



# **PART I: Audit Committee Administration**

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# Chapter 1

## Audit Committee Member Roles and Responsibilities

Boards of directors are faced with ongoing challenges related to the governance of their organizations, risks associated with achieving their organizations' objectives, and compliance with revised and emerging laws and regulations. Responsibilities are ultimately identified by the Board and assigned to various Board Committees, including the audit committee. Delegation of responsibilities and roles to the audit committee varies from entity to entity and continues to evolve. Beyond their responsibility for ensuring accurate and transparent information to investors and other interested parties, audit committee members are being asked to address increasing challenges.

Audit committees generally consist of a minimum of three independent directors, at least one of whom is a "financial expert." Other key qualifications may include risk management expertise, and broad business or leadership experience. Responsibilities of the audit committee vary from organization to organization.

The following information provides areas to consider as the audit committee's responsibilities are defined, assigned, and implemented. In addition to the items discussed, your entity should consult concurrently with your identified experts, such as legal, accounting, auditing, or compliance.

The audit committee assists the board in its oversight of:

- Integrity of the company's financial statements;
- Internal controls including internal control over financial reporting;
- Independent auditor's qualifications, independence, and performance;
- Internal audit function's qualifications, independence, and performance;
- The company's risk management and overall governance process; and
- The company's ethics and compliance program, which includes legal and regulatory requirements.

Specific responsibilities assigned to an audit committee are set forth in an audit committee charter that is approved by the board of directors. An audit committee charter should address processes, procedures, and responsibilities. Audit committee responsibilities can vary by company due to factors such as the size of the company (for example, small-cap, mid-cap, or large); stage of development; complexity of the business (for example, single service/product line, or multiple service or product lines); type of business the company is involved in (for example, insurance, financial services, manufacturing, telecommunications, retail, or pharmaceutical); the stock exchanges on which they are listed, and whether the company is public or private.

The following illustrative list of responsibilities, which is not intended to be complete, includes both required and best practice for audit committee members.

### **Audit Committee Process and Procedures**

- Develop an audit committee charter and obtain approval from the board of directors.
- Conduct annual review of the audit committee charter.
- Set agenda for the audit committee meetings based upon the audit committee charter and other relevant issues.
- Ensure meeting minutes are prepared.
- Provide audit committee reporting responsibilities to the board of directors.
- Educate the other Board members on the understanding of the financial statements, financial statements risks, and internal controls over financial reporting.
- Prepare annual audit committee report for inclusion in the proxy statement.
- Conduct annual self-assessment of effectiveness and efficiency of the audit committee.
- Conduct regularly scheduled and documented meetings with the independent external auditor, chief audit executive (leader of the internal audit function), as well as the general counsel, CEO, CFO, senior business leaders, and others as needed. These meetings are generally conducted in executive session at the conclusion of each regularly scheduled meeting.
- Consider development of annual calendar based upon audit committee charter.

### **Oversight of the Financial Reporting Process**

- Review critical accounting policies, practices, judgments, estimates, significant issues, significant transactions, adjustments, unusual items, complex issues, and business arrangements.
- Review annual and interim financial statements and management's discussion and analysis.
- Review earnings releases and information provided to analysts and rating agencies.
- Obtain explanations from management on all significant variances.
- Question management and the independent auditor on significant financial reporting issues.
- Review comparative data from other companies within the industry to perform reasonableness tests of the company's results.
- Facilitate the resolution of disagreements between management and the independent auditor regarding financial reporting issues.
- Determine when a subject matter expert is required and hire advisers when needed.
- Review management letters containing the recommendations of the independent auditor and management's responses to those recommendations.
- Determine that adequate procedures are in place for the review of the company's disclosure of financial information extracted or derived from the company's financial statements and assess periodically the adequacy of these procedures.

- Understand complex accounting and reporting areas and how management addresses them.
- Understand significant judgments and estimates used by management and their impact on the financial statements, such as fair-value accounting and related assumptions.
- Review new accounting and reporting requirements, and assess how pending financial reporting and regulatory developments may affect the company.
- Ensure compliance with legal and regulatory requirements for financial reporting and auditing of financial statements, such as SEC, FASB, PCAOB, Stock Exchanges.
- Discuss succession planning for the CFO and staff. Understand management incentives, perhaps through periodic discussions with the compensation committee, and assess their impact on the financial reporting process. Consider whether the incentive structure contributes to an increased fraud risk.

### **Oversight of Financial Reporting**

- Oversee adequacy of the company's system of internal controls and for compliance with Sarbanes Oxley section 404 attestations.
- Determine if the company has adopted an internal control framework, such as COSO in the establishment of their system of internal controls.
- Review development and implementation of a sub-certification process over internal controls and compliance with related Sarbanes Oxley section 404 attestations.

### **Oversight of the Independent Auditor**

- Review audit plan and scope of audit to be conducted by the independent auditor.
- Provide pre-approval of all audits, permitted non-audit services, and proposed fees.
- Appoint or replace the independent auditor, including the periodic rotation of the audit partner.
- Conduct evaluations of the independent auditor. Meet periodically with tax, IT, SEC, and other specialists.

### **Oversight of the Internal Audit Function**

- Approve the internal audit department charter.
- Ensure that the internal audit department follows the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing, and maintains an effective quality assessment and improvement program.
- Concur in the appointment of the chief audit executive.
- Review the internal audit department's planning and risk assessment process.
- Review and approve the internal audit department's annual (or periodic) audit plan and scope of audits to be conducted.
- Conduct evaluations of chief audit executive.
- Ensure that the chief audit executive reports functionally to the audit committee and administratively to senior management.

## **Oversight of Risk Management**

- Oversee system of risk assessment and risk management as determined by the board of directors. The audit committee should be focused primarily on financial risk.
- Oversee and respond to enterprise risk management activities.
- Periodically reassess the list of top enterprise risks, determining who in the management committee is responsible for each risk.

## **Oversight of Ethics and Compliance**

- Oversee system for compliance with legal and regulatory requirements.
- Ensure that management exhibits ethical behavior and reported violations receive action.
- Ensure that a code of conduct has been developed, reviewed, and updated as needed, and that all employees are given the code of conduct, understand it, and receive training on a regular basis.
- Ensure that a chief ethics and compliance officer or equivalent has been appointed and has sufficient personnel and resources commensurate with company needs.
- Review the company's procedures for reporting problems, including whistleblower hotline and other communication methods.
- Establish a process for audit committee special investigations, including but not limited to whistleblower allegation, anti-fraud plan compliance, discovery of error, and illegal acts.
- Ensure that the chief ethics and compliance officer or equivalent has direct access to the board or one of its committees.

## **Limitation of Audit Committee's Role**

While the audit committee has the responsibilities set forth in its charter, it is not the responsibility of the audit committee to plan or conduct routine audits or to be the primary determinant that the company's financial statements and disclosures are complete and accurate and are in accordance with generally accepted accounting principles and applicable rules and regulations. These tasks are the responsibility of management and the independent auditor, and the audit committee has an oversight responsibility to see that the objective is achieved.