-term and short-term metrics—to investors?

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 investors.

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 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 Non-Audit Services Pre-Approval Policy.)

- Overseeing the strategy, scope, progress, and results of the external audit of financial statements and audit of ICOFR
- 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.

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.⁴ In order to provide continuity and avoid disruptions, audit committees should ensure that the audit firm has developed a clear schedule and time line 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.

“*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**

⁴ Sarbanes-Oxley, Section 203, “Audit Partner Rotation”

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 Appendix G: 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? Surveys continue to suggest that in many cases, the CFO—and not the audit committee—plays *the primary* role 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 stakeholders—noting stronger communications and deeper engagement between audit committees and auditors—generally have expressed confidence in the quality of financial statement audits. That said, the PCAOB continues to focus on internal control over financial reporting (ICOFR) as well as various projects to enhance audit quality and auditor independence, objectivity, and professional skepticism, including changes to the auditor’s reporting model, enhanced transparency (auditor’s signature on the audit opinion), 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 role in helping to ensure audit quality.

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 their 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 two 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 in that role
- Defining the reporting relationships for internal audit.

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 new 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, data analytics, fraud detection, local language skills, and more.
- **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 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.

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 to continue 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.



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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 whether and how the board administers its oversight function, such as through the full board, a separate risk committee, or the audit committee. 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 that are not subject to this requirement, there are differing views as to what should be the role of the full board versus the audit committee (and other board standing committees) in the oversight of risk. 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

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. Because it is such an important effort, some boards are assigning this responsibility to a committee—and in many cases, to the audit committee. 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?
- Does internal audit provide added assurance regarding the adequacy of risk management systems?

assessment and risk management;” yet, the standards also make clear that the audit committee is “not the sole body responsible for risk.”)

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 BRC 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 that a company faces. 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?
- **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? Should we make changes to our committee structure or the allocation of risk oversight responsibilities? Do directors have a shared view as to the three, four, or five

⁵ NACD’s Blue Ribbon Commission on Risk Governance: Balancing Risk and Reward, 2009.

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 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?

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 quickly to capitalize on opportunities in new global markets, leveraging new technologies and data, and engaging with more 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 FCPA and antibribery programs—are keeping pace with the new 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 international companies is the Organisation for Economic Co-operation and Development (OECD) and governmental efforts globally to address perceived transfer pricing abuses (note in particular the OECD's Action Plan on Base Erosion and Profit Shifting, which includes an agreement on automatic sharing of tax information). 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.

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.? Do the company's tax decisions take into account reputational risks and not simply whether the company has technically complied with tax laws? In short, tax is no longer simply an expense to be managed; it now involves fundamental changes in attitudes as the global "tax transparency and morality" debate is increasingly driven by notions of "fairness" and "morality."

- *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.

- *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. Boards that are in the forefront oversee these issues as part of overall risk oversight 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 if 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, it's clear that the pace of technology change—and the escalating and persistent threat of cyber attacks—have pushed IT risk steadily higher on board agendas, and audit committees may play a pivotal role in helping to ensure robust discussions around IT risk generally, and cybersecurity in particular.

Audit committee effectiveness

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 in the current business environment—from operational and compliance risks posed by globalization and the extended organization (partners, suppliers, vendors, etc.) to cybersecurity 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 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” and 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 (and expect pre-read materials to be read) and 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. One of the biggest changes in audit committee service in recent years is the degree of engagement. 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's 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."

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 de facto 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. (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**

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:

“*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**

- 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.

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, and expect preread materials to have been read in advance of the meeting.
- 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 with committee members: Based on the committee members’ review of meeting materials, does the amount of time allocated to each agenda item still seem appropriate?

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. These “between meeting updates” can help streamline committee meetings.

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 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 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.

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.)

Appendices

- Appendix A: Sample audit committee charter
- Appendix B: Sample audit committee meeting planner
- Appendix C: Sample audit committee evaluation
- Appendix D: Sample audit and non-audit services pre-approval policy
- Appendix E: Sample whistle-blower policy
- Appendix F: Oversight of external audit – Fundamental and leading practices
- Appendix G: CAQ’s external auditor assessment tool:
A reference for U.S. audit committees

A

Sample audit committee charter

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.

Explanatory note

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 non-audit services without audit committee prior approval); and
 - 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.
- 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:

- 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.
- 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.
- 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
 - 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 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.

This sample form is provided 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.

Audit committee charter of
[_____]
(the “Company”)

As adopted by the Board of Directors, effective [_____], [20__]

Purpose

The purpose of the Audit Committee (the “**Committee**”) of the Board of Directors (the “**Board**”) of the Company is to assist the Board in its oversight of [(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 department (“**Internal Audit**”) and the Independent Auditor.]³ The Committee shall also prepare the report of the Committee required to be included in the Company’s annual report or proxy statement relating to the election of directors.⁴

The Board recognizes that while the Committee has been given certain duties and responsibilities pursuant to this Charter, the Committee is not responsible for guaranteeing the accuracy of the Company’s financial statements or the quality of the Company’s accounting and financial reporting processes. The fundamental responsibility for the Company’s financial statements and disclosures rests with management and the Independent Auditor.⁵

Composition of the Committee

The Committee shall be comprised of three or more directors,⁶ each of whom (i) meets the independence requirements of the [[New York Stock Exchange (the “**NYSE**”)]⁷/The NASDAQ Stock Market (“**NASDAQ**”)]⁸ 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**”)⁹, and [[the NYSE]/[NASDAQ]] [; provided that the Board may elect to take advantage of any exception from such requirements provided by NASDAQ rules]¹⁰.

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

² §5605(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(b)(i)(B) of the NYSE Rules.

⁵ General Commentary to §303A.07(b) of the NYSE Rules.

⁶ §303A.07(a) of the NYSE Rules and §5605(c)(2)(A) of the NASDAQ Rules.

⁷ §§303A.07(a) and 303A.02 of the NYSE Rules.

⁸ §§5605(c)(2)(A) and 5605(a)(2) of the NASDAQ Rules.

⁹ Rule 10A-3(b)(1) under the Exchange Act.

¹⁰ §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 otherwise non-independent 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.

At least one member of the Committee shall be an “audit committee financial expert” in accordance with the rules of the Securities and Exchange Commission¹¹, and at least one member (who may also serve as the audit committee financial expert) shall have [[accounting or related financial management expertise]¹²/[past employment experience in finance or accounting, requisite professional certification in accounting or other comparable experience or background that leads to financial sophistication]¹³]. The designation or determination by the Board of a person as an audit committee financial expert will not impose on such person individually, on the Committee, or on the Board as a whole, any greater duties, obligations or liability than would exist in the absence of such designation or determination. All other Committee members shall be [[financially literate]¹⁴/ [able to read and understand fundamental financial statements, including the Company’s balance sheet, income statement and cash flow statement]¹⁵]. To effectively perform his or her role, each Committee member will obtain an understanding of the detailed responsibilities of Committee membership as well as the Company’s business, operations and risks.

Committee members shall not simultaneously serve on the audit committees of more than [two]¹⁶ 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.]¹⁷ Determinations as to whether a particular director satisfies the requirements for membership on the Committee shall be made by the Board.

Committee members (i) shall be appointed by the Board on the recommendation of the Nominating and Corporate Governance Committee, (ii) shall serve for such terms as the Board may determine, or until their earlier resignation, death or removal, and (iii) may be removed by the Board in its discretion.¹⁸

Meetings

The Committee shall meet with such frequency and at such intervals as it determines necessary to carry out its duties and responsibilities, but in any case, not less than [four] times a year. The Board shall designate one member of the Committee to serve as its chairperson. The chairperson will preside, when present, at all meetings of the Committee. The Committee will meet at such times as determined by its chairperson or as requested by any two of its members. Notice of all Committee meetings shall be given, and waiver thereof determined, in accordance with the notice and waiver of notice requirements applicable to the Board. The Committee may meet by telephone, video conference or similar means of remote communication.

¹¹ Item 407(d)(5)(ii) of Regulation S-K.

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

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

¹⁴ Commentary to §303A.07(a) of the NYSE Rules.

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

¹⁶ Commentary to §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.

¹⁷ §5605(c)(2)(A)(iii) of the NASDAQ Rules.

¹⁸ 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.

Each member of the Committee shall have one vote. One-third of the Committee members, but not less than two, shall constitute a quorum. The Committee shall be authorized to take any permitted action only by the affirmative vote of a majority of the Committee members at any meeting at which a quorum is present, or by the unanimous written consent of all of the Committee members.

The Committee shall maintain copies of minutes of each meeting of the Committee, and each written consent to action taken without a meeting, reflecting the actions so authorized or taken by the Committee. A copy of the minutes of each meeting and all consents shall be placed in the Company's minute book.

Delegation

The Committee may form and delegate authority to subcommittees consisting of one or more members when it deems appropriate, including the authority to grant pre-approvals of audit and permitted non-audit and tax services, provided that decisions of such subcommittee to grant pre-approvals and take any other actions shall be presented to the full Committee at its next scheduled meeting.¹⁹

External advisors

The Committee shall have the sole authority to obtain, at the Company's expense but at funding levels determined by the Committee, advice and assistance from outside legal, accounting or other advisors to assist with the execution of its duties and responsibilities as set forth in this Charter.²⁰ The Committee shall also have authority to obtain advice and assistance from any officer or employee of the Company and to require any officer or employee of the Company or the Company's outside counsel or Independent Auditor to attend a meeting of the Committee or to meet with any members of, or advisors to, the Committee. The Committee shall have full, unrestricted access to Company records.

Duties and responsibilities²¹

In furtherance of its purpose, the Committee shall:

1. Meet to review and discuss the annual audited financial statements and quarterly financial statements with management and the Independent Auditor, including the disclosures under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations."²² 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.²³
2. Discuss earnings press releases, as well as financial information and earnings guidance provided to analysts and ratings agencies.²⁴
3. Review reports to management prepared by the Independent Auditor or Internal Audit and any responses to the same by management.

¹⁹ Section 10A(i) of the Exchange Act.

²⁰ Rule 10A-3(b)(4)-(5) under the Exchange Act and §303A.07(b)(iii) of the NYSE Rules.

²¹ §303A.07(b)(iii) of the NYSE Rules and §5605(c)(3) of the NASDAQ Rules.

²² §303A.07(b)(iii)(B) of the NYSE Rules.

²³ §303A.07(b)(i)(B) of the NYSE Rules (referencing Item 407(d)(3)(i) of Regulation S-K).

²⁴ §303A.07(b)(iii)(C) of the NYSE Rules and commentary.

4. Be responsible for the appointment, compensation, retention, oversight of the work of, and termination of the Independent Auditor. The Committee shall also be responsible for the resolution of disagreements between management and the Independent Auditor regarding accounting and financial reporting. The Independent Auditor shall report directly to the Committee.²⁵
5. Pre-approve all audit and permitted non-audit and tax services to be provided to the Company by the Independent Auditor, subject to the de minimis exceptions for non-audit services which are approved by the Committee prior to the completion of the audit. The Committee may delegate to one or more of its members the authority to grant such pre-approvals, provided that any decisions of such member or members to grant pre-approvals must be presented to the full Committee at its next scheduled meeting.²⁶
6. 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; and (iv) all relationships between the Independent Auditor and the Company. 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.²⁷
7. Obtain and review annually, prior to the completion of the Independent Auditor's annual audit of the Company's year-end financial statements (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) all alternative treatments of financial information within generally accepted accounting principles for policies and procedures related to material items that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the Independent Auditor, 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.²⁸
8. Review and evaluate the lead audit partner of the Independent Auditor and assure the regular rotation of the lead audit partner, the concurring partner and other audit partners engaged in the Annual Audit, to the extent required by law.²⁹

²⁵ 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.

²⁶ Section 10A(i) of the Exchange Act.

²⁷ §303A.07(b)(iii)(A) of the NYSE Rules and §5605(c)(1)(B) of the NASDAQ Rules.

²⁸ Section 10A(k) of the Exchange Act and Rule 2-07 of Regulation S-X.

²⁹ Commentary to §303A.07(b)(iii)(A) of the NYSE Rules.

9. Obtain assurance from the Independent Auditor that the audit was conducted in a manner consistent with Section 10A of the Exchange Act.
10. Review the Company's financial reporting processes and internal controls, based on 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, and major issues as to the adequacy of the Company's internal controls and any special audit steps adopted in light of identified deficiencies.³⁰
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.³¹
12. Discuss with the Independent Auditor the Independent Auditor's judgment about the competence, performance and cooperation of Internal Audit and management.³²
13. Discuss with Internal Audit and management their views as to the competence, performance and independence of the Independent Auditor.³³
14. Review with the Independent Auditor any audit problems or difficulties and management's response thereto. The review should include discussion of the responsibilities, budget and staffing of Internal Audit.³⁴
15. Review with the Independent Auditor, Internal Audit and management the extent to which any previously-approved changes or improvements in financial or accounting practices and internal controls have been implemented.
16. [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 party transaction approval policy].]³⁵
17. Review annually the effect of legal, regulatory and accounting initiatives on the Company's financial statements.³⁶
18. Review annually the effect of off-balance sheet arrangements, if any, on the Company's financial statements.³⁷
19. Review and discuss with the Independent Auditor the matters required to be discussed by the applicable requirements of the Public Company Accounting Oversight Board regarding communications with audit committees.

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

³¹ PCAOB Auditing Standard No. 16 and commentary to §303A.07(b)(iii)(H) of the NYSE Rules.

³² Section 303A.07(b)(iii)(F) of the NYSE Rules and commentary.

³³ Commentary to §303A.07(b)(iii)(H) of the NYSE Rules.

³⁴ Section 303A.07(b)(iii)(F) of the NYSE Rules and commentary.

³⁵ §314 of the NYSE Rules. Alternatively, this responsibility can be given to the Company's Nominating and Corporate Governance Committee.

³⁶ General Commentary to §303A.07(b) of the NYSE Rules.

³⁷ General Commentary to §303A.07(b) of the NYSE Rules.

20. 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.³⁸
21. Set clear hiring policies for employees or former employees of the Independent Auditor and oversee the hiring of any personnel from the Independent Auditor into positions within the Company in accordance with the hiring restrictions of the Sarbanes-Oxley Act of 2002.³⁹
22. 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 any significant complaints received.⁴⁰
23. Meet separately, periodically, with management, with Internal Audit (or other Company personnel responsible for the internal audit function) and with the Independent Auditor.⁴¹
24. Review periodically with the Company's chief legal officer, or appropriate delegates, the Company's compliance with legal and regulatory requirements.⁴²
25. Prepare the report of the Committee required to be included in the Company's annual report or proxy statement.⁴³
26. Report regularly to the Board, both with respect to the activities of the Committee generally and with respect to any issues that arise regarding the quality or integrity of the Company's financial statements, the Company's compliance with legal and regulatory requirements, the performance and independence of the Independent Auditor or the performance of Internal Audit.⁴⁴
27. Conduct an annual performance evaluation of the Committee and its members, including a review of adherence to this Charter.⁴⁵
28. Review the adequacy of this Charter annually and recommend any proposed changes to the Board for approval.⁴⁶
29. Perform such other duties and responsibilities, consistent with 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, delegated to the Committee by the Board.

³⁸ §303A.07(b)(iii)(D) and commentary of the NYSE Rules.

³⁹ §303A.07(b)(iii)(G) of the NYSE Rules.

⁴⁰ 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.

⁴¹ §307A.07(b)(iii)(E) of the NYSE Rules.

⁴² §303A.07(b)(i)(A) and commentary to §303A.07(b)(iii)(H) of the NYSE Rules.

⁴³ §303A.07(b)(i)(B) of the NYSE Rules and Item 407(d)(3)(i) of Regulation S-K.

⁴⁴ §303A.07(b)(iii)(H) of the NYSE Rules and commentary.

⁴⁵ §303A.07(b)(ii) of the NYSE Rules.

⁴⁶ §5605(c)(1) of the NASDAQ Rules.

B

Sample audit committee meeting planner

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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 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 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	Discuss earnings press releases, set earnings guidance and determine what other financial information will be shared with analysts and rating agencies							

Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
5	Review management's process for performing its certifications under Sarbanes-Oxley Act Section 302							
6	Review management's certifications of quarterly and annual reports							
7	Review the effect of legal, regulatory and accounting initiatives on the Company's financial statements							
8	Review the effect of off-balance sheet arrangements, if any, on the Company's financial statements							
9	Recommend to the Board whether the annual financial statements should be included in the Company's Annual Report on Form 10-K							
Accounting policies & controls								
10	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							
11	Review the results of management's internal control assessment. Discuss any identified material weaknesses and deficiencies as well as management's remediation plans							
12	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							
13	Review any new accounting and financial reporting requirements							
14	Review any critical accounting policies and all material alternative accounting treatments that management discussed with the independent auditor							



Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
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 pre-clearance 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							
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 programs and controls							
21	Discuss any events, conditions or opportunities that could create a risk of fraud due to management overriding internal controls							

Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
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 party transactions¹								
23	Discuss the process for identifying related-party transactions							
24	Review and approve any transaction between the Company and any related person in accordance with the Company's related party 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							
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 culture and environment							
32	Discuss information systems matters							
33	Discuss tax matters							

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

Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
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 auditors								
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							
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, and (iv) all relationships between the independent auditor and the Company							

Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
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							
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							

Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
53	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							
54	Review other material written communications that the independent auditor discussed with management and any responses to the same by management							
55	Discuss and review any updates to the scope of the audit							
56	Understand areas of emphasis in the audit							
57	Pre-approve all audit and non-audit services (specifically pre-approve internal control-related services and receive certain disclosure, documentation and discussion of non-prohibited tax services from the independent auditor)							
58	Discuss the quality, not just the acceptability, of the accounting principles applied in the Company's financial reporting							
59	Discuss the independent auditor's observations related to the effectiveness of the Committee							
60	Discuss any significant deficiencies and material weaknesses in the Company's internal controls and the adequacy of management's plans for remediation							
61	Review disclosures related to material weaknesses, if any noted							
62	Discuss the independent auditor's judgment about the competence, performance and cooperation of the Company's internal audit department and management							

Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
63	Discuss the resolution of any disagreements between management and the independent auditor regarding accounting and financial reporting							
64	Discuss any identified or suspected fraud and other illegal acts involving senior management and other employees							
65	Consider areas that require special attention							
66	Set clear hiring policies for employees or former employees of the independent auditor within the hiring restrictions of the Sarbanes-Oxley Act of 2002							
67	Oversee the hiring of any personnel from the independent auditor into positions within the Company							
68	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 regarding communications with audit committees							
Internal auditor								
69	Hold executive session with the director of internal auditing							
70	Review responsibilities, communication procedures and performance expectations							
71	Review resources, expertise, the appropriateness of the internal audit department's staffing and the functional reporting of internal audit							
72	Review scope of internal audit plan for upcoming year, including responsibilities, budget and staffing							

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

Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
84	Review any personnel issues related to the Internal Audit Director (appointment, replacement, reassignment or dismissal)							
Whistle-blower procedures								
85	Establish procedures for (i) the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters and (iii) the confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters							
86	Review with management and internal audit department the above procedures and any significant complaints received							
87	Review any other complaints received regarding accounting and auditing matters							
Other audit committee matters and governance								
88	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)							
89	Appoint independent auditor							
90	Review Committee charter, with particular attention to recent developments in securities regulations and listing standards							
91	Recommend any proposed changes to Committee charter to the Board for approval							
92	Prepare and review annual proxy statement Committee report							
93	Evaluate Committee performance evaluation							

Item No.	A = Annually; Q = Quarterly; P = Periodically	Frequency			Period to be completed			
		A	Q	P	Q1	Q2	Q3	Q4
94	Evaluate the financial expertise of Committee members and identify financial experts							
95	Evaluate management's process for determining the continued independence of the independent auditor							
96	Evaluate any business relationships and independence of Committee members in relation to both the Company and the independent auditor							
97	Evaluate the processes and procedures in place for pre-approval of audit and non-audit services of the independent auditor							
98	Approve minutes of previous meeting							
99	Hold executive session of Committee members							
100	Plan and conduct orientation of new members and relevant continuing education for new and existing members of the Committee							
101	Develop succession plans for the Committee's chair and financial expert(s)							
102	Engage independent counsel and other advisors							
103	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							
104	Receive updates from the Company's attorneys on legal and regulatory matters, including any formal communications from regulatory bodies							
105	Approve Committee meeting planner for the upcoming year. Share expectations with management, the internal audit team and the independent auditors							



Sample audit committee evaluation form

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 evaluation form provided herein should not be used unless tailored for the specific corporation based on applicable law, regulation and listing rules as well as factors such as organizational structure and lines of business.

Explanatory note

Audit committee evaluation is a best practice that has gained considerable traction in the last 15 years, 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 of 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

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.

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 in 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.

Typical questions for audit committee self-evaluation:

- Is the audit committee fulfilling the duties set forth in its charter?
 - [Management should provide checklist.]
- Are committee meetings efficient and productive?
- Does the committee hold an adequate number of meetings during the year?
- Is the length of committee meetings appropriate?
- Are committee agendas set in a way that allows the committee to function effectively?
- Do committee members have adequate input into the preparation of agendas?
- Do committee members receive adequate background information prior to committee meetings?
- Are committee meeting times appropriately allocated between committee discussion and management presentation?
- Are committee meetings conducted in a manner and on a schedule that ensures open communication and meaningful participation?
- Do committee meetings include adequate opportunities for discussion?
- Does the committee reach timely resolution of issues?

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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 questionnaire 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 questionnaire will be discussed by the Committee and by the Board. All evaluation forms will be treated confidentially.

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.

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

For each statement listed below, 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.

Legend: 1 = Strongly disagree 2 = Disagree 3 = Neither agree nor disagree 4 = Agree
5 = Strongly agree n/a = Not applicable

		1	2	3	4	5	n/a
Charter role and responsibilities							
1	The Charter clearly and appropriately defines the Committee’s responsibilities						
2	Members understand their responsibilities as set forth in the Committee Charter						
3	The Committee is effective in fulfilling its responsibilities as defined in the Charter						
4	The Charter does not require any revisions at this time. (If you have suggested revisions for the Charter, please provide in comments below)						
Comments:							
Composition & leadership							
5	Committee size is appropriate						
6	The Committee (as a whole) reflects appropriate skills, experience, expertise and diversity						
7	Members are independent and objective						
8	The Committee chair is an effective leader						
9	The Committee considers succession in terms of Committee composition, leadership and financial expertise as appropriate						
Comments:							

1 2 3 4 5 n/a

External resources & advisers

10	The use and quality of, and funding for, external resources, including independent counsel and other advisers, is appropriate						
11	Relationships with key external resource providers are appropriate						
12	Members receive appropriate orientation and continuing education						
13	Please indicate if you would like additional education or information on the following topics:						
	a. Accounting developments						
	b. Auditing developments						
	c. Financial reporting developments						
	d. Business and industry issues						
	e. Compliance, ethics, conflicts and related person transactions						
	f. Internal controls and fraud protection						
	g. Risk oversight						
	h. Other _____						
14	The process the Committee uses to select advisers is appropriate						

Comments:

Committee culture

15	Members have developed a collegial atmosphere of trust and respect, and rely on one another as appropriate						
16	Meetings are conducted in a manner that fosters open and honest communication and debate, and efficient development of consensus						

Legend: 1 = Strongly disagree 2 = Disagree 3 = Neither agree nor disagree 4 = Agree 5 = Strongly agree n/a = Not applicable



		1	2	3	4	5	n/a
17	The Committee is effective in operating as a team						
18	Members maintain the confidentiality of Committee discussions and decisions as appropriate						
Comments:							
Information flow & communication							
19	The Committee has communicated its expectations about information flow with key members of the management team, and internal and independent auditors						
20	The Committee meets as appropriate with key members of the management team, and the internal and independent auditors, including in executive session						
Comments:							
Meetings							
21	The number and length of meetings is appropriate						
22	Members receive appropriate and timely agendas and materials to prepare in advance						
23	Members attend and prepare for meetings as appropriate						
24	Members spend appropriate time outside meetings on Committee responsibilities						
Comments:							

Legend: 1 = Strongly disagree 2 = Disagree 3 = Neither agree nor disagree 4 = Agree 5 = Strongly agree n/a = Not applicable

1 2 3 4 5 n/a

Risk assessment and risk management

25	The Committee has sufficient opportunity and information to review and discuss with management and the internal audit department the process by which management assesses and manages the Company's risk						
26	Please indicate if you would like additional information or education about any of the following types of risk:						
	a. Strategic risks (e.g., communication and investor relations, governance, major initiatives, market dynamics, mergers, acquisitions and divestitures, planning and resource allocation, reputational risk)						
	b. Operational risks (e.g., hazards, IT and cyber security, physical assets, sales and marketing)						
	c. Financial risks (e.g., accounting and reporting, capital structure, credit, liquidity, market, tax)						
	d. Compliance risks (e.g., code of conduct, legal, regulatory)						

Comments:

Internal relationships

27	Members have constructive relationships with members of management and internal audit						
28	The Committee is appropriately supportive and challenging of management						
29	Members understand and observe the difference between oversight and management						
30	The Committee provides appropriate attention to internal audit						

Comments:

Legend: 1 = Strongly disagree 2 = Disagree 3 = Neither agree nor disagree 4 = Agree 5 = Strongly agree n/a = Not applicable



1 2 3 4 5 n/a

Relationship with the independent auditors

31	The Committee has sufficient opportunity and information to monitor the independence and performance of the independent auditors						
32	The Committee has sufficient opportunity to discuss issues with the independent auditors						
33	The Committee receives adequate information from the independent auditors for its decision-making						
34	The Committee has established an appropriate relationship with the independent auditors						

Comments:

Oversight of the financial reporting process

35	The Committee has appropriate opportunity and information to review and discuss with management, members of the internal audit department and the independent auditors matters related to the following:						
	a. The Company's audit						
	b. The preparation and presentation of the financial statements						
	c. The adequacy and effectiveness of internal controls						
	d. Any concerns about deficiencies or weaknesses						
	e. The structure and content of the Company's financial reports						

Comments:

Legend: 1 = Strongly disagree 2 = Disagree 3 = Neither agree nor disagree 4 = Agree 5 = Strongly agree n/a = Not applicable

1	2	3	4	5	n/a
---	---	---	---	---	-----

Legal and ethical compliance

36	The Committee has appropriate opportunity and information to review and discuss with management and other advisers the overall tone for ethics and compliance and the policies and procedures that support the appropriate tone						
37	The Committee provides appropriate attention to its oversight of ethics and compliance						
38	The Committee receives timely updates on material legal and regulatory matters and on the functioning of its internal reporting procedures						

Comments:

Do you feel that there are any priority items that the Committee should focus on in the next year? If so, please list below:

Do you have any suggestions on how the Committee’s organization, performance or effectiveness can be improved? If so, please list below:

Legend: 1 = Strongly disagree 2 = Disagree 3 = Neither agree nor disagree 4 = Agree 5 = Strongly agree n/a = Not applicable



D

Sample audit and non-audit services pre-approval policy

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Audit and non-audit services pre-approval policy

I. Statement of principles

Under the Sarbanes-Oxley Act of 2002 (the “Act”), the Audit Committee of the Board of Directors of [_____] (the “Company”) is responsible for the appointment, compensation and oversight of the work of the Company’s independent auditor. As part of this responsibility, the Audit Committee is required to pre-approve the audit and non-audit services performed by the independent auditor to ensure that the provision of such services does not impair the auditor’s independence.

The Audit Committee has adopted this Audit and Non-Audit Services Pre-Approval Policy (the “Policy”), which sets forth the procedures and the conditions under which services proposed to be performed by the independent auditor must be pre-approved. The purpose of this Policy is to set forth the procedures by which the Audit Committee intends to fulfill its responsibilities regarding pre-approval. This Policy does not delegate the Audit Committee’s responsibilities to pre-approve services performed by the independent auditor to management.

Before the Company or any of its subsidiaries engages the independent auditor to render a service, the proposed services must be either: 1) pre-approved by the Audit Committee as a general category of service (“general pre-approval”); or 2) be pre-approved by the Audit Committee as a specific service (“specific pre-approval”). The Audit Committee believes that the combination of these two approaches in this Policy will result in an effective and efficient procedure to pre-approve services performed by the independent auditors. For both types of pre-approval, the Audit Committee will consider whether such services are consistent with the Securities and Exchange Commission (“SEC”) and Public Company Accounting Oversight Board

("PCAOB") rules on auditor independence. The Audit Committee will also be mindful of the relationship between fees for audit and non-audit services in deciding whether to pre-approve such services. The term of any pre-approval is 12 months from the date of pre-approval, unless the Audit Committee specifically provides for a different period.

The Audit Committee may delegate pre-approval authority to one or more of its members. [] will be designated as the member to whom such authority is delegated, and [he/she] must report, for information purposes only, any pre-approval decisions to the Audit Committee at or prior to its next scheduled meeting.

The Audit Committee shall review this Policy periodically and take additional measures on an annual basis to meet its responsibility to oversee the work of the independent auditors and to review the auditor's independence from the Company, such as reviewing a formal written statement from the independent auditor delineating all relationships between the independent auditor and the Company, consistent with applicable requirements, and discussing with the independent auditor its methods and procedures for ensuring independence.

II. Audit services

The Audit Committee must specifically pre-approve the terms of the independent auditor's annual audit and quarterly reviews of the Company's financial statement and the audit of internal controls as evidenced by a services engagement letter. The Audit Committee shall also approve any proposed significant changes in terms resulting from changes in audit scope, Company structure or other matters. It is the responsibility of management and the independent auditor to promptly inform the Audit Committee of any such proposed significant changes in terms.

In addition to the annual audit and quarterly review services engagement approved by the Audit Committee, the Audit Committee may grant general pre-approval for other audit services, which are those services that only the independent auditor reasonably can provide. The Audit Committee has granted general pre-approval to the audit services listed in **Appendix A**. Management shall promptly inform the Audit Committee whenever the independent auditor provides any of the services listed in **Appendix A**. It is also management's responsibility to track the actual fees incurred against the pre-approved limits set forth in **Appendix A** and promptly inform the Audit Committee upon the reasonable likelihood that such limits may be [materially] exceeded. All other audit services not listed in **Appendix A** or addressed in an engagement letter must be specifically pre-approved by the Audit Committee. It is the independent auditor's responsibility to seek such specific pre-approval.

III. Audit-related services

Audit-related services, including internal control-related services, are 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 and that are traditionally performed by the independent auditor. The Audit Committee believes that the provision of audit-related services does not impair the independence of the auditor and has granted general pre-approval to the audit-related services listed in **Appendix B**. Management shall promptly inform the Audit Committee whenever the independent auditor provides any

of the services listed in **Appendix B**. It is also management's responsibility to track the actual fees incurred against the pre-approved limits set forth in **Appendix B** and promptly inform the Audit Committee upon the reasonable likelihood that such limits may be [materially] exceeded. All other audit-related services not listed in **Appendix B**, including *all internal control-related services*, must be specifically pre-approved by the Audit Committee. It is the independent auditor's responsibility to seek such specific pre-approval.

IV. Tax services

The Audit Committee believes that the independent auditor can provide tax services to the Company, such as tax compliance, tax planning and tax advice, without impairing the auditor's independence. However, the Audit Committee will carefully scrutinize the retention of the independent auditor in connection with any tax-related transaction initially recommended by the independent auditor. The Audit Committee has granted general pre-approval to the tax services listed in **Appendix C**. Management shall promptly inform the Audit Committee whenever the independent auditor provides any of the services in **Appendix C**. It is also management's responsibility to track the actual fees incurred against the pre-approved limits set forth in **Appendix C** and promptly inform the Audit Committee upon the reasonable likelihood that such limits may be [materially] exceeded. All tax services not listed in **Appendix C** must be specifically pre-approved by the Audit Committee. It is the independent auditor's responsibility to seek such specific pre-approval.

V. All other services

The Audit Committee may grant pre-approval to those permissible non-audit services classified as other services that it believes will not impair the independence of the auditor, including those that are routine and recurring services. The Audit Committee will consider requests for specific approval of these other non-audit services on a case-by-case basis.

VI. Prohibited non-audit services

A list of the SEC's and PCAOB's prohibited non-audit services is attached to this Policy as **Exhibit 1**. The rules of the SEC and the PCAOB and relevant guidance shall be consulted to determine the precise definitions of these services and the applicability of exceptions to certain of the prohibitions.

VII. Pre-approval fee levels

The Audit Committee may consider the amount of fees as a factor in determining whether a proposed service would impair the auditor's independence. Where the Audit Committee has granted general pre-approval to an estimated fee for a service, the pre-approval applies to all services described in the approval. However, if the fee for any such service is expected to [materially] exceed the estimated amount, the Audit Committee must approve such excess amount prior to performance of the services. The Audit Committee expects that any request to provide services in excess of an estimated amount will include an explanation as to the reason for the overage. The Company's independent auditor will be informed of this policy.

VIII. Procedures

Requests to provide services that require specific pre-approval by the Audit Committee shall be submitted to the Audit Committee by both the independent auditor and the [Chief Financial Officer, Treasurer, Controller or other designated officer], and must include a joint statement as to whether, in their view, the request is consistent with the SEC's and PCAOB's rules on auditor independence. See **Exhibit 2** for a copy of the Company's specific pre-approval form.

List of appendices

Appendix A	Pre-Approved Audit Services
Appendix B	Pre-Approved Audit-Related Services
Appendix C	Pre-Approved Tax Services

List of exhibits

Exhibit 1	Prohibited Non-Audit Services
Exhibit 2	Specific Pre-Approval of Audit and Non-Audit Services Form

Appendix A

Pre-approved audit services for fiscal year 20[]

Service	Estimated fees
Services associated with SEC registration statements, periodic reports and other documents filed with the SEC or other documents issued in connection with securities offerings (e.g., comfort letters, consents) and assisting in responding to SEC comment letters	\$ _____
Statutory audits or financial audits for subsidiaries or affiliates of the Company	\$ _____
Consultations with the Company's management 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 ¹	\$ _____
Total pre-approved fees for 20[]	\$ _____

¹ Some consultations may be audit-related services rather than audit services, to be determined by the Audit Committee.

Appendix B

Pre-approved audit-related services for fiscal year 20[]

Service	Aggregate fees
Due diligence services related to acquisitions/dispositions	\$ _____
Consultations with the Company's management 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 ¹	\$ _____
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 pre-approved fees for 20[]	\$ _____

¹ Some consultations may be audit services rather than audit-related services, to be determined by the Audit Committee.



Appendix C

Pre-approved tax services for fiscal year 20[__]

Service	Aggregate fees
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, provided that the functionality is limited to preparation of tax returns ²	\$ _____
Total pre-approved fees for 20[__]	\$ _____

² Licensing or purchasing income tax preparation software is permitted so long as the functionality is limited to preparation of tax returns. If the software performs additional functions, each function must be evaluated separately for its potential effect on the auditor's independence.

Exhibit 1

Prohibited non-audit services

- 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*
- 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 (regardless of whether the Company or the officer 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 restriction 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 laws¹

* Provision of these non-audit services is permitted 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.²

¹ 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.

² Regulation S-X Section 210.2-01(c)(4).

Exhibit 2

Specific pre-approval of audit and non-audit services form

This form will be used by the Audit Committee of the Board of Directors to document specific pre-approval of any service performed by the independent auditor that has not already received general pre-approval in the Audit and Non-Audit Services Pre-Approval Policy. A designated member of the Audit Committee can approve the service and then report his or her decision to the other Audit Committee members.

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

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.



E

Sample whistle-blower policy

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 whistle-blower policy and procedures 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.

Whistle-blower policy and procedures

[COMPANY NAME] (together with its subsidiaries and affiliates, the “Company”) is committed to conducting business in accordance with the highest ethical standards and complying with all applicable securities laws and regulations, accounting standards, accounting controls and audit practices. In that regard, the Company is establishing procedures (these “Procedures”), which have been reviewed and approved by the Audit Committee of the Board of Directors of the Company, to ensure compliance with such standards and laws. In particular, the Procedures relate to (i) the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters or possible violations of the federal securities laws, and (ii) the confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters, as that term is used in these Procedures, or possible violations of the federal securities laws. The Company and the Audit Committee also want to ensure that any employee wishing to submit a report of the type contemplated in these Procedures shall be free to do so without fear of dismissal or retaliation.

As used in these Procedures, the term “questionable accounting or auditing matters” includes, without limitation, (i) fraud or deliberate error in the preparation, evaluation, review or audit of any financial statement of the Company, (ii) fraud or deliberate error in the recording and maintaining of financial records of the Company, (iii) deficiencies in or noncompliance with the Company’s internal accounting controls, (iv) misrepresentation or false statements to or by a senior officer or accountant regarding a matter contained in the Company’s financial records, financial reports or audit reports or (v) deviation from full and fair reporting of the Company’s financial condition.

1. **General; Filing Reports.** Any person may submit a good faith report of suspected questionable accounting or auditing matters or possible violations of the federal securities laws related to the Company. Any such allegations may be based on first-hand, direct information, or on other information from any source that the reporting person reasonably believes to be credible. As described herein, any person wishing to make such a report may choose (i) the form of the report, (ii) the designated person to whom such report may be submitted and (iii) the manner in which the report may be submitted:
- **Form of Report.** A report of the type contemplated by these Procedures may be submitted orally or in writing, and may be submitted in person, by courier, or electronically (by telephone, voicemail or email) or by any other means reasonably likely to result in direct delivery of such report to a person designated under these Procedures to receive such a report.
 - **To Whom Submitted.** A report may be submitted to the Company’s (i) ethics hotline, [(ii) web submission system,] [(ii)] Audit Committee (or its designee) or [(iii)] any of the officers whose contact information is set forth on **Exhibit A**. Contact information for the Audit Committee Chair is also set forth on **Exhibit A**. The Company’s ethics hotline can be accessed 24 hours a day, 7 days a week by telephone at [_____] or through the hotline website at [_____]. The third-party ethics hotline provider will route all reports received directly to the Chair of the Audit Committee, the Company’s General Counsel [and the Company’s Director of Internal Audit]¹. [The Company’s confidential, anonymous web submission system can be accessed at www.____.com.]

These Procedures are designed to complement normal communication channels between supervisors and employees. Employees are encouraged to continue to raise appropriate matters with their supervisors at any time. As an alternative, employees may submit information relating to misconduct in accordance with these Procedures.

Any person who receives a report under these Procedures that appears not to have been submitted directly to the Audit Committee shall promptly make the report or a summary of the report prepared in accordance with these Procedures available to the Chair of the Audit Committee.

- **Confidentiality of Submission.** A report may be submitted by any of the means described above (i) in the name of the party submitting the report without any limitation, (ii) in the name of the party submitting the report with a request for confidential treatment or (iii) anonymously. A request for confidential treatment means that the name of the party submitting the report will be revealed only to the person to whom the report has been submitted, to the members of the Audit Committee and to such other persons as the party receiving the report and the Audit Committee reasonably determine is advisable in order to carry out an appropriate and adequate evaluation or investigation of the matters described in the report. If a report is made anonymously, it would be a violation of these Procedures and any other applicable Company policy for the protection of whistle-blowers for any employee to seek to determine the identity of the party making

¹ Delete if Company procedures do not anticipate the Director of Internal Audit receiving hotline reports.

the anonymous submission or, upon learning through any means the identity of the party making the anonymous submission, to divulge such information to any other party. Parties are cautioned that transmission of information by way of regular email systems typically reveals the identification of the sender, and that email services provided by the Company may be reviewed by Company personnel periodically to ensure compliance with the Company's [NAME OF EMAIL/INTERNET USAGE POLICY]. As a result, submitting a report of the type contemplated by these Procedures by way of the Company's (or any other) regular email system may not be an effective means for submitting either a confidential or an anonymous report. [The Company has established, as part of its ongoing compliance program, a compliance hotline email address referenced above to which persons may submit a report anonymously and that does not reveal the identity of the sender.]² In considering the manner of submitting any report under these Procedures, employees should also take into account the matters described under the heading "Handling of Reports – Notification of Others" under Paragraph 2.

2. **Handling of Reports.** The following steps shall be taken with respect to each report received:

- **Preservation.** Any person designated under these Procedures to receive a report and who receives a report in any written form (including by email) will take appropriate steps to ensure that a paper or electronic copy of the report is preserved, as the case may be. Any person designated to receive a report who receives a report by voicemail shall take appropriate steps to cause an accurate transcription to be made and to ensure that a paper copy of the transcription is preserved. Any person designated to receive a report who receives an oral report shall promptly prepare a reasonable summary of the report and shall take appropriate steps to ensure that a paper copy of the summary is preserved.
- **Response to Reporting Party.** Upon receipt of a report, the party to whom the report has been submitted will, unless the report has been submitted anonymously, promptly acknowledge receipt of the report from the sender in writing.
- **Audit Committee Review.** Upon receipt of a report of the type contemplated by these Procedures, the Audit Committee (or its designee) will be responsible for overseeing and directing the evaluation of the report. Such evaluation may be made independently of Company management if the Audit Committee so chooses under the circumstances. Any review and evaluation of a report will include consideration of whether the matters described in the report pertain to questionable accounting or auditing matters or possible violations of the federal securities laws, the merits of the report and whether further review and/or investigation is warranted. The Audit Committee (or its designee) shall have the authority to utilize the services of any Company personnel or retain (at the Company's expense) any third-party consultants and/or advisors it deems appropriate under the circumstances to assist in its evaluation. Any decision by the Audit Committee to review or investigate any matter brought to its attention as a result of these Procedures will not in any way be, or be deemed to be, a determination by the Audit Committee or the Company that any actions or inactions that are the subject of the

² Delete if inapplicable.

- report have, in fact, occurred or constitute questionable accounting or auditing matters or possible violations of the federal securities laws. The Audit Committee (or its designee) will maintain a log of all reports of the type contemplated by these Procedures that are submitted and the status of any such reports, and the Audit Committee will establish and maintain regular procedures to review (no less frequently than quarterly) the status of reports received.
 - **Conduct of Investigations.** If the Audit Committee (or its designee) determines that further review or investigation of the matters raised in a report would be appropriate under the circumstances, the Audit Committee (or its designee) will promptly notify those parties the Audit Committee deems appropriate, promptly have such a review or investigation undertaken and authorize the retention (at the Company’s expense) of any third-party consultants and/or advisors it deems appropriate. At the conclusion of such review and/or investigation, the Audit Committee will determine by majority vote what, if any, remedial action is appropriate. The Audit Committee will consult with and coordinate with the full Board of Directors as the Audit Committee deems appropriate. All officers, directors, employees and agents of the Company have an obligation to cooperate and comply with any review or investigation initiated by the Audit Committee pursuant to these Procedures.
 - **Delegation.** The Audit Committee may delegate the responsibility to oversee, evaluate and investigate reports to one of its members[, to the Director of Internal Audit who is independent of Company management and reports to the Chair of the Audit Committee]¹ or to any other designee as it deems appropriate. Such designee will provide a status update of reports received at Audit Committee meetings (no less frequently than quarterly).
 - **Notification of Others.** At any time during a review and/or investigation of a report, the Chair of the Audit Committee [or the Company’s General Counsel] may notify the Company’s Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, General Counsel, Chief Compliance Officer, Director of Internal Audit, directors or outside auditors of the receipt of a report and/or the progress or results of any review and/or investigation of the report and will provide such level of detail as may be necessary to allow for appropriate consideration by such parties of the Company’s ongoing disclosure obligations, including with regard to any required officer certifications. The Audit Committee [or the Company’s General Counsel] may also disclose the misconduct described in a report to the Securities and Exchange Commission (the “SEC”) or other governmental authority as it deems appropriate.
3. **Non-Retaliation.** Neither the Company nor any officer, director, employee, contractor, subcontractor or agent of the Company will discharge, demote, suspend, threaten, harass or in any manner discriminate against any employee with regard to his or her employment

¹ Delete if inapplicable.

(a) based upon any lawful action of that employee of the type contemplated by these Procedures, Section 806 or Section 1107 of the Sarbanes-Oxley Act of 2002 or Section 922(a) or Section 748 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, (b) because the employee has provided information to, or assisted in an investigation by (i) supervisory personnel of the Company, (ii) any federal regulatory or law enforcement agency or (iii) any member or committee of the Congress, regarding the activities the employee reasonably believes are a violation of federal fraud laws or any rule or regulation of the SEC, or (c) because the employee filed, testified, participated in or otherwise assisted in a proceeding that has been filed or is about to be filed relating to alleged fraudulent activities or violations of SEC rules and regulations. The Company further hereby prohibits its officers, directors, employees, contractors, subcontractors and agents from taking any such retaliatory action. For the Company to implement this policy effectively, it is critical that all employees and other persons respond to and report any concerns of retaliatory behavior. If an employee or other person believes that he or she has been subject to retaliation because he or she has taken any of the actions referenced above, or an employee or other person is aware that any such retaliation may have been made against any other employee, the employee or other person should report such conduct to the persons designated to receive a report under these Procedures or to a member of the Company's Human Resources Department.

The Company will review promptly any complaint of retaliatory or other similar behavior. Complaints and investigations will be handled in a confidential manner, consistent with any corrective action that needs to be taken by the Company. Employees should note that they personally may be subject to criminal liability if they retaliate against a person because such person provided truthful information to law enforcement officials regarding the commission or possible commission of a federal offense.

4. **Destruction of Documents and Other Items.** Employees should be mindful of the Company's document retention policy and retain documents or other items that relate to any investigation or other official proceeding that is pending with a government department or agency. If an employee receives a request concerning the alteration, concealment or destruction of a document that the employee believes is improper, the employee is entitled to and should contact his or her supervisor if appropriate or any of the other persons who are designated to receive reports under these Procedures.
5. **Questions.** Employees are strongly encouraged to raise concerns they may have regarding any suspected violations of the standards contained in these Procedures. If you have a question about any aspect of these Procedures, you may submit it directly or through an intermediary to the Company's General Counsel[or Director of Internal Audit/Chief Compliance Officer]². All such inquiries will be treated confidentially.

Adopted by the Audit Committee in [_____]

² Delete if inapplicable.

Contact Information¹

Chief executive officer

[Name]

[Title]

[Company name]

[Street address]

[Telephone number]

[Email address]

Chief operating officer

[Name]

[Title]

[Company name]

[Street address]

[Telephone number]

[Email address]

Chief financial officer

[Name]

[Title]

[Company name]

[Street address]

[Telephone number]

[Email address]

¹ Clients may choose to limit this list of officers, such as only listing the General Counsel and Chief Compliance Officer.

General counsel

[Name]

[Title]

[Company name]

[Street address]

[Telephone number]

[Email address]

Chief compliance officer

[Name]

[Title]

[Company name]

[Street address]

[Telephone number]

[Email address]

Director of internal audit

[Name]

[Title]

[Company name]

[Street address]

[Telephone number]

[Email address]

Audit committee chair

[Name]

[Title]

[Company name]

[Street address]

[Telephone number]

[Email address]

F

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 time frame 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., 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.

G

CAQ's external auditor assessment tool: A reference for U.S. audit committees

The following sample external auditor assessment tool is provided courtesy of the Center for Audit Quality, in collaboration with the Association of Audit Committee Members, Inc., Independent Directors Council, Mutual Fund Directors Forum, National Association of Corporate Directors, NYSE Governance Services, and Tapestry Networks. Together, these groups comprise the Audit Committee Collaboration. (For more information and resources from the Collaboration, visit www.auditcommitteecollaboration.org.)

Introduction

Among other important duties, audit committees of U.S. public companies and registered investment companies have direct responsibility to oversee the integrity of a company's financial statements and to hire, compensate, and oversee the external auditor. Public focus on how audit committees discharge their responsibilities, including their oversight of the external auditor, has increased significantly.

Audit committees should regularly (at least annually) evaluate the external auditor in fulfilling their duty to make an informed recommendation to the board whether to retain the auditor. The evaluation should encompass an assessment of the qualifications and performance of the auditor; the quality and candor of the auditor's communications with the audit committee and the company; and the auditor's independence, objectivity, and professional skepticism.

To this end, the assessment questionnaire included in this tool can be used by audit committees to inform their evaluation of the auditor (i.e., the audit firm, as well as the lead audit engagement partner, audit team, and engagement quality reviewer). The sample questions highlight some of the more important areas for consideration; they are not intended to cover all areas that might be relevant to a particular audit committee's evaluation of its auditor, nor do they suggest a "one-size-fits-all" approach. Moreover, this assessment tool is not meant to provide a summary of legal or regulatory requirements for audit committees or auditors. An overview of portions of the relevant standards on required auditor communications with the audit committee (Appendix I) and sources of additional information on hiring and evaluating the auditor (Appendix II) are included at the end of this document.

Assessment process

The auditor assessment should draw upon the audit committee's experience with the auditor during the current engagement (presentations; reports; dialogue during formal meetings, ad hoc meetings, and executive sessions), and should be informed by prior-year evaluations, as applicable. It is appropriate to obtain observations on the auditor from others within the company, including management and internal audit, accompanied by discussions with other key managers. A suggested survey for obtaining observations from others within the company follows the assessment questionnaire. In assessing information obtained from management, the audit committee should be sensitive to the need for the auditor to be objective and skeptical while still maintaining an effective and open relationship. Accordingly, audit committees should be alert to whether management displays a strong preference for or a strong opposition to the auditor—and follow up as appropriate.

It makes good sense for audit committee members to continuously evaluate, through formal and informal assessments, the auditor's performance throughout the audit process. Formal assessments can include an evaluation of the auditor's skepticism in evaluating unusual transactions and responsiveness to issues. Informal assessments can be made based on private meetings between the audit committee chair and the lead audit engagement partner, which can help build a constructive and mutually respectful working relationship between the audit committee and the auditor. These contemporaneous assessments provide important input into the annual assessment. Audit committees may wish to consider those contemporaneous observations during a more formal assessment process, perhaps by using a questionnaire or guide, such as the one included in this tool. To ensure that all views are considered, audit committees may wish to finalize their assessment during group discussions (as opposed to collecting audit committee member comments separately) during formal committee meetings or conference calls.

Other sources of input into the audit committee's assessment of the external auditor include reviews of regulator inspection reports and peer review findings. Audit committees can also request input from the audit firm itself on its performance through reporting as to how an audit firm's management and operations support the performance of high-quality audits.

Finally, the audit committee should consider advising shareholders that they perform an annual evaluation of the auditor. The audit committee should also explain its process, scope of the assessment, and factors considered in selecting or recommending the audit firm, or assessing its performance.¹

¹Through *Enhancing the Audit Committee Report: A Call to Action*, the Audit Committee Collaboration encouraged public company audit committees to voluntarily and proactively improve their public disclosures to more effectively convey to investors and others the critical aspects of the important work that they currently perform, including the oversight of the external auditor. Please see Appendix II for more information on the *Call to Action* and other important resources.

Quality of services and sufficiency of resources provided by the auditor: Part I

The audit committee's evaluation of the auditor begins with an examination of the quality of the services provided by the engagement team during the audit and throughout the financial reporting year. Because audit quality largely depends on the individuals who conduct the audit, the audit committee should assess whether the primary members of the audit engagement team demonstrated the skills and experience necessary to address the company's areas of greatest financial reporting risk and had access to appropriate specialists and/or national office resources during the audit. The engagement team should have provided a sound risk assessment at the outset of the audit, including an assessment of fraud risk. During the engagement, the auditor should have demonstrated a good understanding of the company's business, industry, and the impact of the economic environment on the company. Moreover, the auditor should have identified and responded to any auditing and accounting issues that arose from changes in the company or its industry or changes in applicable accounting and auditing requirements. Another consideration for the audit committee is the quality of the engagement teams that perform portions of the audit in various domestic locations or in other countries by the audit firm's global network or by other audit firms.

Sample question sets	Observations
1. Did the lead audit engagement partner and audit team have the necessary knowledge and skills (company-specific, industry, accounting, auditing) to meet the company's audit requirements? Were the right resources dedicated to the audit? Did the auditor seek feedback on the quality of the services provided? How did the auditor respond to feedback? Was the lead audit engagement partner accessible to the audit committee and company management? Did he/she devote sufficient attention and leadership to the audit?	
2. Did the lead audit engagement partner discuss the audit plan and how it addressed company/industry-specific areas of accounting and audit risk (including fraud risk) with the audit committee? Did the lead audit engagement partner identify the appropriate risks in planning the audit? Did the lead audit engagement partner discuss any risks of fraud in the financial statement that were factored into the audit plan? Did the lead audit engagement partner express his or her intent to perform detailed substantive testing?	

Sample question sets	Observations
<p>3. If portions of the audit were performed by other teams in various domestic locations, or in other countries by the audit firm’s global network or other audit firms, did the lead audit engagement partner provide information about the technical skills, experience, and professional objectivity of those auditors? Did the lead audit engagement partner explain how he/she exercises quality control over those auditors? Did the lead audit engagement partner and/or team provide information on significant interactions between his/her team and those auditors?</p>	
<p>4. If applicable, has the audit firm sufficiently explained how the changes or rotations of lead audit engagement partner or senior engagement team personnel would be handled and managed (including maintaining independence and monitoring compliance with relevant requirements)?</p>	
<p>5. During the audit, did the auditor meet the agreed-upon performance criteria as reflected in the engagement letter and audit scope? Did the auditor adjust the audit plan to respond to changing risks and circumstances? Did the audit committee understand the changes and agree that they were appropriate?</p>	
<p>6. Did the lead audit engagement partner advise the audit committee of the results of consultations with the audit firm’s national professional practice office or other technical resources on accounting or auditing matters? Were such consultations executed in a timely and transparent manner?</p>	

Quality of services and sufficiency of resources provided by the auditor: Part II

Broader but nevertheless important considerations are (1) whether the audit firm has the relevant industry expertise, as well as the geographical reach necessary to continue to serve the company and (2) whether the engagement team effectively uses those resources. Other firmwide questions include the results of the audit firm's most recent inspection report by the Public Company Accounting Oversight Board (PCAOB), including whether the company's audit had been inspected and, if so, whether the PCAOB made comments on the quality or results of the audit. The audit committee also may want to know how the firm plans to respond to PCAOB comments contained in the inspection report, more generally, and to any internal findings regarding the audit firm's quality control program.

Sample question sets	Observations
<p>7. If the company's audit was subject to inspection by the PCAOB or other regulators, did the auditor advise the audit committee of the selection of the audit, findings, and the impact, if any, on the audit results in a timely manner? Did the auditor communicate the results of the firm's inspection more generally, such as findings regarding companies in similar industries with similar accounting/audit issues that may be pertinent to the company? Did the audit or explain how the firm planned to respond to the inspection findings and to internal findings regarding its quality control program?</p>	
<p>8. Does the audit firm have the necessary industry experience, specialized expertise in the company's critical accounting policies, and geographical reach required to continue to serve the company?</p>	
<p>9. Did the audit engagement team have sufficient access to specialized expertise during the audit? Were additional and appropriate resources dedicated to the audit as necessary to complete the audit work in a timely manner?</p>	
<p>10. Was the cost of the audit reasonable and sufficient for the size, complexity, and risks of the company? Were the reasons for any changes to cost (e.g., change in scope of work) communicated to the audit committee? Did the audit committee agree with the reasons?</p>	

Communication and interaction with the auditor

Frequent and open communication between the audit committee and the auditor is essential for the audit committee to obtain the information it needs to fulfill its responsibilities to oversee the company's financial reporting processes. The quality of communications also provides opportunities to assess the auditor's performance. In addition to communicating with the audit committee as significant issues arise, the auditor should also meet with the audit committee on a frequent enough basis to ensure the audit committee has a complete understanding of the stages of the audit cycle (e.g., planning, completion of final procedures, and, if applicable, completion of interim procedures). Such communications should focus on the key accounting or auditing issues that, in the auditor's judgment, give rise to a greater risk of material misstatement of the financial statements, as well as any questions or concerns of the audit committee.

PCAOB standards, SEC rules, and stock exchange listing requirements identify a number of matters the auditor must discuss with the audit committee. Audit committees should be familiar with those requirements and consider not only whether the auditor made all of the required communications, but, importantly, the level of openness and quality of these communications, whether held with management present or in executive session.

Sample question sets	Observations
11. Did the lead audit engagement partner maintain a professional and open dialogue with the audit committee and audit committee chair? Were discussions frank and complete? Was the lead audit engagement partner able to explain accounting and auditing issues in an understandable manner?	
12. Did the auditor adequately discuss the quality of the company's financial reporting, including the reasonableness of accounting estimates and judgments? Did the auditor discuss how the company's accounting policies compare with industry trends and leading practices?	
13. In executive sessions, did the auditor discuss sensitive issues candidly and professionally (e.g., his/her views on, including any concerns about, management's reporting processes; internal control over financial reporting (e.g., internal whistle-blower policy); the quality of the company's financial management team)? Did the lead audit engagement partner promptly alert the audit committee if he/she did not receive sufficient cooperation?	
14. Did the auditor inform the audit committee of current developments in accounting principles and auditing standards relevant to the company's financial statements and the potential impact on the audit?	

Auditor independence, objectivity, and professional skepticism

The auditor must be independent of the issuer and—in the case of mutual funds—independent of the investment of the investment company. Audit committees should be familiar with the statutory and regulatory independence requirements for auditors, including requirements that the auditor advise the audit committee of any services or relationships that reasonably can be thought to bear on the firm’s independence, and evaluate the auditor in light of those requirements.

The technical competence of the auditor alone is not sufficient to ensure a high-quality audit. The auditor also must exercise a high level of objectivity and professional skepticism. The audit committee’s interactions with the auditor during the audit provide opportunities to evaluate whether the auditor demonstrates integrity, objectivity, and professional skepticism. For example, the use of estimates and judgments in the financial statements and related disclosures (e.g., fair value, impairment) continues to be an important component of financial reporting. The auditor must be able to evaluate the methods and assumptions used and to challenge, where necessary, management’s assumptions and application of accounting policies, including the completeness and transparency of the related disclosures.

An important part of evaluating the auditor’s objectivity and professional skepticism is for the audit committee to gauge the frankness and informative nature of responses to open-ended questions put to the lead audit engagement partner (and members of the audit engagement team as appropriate). Examples of appropriate topics include the financial reporting challenges posed by the company’s business model, the quality of the financial management team, the robustness of the internal control environment, changes in accounting methods or key assumptions underlying critical estimates, and the range of accounting issues discussed with management during the audit (including alternative accounting treatments where the auditor and management differed with respect to those treatments). The auditor also should be able to clearly articulate the processes followed and summarize the evidence used to evaluate management’s significant estimates and judgments, and to form an opinion whether the financial statements, taken as a whole, were fairly presented in accordance with generally accepted accounting principles (GAAP).

Sample question sets	Observations
15. Did the audit firm report to the audit committee all matters that might reasonably be thought to bear on the audit firm’s independence, including exceptions to its compliance with independence requirements? Did the audit firm discuss safeguards in place to detect independence issues?	
16. Were there any significant differences in views between management and the auditor? If so, did the auditor present a clear point of view on accounting issues where management’s initial perspective differed? Was the process of reconciling views achieved in a timely and professional manner?	

Sample question sets	Observations
17. If the auditor is placing reliance on management and internal audit testing, did the audit committee agree with the extent of such reliance? Were there any significant differences in views between the internal auditors and the auditor? If so, were they resolved in a professional manner?	
18. In obtaining preapproval from the audit committee for all nonaudit services, did the lead audit engagement partner discuss safeguards in place to protect the independence, objectivity, and professional skepticism of the auditor?	

Obtaining input from company personnel about the external auditor

Because you have substantial contact with the external auditor throughout the year, the audit committee is interested in your views on the quality of service provided, and the independence, objectivity, and professional skepticism demonstrated throughout the engagement by the external audit team and firm.

Please rate the auditor's performance on each of the following attributes using a five-point scale, where **5 = Very High/Completely Satisfied** and **1 = Very Low/Completely Dissatisfied**.

Quality of services provide by the external auditor	Rating
1. Meets commitments (e.g., by meeting agreed-upon performance delivery dates, being available and accessible to management and the audit committee).	
2. Is responsive and communicative (e.g., by soliciting input relative to business risks or issues that might impact the audit plan, identifying and resolving issues in a timely fashion, and adapting to changing risks quickly).	
3. Proactively identifies opportunities and risks (e.g., by anticipating and providing insights and approaches for potential business issues, bringing appropriate expertise to bear, and by identifying meaningful alternatives and discussing their impacts).	
4. Delivers value for money (e.g., by charging fees that fairly reflect the cost of the services provided and being thoughtful about ways to achieve a cost-effective quality audit).	

Sufficiency of audit firm and network resources	Rating
5. Is technically competent and able to translate knowledge into practice (e.g., by delivering quality services within the scope of the engagement, using technical knowledge and independent judgment to provide realistic analysis of issues, and providing appropriate levels of competence across the team).	
6. Understands our business and our industry (e.g., by demonstrating an understanding of our specific business risks, processes, systems, and operations, by sharing relevant industry experience and by providing access to firm experts on industry and technical matters).	
7. Assigned sufficient resources to complete work in a timely manner (e.g., by providing access to specialized expertise during the audit and assigning additional resources to the audit as necessary to complete work in a timely manner).	

Communication and interaction	Rating
8. Communicates effectively (e.g., by maintaining appropriate levels of contact/dialogue throughout the year, effectively communicating verbally and in writing, being constructive and respectful in all interactions, and providing timely and informative communications about accounting and other relevant developments).	
9. Communicates about matters affecting the audit firm or its reputation (e.g., by advising us on significant matters pertaining to the audit firm while respecting the confidentiality of other clients' information, and complying with professional standards and legal requirements, including informing us when the company's audit is subject to inspection by the PCAOB or other regulatory review and sharing the results of the review that are pertinent to the company's accounting or auditing issues).	

Appendix I: Relevant U.S. requirements and standards

Prohibited non-audit services

There are nine statutory categories of nonaudit services that may not be provided to companies by the external auditors (Section 10A (g) to the Securities Exchange Act of 1934). For investment companies, these nonaudit services may not be provided to any company in the investment company complex (as defined in 210.2-01(f)(14)):

- Bookkeeping or other services related to the accounting records or financial statements of the audit client
- Financial information systems design and implementation
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
- Actuarial services
- Internal audit outsourcing services
- Management functions or human resources
- Broker or dealer, investment adviser, or investment banking services
- Legal services and expert services unrelated to the audit
- Any other service that the PCAOB determines, by regulation, is impermissible.

Audit committees must preapprove the provision of all other nonaudit services by the auditor.

Overview of auditor communications with audit committees

SEC Rule 2-07 requires the auditor to communicate the following to the audit committee prior to the filing of the company's Form 10-K. For investment companies that file Form N-CSR, these communications must take place annually, except that if the annual communication takes place more than 90 days prior to the filing, the auditor must provide an update describing any changes to the previously reported information.

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

PCAOB Auditing Standard No. 16 (AS 16), Communications with Audit Committees, replaces AU 380 for audits of issuers for fiscal years beginning on or after December 15, 2012. The standard requires the following communications with the audit committee:

- The independent auditor's responsibilities in relation to the audit under the standards of the PCAOB; as part of establishing an understanding with the audit committee on the terms of the engagement; preferably through a written communication (i.e., engagement letter). Also requires communication of major issues discussed with management prior to the initial selection or retention as auditors
- Whether the audit committee is aware of any matters relevant to the audit, particularly any violations of laws or regulations. Also requires the auditor to communicate the overall audit strategy, timing of the audit, and significant risks, including the participation of others in the audit (i.e., specialists, firms beside the principal auditor, etc.)
- The following with respect to the entity's accounting policies and practices, estimates, and significant unusual transactions and the auditor's evaluation of the quality of a company's financial reporting:
 - Significant accounting policies and practices – Management's initial selection of, or changes in the current period; the effect on financial statements or disclosures for policies that are considered controversial, there is a lack of guidance, or diversity in practice; and the auditor's qualitative assessment of such policies and practices. Specifically, the quality, not just the acceptability, of the company's accounting principles as applied in its financial reporting and disclosures, including situations in which the auditor identified

bias in management's judgments and the auditor's evaluation of the differences between (i) estimates best supported by the audit evidence and (ii) estimates included in the financial statements which are individually reasonable, that indicate a possible bias on the part of company management

- Critical accounting policies and practices – The reasons such policies and practices are considered critical; how current and anticipated events could affect this determination; and the auditor's assessment of related management disclosures
 - Critical accounting estimates – A description of the process used to develop such estimates; management's significant assumptions in the estimates that have a high degree of subjectivity; any significant changes in management's process to develop an estimate; and the auditor's conclusion as to the reasonableness of such estimates
 - Significant unusual transactions – Significant transactions outside the normal course of business or that are unusual due to timing, size, or nature and the auditor's understanding for the business rationale of such transactions
 - Financial statement presentation – The evaluation of whether the financial statements and related disclosures are presented fairly in accordance with the applicable financial reporting framework
 - New accounting pronouncements – Any concern identified by the auditor related to management's application of pronouncements that have been issued but are not yet effective in relation to future periods
 - Alternative accounting treatments – All alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative disclosures and treatments and the treatment preferred by the auditor.
- Other communications from the auditor include:
- Other information – The auditor's responsibility with respect to and results of audit procedures performed on other information accompanying the audited financial statements
 - Difficult or contentious matters for which the auditor consulted
 - Management consultation with other accountants
 - Going concern – Whether the auditor believes there is i) substantial doubt including related events or conditions; ii) substantial doubt has been alleviated due to management's plan; iii) substantial doubt remains despite management's plans; and iv) related effect on the financial statements
 - Corrected and uncorrected misstatements and omitted disclosures – Requires the auditor to provide the audit committee with a written schedule of uncorrected misstatements that was provided to management. Also requires communication for the basis of whether i) uncorrected misstatements were immaterial, including qualitative assessment;

- ii) uncorrected misstatements or underlying matters could potentially cause future-period financial statements to be materially misstated; and iii) corrected misstatements other than those deemed trivial, that might not have been detected other than through the audit procedures
- Disagreements with management, whether or not satisfactorily resolved that individually or in the aggregate could be significant to the entity’s financial statements or the audit report
- Significant difficulties encountered with management in performing the audit.

PCAOB standards require the independent auditor to communicate all material weaknesses and significant deficiencies identified during the audit to the audit committee. If the independent auditor concludes that the audit committee’s oversight of the company’s external financial reporting and internal control over financial reporting is ineffective, the auditor is required to inform the board of directors.

PCAOB rules also require at least an annual written statement delineating all relationships between the independent auditor and the company, including individuals in financial reporting oversight roles at the company that reasonably can be thought to bear on independence.

New York Stock Exchange Rule 303A.07(b), from its Listed Company Manual, requires audit committees to have a written charter that sets forth the committee’s purpose, including, at a minimum, certain provisions of SEC rule 10A-3(b) (2), (3), (4), and (5), as well as other specific duties and responsibilities, to assist board oversight of the integrity of the company’s financial statements, and the independent auditor’s qualifications, independence, and performance. Pertinent to auditor oversight, the rule includes the following audit committee requirements:

- Obtain and review at least annually a report by the independent auditor which describes the firm’s internal quality-control procedures; any material issues raised by the 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 five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues; and (to assess the auditor’s independence) all relationships between the independent auditor and the listed company;
- Meet to review and discuss the listed company’s annual audited financial statements and quarterly financial statements with management and the independent auditor, including reviewing the listed company’s i) specific disclosures under “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and ii) policies with respect to risk assessment and risk management, the company’s earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies

- Meet separately, periodically, with management, with internal auditors (or other personnel responsible for the internal audit function) and with independent auditors
- Review with the independent auditor any audit problems or difficulties and management’s response
- Set clear hiring policies for employees or former employees of the independent auditors
- Report regularly to the board of directors.

Commentary to the rule pertinent to the assessment of the independent auditor further provides that after reviewing the auditor’s quality control report and the auditor’s work throughout the year, the audit committee will be in a position to evaluate the auditor’s qualifications, performance, and independence (including a review and evaluation of the lead partner) taking into account the opinions of management and the company’s internal auditors. The commentary further provides that, in addition to assuring the regular rotation of the lead audit partner as required by law, the audit committee should consider whether, in order to assure continuing auditor independence, there should be regular rotation of the audit firm itself. Finally, audit committees are instructed to present their conclusions to the full board of directors.

Appendix II: Resources and suggested reading

Deloitte & Touche LLP. *Audit Committee Resource Guide*. February 2015.

KPMG's Audit Committee Institute. *2015 Global Audit Committee Survey*. 2015.

EY Center for Board Matters. *Staying on Course: A Guide for Audit Committees*. 2014.

National Association of Corporate Directors, Corporate Board Member/NYSE Euronext, Tapestry Networks, the Directors' Council, the Association of Audit Committee Members, Inc., and the Center for Audit Quality. *Enhancing the Audit Committee Report: A Call to Action*. 2013.

Frederick D Lipman, Barry H Genkin, Yelena M Barychev, Bureau of National Affairs (Arlington, Va.), *Bloomberg BNA. Audit Committees, Corporate Practice Series No. 49-6th*. 2013.

New York Stock Exchange. *New York Stock Exchange Listed Company Manual*. 2012.

Public Company Accounting Oversight Board. *Information for Audit Committees about the PCAOB's Inspection Process*. August 2012.

KPMG Audit Committee Institute. *"Is Governance Keeping Pace?" 2012 Audit Committee Issues Conference Highlights*. March 2012.

The Institute of Chartered Accountants in Australia, the Financial Reporting Council, and The Institute of Chartered Accountants of Scotland. *Walk the Line: Discussions and Insights With Leading Audit Committee Members*. February 2012.

PwC LLP. *Audit Committee Effectiveness: What Works Best, 4th Edition*. Catherine L. Bromilow and Donald P. Keller. June 2011.

National Association of Corporate Directors in collaboration with KPMG's Audit Committee Institute. *Report of the NACD Blue Ribbon Commission on The Audit Committee*. October 2010.

Grant Thornton LLP. *The Audit Committee Handbook, Fifth Edition*. Louis Braiotta, Jr., R. Trent Gazzaway, Robert H. Colson and Sridhar Ramamoorthi. April 2010.

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