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Audit Committee Resource Guide

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Audit Committee Resource Guide

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Introduction

Emerging practices and public expectations continue to affect the roles, responsibilities, and behavior of audit committees.

The past few years have been a dynamic period of reform in corporate America. Management, audit committee members, and registered public accounting firms (hereinafter referred to as independent auditors) have been affected by regulatory and legislative developments, including the Sarbanes-Oxley Act of 2002, the SEC's related rule-making, and the New York Stock Exchange (NYSE) and NASDAQ Stock Market (NASDAQ) corporate-governance listing standards that were finalized in 2003. In addition to these reforms, emerging practices and public expectations and perceptions continue to contribute to changes in the roles, responsibilities, and behavior of audit committees.

The roles and responsibilities of audit committees began to expand and shift with the issuance of the *Report of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees* in 1999. The Sarbanes-Oxley Act, related SEC rule-making, and the NYSE and NASDAQ listing standards expanded, codified, and formalized the composition, duties, and responsibilities for the audit committees of public companies.

Although these legislative and regulatory reforms generally have been implemented by public companies, audit committees continue to seek resources to help fulfill their responsibilities effectively. Deloitte & Touche LLP (Deloitte & Touche) is committed to helping audit committee members understand established rules and practices.

The *Audit Committee Resource Guide* presents an overview of audit committee requirements. More importantly, the guide discusses common practices and specific steps for audit committees to consider, and provides references to relevant tools and resources.

The *Audit Committee Resource Guide* discusses many tools and resources that are available on Audit Committee Online. This is Deloitte & Touche's Web site for audit committee members, directors, and management. The site provides access to relevant and useful information without the burden of time-consuming research. To register for Audit Committee Online, send an e-mail to auditcommittee@deloitte.com. Please refer to the "Audit Committee Resource Guide" page on the site for a list of the resources referenced in this document.

Please note that references represent tools and resources that were available on Audit Committee Online as of the *Audit Committee Resource Guide's* publication date. Circumstances may warrant changes of some materials in the future.



Unless otherwise stated, the *Audit Committee Resource Guide* focuses on the requirements for domestic listed companies. Requirements and effectiveness dates may vary for investment companies and foreign private issuers. For information specific to foreign private issuers, refer to Deloitte & Touche's audit committee checklist for foreign private issuers, which is available on Audit Committee Online. Please note that the *Audit Committee Resource Guide* is not a comprehensive view of audit committee requirements, and it should not be relied upon as such. Companies should seek legal counsel regarding the need to comply with various requirements.



Audit Committee Charter and Calendar of Activities

The increased responsibilities of the audit committee and the requirements of the NYSE and NASDAQ listing standards led most audit committees to make significant revisions to their charters.

Overview of the Requirements. Both the NYSE and NASDAQ outline minimum requirements for the content of the audit committee charter. The NYSE requires the audit committee charter to include oversight of the following as purposes of the audit committee:

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

In addition, charters of NYSE-listed companies must include the audit committee's responsibility to prepare the audit committee report for the proxy; responsibility to perform an annual assessment of the audit committee's performance; responsibilities outlined by the Sarbanes-Oxley Act; and various other audit committee responsibilities specified by the NYSE listing standards. These are discussed in the remainder of the *Audit Committee Resource Guide* and are outlined in the template charter in the appendix.

NASDAQ requires the audit committee charter to include the committee's purpose of overseeing the accounting and financial reporting processes of the company and the audits of its financial statements. The charter should also address the committee's responsibilities and how it carries out those responsibilities, including structure, processes, and membership requirements. The responsibilities in the charter should include:

- Ensuring receipt from the independent auditor of a formal written statement delineating all relationships between the auditor and the company, consistent with Independent Standards Board Standard No. 1

- Actively engaging in dialogue with the independent auditor with respect to any disclosed relationships or services that may affect the objectivity and independence of the auditor
- Taking appropriate action to oversee the independence of the auditor.

Finally, like the NYSE, NASDAQ requires the audit committee charter to include the audit committee responsibilities outlined by the Sarbanes-Oxley Act. Refer to the template charter in the appendix for these responsibilities.

Common Practices and Steps for Consideration. Most listed-company audit committees made significant revisions to their charters after the new regulations were implemented a few years ago. An annual review of the charter is recommended for all audit committees, not only those that are listed. Updates may be necessary as a result of:

- Changes in regulatory or legal requirements
- The board's delegation of new responsibilities to the audit committee
- Reassignment of certain responsibilities that are not required of the audit committee by law or regulation to other board committees
- Changes in the company's bylaws that affect the composition of the committee or how committee members are appointed
- Identification of common practices that the committee wishes to incorporate into its responsibilities.

To help accomplish its responsibilities in a timely and efficient manner, the audit committee may use the responsibilities outlined in the charter to develop an annual calendar and meeting agendas. Concurrent with the charter review, the committee should examine its calendar of activities and consider modifications based on the changes to the charter. The committee may also wish to reconsider

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Audit Committee Charter and Calendar of Activities

whether the frequency and timing of activities already on the calendar are adequate.

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

Tools and Resources. Deloitte & Touche developed a template for an audit committee charter based on the leading practices of various Fortune 1000 companies, as well as the requirements of the Sarbanes-Oxley Act, the NYSE, and NASDAQ. The template, which is located in the appendix (page A-1), is intended to be used in conjunction with Deloitte & Touche's audit committee planning tool, also located in the appendix (page B-1). Audit committees can use the planning tool to schedule their activities for the year.



Independence of Audit Committee Members

Section 301 of the Sarbanes-Oxley Act requires audit committee members to be independent, and it sets forth criteria for independence.

Overview of the Requirements. Section 301 of the Sarbanes-Oxley Act requires the audit committee members of all listed companies to be independent, and it specifies general criteria for independence.

Section 301 and the SEC's implementing rule state that an audit committee member may not, other than in his or her capacity as a member of the audit committee, board, or other board committee:

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

The SEC's rule prohibits any compensation other than that accepted as a board or committee member, whether it is received directly or indirectly. Prohibited compensation includes, but is not limited to, compensation for services rendered by a law firm, accounting firm, consulting firm, investment bank, or similar entity in which the audit committee member is a partner, executive officer, or the equivalent. The SEC's rule does not cover payments made by the company in the ordinary course of business for services other than legal, accounting, consulting, investment-banking, or financial-advisory services. Prohibited indirect compensation also includes payments to spouses, minor children or stepchildren, and adult children or stepchildren who share a home with the audit committee member.

The SEC's rule also includes a definition of "affiliate" for the purpose of determining independence. An affiliate is a "person that directly, or indirectly through one or more intermediaries, controls or is controlled by or is under common control with the person [or entity] specified." The definition of "control" is consistent with the definition in the Securities Exchange Act of 1934, as amended: "The possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person [or entity], whether through the ownership of voting securities, by contract, or otherwise." The SEC's rule includes a safe harbor for a person who is not an executive officer of the issuer and who does not hold at least 10 percent of the issuer's shares. Such a person would not be considered to control the issuer.

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

The NYSE and NASDAQ listing standards incorporate the audit committee member independence requirements of the SEC's rule to implement Section 301 of the Sarbanes-Oxley Act. The listing standards also require that all audit committee members be independent directors, as defined not only by the Sarbanes-Oxley Act, but also by the applicable listing standards. Both the NYSE and NASDAQ define their own director requirements for independence, incremental to those requirements for audit committee members outlined in the Sarbanes-Oxley Act.

NYSE Independence Requirements. Although there are some exceptions, the NYSE listing standards require most listed-company boards to have a majority of independent directors. For a director to be considered independent, the board must make an affirmative finding that the director has no "material relationship" with the listed company, taking into account all relevant facts and circumstances. The NYSE's independence criteria require an examination not only of current relationships, but those for the past three years. According to the NYSE standards, the director of a listed company is not independent if:

- The director is an employee, or an immediate family member is an executive officer, of the listed company or was during the past three years
- The director or an immediate family member received more than \$100,000 in direct compensation from the listed company in any 12-month period during the previous three years, except for director fees and other permitted payments
- The director or an immediate family member is a current partner of the company's internal or external auditor; the director is a current employee of such a firm; the director has an immediate family member who is a current employee of such a firm and who participates in the firm's audit, assurance, or tax-compliance (but not tax-planning) practice; or the director, or an immediate

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family member was, within the previous three years (but is no longer), a partner or employee of such a firm and personally worked on the company's audit during that time

- The director or an immediate family member is, or was during the previous three years, employed as an executive officer of another company where any of the listed company's current executive officers serves or served on the other company's compensation committee at the same time
- The director is a current executive officer or employee, or an immediate family member is a current executive officer, of another company that made payments to, or received payments from, the listed company in an amount that, in any one of the previous three fiscal years, was in excess of the greater of \$1 million or two percent of the other company's gross revenues.

To assist the board in making the independence determination, the NYSE listing standards provide that the board can adopt and disclose "categorical standards," which can be tailored to the company's circumstances.

NASDAQ Independence Requirements. Like those of the NYSE, the NASDAQ listing standards require most listed companies to have a board composed of a majority of independent directors. For a director to be considered independent, the board must make an affirmative determination that the director is free from any relationship that, in the board's opinion, would "interfere with the exercise of independent judgment in carrying out the responsibilities of a director." Like those of the NYSE, the NASDAQ independence criteria require an examination not only of current relationships, but also those in the previous three years. According to the NASDAQ listing standards, a listed company's director is not independent if:

- The director is an employee, or a family member is an executive officer, of the listed company, or was during the previous three years
- The director or a family member accepted payments in excess of \$60,000 from the listed company in the current fiscal year or any of the past three fiscal years, except for director fees and other permitted payments

- The director or a family member is a current partner of the listed company's independent auditor or was a partner or employee of the listed company's independent auditor who worked on the company's audit during the previous three years
- The director or a family member is a partner, controlling shareholder, or executive officer of another organization that received from, or made payments to, the listed company in an amount in excess of the greater of five percent of the recipient's gross revenues or \$200,000, or did so during the previous three years
- The director or a family member is employed as an executive officer of another entity where an executive officer of the listed company serves on the compensation committee, or did so during the previous three years.

Common Practices, Tools, and Resources. The independence of board and audit committee members requires continuous monitoring. Listed companies should have processes and policies in place to facilitate timely identification of changing relationships or circumstances that may affect the independence of directors and audit committee members. Many companies require directors to complete an independence questionnaire upon appointment to the board and annually thereafter, and to notify the company during the course of the year of any changes in circumstance that may affect independence. For audit committee members, these questionnaires should be tailored to incorporate the independence criteria of Section 301 of the Sarbanes-Oxley Act. Companies may want to involve legal counsel in monitoring and assessing the independence of directors.

The Society of Corporate Secretaries and Governance Professionals (www.governanceprofessionals.org) also has a questionnaire on director independence that is available to its members.



Financial Literacy and Expertise

The SEC's rule on Section 407 of the Sarbanes-Oxley Act outlines five criteria to determine whether an individual qualifies as an audit committee financial expert.

Overview of the Requirements. Section 407 of the Sarbanes-Oxley Act requires an issuer to disclose whether at least one “audit committee financial expert” serves on the audit committee. The SEC’s rule to implement Section 407 defines the audit committee financial expert as an individual who is determined by the board of directors to possess all of the following attributes:

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

The rule indicates that the attributes may be acquired by one or more of:

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

These criteria permit a chief executive officer who “actively supervised” the specified individuals to qualify as an audit committee financial expert if he or she possesses the five necessary attributes.

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

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

The NYSE requires all audit committee members to be “financially literate” as interpreted by the business judgment of the company’s board, or to become financially literate within a reasonable period after appointment to the committee.

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

NASDAQ listing standards require audit committee members to be able to read and understand financial statements at the time of their appointment to the committee. NASDAQ also requires at least one audit committee member to be “financially sophisticated.” Financial sophistication may be obtained through employment experience in finance or accounting, requisite professional certification in accounting, or any comparable experience, including current or past employment as a chief executive officer, chief financial officer, or other senior officer with responsibility for financial oversight. Like the NYSE, NASDAQ does not require an audit committee financial expert to be resident on the audit committee, but the NASDAQ listing standards provide that if the board determines an individual to be an audit committee financial expert, that individual is financially sophisticated.

Common Practices and Steps for Consideration. In designating an audit committee financial expert, the board of directors should consider the SEC’s five specified attributes and prescribed methods of acquiring the appropriate expertise. After seeking appropriate legal counsel, the board should decide whether one or more members of the audit committee is an audit committee financial expert. In making this determination, the board of directors may have audit committee members complete a questionnaire.

Section 407 of the Sarbanes-Oxley Act requires only the disclosure of whether an audit committee financial expert is resident on the audit committee, but it is now a general practice to have at least one committee member who meets the definition. Although audit committee financial experts are not expected to lose that expertise, it may be prudent for the board to revisit the designation periodically. It is important for the board and the audit committee to consider succession planning, with an emphasis on the need for members with specific financial experience. Periodically, the board and the audit committee may consider whether additional audit committee financial experts are needed or whether the financial expertise of those with the designation should be broadened. A robust program of continuing education will help the audit committee maintain the requisite knowledge to perform its duties effectively. Refer to Section 14 for a discussion of common practices related to general board education and financial-literacy training.

Tools and Resources. Deloitte & Touche has developed various resources to help boards assess the financial literacy of audit committee members. Deloitte & Touche’s *Basic Financial Literacy Self-Assessment Tool* and *Advanced Financial Literacy Self-Assessment Tool* can be used for this purpose. These documents, available on Audit Committee Online, should be used in conjunction with other processes in assessing an individual’s financial literacy.

Because there are many factors to consider in selecting an audit committee financial expert, a framework is useful. A decision tree published by the American Institute of Certified Public Accountants (AICPA) is available at www.aicpa.org.





Auditor Independence

Pursuant to the Sarbanes-Oxley Act, the SEC adopted amendments to enhance the independence of auditors.

Overview of the Requirements. On January 28, 2003, the SEC released its final rule to enhance the independence of accountants who audit or review financial statements and prepare attestation reports filed with the SEC. The rule, which became effective on May 6, 2003, addresses the provisions of Title II of the Sarbanes-Oxley Act and recognizes the critical role of audit committees in financial reporting, as well as the unique position of audit committees in monitoring auditor independence.

The rule addresses the following issues related to SEC registrants:

- Conflicts of interest resulting from employment relationships
- The scope of services provided by auditors
- Partner rotation
- The audit committee’s administration of the audit engagement
- Compensation of audit partners
- Revised proxy disclosures of fees paid to the independent auditor (see Section 6)
- Auditor communication with audit committees (see Section 7).

Conflicts of Interest Resulting from Employment Relationships. The rule states that independence is impaired if the issuer employs a member of the engagement team in a financial reporting oversight role¹ before completion of one annual audit subsequent to the engagement period when the individual was a part of the engagement team. Restrictions on employment apply to lead partners, concurring-review partners, and other members of the engagement team² who provide more than 10 hours of service in an audit capacity. An audit engagement period begins the day after the issuer has filed its annual report with the SEC. For example, if the issuer filed its Forms 10-K on March 10, 2003; March 15, 2004; March 12, 2005; and March 5, 2006, the engagement periods would commence and end as follows:

Annual Period	Engagement Period Begins	Engagement Period Ends
2003	March 11, 2003	March 15, 2004
2004	March 16, 2004	March 12, 2005
2005	March 13, 2005	March 5, 2006

If a member of the engagement team last provided audit, review, or attest services to the issuer during the 2003 engagement period (March 11, 2003–March 15, 2004), he or she may not begin employment with the issuer before March 13, 2005, or the audit firm will not be considered independent.

The rule excludes employment conflicts that result from mergers or acquisitions, as long as the employment was not taken in contemplation of the transaction, and the audit committee of the entity that results from the transaction is aware of the employee’s former association with the audit firm.

NYSE listing standards require audit committee charters to delineate the committee’s responsibility to set clear hiring policies for employees or former employees of the independent auditor. These policies should comply with the SEC’s rule on conflicts of interest arising from employment relationships.

Scope of Services Provided by Independent Auditors. The SEC’s rule updates its scope-of-services rules issued in February 2000. The rule establishes 10 categories of services which, if provided to an audit client, impair the independence of the registered public accounting firm. The rule permits an auditor to provide other nonaudit services to an issuer if the services are preapproved by the audit committee. Permissible nonaudit services include merger-and-acquisition due diligence, internal control reviews, audits of employee benefit plans, and tax services that are not prohibited by the PCAOB rules adopted in 2005 (see discussion later in this section).

¹ In Release 33-7919, the SEC defines “accounting role or financial reporting oversight role” as “a role in which a person is in a position to or does:

(i) Exercise more than minimal influence over the contents of the accounting records or anyone who prepares them; or
(ii) Exercise influence over the contents of the financial statements or anyone who prepares them, such as when the person is a member of the board of directors or similar management or governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, vice president of marketing, or any equivalent position.”

² The SEC defines the term “audit engagement team” in Release 33-8183 as “all partners (or person in an equivalent position) and professional employees participating in an audit, review, or attestation engagement of an audit client. Included within the audit engagement team would be partners and all other persons who consult with other members of the engagement team during the audit, review, or attestation engagement regarding technical or industry-specific issues, transactions, or events.” Likewise, “audit partner” is defined by the SEC in Release 33-8183 as “a partner (or person in an equivalent position) who is a member of the audit engagement team (as defined above) who has responsibility for decision-making on significant auditing, accounting, and reporting matters that affect the financial statements or who maintains regular contact with management and the audit committee.”

The term “audit partner” would include the lead and concurring partners; partners, such as relationship partners, who serve the client at the issuer or parent level, other than a partner who consults with others on the audit engagement team during the audit, review, or attestation engagement regarding technical or industry-specific issues, transactions, or events; and the lead partner on subsidiaries of the issuer whose assets or revenues constitute 20 percent or more of the consolidated assets or revenues of the issuer.

Prohibitions on bookkeeping, the design and implementation of financial-information systems, appraisal or valuation services, actuarial services, and internal audit outsourcing state that the service may not be provided “unless it is reasonable to conclude that the results of these services will not be subject to auditing procedures during an audit of the audit client’s financial statements.” This is referred to as the “not-subject-to-audit” standard.

1. Bookkeeping or Other Services Related to the Accounting Records or Financial Statements of the Audit Client

Under the rule, bookkeeping services are prohibited, except when the services are not subject to audit. These services are defined as: (1) maintaining or preparing the audit client’s accounting records, (2) preparing financial statements that are filed with the SEC or the information that forms the basis of financial statements filed with the SEC, or (3) preparing or originating the source data underlying the audit client’s financial statements. Statutory audit services are not prohibited.

2. Design and Implementation of Financial-Information Systems

Design and implementation of financial-information systems that aggregate source data or generate significant information for the financial statements of an audit client are prohibited, except when those services are not subject to audit. This rule does not preclude an accounting firm from working on hardware or software systems that are unrelated to the audit client’s financial statements or accounting records. In addition, an auditor can evaluate the internal controls of a system and recommend improvements. Similarly, the auditor can make recommendations on internal control to management or other service providers in conjunction with the design and installation of a system by another service provider.

3. Appraisal or Valuation Services, Fairness Opinions, or Contribution-in-Kind Reports

Appraisal and valuation services include any process of valuing tangible and intangible assets and liabilities. In fairness opinions and contribution-in-kind reports, the registered public accounting firm provides its opinion on the adequacy of consideration in a transaction. The rule prohibits an auditor from providing any appraisal or valuation service or any service involving a fairness

opinion or contribution-in-kind report for an audit client for the purpose of financial reporting, except when those services are not subject to audit. The rule does not preclude an auditor from providing appraisal or valuation services for nonfinancial reporting purposes (e.g., transfer-pricing studies, cost-segregation studies, and other tax-only valuations). An auditor also can use his or her own valuation specialist to review work performed by the client or other third-party specialists in connection with the audit.

In situations where certain foreign jurisdictions require the auditor to provide fairness opinions or contribution-in-kind reports, the SEC will evaluate these services case by case in cooperation with the regulatory agency in the foreign jurisdiction.

4. Actuarial Services

The rule prohibits an auditor from providing any actuarial services involving the determination of amounts recorded in the financial statements or related accounts for an audit client, except when those services are not subject to audit. The auditor can assist a client in understanding the methods, models, assumptions, and data used to compute an amount, or use its own actuaries to assist in the audit if the audit client uses its own actuaries or third-party actuaries to calculate the amounts recorded in the financial statements.

5. Internal Audit Outsourcing

The rule prohibits auditors from providing internal audit outsourcing services to audit clients. The prohibition includes any outsourced internal audit service related to the audit client’s accounting controls, financial systems, or financial statements, except when those services are not subject to audit.

The prohibition on outsourcing does not preclude the auditor from performing nonrecurring evaluations of discrete items or other programs that are not, in substance, the outsourcing of the internal audit function. The auditor may conduct “agreed-upon procedures” related to the company’s internal controls, because management takes responsibility for the scope and assertions in those engagements. The prohibition does not preclude the auditor from performing

operational internal audits unrelated to internal accounting controls, financial systems, or financial statements.

6. Management Functions

The rule prohibits the auditor from acting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client (collectively referred to as management functions).

7. Human-Resource Services

An auditor is also prohibited from searching for prospective candidates for managerial, executive, or director positions; engaging in psychological testing or other formal testing or evaluation programs; negotiating on behalf of an audit client or determining position, status, title, compensation, fringe benefits, or other conditions of employment; recommending the audit client to hire a specific candidate for a specific job; or undertaking reference checks of prospective candidates for an executive or director position with the audit client (collectively referred to as human-resource services).

8. Broker/Dealer, Investment-Advisory, or Investment-Banking Services

An auditor is prohibited from performing brokerage or investment-advisory and investment-banking services for an audit client. The rule prohibits an auditor from serving as a promoter or underwriter of the audit client's investment; making investment decisions on behalf of the audit client or otherwise having discretionary authority over an audit client's investments; executing a transaction to buy or sell an audit client's investment; or having custody of assets of the audit client. Both registered and unregistered broker/dealers are covered by the rule.

The rule does not preclude the auditor's broker/dealer division from covering an industry that includes an audit client when performing analyst functions. However, analysis of a specific audit client's stock makes the auditor an advocate for the client and impairs independence.

9. Legal Services and Expert Services

Auditors are prohibited from providing audit clients with any services that, under the circumstances in which they are provided, can be provided only by someone licensed, admitted, or otherwise qualified to practice law in the jurisdiction in which the service is provided (collectively referred to as legal services). As a general matter, the SEC's rule is not intended to prohibit services in foreign jurisdictions that would otherwise be allowed in the United States. The SEC encourages foreign firms and regulators to consult with the SEC staff as issues arise.

Expert services advocating a client's position in litigation, regulatory or administrative proceedings, or investigations are prohibited. The prohibition includes providing expert services to a client's legal counsel in similar situations. Under the rule, an auditor's specialized knowledge, experience, and expertise, whether provided directly to the client or to an intermediary, may not be used to advocate a client's position (collectively referred to as expert services).

The rule does not preclude an audit committee or the audit committee's legal counsel from engaging an auditor to perform investigations or fact-finding engagements, including forensic work that results in a report to the client. Furthermore, an auditor may provide factual accounts or testimony describing work performed, positions taken, or conclusions reached. Litigation or other proceedings that commence while an auditor is completing expert services do not impair independence if the auditor remains in control of his or her work through completion of the procedures and the work does not become subject to the direction or influence of legal counsel for the issuer.

10. PCAOB Discretion

The Sarbanes-Oxley Act prohibits any other service that the PCAOB determines, by regulation, to be impermissible. On July 26, 2005 (amended November 22, 2005), the PCAOB approved new independence rules related to certain tax services and contingent fees. These PCAOB rules were approved by the SEC on April 19, 2006.

Under these rules, a registered public accounting firm is presumed not to be independent of an audit client if it, or one of its affiliates:

- Enters into a contingent-fee arrangement with the audit client
- Provides certain services related to the tax treatment of a confidential or “aggressive” transaction (including listed transactions)
- Provides tax services to certain members of management who serve in financial reporting oversight roles at the audit client or its affiliates.

- a. **Contingent Fees:** The PCAOB rules state that a registered public accounting firm is not independent of its audit client if, during the audit and professional engagement period, the firm or any of its affiliates provides any service or product to the audit client for a contingent fee or a commission, or receives a contingent fee or a commission from the audit client, either directly or indirectly. This rule is modeled on a similar SEC independence rule, but the PCAOB’s rule does not provide an exception for fees for tax services that are based on the results of judicial proceedings or the findings of governmental agencies. The PCAOB’s rule does, however, retain an exception related to fees fixed by courts or other public authorities that do not depend on a finding or result (e.g., fees fixed by a bankruptcy court).

This rule does not apply to contingent fees that are paid in their entirety, converted to fixed fees, or otherwise unwound by June 18, 2006. The SEC independence rules that prohibit contingent fees are currently effective.

- b. **Confidential and Aggressive (Including Listed) Transactions:** The PCAOB rules indicate that a registered public accounting firm is not independent of its audit client if, during the audit and professional engagement period, the firm or any of its affiliates provides any nonaudit service to the audit client related to marketing, planning, or opining in favor of the tax treatment of a confidential transaction or an aggressive tax position transaction. For this purpose, the definition of “confidential transaction” is adapted from U.S. Treasury regulations.

An “aggressive tax position transaction” is a transaction that meets all three prongs of the following test:

- The transaction was initially recommended, directly or indirectly, by the audit firm
- A significant purpose of the transaction is tax avoidance
- The proposed tax treatment of the transaction is not at least more likely than not to be allowed under applicable tax laws.

Aggressive transactions include those transactions that are listed by the IRS. This rule does not apply to tax services that are completed by June 18, 2006.

- c. **Tax Services Provided to Certain Management in a Financial Reporting Oversight Position:** The PCAOB rules provide, in general, that a registered public accounting firm is not independent of its audit client if, during the audit and professional engagement period, the firm or any of its affiliates provides any tax service to a person in a financial reporting oversight role at the audit client, or to an immediate family member of such a person. The rule’s use of “financial reporting oversight role” is based on the SEC’s definition. It includes any person who is in a position to or does exercise influence over the contents of the financial statements or anyone who prepares them.

Although the term's use is based on the SEC's definition, the PCAOB clarified that its rule does not apply to anyone who serves in a financial reporting oversight role "only because he or she serves as a member of the board of directors or similar management or governing body of the audit client." In addition, the rule does not restrict an auditor's provision of tax services to employees in a financial reporting oversight role at an affiliate of an audit client if the affiliate's financial statements are not material to those of the audit client, or are audited by another firm not associated with the auditor.

This rule does not apply to any engagement in process on April 19, 2006, provided that the services are completed on or before October 31, 2006. An engagement is considered to be in process if the engagement letter was executed and work of substance had commenced by April 19, 2006.

Partner Rotation. The SEC's rule requires the lead audit and concurring-review partners to rotate after five years; upon rotation, they are subject to a five-year "time-out" period. Audit partners who have significant involvement with senior management or the audit committee or responsibility for decisions on accounting matters that affect the financial statements are required to rotate after seven years, and are subject to a two-year time-out period. This includes audit partners who serve as the lead partner for significant subsidiaries. Significant subsidiaries are defined as those accounting for greater than 20 percent of an issuer's revenues or assets. Specialty partners, such as tax partners, are not required to rotate.

The rotation requirements applicable to lead partners became effective for the first fiscal-year audit beginning after May 6, 2003. Time served as lead audit partner before this date is included for the purpose of calculating the five years. For example, if a lead audit partner is serving a calendar-year audit client and fiscal 2006 is the fifth year as lead audit partner for that issuer, he or she will complete the fiscal 2006 audit, but will have to rotate for the 2007 engagement.

To maintain a high level of knowledge and facilitate the rotation, the requirements for the concurring partner did not become effective until fiscal years beginning after May 6, 2004. As in the case of lead audit partners, all time served is included in determining the requirement for rotation of the concurring partner.

Because the other audit partners covered by the rule were neither identified in the Sarbanes-Oxley Act nor previously subject to rotation requirements, a longer transition period was provided by the SEC. Time served prior to the rule's effective date is not used in determining rotation for the other partners. Thus, if an audit partner was serving a significant subsidiary with a calendar-year reporting period, fiscal 2004 would be the first year in the seven-year rotation period. Similarly, for partners from foreign accounting firms who are subject to rotation requirements, time served before the effective date of May 6, 2003, is not used to determine the rotation period.

The Audit Committee's Administration of the Engagement (Preapproval).

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

Further, the PCAOB rules approved by the SEC in April of 2006 provide that an audit firm seeking preapproval of tax services must:

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

(3) Document the substance of its discussion with the audit committee of the issuer.

This rule does not apply to any tax service preapproved on an engagement-by-engagement basis before June 18, 2006, or, in the case of an issuer that preapproves nonaudit services by policies and procedures, the rule does not apply to any tax service that begins within one year of April 19, 2006. Nevertheless, SEC rules that require preapproval of audit and nonaudit services, including tax services, are currently effective.

Compensation of Audit Partners. Under the SEC's rule, an auditor is not independent if, at any point during the audit and professional engagement period, any audit partner, other than a specialty partner, earns or receives compensation from selling engagements to provide the audit client with any services other than audit, review, or attest services. For the purpose of this restriction, the SEC defines the term "audit partner" as the lead and concurring partners and other partners on the engagement team who have responsibility for decision-making on significant auditing, accounting, and reporting matters that affect the financial statements or who maintain regular contact with management or the audit committee. This includes all audit partners serving the client at the issuer or parent, with the exception of specialty partners, as well as the lead partner on subsidiaries whose assets or revenues constitute at least 20 percent of the consolidated assets or revenues.

Tools and Resources. Because the audit committees of NYSE-listed companies are required to have policies for hiring former employees of their independent auditor, Deloitte & Touche has devoted a section of its *Corporate Governance Listing Standards Audit Committee Handbook* to assisting audit committees with the development of these policies. This handbook, and additional resources regarding auditor independence and preapproval, can be found on Audit Committee Online.





Disclosure of Fees Paid to the Independent Auditor

The SEC's rule to implement Title II of the Sarbanes-Oxley Act expanded the requirements to disclose auditor fees, and many companies have opted to provide even more information.

Overview of the Requirements. The SEC approved modified fee-disclosure requirements in its final rule to implement Title II of the Sarbanes-Oxley Act. These requirements expanded the disclosure of fees for services provided by the principal auditor to the issuer and its consolidated subsidiaries from three categories to four, provided guidance on classification, and better defined the services that should be classified in the audit fees category. The following provides insight on the type of items to be disclosed in the four categories:

- **Audit fees** are fees for services that normally would be provided in connection with statutory and regulatory filings or engagements, including the attestation mandated by Section 404 of the Sarbanes-Oxley Act. This category also may include services that only the independent accountant reasonably can provide, such as comfort letters, statutory audits, attest services, consents, and assistance with documents filed with the SEC. Audit fees also may include certain services provided by specialists who assist in the audit, such as tax specialists needed to audit the tax provision or valuation specialists needed to audit a fair-value assertion; certain accounting consultations in connection with the audit; and similar items that are not billed as audit services and that only the independent auditor reasonably can provide.
- **Audit-related fees** are assurance and related services that are performed by the independent accountant, such as audits of employee benefit plans, due diligence related to mergers and acquisitions, accounting consultations and audits in connection with acquisitions, internal control reviews (not the Sarbanes-Oxley Act Section 404 attestation, which is part of audit fees), attest services that are not required by statute or regulation, and consultation concerning financial accounting and reporting standards (to the extent that such consultation is not necessary to complete the GAAS audit).
- **Tax fees** include all services performed by professional staff in the independent accountant's tax division except those related to the audit, such as review of the tax provision (which would be included in audit fees). Typically, tax fees cover tax compliance, tax planning, and tax advice. Tax compliance generally involves preparation of original and amended tax returns, claims for refund, and tax-

payment planning services. Tax planning and tax advice encompass a diverse range of services, including assistance with tax audits and appeals, tax advice related to mergers and acquisitions, employee benefit plans, and requests for rulings or technical advice from tax authorities.

- **All other fees** would include all fees paid to the principal auditor other than audit, audit-related, or tax services.

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

Common Practices. The SEC rule outlines the required elements of the disclosure of auditor fees, but many companies opt to provide more information. For instance, many companies choose to subtotal the audit and audit-related fee amounts so shareholders can easily quantify the portion of services provided by the auditor that are audit and audit-related in nature. Because certain institutional investors and investor advisors, such as Institutional Shareholder Services, have guidelines on which they base certain proxy-vote recommendations, many companies disclose not only the nature of services comprising the fee categories but also the amounts associated with specific types of services in a particular fee category. For example, it is not uncommon for companies to bifurcate the disclosed tax fees into amounts for tax-compliance and -preparation services and tax-planning services. Issuers should consult with legal counsel in determining the content of the disclosure of auditor fees.



Interaction with the Independent Auditor

The Sarbanes-Oxley Act required several changes to the relationship between the independent auditor and the audit committee.

Overview of the Requirements. The Sarbanes-Oxley Act required several changes to the relationship between the independent auditor and the audit committee. Section 301 makes the audit committees of listed companies directly responsible for the appointment, compensation, and oversight of the independent auditor, including the resolution of any disagreements with management. The NYSE and NASDAQ listing standards also incorporate the provisions of Section 301.

Until the Sarbanes-Oxley Act became law, Statement on Auditing Standards (SAS) 61, *Communications with Audit Committees* (as amended by SAS 89 and SAS 90), was the principal guidance for communication between the auditor and the audit committee. Generally speaking, SAS 61 requires the independent auditor to communicate the following to the audit committee:

- The independent auditor's responsibilities under GAAS
- The company's significant accounting policies
- Management judgments and accounting estimates
- Audit adjustments
- The independent auditor's judgments about the quality of the company's accounting principles as applied in the financial statements
- Other information in documents containing audited financial statements
- Disagreements with management
- Consultations management has had with other accountants
- Major issues discussed with management prior to retention
- Difficulties encountered in performing the audit.

While the SAS 61 communications are still required, the Sarbanes-Oxley Act also mandated the communications discussed in the following subsection.

Communications Required by Section 204 of the Sarbanes-Oxley Act.

Pursuant to Section 204 of the Sarbanes-Oxley Act, the SEC issued Rule 2-07, *Communication with Audit Committees*, which requires the independent auditor to communicate the following to the audit committee before the company files its annual report with the SEC:

- Critical accounting policies and practices used by the issuer (either orally or in writing)
- Alternative accounting treatments within U.S. GAAP for accounting policies and practices related to material items (including specific transactions) 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 accounting firm (either orally or in written form)
- Other material written communications between the independent auditor and management of the issuer.

The SEC stated in its rule release that it expects such discussions to occur as often as quarterly, or perhaps even in real time.

Communications Required by the NYSE Listing Standards. The NYSE listing standards require the audit committees of listed companies to obtain a report from the independent auditor, at least annually, which describes:

- The independent auditor's internal quality-control procedures
- Any material issues raised by the most recent internal quality-control review, peer review, or any inquiry or investigation conducted by governmental or professional authorities during the preceding five years with respect to independent audits carried out by the firm, as well as steps taken to address those issues
- All relationships between the independent auditor and the company, to assess the auditor's independence.

Section Seven

Interaction with the Independent Auditor

The standards also require the audit committee to:

- Discuss with the independent auditor the company's annual audited financial statements and quarterly financial statements, including disclosures in management's discussion and analysis
- Periodically, meet separately with the independent auditor, as well as management and the internal auditor
- Review with the independent auditor problems or difficulties and management's response
- As discussed in Section 5, establish clear hiring policies for employees or former employees of the company's independent auditor.

Communications Required by the NASDAQ Listing Standards. The NASDAQ listing standards require the audit committees of listed companies to obtain a formal written statement from the independent auditor, consistent with Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*, delineating all relationships between the independent auditor and the company that can reasonably be thought to bear on independence, and to engage in an active dialogue with the auditor about any relationship or services that may affect independence.

Common Practices. It is optimal when the audit committee, management, the internal auditor, and the independent auditor work together in a spirit of mutual respect and cooperation. The enhanced communication between the independent auditor and the audit committee resulting from recent regulations promotes a balanced and effective relationship among all parties. Although the new requirements have opened formal and informal lines of communication between the independent auditor and the audit committee, the board of directors and the audit committee should continue to foster an environment in which the independent auditor can communicate with the audit committee directly regarding issues or concerns that may arise.

Private meetings with the independent auditor may be another key element to maintaining communication and identifying potential issues. Meetings between the audit committee and the independent auditor should take place at least quarterly and be of sufficient duration to permit thorough discussion. The audit committee should have a process for overseeing management's resolution of significant issues raised by the independent auditor.

Tools and Resources. The AICPA's Audit Committee Toolkit includes a document entitled "Discussions to Expect from the Independent Auditor," which is available at www.aicpa.org. Details of, and common practices related to, the NYSE and NASDAQ listing standards are available in Deloitte & Touche's *Corporate Governance Listing Standards Audit Committee Handbook*, which can be accessed through Audit Committee Online.





Evaluation of the Independent Auditor

Although Section 301 does not require the audit committee to evaluate the independent auditor, many conduct some form of evaluation to make decisions on auditor appointment and retention.

Overview of the Requirements. As noted previously, Section 301 of the Sarbanes-Oxley Act established the audit committee's responsibility for the appointment, compensation, and oversight of the independent auditor. Although Section 301 does not require the audit committee to evaluate the independent auditor, many audit committees conduct some form of evaluation to make decisions on auditor appointment and retention.

The NYSE listing standards require the audit committee to review a report by the independent auditor describing quality control, results of investigations, and independence. (Refer to Section 7 for more information.) The commentary accompanying this listing standard states that, after reviewing the report and the "independent auditor's work throughout the year, the audit committee will be in a position to evaluate the auditor's qualifications, performance, and independence." The commentary also specifies that the "evaluation should include the review and evaluation of the lead partner of the independent auditor," and "should take into account the opinions of management and the company's internal auditors (or other personnel responsible for the internal audit function)." Once the evaluation is completed, the NYSE directs the audit committee to present its conclusions to the full board.

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

- **Frequency and timing of the evaluation** – Many companies perform the evaluation annually, immediately following the fiscal-year financial reporting.
- **Parties involved in the assessment** – From a practical standpoint, it may not be feasible for the audit committee to oversee and coordinate the entire evaluation of the independent auditor. In many instances, the audit committee delegates the coordination responsibility to the internal audit department or another group in the company. The party responsible for coordinating the

evaluation should obtain information not only from the audit committee, but from senior financial management and the internal auditor. Depending on the size and structure of the company, it may be appropriate to obtain input from the management of significant operating locations or business units.

- **Form and nature of the assessment** – Some independent auditors have assessment questionnaires that form the basis for evaluating client service. Audit committees can use these questionnaires, tailor them to fit their needs, or create their own. The assessment may be done by having the relevant parties complete the questionnaire in writing or by holding interviews.
- **Assessment criteria** – The criteria for evaluating the independent auditor vary. Common criteria specific to the engagement team include technical competence, industry expertise, frequency and quality of communication, cohesiveness as a team, and the level of support provided to the audit committee in fulfilling its responsibilities. Audit committees may also consider characteristics of the audit firm itself, such as size, financial strength and stability, presence in key markets, approach to professional development, technological capabilities, nature of the audit approach, quality of thought leadership, and eminence in the marketplace. Of course, the results of the PCAOB inspection process, peer reviews, and internal practice reviews may also be considered in the evaluation process.

Tools and Resources. The AICPA's Audit Committee Toolkit includes a document entitled "Evaluating Independent Auditors," which provides examples of questions to be asked of the audit committee, the chief financial officer, the internal auditor, and the independent auditor. It is available at www.aicpa.org.



Interaction with Internal Audit

The NYSE listing standards require audit committee charters to include oversight of the internal audit function as one of the committee's purposes.

Overview of Requirements. The NYSE listing standards require listed companies to have an internal audit function. The commentary to the rules clarifies that this does not necessarily mean that listed companies must have an internal audit department. Rather, the internal audit function must be performed by someone—or more likely, a group of people—inside or outside of the organization.

The NYSE listing standards require audit committee charters to include oversight of the internal audit function as one of the committee's purposes. The standards also dictate that, periodically, the audit committee must meet with the internal auditor in private session. Finally, commentary to the NYSE listing standards indicates that the audit committee should periodically review, with the independent auditor, the internal audit function's responsibilities, budget, and staffing.

Common Practices and Steps for Consideration. Although the Sarbanes-Oxley Act did not address the interaction of the audit committee and the internal auditor, there has been a marked increase in its involvement since the legislation was enacted, particularly when the internal auditor is responsible for portions of the Section 404 compliance process.

With increasing frequency, the internal audit function's direct reporting line is to the audit committee. When the internal auditor reports to the audit committee, the function is kept structurally separate from management. This structure is designed to enhance objectivity. This alignment also encourages the free flow of communication on issues and promotes direct feedback from the audit committee on the performance of the chief audit executive. Because the audit committee does not have a day-to-day presence in business operations, a dual reporting relationship to management may be appropriate for some companies.

Regardless of the reporting structure, in addition to reviewing key internal audit reports, there are several activities the audit committee should consider in overseeing the performance of the internal audit function. These include:

- Participating actively in the selection, removal (if necessary), performance evaluation, and compensation determination of the chief audit executive
- Reviewing the objectives, plans, organization, qualifications, and staffing of the internal audit function
- Reviewing the sufficiency of the internal audit function's budget

- Reviewing and recommending changes to internal auditing procedures and the internal audit charter
- Understanding the extent to which the internal audit function is involved in Section 404 compliance
- Understanding the extent to which the independent auditor relies on the work of the internal auditor for the audits of the financial statements and internal control over financial reporting
- Monitoring whether management implements necessary changes and improvements as recommended by the internal audit function
- Meeting privately with the chief audit executive—optimally, at least once every quarter—to discuss any appropriate matters, as required by the NYSE corporate governance listing standards
- Periodically reviewing with the chief audit executive any significant difficulties, disagreements with management, or scope restrictions encountered in the course of the function's work
- As outlined by the commentary to the NYSE listing standards, periodically reviewing with the independent auditor the internal audit function's responsibilities, budget, and staffing.

Tools and Resources. Audit Committee Online includes a number of tools and resources to help the audit committee better understand the internal audit function and its oversight responsibilities. For instance, Deloitte & Touche's *Optimizing the Role of Internal Audit in the Sarbanes-Oxley Era* outlines essential components of an effective and fully optimized internal audit function. The Institute of Internal Auditors' *The Audit Committee: Purpose, Process, Professionalism* provides insight into the audit committee's interaction with the internal audit function and a list of questions for audit committees to consider.

Audit Committee Online also provides resources for evaluating the performance of the internal audit function, and the AICPA's Audit Committee Toolkit includes "Hiring the Chief Audit Executive," which discusses considerations in recruiting and interviewing the internal audit director. This document is available at www.aicpa.org.



Whistleblower Procedures

The whistleblower procedure that appears to be most common is use of a telephone hotline administered by an internal department or a third party.

Overview of the Requirements. Section 301 of the Sarbanes-Oxley Act and the securities market listing standards require that audit committees of listed companies establish procedures for:

- The receipt, retention, and treatment of complaints received by the company regarding accounting, internal accounting controls, or auditing matters, whether from an internal or external source
- The confidential, anonymous submission of employee concerns regarding questionable accounting or auditing matters.

Common Practices and Steps for Consideration. Companies use various whistleblower procedures. The practice that appears to be most common in receiving tips from both inside and outside the organization is use of a telephone hotline or helpline administered by an internal department or a third party. Telephone hotlines have emerged as a preferred mechanism because they are interactive, allowing a skilled interviewer to elicit the necessary details. Other approaches typically do not offer the same degree of interactivity or anonymity. If the hotline is administered internally, it may be most efficient to rely on an existing toll-free line that is used for other types of questions or complaints, such as human resources issues. If the internal option is used, operators should have specific instructions on where to direct questions or complaints.

Another means of receiving complaints is to establish an e-mail address or a post-office box that is accessible only by the ethics and compliance officer, the chief audit executive, or legal counsel. Some companies prefer to use Web-based technology.

Whatever the chosen method, audit committee members should work with management to make employees, investors, and others aware of the option of confidential disclosure. Employees can be informed in the code of ethics, the employee handbook, human resources orientation, and ethics training. Instructions for submitting questions or complaints can be posted in company facilities and on intranet sites.

Notifying outsiders of avenues for submitting their concerns poses different challenges. The company Web site is a natural vehicle for communicating the procedures to individuals outside the organization. As discussed in Section 11, the NYSE listing standards require companies to adopt codes of ethics and disclose them on their Web sites. NASDAQ-listed companies also must adopt and disclose codes of ethics, and many have chosen to post their codes on their Web sites. Information regarding the code of ethics and the whistleblower hotline often is linked from the home page under a section called “Ethics” or an equivalent name. Telephone operators working in customer service and investor relations should be prepared to answer questions on how to submit questions, concerns, and complaints regarding financial reporting.

The audit committee should work with management to determine that more than one person in the company is aware of questions or complaints received from third-party vendors, e-mail, or other submission vehicles. The party or parties responsible for addressing and investigating questions or concerns and reporting back to the audit committee varies. These duties often are performed by individuals in the ethics and compliance, internal audit, legal, or risk management departments. Reports should be given to the audit committee regularly, in accordance with standing instructions. Some complaints and concerns may warrant immediate communication to the audit committee, such as those involving significant dollar amounts and/or senior management. The audit committee should establish a schedule for reporting to the board.

Tools and Resources. “Effective Ethics and Compliance Helplines,” an article from the December 2005 issue of *Compliance & Ethics*, discusses what organizations have learned from setting up hotlines. It also outlines some of the features of an effective reporting mechanism and how to assess that effectiveness. The article is based on the observations of two professionals from the Forensic and Dispute Services practice of Deloitte Financial Advisory Services LLP. Deloitte & Touche tools and resources to address ethics and compliance issues are discussed in Section 11. The AICPA’s Audit Committee Toolkit includes “Tracking Report: Anonymous Submission of Suspected Wrongdoing,” which may be helpful to audit committees. This tool is available at www.aicpa.org.



Code of Ethics

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

Overview of the Requirements. The Sarbanes-Oxley Act, the NYSE listing standards, and the NASDAQ listing standards all require a code of ethics or a code of conduct. There are similarities between the requirements, but there are also differences.

Requirements of Section 406 of the Sarbanes-Oxley Act. The SEC's final rule to implement Section 406 of the Sarbanes-Oxley Act requires SEC registrants, other than registered investment companies, to disclose whether they have written codes of ethics that apply to their principal executive officers, principal financial officers, principal accounting officers or controllers, or individuals performing similar functions. If they do not, they must explain why not. Companies must promptly disclose amendments to, and waivers from, codes of ethics relating to any of those people.

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

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

Companies must include these code-of-ethics disclosures in their annual reports filed on Forms 10-K, 10-KSB, 20-F, or 40-F. A company must make its code of ethics publicly available, but may choose among the following three methods for doing so:

- File a copy of its code of ethics with the SEC as an exhibit to its annual report

- Post the text of its code of ethics on its Web site, provided that the Web site address and the intention to provide disclosure in this manner are set forth in its annual report filed with the SEC
- Indicate in its annual report that it will provide a copy of its code of ethics to any person, without charge, upon request.

Other than registered investment companies, U.S. registrants must disclose on Form 8-K or their Web sites any changes to or waivers of the five code-of-ethics provisions referenced in the rule, and the extent to which the waiver or amendment relates to the chief executive officer or senior financial officers. A company that chooses to provide the required disclosure on Form 8-K must do so within five business days after it amends its code of ethics or grants a waiver. A company can provide the required disclosure on its Web site only if it disclosed, in its most recent annual report filed with the SEC, its Web address and its intention to disclose these events on its Web site.

Overview of the NYSE Requirements. The NYSE listing standards include requirements for a code of conduct and expand those requirements to cover not only senior financial officers, but all employees. Specifically, the Web sites of NYSE-listed companies must disclose the code of conduct applicable to employees, directors, and officers. Each Form 10-K must state that this information is available in hard copy for any shareholder who requests it. Companies can determine the content of their policies, but the code must contain the items listed below, only some of which are expressly required by the Sarbanes-Oxley Act.

- Treatment of conflicts of interest
- Prohibition from taking advantage of personal opportunities arising through the use of corporate property, information, or position
- Prohibition from using corporate property, information, or position for personal gain
- Prohibition from conducting business that competes with that of the company
- Treatment of confidential information

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

Overview of the NASDAQ Requirements. The NASDAQ listing standards require public disclosure of a code of conduct applicable to all employees, officers, and directors. NASDAQ criteria for the code of conduct are consistent with those in the final rules to implement Section 406 of the Sarbanes-Oxley Act.

In addition, each code of conduct must contain an enforcement mechanism that provides for prompt and consistent enforcement of the code, protection for individuals reporting questionable behavior, clear and objective standards for compliance, and a fair process by which to determine violations. Each code of conduct also must require that any waiver for executive officers or directors be made only by the board and be promptly disclosed to shareholders, along with the reasons for the waiver. Waivers of the code's requirements for executive officers or directors must be disclosed in a Form 8-K within four business days.

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

Common Practices and Steps for Consideration. As required by the U.S. federal sentencing guidelines for organizations, which were amended in November 2004, executives and boards of directors assume responsibility for the oversight and management of ethics and compliance, one important element of which is a robust code of ethics or conduct. The board and the audit committee should consider whether the audit committee should be involved in this aspect of corporate governance.

Whether the responsibility for overseeing ethics and compliance is assigned to the board, the audit committee, another board committee, a chief risk or chief ethics officer, or some combination of these or other parties, those responsible—with appropriate assistance from management—should determine that the company's code of ethics or conduct complies with the applicable requirements. Companies may update the code in response to new issues or situations. When appropriate, legal counsel should be consulted regarding modifications of the code.

A culture that embraces the importance of ethics and compliance can be established only if employees, officers, and directors understand the requirements of the code. Communication and training are key in fostering an ethical culture. The code should be available to all those inside the organization, perhaps through inclusion on the company's intranet site and in the orientation manual. Some companies require all covered individuals to sign an annual representation noting that they have read and understand the requirements of the code.

Board members or members of the designated committee with oversight responsibility for compliance should have a thorough understanding of the waiver definition and the disclosure requirements. Any decision to grant waivers should be considered carefully. A company may consider if a requirement to seek preapproval for a conflict with the code obviates the need for a waiver. To monitor compliance effectively, those with responsibility for overseeing ethics and compliance should work with management to establish a process for reporting and remediating violations promptly.

Tools and Resources. Audit Committee Online contains a number of tools and resources for additional information on establishing codes of ethics and robust ethics and compliance programs. These resources include Deloitte & Touche's *Suggested Guidelines for Writing a Code of Ethics and Conduct* and *Questions that Boards Should Consider Asking Regarding Ethics and Compliance Programs*. The latter includes a discussion regarding chief ethics and compliance officers. More information on this role and related topics is available in the National Association of Corporate Director's (NACD's) *Corporate Director's Ethics and Compliance Handbook*, which can be ordered at www.nacdonline.org.





Internal Control Certifications, Reports, and Audits

An internal control structure that focuses on both disclosure controls and procedures and internal control over financial reporting can help a company comply with Section 302 and Section 404.

Overview of the Requirements. The Sarbanes-Oxley Act introduced three key requirements in the area of internal control: certifications, reporting, and audits. It did not assign the audit committee explicit responsibilities with respect to internal control. However, because the audit committee oversees financial reporting, it generally assumes responsibility for overseeing internal control. As outlined by Section 301, the audit committee is responsible for overseeing the work of the independent auditor, which includes the audit of internal control. Both the NYSE and NASDAQ require the audit committee charter to specify the committee's purpose of overseeing the integrity of the financial statements. Oversight of internal control aligns with this purpose.

Internal Control Certification Requirements. Under the SEC's rules to implement Section 302 of the Sarbanes-Oxley Act, both the chief executive officer and the chief financial officer must make the following certifications in quarterly and annual reports:

1. He or she has reviewed the report being filed
2. Based on his or her knowledge, the report does not contain any material misstatements or omissions
3. Based on his or her knowledge, the financial statements and other financial information included in the report fairly present, in all material respects, the financial condition, results of operations, and cash flows of the company (which representation is not limited by reference to GAAP)
4. He or she and other certifying officers are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the company and have:
 - (a) Designed the disclosure controls and procedures to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to him or her by others in the organization
 - (b) Designed the internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with GAAP

What Is a Disclosure Committee?

Although a disclosure committee is not required, the SEC recommends that companies establish one to assist the chief executive officer and chief financial officer in making their Section 302 certifications. The responsibilities of the disclosure committee typically include:

- Identifying what constitutes a significant transaction or event
- Determining that the chief executive officer and the chief financial officer are aware of material information that could affect disclosures
- Determining the appropriateness of disclosures in drafts of all publicly disseminated information
- Overseeing the process by which disclosures are created and reviewed
- Reviewing significant control deficiencies with the chief executive officer and the chief financial officer to determine whether, individually or in the aggregate, those deficiencies constitute a material weakness that should be disclosed in the SEC filings.

A disclosure committee typically consists of individuals who know the SEC rules, understand the company's business and the disclosure practices of the company's peers, and have the authority to initiate action when appropriate. Committee members may include the chief accounting officer, the controller, legal counsel, the risk management officer, the head of investor relations, and the chief executive and financial officers of business units.

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- (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in the report their conclusions about the effectiveness of the disclosure controls and procedures based on his or her evaluation as of period-end
 - (d) Disclosed in the report any change in internal control over financial reporting that occurred during the most recent fiscal quarter that materially affected, or is reasonably likely to materially affect, internal control over financial reporting
5. He or she and the other certifying officers have disclosed, based on their most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee:
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting that are reasonably likely to adversely affect the company's ability to record, process, summarize, and report financial information
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

The Section 302 certification requirements have been in effect since 2002, with the exception of the references to internal control over financial reporting in the introductory paragraph of item 4 and item 4(b), which are required beginning with the first fiscal quarter after the initial assessment of internal control over financial reporting required by Section 404 of the Sarbanes-Oxley Act.

Internal Control Reporting Requirements. The SEC rules implementing Section 404 of the Sarbanes-Oxley Act require a public company's annual report to contain an internal control report by management that includes:

- A statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting
- A statement identifying the framework used by management to evaluate the effectiveness of the company's internal control over financial reporting
- Management's assessment of the effectiveness of internal control over financial reporting as of the most recent fiscal year-end, including a statement as to whether or not internal control over financial reporting is effective and a disclosure of any material weaknesses identified
- A statement that the independent auditor who audited the financial statements has issued an attestation report on management's assessment of internal control over financial reporting.

Each quarter, the SEC requires the issuer's management, with the participation of the principal executive and financial officers, to evaluate any change in internal control over financial reporting that occurred during that quarter that materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

Accelerated filers were required to comply with Section 404 of the Sarbanes-Oxley Act for fiscal years ended on or after November 15, 2004. As of the publication date of this document, all nonaccelerated filers, including foreign private filers that are not accelerated filers, must comply for fiscal years ending on or after July 15, 2007. Foreign private issuers that are accelerated filers must comply for fiscal years ending on or after July 15, 2006. Registrants must comply with the quarterly requirements to identify and disclose material changes in internal control over financial reporting for the first fiscal quarter occurring after the first annual report filed in compliance with Section 404. In May 2006, the SEC announced the possibility of a delay in implementation for certain smaller companies.

Internal Control Audit Requirements. PCAOB Auditing Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*, provides guidance to registered public accounting firms applicable to auditing internal control over financial reporting. The audit of internal control over financial reporting and the audit of financial statements are performed in an integrated manner. With respect to the internal control attestation, the standard requires the independent auditor to:

- Evaluate management’s assessment and test the effectiveness of internal control over financial reporting
- Issue opinions on management’s assessment of the effectiveness of internal control over financial reporting and on the effectiveness of internal control over financial reporting
- Perform limited quarterly procedures to identify whether any material modification should be made to disclosures regarding changes in internal control over financial reporting made in connection with quarterly filings and the certifications of the chief executive officer and chief financial officer.

The standard also clarifies that the evaluation of the audit committee’s effectiveness is the responsibility of the board of directors. However, the standard indicates that the independent auditor should consider the audit committee’s effectiveness in assessing the control environment. Refer to Section 16 for a more detailed discussion of the factors the auditor should consider in this process.

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Definitions of Internal Control

The Section 302 and 404 rules make reference to internal control, disclosure controls and procedures, and internal control over financial reporting. These are closely related, but also distinguishable. A definition of each follows.

Internal Control – The most widely accepted definition of internal control was developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO): “A process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives” in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations.

Disclosure Controls and Procedures – This concept was introduced by the SEC following passage of the Sarbanes-Oxley Act. Disclosure controls and procedures are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified by the SEC. The definition further states that disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that the information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. This definition includes both financial and nonfinancial disclosures. Examples of nonfinancial disclosure include such items as the signing of a significant contract, reporting of the number of units sold, developments regarding intellectual property, changes in union relationships, termination of a strategic relationship, legal proceedings, or required disclosures in management’s discussion and analysis in Forms 10-K, 10-Q, 20-F, and 40-F.

Internal Control over Financial Reporting – The SEC defines internal control over financial reporting as “a process designed by, or under the supervision of, the issuer’s principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer’s board of directors, management, and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- (1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;
- (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the registrant; and
- (3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the issuer’s assets that could have a material effect on the financial statements.”

Like disclosure controls and procedures, internal control over financial reporting is a subset of internal control.

Relationship between Sections 302 and 404 and a Control Framework.

In adopting its rule on management's internal control reports, the SEC stated that "while there is a substantial overlap between a company's disclosure controls and procedures and its internal control over financial reporting, there are both some elements of disclosure controls and procedures that are not subsumed by internal control over financial reporting and some elements of internal control over financial reporting that are not subsumed by the definition of disclosure controls and procedures."

From a practical point of view, however, companies can benefit by viewing internal control over financial reporting as a subset of disclosure controls and procedures. An internal control structure that simultaneously focuses on both disclosure controls and procedures and internal control over financial reporting can help a company comply with the quarterly requirements of Section 302, the requirements of Section 404, and the independent auditor's requirement to perform the audit procedures prescribed under Section 404.

The COSO internal control framework categorizes effective internal control into five interrelated components, simplifying management's task of administering and supervising all the activities that contribute to a successful structure of internal control. COSO encompasses both financial reporting controls and disclosure controls. A discussion of each element of COSO follows.

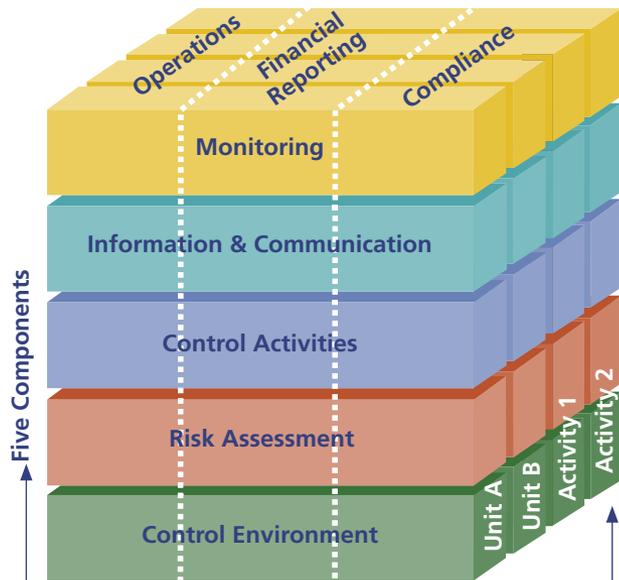


COSO Cube: Relationship of Objectives and Components

There is a direct relationship between objectives, which represent what an entity strives to achieve, and components, which represent what is needed to achieve the objectives.

Information is needed for all three objective categories—to manage business operations effectively, prepare financial statements reliably, and determine compliance.

Three Objectives Categories



Internal control is relevant to an entire enterprise and to any of its units or activities.

All five components are applicable and important in achieving objectives.

- The **control environment** encompasses every facet of the internal control framework; it is the universe in which all other elements exist. The control environment includes such concepts as tone, attitude, awareness, competence, and style. It derives much of its strength from the tone established by the company's board and executives.
- **Risk assessment** involves management's identification and analysis of risks to achieving business objectives. The goal of a risk assessment is to document business objectives and to identify the risks that could undermine those objectives.
- **Control activities** are developed to address each control objective and mitigate the risks identified. They are the specific policies, procedures, and practices for achieving business objectives and mitigating risk. The range of controls is broad; activities for a particular company will depend on the nature of the business. Examples of control activities include segregation of duties, account reconciliation, use of authorization signatures, matching of invoices to purchase orders, and physical security of assets.
- **Information and communication** support internal control by conveying directives from management to the employees in a form and a time frame that allows them to perform control activities effectively. The process should also work in reverse, allowing information on results and deficiencies to be communicated from the lowest levels to executives and the board of directors.
- **Monitoring** assesses the quality of internal control over time through ongoing and special evaluations. Monitoring can include both internal and external oversight of internal control by management, employees, or outside parties (such as outsourced internal audit functions).

Common Practices and Steps for Consideration. Although the audit committee does not have direct responsibility for internal certification, reporting, and audit, there are certain actions that the audit committee might consider in exercising its oversight responsibility. These actions and associated common practices are outlined in the accompanying table.

Action	Associated Practices
Demonstrate that the audit committee takes responsibility for oversight of internal control over financial reporting and devotes sufficient time to that oversight	<ul style="list-style-type: none"> • Include oversight of internal control over financial reporting as a purpose in the audit committee charter • Include Section 404 status updates on the audit committee’s annual calendar and on meeting agendas • Hold substantive discussions of internal control over financial reporting at audit committee meetings and in private sessions with management, the internal auditor, and the independent auditor • Review management’s Section 404 report and the independent auditor’s attestation to be included in the annual report filing
Understand the responsibilities of management, the internal auditor, and the independent auditor with respect to internal control over financial reporting	<ul style="list-style-type: none"> • Hold meetings with management, the independent auditor, and the internal auditor when necessary • Understand background materials on Section 404 requirements • Understand the independent auditor’s audit plan • Understand management’s plan for complying with Section 404
Consider the depth and competency of the internal audit function and understand its involvement in testing internal control over financial reporting	<ul style="list-style-type: none"> • Understand the internal audit plan and scope for Section 404 work and/or the portion of management’s Section 404 plan that relates to the internal audit function • Understand the extent to which the independent auditor relies on the work of the internal auditor • Consider the qualifications of the internal audit professionals involved in the Section 404 work, particularly the chief audit executive
Understand the controls related to the company’s critical accounting policies and accounting estimates that involve significant judgments	<ul style="list-style-type: none"> • Include critical accounting policies and accounting estimates that involve significant judgments as recurring agenda items for discussion with management and the independent auditor • The audit committees of NYSE-listed companies should review analyses prepared by management and/or the independent auditor concerning financial reporting matters and judgments (see further discussion in Section 17) • To the extent possible, consider whether the accounting policies adopted by the company are consistent with those of its peers
Hold management accountable for resolving significant deficiencies and material weaknesses	<ul style="list-style-type: none"> • Understand significant deficiencies and material weaknesses as soon as possible • Understand management’s time frame and plan for resolving significant deficiencies and material weaknesses • Follow up on the status of remediation plans • Discuss the sufficiency of remediation plans and implementation with the independent auditor • Request evidence (i.e., results of testing, etc.) that remediation plans are operating effectively
Monitor the progress and results of management’s assessment of internal control over financial reporting and the independent auditor’s attestation	<ul style="list-style-type: none"> • Make the status of the assessment and attestation of internal control over financial reporting an agenda item for appropriate private sessions with management and the independent auditor • Meet periodically with representatives of the steering committee for internal control over financial reporting to discuss status, obstacles, deficiencies, and remediation plans • Meet periodically with third-party service providers involved in Section 404 work
Understand management’s basis for certifying the financial statements in accordance with Section 302 of the Sarbanes-Oxley Act	<ul style="list-style-type: none"> • Understand the specific process used to enable the chief executive officer and the chief financial officer to sign the certification (i.e., subsidiary subcertifications, disclosure checklists, etc.) • Review the quarterly certification • Meet with representatives of the disclosure committee periodically to understand anomalies, issues, and plans for remediation

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Internal Control Certifications, Reports, and Audits



Considerations Looking Forward. As issuers complete their initial years of compliance with the Section 404 reporting and audit requirements, they should begin to shift their focus to long-term sustainability. The lessons learned in the first years of compliance can be valuable in that effort. The audit committee may consider asking the following questions in this regard:

- Has the company learned from its successes and identified areas for improvement?
- If the internal auditor was used for compliance-related work, has the company considered whether this practice will continue? If so, are additional internal audit resources needed?
- Has the company provided for the appropriate level of accountability by revising the roles and responsibilities of those employees who will continue to play significant roles in compliance efforts?
- Does the company have plans for continuing education on business ethics, internal control, the Sarbanes-Oxley Act, and related topics to support strong internal controls and corporate governance?
- Has the company identified redundant processes, controls, and technologies and put plans in place to eliminate these inefficiencies and rationalize controls?
- Has the company assessed the need for additional technology investment to support sustainable compliance and provide for the integration of financial and internal control monitoring and reporting?
- Has the company established a risk management program to identify key financial reporting risks, assess their potential impact, and link those risks to specific areas and activities in the organization?
- What is the company doing to identify the benefits of future compliance efforts?

Tools and Resources. Deloitte & Touche has a number of tools and resources to help audit committees understand internal control over financial reporting and fulfill their oversight responsibilities. For a programmatic approach to rationalizing controls, refer to *Lean and Balanced: How to Cut Costs without Compromising Compliance*. For information on the audit requirements, refer to *Highlights of the PCAOB's Auditing Standard No. 2*. For background on the reporting requirements, as well as a framework for compliance, refer to Deloitte & Touche's *Taking Control: A Guide to Compliance with Section 404 of the Sarbanes-Oxley Act of 2002*. This document also details the composition and role of the disclosure committee. *A Capital Idea: Why It Just Might Make Sense to Do More than Sarbanes-Oxley Mandates* and *Under Control: Sustaining Compliance with Sarbanes-Oxley in Year Two and Beyond* provide insight on how to move beyond compliance and derive recognizable value from the Section 404 requirements. These and other resources, including benchmarking surveys regarding compliance with Section 404 requirements, are available on Audit Committee Online.

The AICPA's Audit Committee Toolkit includes "Internal Control: A Tool for the Audit Committee." This document provides an overview of internal control, including the COSO framework, key terms, limitations of internal control, roles and responsibilities with respect to internal control, and an overview of the certification and Section 404 requirements. In addition, it provides a thorough list of questions, framed around the COSO elements, that audit committees can use to help understand the control framework and evaluate its effectiveness. The AICPA toolkit also includes "SOX Section 404: Responding to an Adverse Report—A Checklist for the Audit Committee," which outlines steps an audit committee might consider if its company receives an adverse report on internal control over financial reporting. Both tools are available at www.aicpa.org.



Risk Assessment and Oversight

The audit committee should have a thorough understanding of the company's major financial risk exposures.

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

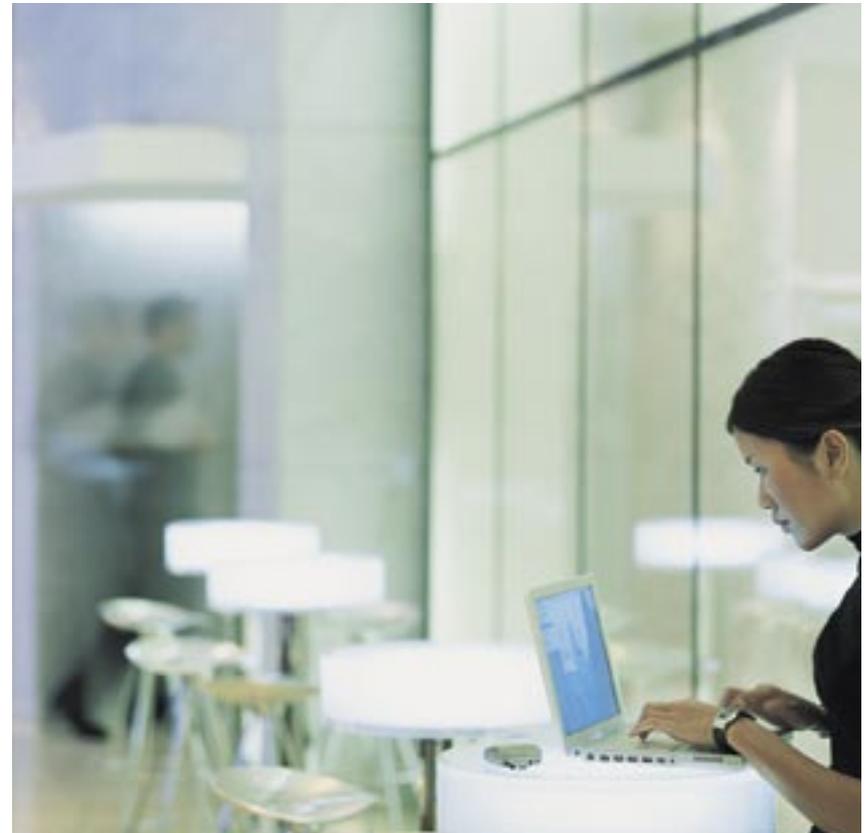
Common Practices and Steps for Consideration. Traditionally, audit committees have focused on understanding a company's financial reporting and the related risk management programs. Audit committees are now obtaining an understanding of the broader risks affecting the company, as well as the company's overall risk management program. The NYSE requirements relate to financial risk exposures, which are often a consequence of other sources of risk, such as those disclosed in the company's Forms 10-Ks and 10-Qs. These may include strategy, operations, and compliance with environmental, health, safety, legal, and regulatory requirements. Thus, audit committees should develop a thorough understanding of the company's overall risk management process across the enterprise.

The Risk Intelligent Audit Committee. There are a growing number of tools companies can use to support the management of enterprise risks, including risks associated with financial reporting; to assess the potential impact of risks and the degree of vulnerability; and to link risks to specific management areas and activities in the organization.

When considering both the effectiveness and efficiency of the company's process for enterprise risk management, audit committees might ask the following questions:

- What is the company's policy and process for assessing and managing major financial risk exposures on an integrated, enterprisewide basis?
- What are the key risks and vulnerabilities and the plans to address them?
- What is the company's appetite for risk and how much risk has it assumed?
- How capable is the company of preparing for, responding to, and recovering from major financial risk exposures?

Considering Risk Management Capability. In assessing a company's risk management capability, it may be helpful to consider the following eight dimensions that incorporate COSO's guidance on enterprise risk management. A subset of these elements, designed specifically for internal control, is discussed in Section 12.



Section Thirteen
Risk Assessment and Oversight

Capability Category	Capability Category Definition
Governance and Risk Oversight	This dimension encompasses the enterprise's tone at the top; its risk governance structure (e.g., committees, charters, authorities); its risk management policies, including its tolerance of specific types of risk; and its appetite for those risks it is willing to take. This dimension is the basis for all other components of enterprise risk management and risk-intelligent decision-making, including the company's philosophy about how risk should be understood and managed. Properly designated managers should exercise authority and direction over assigned resources to accomplish business objectives.
Risk Identification	Management identifies potential internal and external events that are relevant to the business and that could significantly affect the entity. Risks to business objectives should be considered as scenarios and chains of events rather than as isolated incidents. This includes risks to future growth objectives as well as risks to existing assets.
Risk Assessment	Risk assessment enables the business to consider the extent to which potential events may have an impact on the achievement of objectives, as well as the residual exposure of the business after taking into account current risk mitigation and controls. It also helps prioritize the allocation of resources.
Response Alternatives and Response Plan	Risk response is management's determination of how to respond based on its assessment of the relevant risks. The response may be to avoid a risk, accept it, or transfer it.
Control Activities, Assurance, and Testing	Control activities are the policies and procedures that help management carry out risk responses. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities, such as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties.
Risk Intelligence, Communication, and Training	Risk intelligence results from the collection, processing, integration, analysis, evaluation, and interpretation of available information concerning risks to the enterprise. Pertinent risk intelligence is identified, captured, and communicated in a form and time frame that enables trained people to carry out their responsibilities. Personnel should be trained to make rapid and appropriate decisions using the risk intelligence available to them.
Monitoring and Escalation	Enterprise risk management is monitored by assessing the presence and functioning of its components over time, and deficiencies should be reported upward. Serious matters should be reported to top management and the board.

Assessment of Enterprise Risk. To keep the company's risk profile aligned with changes in the business, enterprise risk should be assessed by management at least once a year. Also, any significant business events (e.g., acquisitions, mergers, or divestitures) should result in the re-evaluation of a company's risk profile and its implications for financial reporting. Although management has the primary responsibility for assessing enterprise risk, the audit committee and the board may have an active role in overseeing the process and in understanding management's response to the identified risks.

In its assessment of enterprise risk, management should:

- Determine the specific risks that might arise as a consequence of the organization's business model, strategy, and operations, thereby identifying and prioritizing risks in the context of the company's unique characteristics and operating environment
- Assess the potential impact of each identified risk on the integrity of financial reporting, as well as on the company's strategy, operations, and compliance activities

- Align each risk with the company's objectives for creating and preserving value, including specific business processes or functional areas in which that risk may occur
- Assign responsibility for monitoring, responding to, and controlling each risk, or set of risks, to the appropriate individuals
- Monitor and report on changing risk conditions
- Establish formal communication and escalation protocols regarding risk response, control performance, and changes to the organization's risk profile.

In considering the effectiveness of the company's risk assessment process, the audit committee may pose the following questions:

- Has the company assigned responsibility for the overall assessment of enterprise risk to a specific group of people at the appropriate organizational level?
- Are risks consistently prioritized, controlled, and communicated throughout the organization?
- Have specific risks been explicitly mapped to specific business strategies, lines of business, legal entities, product lines, geographies, business functions, business processes, and relevant control areas and, in turn, to the individuals responsible for these areas?
- Do employees and third parties (such as contractors and outsourcing organizations) understand the risks associated with their business areas and the processes they perform? Do they execute appropriate risk response and relevant control activities?
- Does the supporting technology adequately collect, document, track, and maintain risk-related information?

Tools and Resources. Audit Committee Online includes a number of tools and resources to assist audit committee members in better understanding risk management. These include Deloitte & Touche's *ERM Done Right: The Risk Intelligent Enterprise* and Deloitte Research's *Disarming the Value Killers: A Risk Management Study*. In addition, *Report of the NACD Blue Ribbon Commission on Risk Oversight: Board Lessons for Turbulent Times* can be ordered at www.nacdonline.org.

General characteristics of a risk intelligent organization supported by an effective risk management program:

- Intelligent risk-taking is consistent with the enterprise's approved risk appetite and is consistent with performance measurement and management.
- Key decisions are based on strategic risk-taking and are made in a risk-informed manner. For instance, new markets, new products, new business models, and strategies consider the "worst-case/weakest-link" scenarios, the value of these risks to the enterprise, and the relationship of these scenarios to the risk appetite of the enterprise.
- The enterprise should be able to reduce its vulnerability to adverse events through increased preparedness and a greater ability to prevent, detect, correct, and escalate such events when required.
- Risks are aggregated and interdependencies, potential chain reactions, and scenarios are understood and embedded in monitoring, response, and control activities.
- The board of directors approves the delegation of authority to those who are permitted to take risks.
- An enterprise risk officer is commissioned to enable the integration of risk management across the enterprise. Business-unit leaders own the risk and are responsible for risk response. Executive compensation reflects the business-unit leaders' accountability for risk response.
- Sustainable processes are used and are supported by an infrastructure to identify and deploy effective practices.
- Risk management is everyone's job, and is embedded in day-to-day management processes and incentive compensation.
- The organization values the risk it takes and discloses.
- The organization is risk-aware, risk-informed, and selectively risk-averse relative to its risk appetite.



Board Education and Orientation

Boards and audit committees should use a needs-based approach to determine the specific topics in a continuing-education program.

Background. With the enhanced focus on the roles and responsibilities of boards and audit committees, continuing education for directors is an area of increasing importance. The NYSE listing standards require companies to adopt and disclose guidelines for corporate governance that address their policies for director orientation and continuing education.

Directors who serve on audit committees have an additional reason to focus on continuing education. Even if an audit committee member is not determined to be an audit committee financial expert, as defined by the SEC's final rule to implement Section 407 of the Sarbanes-Oxley Act, the NYSE requires audit committee members of listed companies to be financially literate. NASDAQ requires them to be able to read and understand financial statements. This concept is not new—the NYSE and NASDAQ began requiring financial literacy for audit committees in 2000, after the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees issued its recommendations. Heightened media scrutiny in the wake of scandals is shining a brighter light on the competency of audit committee members.

Further contributing to the need for enhanced board education is the trend for third parties to analyze a company's governance practices, either qualitatively or quantitatively. Several organizations, including GovernanceMetrics International, Institutional Shareholder Services, and the Corporate Library, are analyzing and grading boards in the area of corporate governance. Continuing education is one area that affects a company's overall governance score. For example, boards that participate in programs accredited by Institutional Shareholder Services receive points toward their overall corporate-governance quotient.

Common Practices, Tools, and Resources. A needs-based approach may help determine the specific topics in a program of continuing education. There are many program options; for instance, public forums on corporate governance are offered by many professional-services firms, universities, and not-for-profit organizations. These programs have a number of benefits, including the opportunity to meet with peers and share experiences, and they can be invaluable for gaining knowledge from experts on legislative and regulatory developments and trends in corporate governance. These forums often feature thought leaders who would not be available otherwise. However, boards should be careful not to rely completely on public programs designed for a broad audience, because these programs may not address the unique dynamics of each industry and company.

An increasingly popular option is a customized program of continuing education. The objective of a customized program is to focus on improvement opportunities

in broad categories, such as the roles and responsibilities of the board and audit committee, risk monitoring, industry expertise, and financial literacy. Customized courses can address topics that are relevant to the company's needs and incorporate company-specific policies, processes, and objectives. Deloitte & Touche offers a number of Web-based and live opportunities for director education. For additional information, visit the Deloitte Learning Web site at www.deloittelearning.com.

Deloitte & Touche's *10 Tips for Educating Your Board*, which is available on Audit Committee Online, provides suggestions for effective director education. For instance, when designing a continuing-education program, the board should identify the key risks and complex issues facing the organization. Directors can then rate their knowledge of these areas. This self-assessment can help the board gain a better picture of the issues it should include in its continuing-education program. Depending on the size and complexity of the organization, the board may also enlist the internal auditors or outside consultants in the self-assessment process.

For the audit committee, the focus is more specific, centered on key financial reporting and accounting issues such as revenue recognition, pensions and other post-employment benefits, financial instruments, other critical accounting policies, and internal controls. The audit committee may use Deloitte & Touche's financial literacy self-assessment tools, available on Audit Committee Online, to help identify specific areas that require enhanced educational focus.

Once a curriculum is set, the board, the audit committee, and management should assess the resources available to create and deliver the program. The program should be developed with an appropriate mix of individuals with company knowledge and those with an objective, external perspective.

In addition to continuing education for the board, the company should consider orientation programs for new directors and audit committee members. Materials can include general information on the history of the company and its operations, corporate governance, recent SEC filings, industry-specific information, accounting policies and practices, company policies and the code of ethics, and major business and financial risks. To assist in this process, Deloitte & Touche has developed a template for board orientation, which is available on Audit Committee Online.

Finally, a 2006 survey by Deloitte & Touche includes benchmarking information on the education practices of boards and audit committees. The results of the survey are available through your Deloitte & Touche partner.



Review of Earnings Press Releases and Use of Non-GAAP Financial Measures

The audit committee should consider what protocols it will employ to oversee earnings press releases, as well as financial information and earnings guidance provided to analysts and ratings agencies.

Overview of the Requirements. The NYSE listing standards now require the audit committee charter to include a provision regarding the audit committee's responsibility to discuss the company's earnings press releases, as well as financial information and guidance provided to analysts and ratings agencies. The commentary to the listing standards indicates that these discussions may be on general terms, and the audit committee may discuss the types of information to be disclosed and the types of presentations to be made. The commentary also indicates that the review should pay particular attention to the use of any pro forma or adjusted non-GAAP financial information. In addition, SEC rules require registrants to furnish earnings releases or similar announcements on Form 8-K.

Regulation G, one of the SEC's rules implementing Section 401 of the Sarbanes-Oxley Act, requires the disclosure or release of any material information containing non-GAAP financial measures to include a presentation of the most directly comparable GAAP financial measures and a reconciliation of the two.

In addition, the SEC adopted rules under Section 401 of the Sarbanes-Oxley Act that govern the use of non-GAAP financial measures in SEC filings. Like Regulation G, these rules require a presentation of the most directly comparable GAAP financial measure and a reconciliation of the two, and also require a statement of why the company's management believes the non-GAAP financial measure provides useful information to investors and for what purpose management uses the non-GAAP financial measure. Although companies may be permitted to use certain non-GAAP financial measures in press releases under Regulation G, there are additional prohibitions on the use of certain non-GAAP measures disclosed in SEC filings. For example, common recurring adjustments to GAAP earnings, such as restructuring charges, asset impairments, realized gain or loss on investment securities, and gain or loss on asset sales may not be permitted unless the company can demonstrate the usefulness of the measure.

Common Practices and Steps for Consideration. The audit committee should consider what protocols it will employ to oversee earnings press releases, as well as financial information and earnings guidance provided to analysts and ratings agencies. For example, a number of companies now have the full audit committee review earnings press releases before they are issued. In its discussion

of press releases and earnings guidance, the audit committee should confirm that an appropriate legal review has been completed covering the accuracy and completeness of the disclosure, including any obligation to report on trends, as well as compliance with the company's policies concerning the issuance of forward-looking statements and the completeness of any related disclaimers included in the disclosure.

The committee should consider the SEC's rules under Section 401 of the Sarbanes-Oxley Act regarding the use of non-GAAP financial measures. In this regard, the audit committee may wish to ask questions of management regarding the use of non-GAAP and pro forma financial measures in earnings press releases, filings with the SEC, and other public releases of information. These could include:

- Does management have an established policy for the determination of non-GAAP or pro forma financial measures?
- What non-GAAP or pro forma financial measures are used?
- What are the underlying rationale, purpose, and usefulness of the non-GAAP or pro forma financial measures used?
- Are there substantive reasons why management believes the non-GAAP measure provides useful information to investors?
- Are the non-GAAP or pro forma measures consistent with those used by peers and competitors in the industry?
- Are all non-GAAP financial measures reconciled to appropriate GAAP measures?
- Are the GAAP financial measures presented with greater prominence than, or at least equal prominence to, the non-GAAP financial measures?
- What is the difference in earnings per share under the GAAP and non-GAAP financial measures?
- Did the company meet analyst expectations for earnings per share using non-GAAP or pro forma financial measures, but not using GAAP financial measures?

Section Fifteen

Review of Earnings Press Releases and Use of Non-GAAP Financial Measures

- Is the company in a net-loss position when GAAP financial measures are used, but in a net-income position when non-GAAP or pro forma financial measures are used?
- When reconciling from non-GAAP to GAAP financial measures, are there only subtractive adjustments? Stated differently, has management only included non-GAAP adjustments that increase income? If so, are there non-GAAP adjustments that would decrease income that should have been highlighted to ensure the financial information is not misleading and is appropriately balanced?
- Is management comfortable that no material facts have been omitted or misrepresented?
- Are changes made to the non-GAAP or pro forma financial measures used from period to period? If so, do these changes enhance non-GAAP or pro forma adjusted earnings for the current period?

Resources and Tools. A number of relevant tools and resources are available on Audit Committee Online's "Earnings Guidance Practices" page. These include results of a 2005 benchmarking survey conducted by the National Investor Relations Institute and *Meeting the Street: A Discussion of Earnings and Other Guidance Provided to Investors*, a publication produced by Deloitte & Touche and FEI. Deloitte & Touche's *Conditions for Use of Non-GAAP Financial Measures*, which also is available on the site, provides an in-depth look at the SEC rules governing the use of non-GAAP financial measures.





Audit Committee Performance Evaluation

Committee members should collaborate on a process that is appropriate for the board and the audit committee.

Overview of the Requirements. The Sarbanes-Oxley Act does not require audit committees to assess their performance, but the legislation may be the strongest argument yet for a robust evaluation process. The NYSE listing standards do require boards and audit committees to perform an annual performance evaluation, and the responsibility for conducting this must be set forth in the audit committee's charter.

Aside from the requirements, performance assessment provides information that the audit committee can use to improve processes. This is important because the independent auditor must consider the effectiveness of the audit committee's oversight of financial reporting when evaluating the control environment as part of its Section 404 audit procedures. Although it acknowledges that the board of directors is ultimately responsible for evaluating the audit committee's performance, PCAOB Auditing Standard No. 2 indicates that the following factors should be included in the auditor's consideration of the audit committee's effectiveness:

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

Common Practices and Steps for Consideration. Because there are no specific, comprehensive guidelines for assessing an audit committee's performance, members and directors have the benefit and the burden of collaborating on a process that is appropriate for the company. When appropriate, this should be done in consultation with legal counsel.

In shaping the assessment process, there are several considerations. First, there are various parties that may lead the assessment: the audit committee; the entire board or its nominating/governance committee, which often oversees the board

and committee evaluation process; the internal auditor; or management. The audit committee and the board may find that some combination of these is optimal.

The format of the evaluation process is another consideration. If a self-assessment is performed, audit committee members may complete a questionnaire collectively or individually. If the internal auditor, the board, or management leads the process, the format may include evaluation forms, interviews, or both. The party leading the evaluation—whether it is the audit committee, the board, the internal auditor, or management—might consider how to solicit information from individuals who have significant interaction with the audit committee.

The documentation process is another significant consideration. The advice of corporate counsel is important in this matter. Regardless of the level of documentation in the evaluation process, the audit committee should develop a plan for identifying and addressing opportunities for improvement.

Developing and executing a plan for improvement is the ultimate objective of the assessment. A performance evaluation may highlight the need to re-examine certain issues, such as the audit committee's composition and qualifications, information that is received or reviewed related to key financial reporting areas, members' understanding of complex or significant accounting and financial reporting issues, and the appropriateness of meeting agendas.

Tools and Resources. There are a number of tools for performance evaluation available to the audit committee, including one developed by Deloitte & Touche. Our form for the evaluation of audit committee performance includes questions on topics such as risk monitoring, internal controls, the audit function, and financial reporting. This evaluation model incorporates examples of practices that have been employed by audit committees. The performance-evaluation tool, a document discussing key considerations in the assessment, and our financial-literacy assessments are available on Audit Committee Online. The AICPA's Audit Committee Toolkit also includes an audit committee self-evaluation. It is available at www.aicpa.org.

The NYSE listing standards require boards to adopt and disclose corporate-governance guidelines that address an annual evaluation of the board. NACD published a Blue Ribbon Commission report on board evaluation, which is available at www.nacdonline.org.

Other Areas of Focus for the Audit Committee

The NYSE and NASDAQ listing standards include additional responsibilities for audit committee members, and the Sarbanes-Oxley Act also grants additional authority.

The NYSE and NASDAQ listing standards include various responsibilities for audit committee members beyond those discussed in the previous sections. The Sarbanes-Oxley Act also grants additional authority to the audit committee.

Audit Committee Holds Periodic Private Meetings with Management, the Independent Auditor, and the Internal Auditor.

Under the NYSE listing standards, the audit committee must meet periodically in private session with management, the independent auditor, and the internal auditor. Separate executive sessions should be held with each party each quarter. These sessions should be scheduled on the audit committee's calendar of activities, but there should be enough flexibility to hold additional, unscheduled private sessions when circumstances warrant.

For a list of suggested questions for management, the independent auditor, and the internal auditor during private sessions, refer to the AICPA's "Conducting an Executive Session: Guidelines and Questions." This is part of the AICPA's Audit Committee Toolkit and is available at www.aicpa.org.

Authority to Engage Independent Counsel and Advisors and the Authority to Determine Funding. Section 301 of the Sarbanes-Oxley Act and the NYSE and NASDAQ listing standards provide the audit committees of listed companies with the authority to engage independent counsel and advisors as needed. The audit committee is also granted the authority to compensate those parties as it considers appropriate.

The audit committee may use the same counsel and advisors as management, but certain circumstances may warrant otherwise. To date, the outside advisors most often engaged by audit committees appear to be lawyers. A 2004 survey of the client service teams for Deloitte & Touche's largest attest clients indicated that the top five reasons audit committees engage legal counsel are: legal proceedings, corporate-governance issues, whistleblower inquiries, fraud concerns, and SEC matters. The services may be investigative, or they may be used to identify potential process improvements.

The AICPA's Audit Committee Toolkit includes a document entitled "Engaging Independent Counsel and Other Advisors," which is intended to help audit committees understand the considerations associated with engaging outside advisors. The document is available at www.aicpa.org.

Review and Approval of Related-Party Transactions. The NASDAQ listing standards require the audit committee of a listed company, or another independent body of the board, to review and approve all related-party transactions. To help determine that the audit committee has an efficient process for fulfilling this responsibility, the following questions may be helpful:

- What process will the committee follow in reviewing and approving related-party transactions?
- Will special meetings be called as potential transactions arise?
- What type of information is needed about each potential transaction to enable the committee to make an informed judgment about its appropriateness?
- Who will be responsible for presenting such information?

For each potential transaction brought to the committee for approval, the committee might consider asking:

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

Section Seventeen

Other Areas of Focus for the Audit Committee

The NYSE listing standards do not require audit committees to review and approve related-party transactions. However, some audit committees of those companies may have determined, in conjunction with legal counsel and management, that the audit committee should have some involvement in reviewing and approving such transactions. This determination recognizes that these transactions may be associated with elevated risk and shareholders may take additional comfort in the knowledge that the audit committee is overseeing their approval.

Other Review Requirements. NYSE listing standards require the audit committee to review certain other items. The first involves major issues regarding accounting principles and the presentation of the financial statements. These include any significant changes in the company's selection or application of accounting principles, major issues as to the adequacy of the company's internal controls, and any special audit steps adopted in light of what the NYSE terms "material control deficiencies." These discussions with management might be held during the review and discussion of the quarterly financial statements to be filed with the SEC. Certain discussions regarding internal controls and special audit steps adopted to address significant deficiencies also may be dictated by the Sarbanes-Oxley Act's Section 302 requirements for the chief executive officer and the chief financial officer. Refer to Section 12 for further discussion.

The second requirement is to review analyses prepared by management setting forth significant issues in financial reporting and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods. This discussion may be held during the meeting to review the quarterly financial statements. For ease of review, the audit committee may consider having management identify recurring issues related to financial reporting, including significant accounting policies, estimates, and judgments. In addition, a standard quarterly analysis may be useful for these meetings. Of course, management should tailor the analysis to include new or unusual items arising in the quarter. Because the rules to implement Section 204 of the Sarbanes-Oxley Act require the independent auditor to discuss alternative effects of GAAP methods on the financial statements, the information presented by management should be corroborated by the independent auditor.

The audit committee may find the lists of questions provided in Deloitte & Touche's Integrity & Quality series useful when considering questions to pose to management with regard to significant accounting issues, estimates, judgments, and initiatives. *IQ: Quality of Earnings* and *IQ: Quality of Financial Position: The Balance Sheet and Beyond* are both available on Audit Committee Online. In addition, the AICPA's Audit Committee Toolkit includes "Issues Report from Management," which can be used to document significant issues, judgments, and estimates for discussion with the audit committee.

The final requirement is to review the effect of regulatory and accounting initiatives, as well as off-balance-sheet structures, on the financial statements. As the audit committee is informed of pending technical and regulatory matters that could affect the company, management should discuss the potential effect of such initiatives on the financial statements. The audit committee should be apprised in a timely manner of management's plans to implement new technical or regulatory guidelines. The review of off-balance-sheet structures should be a recurring item on the agenda, and may be done as part of the committee's review of management's discussion and analysis in the annual and quarterly reports. The frequency will depend on the company's operations and inclination to use such structures. The audit committee should consider requiring a review of off-balance-sheet structures, or at least material ones, before they are executed.

Questions that may help audit committees in their review and discussions of related-party transactions can be found under the heading "Management's Summary of Off-Balance-Sheet Transactions," in the AICPA's Audit Committee Toolkit at www.aicpa.org. Because the accounting, legal, and financial implications of off-balance-sheet structures can be complex, the audit committee should seek advice from the appropriate internal and external advisors.





Sample Audit Committee Charter

This sample audit committee charter is based on a review of selected Fortune 1000 company charters, as well as the requirements of the Sarbanes-Oxley Act of 2002 and the NYSE and NASDAQ corporate-governance listing standards. It contains general information only and does not constitute, and should not be regarded as, legal or similar professional advice. This charter is not a substitute for such professional advice, nor should it be used as a basis for any decision or action that may affect you or your business. Any such decision or action should be taken only upon the advice of a qualified professional advisor. This charter was prepared based on information available as of June 21, 2006, and is subject to change if additional guidance is issued by the SEC, NYSE, or NASDAQ. Neither Deloitte & Touche LLP nor any of its affiliates or related entities have any liability or responsibility to any person or entity with respect to their use of or reliance on this charter. All companies should consult with legal counsel regarding the applicability and implementation of the various requirements identified.

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

Audit Committee of the Board of Directors—Charter

I. Purpose

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

- Overseeing the integrity of the company's financial statements **[NYSE Corporate Governance Rule 7(c)(i)(A)]** and the company's accounting and financial reporting processes and financial statement audits **[NASDAQ Corporate Governance Rule 4350(d)(1)]**
- Overseeing the company's compliance with legal and regulatory requirements **[NYSE Corporate Governance Rule 7(c)(i)(A)]**
- Overseeing the registered public accounting firm's (independent auditor's) qualifications and independence **[NYSE Corporate Governance Rule 7(c)(i)(A) and NASDAQ Corporate Governance Rule 4350(d)(1)(c)]**
- Overseeing the performance of the company's independent auditor **[NYSE Corporate Governance Rule 7(c)(i)(A) and NASDAQ Corporate Governance Rule 4350(d)(1)]** and internal audit function **[NYSE Corporate Governance Rule 7(c)(i)(A)]**
- Overseeing the company's systems of disclosure controls and procedures, internal controls over financial reporting, and compliance with ethical standards adopted by the company.

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

The audit committee has the authority to obtain advice and assistance from outside legal, accounting, or other advisors as necessary to perform its duties and responsibilities **[Sarbanes-Oxley Act Section 301, NYSE Corporate Governance Rule 6, and NASDAQ Corporate Governance Rule 4350(d)(3)]**.

The company will provide appropriate funding, as determined by the audit committee, for compensation to the independent auditor, to any advisors that the audit committee chooses to engage, and for payment of ordinary administrative expenses of the audit committee that are necessary or appropriate in carrying out its duties. **[Sarbanes-Oxley Act Section 301, NYSE Corporate Governance Rule 6, and NASDAQ Corporate Governance Rule 4350(d)(3)].**

The audit committee will primarily fulfill its responsibilities by carrying out the activities enumerated in Section III of this charter. The audit committee will report regularly to the board of directors regarding the execution of its duties and responsibilities **[NYSE Corporate Governance Rule 7(c)(iii)(H)].**

II. Composition and Meetings¹

The audit committee will comprise three or more directors as determined by the board. Each audit committee member will meet the applicable standards of independence and the determination of independence will be made by the board **[Sarbanes-Oxley Act Section 301, NYSE Corporate Governance Rules 6 and 7(a) and (b), and NASDAQ Corporate Governance Rule 4350(d)(2)].**

All members of the committee must comply with all financial-literacy requirements of the securities exchange(s) on which the company is listed. At least one member will qualify as an “audit committee financial expert” as defined by the SEC and determined by the board **[Sarbanes-Oxley Act Section 407].**²

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

The committee will meet at least quarterly, or more frequently as circumstances dictate. The committee chairperson will approve the agenda for the committee’s meetings and any member may suggest items for consideration. Briefing materials will be provided to the committee as far in advance of meetings as practicable. Each regularly scheduled meeting will conclude with an executive session of the committee absent members of management. As part of its responsibility to foster open communication, the committee will meet periodically with management, the director of the internal audit function, and the independent auditor in separate executive sessions **[NYSE Corporate Governance Rule 7(c)(iii)(E)].** In addition, the committee will meet with the independent auditor and management to discuss the annual audited financial statements and quarterly financial statements, including the company’s disclosures under “Management’s Discussion and Analysis of Financial Condition and Results of Operations” **[NYSE Corporate Governance Rule 7(c)(iii)(B)].**

¹Consideration also should be given to the amount of time members of the audit committee can devote to the role. Although there are no limits on the number of public-company audit committees on which an individual may serve, the NYSE states in the commentary to Corporate Governance Rule 7: “...if an audit committee member simultaneously serves on the audit committee of more than three public companies...the board must determine that such simultaneous service would not impair the ability of such member to effectively serve on the listed company’s audit committee and disclose such determination in the annual proxy statement.”

²A company is not required to have an audit committee financial expert, but the existence of at least one audit committee financial expert on the board is a common practice. A director who satisfies the criteria for an audit committee financial expert is presumed to satisfy the heightened financial literacy required of one member of the committee by the NYSE and NASDAQ. If a company has more than one audit committee financial expert, the rules allow the company to decide whether to disclose the existence and names of other individuals who qualify. If the board determines there is no audit committee financial expert on the audit committee, the company must disclose this fact in its applicable SEC filing and the reason why there is none.

III. Responsibilities and Duties

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

Documents/Reports/Accounting Information Review

1. Review this charter at least annually and recommend to the board of directors any necessary amendments **[NYSE Corporate Governance Rules and NASDAQ Corporate Governance Rule 4350(d)(1)]**.
2. Meet with management and the independent auditor to review and discuss the company's annual financial statements **[Item 306 of Regulation S-K]** and quarterly financial statements (prior to the company's Form 10-Q filings or release of earnings), as well as all internal control reports (or summaries thereof). Review other relevant reports or financial information submitted by the company to any governmental body or the public, including management certifications as required by the Sarbanes-Oxley Act of 2002 **[Sarbanes-Oxley Act Sections 302 and 906]** and relevant reports rendered by the independent auditor (or summaries thereof).
3. Recommend to the board whether the financial statements should be included in the annual report on Form 10-K **[Item 306 of Regulation S-K]**.
4. Discuss earnings press releases, including the type and presentation of information, paying particular attention to any pro forma or adjusted non-GAAP information. Such discussions may be in general terms (i.e., discussion of the types of information to be disclosed and the type of presentations to be made) **[NYSE Corporate Governance Rule 7(c)(iii)(C) and general commentary to Rule 7(c)]**.
5. Discuss financial information and earnings guidance provided to analysts and ratings agencies. Such discussions may be in general terms (i.e., discussion of the types of information to be disclosed and the type of presentations to be made) **[NYSE Corporate Governance Rule 7(c)(iii)(C) and general commentary to Rule 7(c)]**.
6. Review the regular internal reports to management (or summaries thereof) prepared by the internal audit function, as well as management's response.

Independent Auditor

7. Appoint (and recommend that the board submit for shareholder ratification, if applicable), compensate, retain, and oversee the work performed by the independent auditor for the purpose of preparing or issuing an audit report or related work. Review the performance and independence of the independent auditor and remove the independent auditor if circumstances warrant. The independent auditor will report directly to the audit committee and the audit committee will oversee the resolution of disagreements between management and the independent auditor if they arise **[Sarbanes-Oxley Act Section 301, NYSE Corporate Governance Rule 6, and NASDAQ Corporate Governance Rule 4350(d)(3)]**.
8. Consider whether the auditor's provision of permissible nonaudit services is compatible with the auditor's independence. Discuss with the independent auditor the matters required to be discussed under Statement on Auditing Standards (SAS) No. 61, as amended by SAS No. 84 and SAS No. 90 **[Item 306 of Regulation S-K]**.
9. Review with the independent auditor any problems or difficulties and management's response **[NYSE Corporate Governance Rule 7(c)(iii)(F)]**.

10. Review the independent auditor's attestation and report on management's assessment of internal control over financial reporting **[Sarbanes-Oxley Act Section 404]**.
11. Hold timely discussions with the independent auditor regarding the following:
 - All critical accounting policies and practices **[Sarbanes-Oxley Act Section 204]**
 - All alternative treatments of financial information within generally accepted accounting principles related to material items that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditor **[Sarbanes-Oxley Act Section 204]**
 - Other material written communications between the independent auditor and management, including, but not limited to, the management letter and schedule of unadjusted differences **[Sarbanes-Oxley Act Section 204]**.
12. At least annually, obtain and review a report by the independent auditor describing:
 - The independent auditor's internal quality-control procedures **[NYSE Corporate Governance Rule 7(c)(iii)(A)]**
 - Any material issues raised by the most recent internal quality-control review or peer review, or by any inquiry or investigation conducted by governmental or professional authorities during the preceding five years with respect to independent audits carried out by the independent auditor, and any steps taken to deal with such issues **[NYSE Corporate Governance Rule 7(c)(iii)(A)]**
 - All relationships between the independent auditor and the company **[NYSE Corporate Governance Rule 7(c)(iii)(A)]**, addressing the matters set forth in Independence Standards Board Standard No. 1 **[Item 306 of Regulation S-K]**.

This report should be used to evaluate the independent auditor's qualifications, performance, and independence. Further, the committee will review the experience and qualifications of the lead partner each year and determine that all partner rotation requirements, as promulgated by applicable rules and regulations, are executed. The committee will also consider whether there should be rotation of the independent auditor itself **[Commentary to NYSE Corporate Governance Rule 7(c)(iii)(A)]**.
13. Actively engage in dialogue with the independent auditor with respect to any disclosed relationships or services that may affect the independence and objectivity of the auditor and take appropriate actions to oversee the independence of the outside auditor **[NASDAQ Corporate Governance Rule 4350(d)(1)]**.
14. Review and preapprove (which may be pursuant to preapproval policies and procedures³) both audit and nonaudit services to be provided by the independent auditor. The authority to grant preapprovals may be delegated to one or more designated members of the audit committee, whose decisions will be presented to the full audit committee at its next regularly scheduled meeting **[Sarbanes-Oxley Act Section 202]**.
15. Set policies, consistent with governing laws and regulations, for hiring personnel of the independent auditor **[NYSE Corporate Governance Rule 7(c)(iii)(G)]**.⁴

³Any policy under which audit or nonaudit services are preapproved needs to be detailed as to the particular services and the audit committee needs to be informed of each service **[Regulation S-X, 2-01(c)(7)]**.

⁴Such policy should take into consideration the one-year "cooling-off period" for individuals in a financial reporting oversight role, such as the CEO, CFO, controller, CAO, or the equivalent, as required by Section 206 of the Sarbanes-Oxley Act, as well as other prohibited relationships under the related rules of the SEC.

Financial Reporting Processes, Accounting Policies, and Internal Control Structure

16. In consultation with the independent auditor and the internal audit function, review the integrity of the company's financial reporting processes (both internal and external), and the internal control structure (including disclosure controls and procedures and internal control over financial reporting).
17. Receive and review any disclosure from the company's CEO or CFO made in connection with the certification of the company's quarterly and annual reports filed with the SEC of: a) significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize, and report financial data; and b) any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal controls ***[Sarbanes-Oxley Act Section 302]***.
18. Review major issues regarding accounting principles and financial statement presentations, including any significant changes in the company's selection or application of accounting principles; major issues as to the adequacy of the company's internal controls; and any special audit steps adopted in light of material control deficiencies ***[General commentary to NYSE Corporate Governance Rule 7(c)]***.
19. Review analyses prepared by management (and the independent auditor as noted in item 11 above) setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements ***[General commentary to NYSE Corporate Governance Rule 7(c)]***.
20. Review the effect of regulatory and accounting initiatives, as well as off-balance-sheet structures, on the financial statements of the company ***[General commentary to NYSE Corporate Governance Rule 7(c)]***.
21. Review and approve all related-party transactions, defined as those transactions required to be disclosed under Item 404 of Regulation S-K ***[NASDAQ Corporate Governance Rule 4350(h)]***.
22. Establish and oversee procedures for the receipt, retention, and treatment of complaints regarding accounting, internal accounting controls, or auditing matters, including procedures for confidential, anonymous submissions by company employees regarding questionable accounting or auditing matters ***[Sarbanes-Oxley Act Section 301, NYSE Corporate Governance Rule 6, and NASDAQ Corporate Governance Rule 4350(d)(3)]***.

Internal Audit ^{5,6}

23. Review and advise on the selection and removal of the internal audit director.
24. Review the activities and organizational structure of the internal audit function, as well as the qualifications of its personnel.
25. Annually, review and recommend changes (if any) to the internal audit charter.
26. Periodically review, with the internal audit director, any significant difficulties, disagreements with management, or scope restrictions encountered in the course of the function's work.
27. Periodically review, with the independent auditor, the internal audit function's responsibility, budget, and staffing ***[Commentary to NYSE Corporate Governance Rule 7(c) (iii) (F)]***.

Ethical Compliance, Legal Compliance, and Risk Management⁷

28. Oversee, review, and periodically update the company's code of business conduct and ethics⁸ and the company's system to monitor compliance with and enforce this code.
29. Review, with the company's counsel, legal compliance and legal matters that could have a significant impact on the company's financial statements.
30. Discuss policies with respect to risk assessment and risk management, including appropriate guidelines and policies to govern the process, as well as the company's major financial risk exposures and the steps management has undertaken to control them ***[NYSE Corporate Governance Rule 7(c)(iii)(D)]***.

⁵ Though not required, many companies have a process in place by which the internal and external auditors evaluate each other on an annual basis. Should the audit committee choose to include the responsibility to review any such evaluations, the following language may be used: "Review the results of the annual evaluation of the internal audit function by the independent auditor and the review of the independent auditor by the internal audit function. Recommend improvements as necessary."

⁶ NYSE Corporate Governance Rule 7(d) requires each listed company to have an internal audit function. The NYSE commentary indicates that this function does not have to be a separate department and may be outsourced if the company chooses. Language regarding the internal audit function should be reviewed and modified if necessary to reflect the nature and composition of such function at a given company.

⁷ The audit committee charter should include item 28 if the audit committee, rather than another committee, assumes responsibilities with respect to ethical compliance.

⁸ NYSE Corporate Governance Rule 10 and NASDAQ Corporate Governance Rule 4350(n) require listed companies to maintain a code of business conduct and ethics. The rules do not require the audit committee to be responsible for establishing, maintaining, and overseeing enforcement of this code, but some companies do assign such authority to the audit committee.

Other Responsibilities

31. Review, with the independent auditor, the internal audit function, and management, the extent to which changes or improvements in financial or accounting practices have been implemented.
32. Prepare the report that the SEC requires be included in the company's annual proxy statement ***[NYSE Corporate Governance Rule 7(c)(i)(B); Item 306 of Regulation S-K]***.
33. Conduct an annual performance assessment relative to the audit committee's purpose, duties, and responsibilities outlined herein ***[NYSE Corporate Governance Rule 7(c)(ii)]***.
34. Perform any other activities consistent with this charter, the company's bylaws, and governing law that the board or audit committee determines are necessary or appropriate.



Planning Tool: Audit Committee Calendar of Activities

Audit committees can use this tool to help plan their annual activities and meeting agendas. It considers the requirements, as of June 21, 2006, for the audit committees of U.S. public companies, including NYSE- and NASDAQ-listed companies, as well as common practices in the marketplace. The “Results From:” section indicates if the action or responsibility results from a requirement of the Sarbanes-Oxley Act of 2002 and subsequent SEC rulemaking, the NYSE, the NASDAQ, the SEC (other than those requirements arising from the Sarbanes-Oxley Act), or a common or emerging practice. The action or responsibility, as described, may not be an explicit legislative or regulatory requirement or proposal, but may be an action that logically results from other legislative or regulatory requirements or proposals. The “Suggested Frequency” section offers a benchmark for how often the activity should be performed, while the “Meeting Month” section provides an area where the audit committee can mark the months in which an activity should be performed. The audit committee should use this tool in conjunction with Deloitte & Touche LLP’s “Sample Audit Committee Charter” and it should be tailored to reflect the responsibilities in the company’s audit committee charter.

This document is not an all-inclusive list of activities that an audit committee should or must execute. The planning tool contains general information only and does not constitute, and should not be regarded as, legal or similar professional advice or service. It is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect you or your business. Any such decision or action should be taken only with the advice of a qualified professional advisor. Neither Deloitte & Touche LLP nor any of its affiliates or related entities have any liability or responsibility to any person or entity with respect to their use of or reliance on this document.

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

Action/Responsibility	Results From:					Suggested Frequency	Meeting Month											
	Sarbanes-Oxley Act/ SEC Requirement	NYSE Listing Standards	NASDAQ Listing Standards	Other SEC Requirement	Common Practice		January	February	March	April	May	June	July	August	September	October	November	December
General Responsibilities																		
Review audit committee members’ compliance with applicable independence rules and regulations.	●	●	●			Annually and as needed												
As necessary, engage outside legal, accounting, or other advisors and provide funding to compensate those advisors.	●	●	●			As needed												
Report regularly to the board of directors regarding the execution of duties and responsibilities.		●			●	Each board meeting												

Appendix B

Planning Tool: Audit Committee Calendar of Activities

Action/Responsibility	Results From:					Suggested Frequency	Meeting Month											
	Sarbanes-Oxley Act/ SEC Requirement	NYSE Listing Standards	NASDAQ Listing Standards	Other SEC Requirement	Common Practice		January	February	March	April	May	June	July	August	September	October	November	December
Review the financial literacy and expertise of all audit committee members. Determine audit committee financial expert status and determine that members are in compliance with applicable rules and regulations.	●	●	●			Annually												
Disclose in the Form 10-K (or equivalent annual filing) whether at least one member of the audit committee has been determined to be an "audit committee financial expert," as defined by the SEC. If the board determines that someone on the audit committee meets the definition, disclose his/her name and whether he/she is independent. If more than one audit committee member is determined to fulfill the definition, determine if the names and independence of those individuals will be disclosed. If there is not an audit committee financial expert, disclose why not.	●					Annually												
Conclude each regular audit committee meeting with an executive session of the committee, without members of management.					●	Each audit committee meeting												
Periodically, meet with management privately to discuss any necessary matters.		●			●	Quarterly												
Consider and plan for succession of audit committee members.					●	Annually												
Review of Financial/Controls Information																		
Review and discuss with management and the independent auditors the company's annual financial statements prior to filing, including the company's disclosure under "Management's Discussion and Analysis of Financial Condition and Results of Operations."		●		●		Annually												
Recommend to the board of directors whether the financial statements should be included in the annual report on Form 10-K.				●		Annually												
Review and discuss with management and the independent auditors the company's quarterly financial statements prior to their filing, including the company's disclosure under "Management's Discussion and Analysis of Financial Condition and Results of Operations."		●			●	Quarterly												
Review the internal controls report required under Section 404 of the Sarbanes-Oxley Act.	●					Annually												
Review management certifications required under Sections 302 and 906 of the Sarbanes-Oxley Act.	●					Quarterly												

Action/Responsibility	Results From:					Suggested Frequency	Meeting Month											
	Sarbanes-Oxley Act/ SEC Requirement	NYSE Listing Standards	NASDAQ Listing Standards	Other SEC Requirement	Common Practice		January	February	March	April	May	June	July	August	September	October	November	December
Review other reports rendered by the independent auditors and submitted by the company to any governmental body or the public.					●	As needed												
Discuss earnings press releases, including the type and presentation of information, paying particular attention to any pro forma or adjusted non-GAAP information. This discussion may be in general terms.		●			●	Quarterly												
Discuss the financial information and earnings guidance provided to analysts and ratings agencies. This discussion may be in general terms.		●			●	Annually												
Review the regular internal reports to management prepared by the internal audit function and management's response.					●	Semiannually												
Independent Auditor Relationship																		
Appoint the independent auditor.	●	●	●			Annually												
Compensate, retain, and oversee the work of the independent auditor for the purpose of preparing or issuing an audit report or related work.	●	●	●			Ongoing												
Review the performance of the independent auditor, including the lead audit partner. Ensure that partners are rotated in accordance with applicable requirements.		●			●	Annually												
Preapprove audit and nonaudit services provided by the independent auditor.	●					In accordance with policy (as necessary)												
Consider the independence of the auditor, including engaging in dialogue with the independent auditor with respect to any disclosed relationships or services that may affect the independence and objectivity of the auditor and take appropriate actions to oversee independence.		●	●		●	Annually and as needed												
Oversee the resolution of disagreements between management and the independent auditor if they arise.	●					As needed												
Review with the independent auditor any problems or difficulties encountered in the course of the audit and management's response.		●				Annually												

Appendix B

Planning Tool: Audit Committee Calendar of Activities

Action/Responsibility	Results From:					Suggested Frequency	Meeting Month											
	Sarbanes-Oxley Act/ SEC Requirement	NYSE Listing Standards	NASDAQ Listing Standards	Other SEC Requirement	Common Practice		January	February	March	April	May	June	July	August	September	October	November	December
Review the audit plan and scope with the independent auditor.					●	Annually												
Prior to filing periodic financial statements, receive the report from the independent auditor required by Section 204 of the Sarbanes-Oxley Act. This report includes: - Critical accounting policies - Alternative treatments of financial information within GAAP related to material items that have been discussed with management, the ramifications of using these alternative disclosures and treatments, and the treatment preferred by the independent auditor - Other material written communications between the independent auditor and management, including (but not limited to) the management letter and schedule of unadjusted differences.	●					As reported by the independent auditor												
Receive from the independent auditor the communications required by Statement on Auditing Standard (SAS) No. 61, as amended by SAS No. 84 and SAS No. 90.					●	As reported by the independent auditor												
Periodically, meet with the independent auditor privately to discuss any matters necessary.		●			●	Quarterly												
Review hiring policies for personnel of the independent auditor.		●			●	As needed												
Obtain and review a report by the independent auditor describing: - The independent auditor's internal quality-control procedures - Any material issues raised by the most recent internal quality-control review, peer review, or any inquiry or investigation by governmental or professional authorities, within the preceding five years, with respect to independent audits carried out by the independent auditor, and any steps taken to deal with such issues - All relationships between the independent auditor and the company.		●			●	Annually												
Financial Reporting Processes, Accounting Policies, and Internal Control																		
In consultation with the independent auditor and the internal audit function, review the integrity of the company's financial reporting processes (both internal and external) and the internal control structure (including disclosure controls and procedures and internal control over financial reporting).					●	Quarterly												

Action/Responsibility	Results From:					Suggested Frequency	Meeting Month											
	Sarbanes-Oxley Act/ SEC Requirement	NYSE Listing Standards	NASDAQ Listing Standards	Other SEC Requirement	Common Practice		January	February	March	April	May	June	July	August	September	October	November	December
Meet with representatives of the disclosure committee to discuss any anomalies encountered in the Sarbanes-Oxley Section 302 certification process.					●	Quarterly												
Review with management major issues regarding accounting principles and presentation of the financial statements, including any significant changes in the company's selection or application of accounting principles, major issues as to the adequacy of the company's internal controls, and any special audit steps adopted in response to material control deficiencies.		●			●	Quarterly												
Review management's analyses of financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements.		●			●	Quarterly												
Review with management the effect of regulatory and accounting initiatives, as well as off-balance-sheet structures, on the financial statements of the company.		●			●	As needed												
Review and approve all related-party transactions.			●		●	Quarterly												
Review the adequacy of procedures for the receipt, retention, and treatment of complaints regarding accounting, internal control, or auditing matters, including procedures for confidential, anonymous submissions by company employees.	●	●	●			Annually												
Receive and review reports or complaints of questionable accounting, auditing, or internal control matters.	●	●	●			Semiannually or quarterly												
Internal Audit Activities																		
Review and advise on the selection or removal of the internal audit director.					●	As needed												
Periodically, meet with the director of the internal audit function privately to discuss any necessary matters.		●			●	Quarterly												
Periodically, review with the internal audit director any significant difficulties, disagreements with management, or scope restrictions encountered in the course of the function's work.					●	Annually												

Appendix B

Planning Tool: Audit Committee Calendar of Activities

Action/Responsibility	Results From:					Suggested Frequency	Meeting Month											
	Sarbanes-Oxley Act/ SEC Requirement	NYSE Listing Standards	NASDAQ Listing Standards	Other SEC Requirement	Common Practice		January	February	March	April	May	June	July	August	September	October	November	December
Review the activities and organizational structure of the internal audit function, as well as the qualifications of its personnel.					●	Annually												
Review the internal audit charter and recommend any necessary changes.					●	Annually												
Periodically review, with the independent auditor, the internal audit function's responsibilities, budget, and staffing.		●			●	Annually												
Ethical Compliance, Legal Compliance, and Risk Management																		
Review the company's code of ethical conduct and the company's systems to monitor compliance with and enforce this code. Determine whether the code is in compliance with applicable rules and regulations.					●	Annually												
Receive and review reports of code violations and how they were identified and treated.					●	Quarterly												
In consultation with the company's legal counsel, review legal compliance and legal and regulatory matters that could have a significant impact on the organization's financial statements.		●			●	Semiannually or more often as needed												
Discuss with management significant risk exposures, including major financial and accounting risk exposures, and the steps taken by management to control them.		●			●	Annually												
Other Responsibilities																		
Review the audit committee charter; recommend to the board of directors any necessary amendments, as conditions dictate.		●	●		●	Annually												
Review, with the independent auditors, the internal audit function, and management, the extent to which changes or improvements in financial or accounting practices, as approved by the audit committee, have been implemented.					●	Annually												
Prepare the report that the SEC requires to be included in the company's annual proxy statement.		●		●		Annually												
Participate in appropriate continuing education.					●	As needed												
Assess performance relative to the audit committee's purpose, duties, and responsibilities.		●			●	Annually												

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