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Audit committee guide for financial institutions

March 2024

Dear clients and friends of the firm,

Corporate governance is a significant area of focus for stakeholders of financial institutions. Stakeholders want assurance that the board of directors is providing oversight and direction to management. A strong audit committee, armed with a robust audit committee charter, is an essential part of the governance of a company.

The audit committee provides oversight to the financial reporting process and provides assurance to the board of directors regarding the integrity of financial reporting. Oversight means that the audit committee needs to understand management's objectives and the processes the organization will use to reach those objectives. The audit committee also must ensure that management addresses areas critical to the integrity of the financial reporting process. Oversight is not managing day-to-day activities.

Areas of oversight for the audit committee include:

- Financial reporting process
- Control environment
- Risk assessment, including fraud risk
- External audit
- Internal audit
- Regulatory and compliance issues
- Conflicts of interest

Financial institution directors need little introduction to the concept of the audit committee; in fact, financial institutions established audit committees long before most commercial companies. As a standing committee of the board of directors, often with wide-ranging responsibilities in connection with auditing and financial reporting, the audit committee is recognized for its contributions to corporate accountability. Regulators place significant emphasis on the effective execution of the duties of an audit committee.

Audit committees are of particular importance to independent auditors, boards of directors, management, regulators and investors, since all of these parties have a common interest in and dedication to the quality of the financial institution's financial reporting. This guide offers our perspective on best practices regarding the evolving requirements and expectations of the audit committee and certain tools to assist audit committee members with fulfilling their responsibilities. The Audit Committee Guide for Financial Institutions is a continuation of our commitment to assist you in understanding the issues and successfully building and maintaining an effective audit committee.

Sincerely,

Joel Shamon
National Assurance Leader
RSM US LLP

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Executive summary

An audit committee helps fulfill the board of directors' fiduciary responsibility by overseeing financial reporting and audit processes. The audit committee raises the level of confidence in the financial reporting process by successfully achieving the duties delegated to them by the board of directors. An active audit committee, comprised of strong members, will allow the company and its shareholders to benefit from the collective insight and experience of its members.

Each company is unique in its organization and management style. The composition of the board of directors and the audit committee should reflect the unique aspects of the company and its governance policies. One size does not fit all when it comes to audit committee size or structure. It is vital, however, that the audit committee have the resources, competence, objectivity and capacity to be diligent overseers and to spend the time needed to understand and manage the financial reporting process.

The audit committee should have a framework that provides for effective oversight. Audit committee members should be willing to listen, ask probing questions, assess impact and challenge answers. They should also ensure that findings identified by auditors and the various risk management providers and regulators are properly evaluated and addressed as appropriate.

To accomplish their responsibilities, the members of the audit committee should be informed and vigilant overseers of the financial reporting process and of those involved in that process. The members of the audit committee should understand the business operations and strategies, the risks of the business model, and the interrelationship between the business operations and financial reporting. Another important role of the audit committee is to select and retain the company's independent audit firm.

The audit committee should be willing to ask probing questions of management, the internal auditor and the independent auditors. But asking the tough questions is only part of their responsibility; understanding and evaluating the answers are equally important. The audit committee should understand the business risks and rewards that the company's management team presents to the board of directors.

The audit committee and board of directors need to establish a tone at the top that insists on integrity and accuracy in financial reporting, including internal controls. The tone at the top is set by:

- Ensuring internal controls are properly designed and are operating effectively
- Requiring accurate and clear financial reporting
- Insisting that the numbers and financial statement disclosures accurately reflect the risks that are being managed
- Challenging management's perspectives about the why and what behind the numbers and the business operations

This guide discusses the responsibilities of the audit committee of a lending institution, suggests best practices and provides tools to help the audit committee to accomplish its responsibilities. Lending institutions consist of insured depository institutions (e.g., banks, credit unions) and nondepository institutions (e.g., specialty finance companies). Where there may be differences in audit committee responsibilities and best practices depending on the type of lending institution, such a distinction is noted within the content of this guide.

Additionally, this guide includes discussion and tools that may be used by both private and public companies. While certain references are made to issuers and requirements set forth by the U.S. Securities and Exchange Commission (SEC) and the various stock exchanges, the discussion may not be all-encompassing. Audit committees of public companies should work with legal counsel to ensure that they are aware of and satisfying their responsibilities in accordance with the requirements of all oversight agencies.

The audit committee charter

Audit committees should operate with a written charter that provides a clear understanding of the committee's roles and responsibilities. A well-written, detailed charter will provide a framework of the committee's organization and responsibilities that can be referred to by the board, committee members, management, regulatory bodies, internal auditors and external auditors.

For public companies, SEC rules require the annual proxy statements to disclose whether the board has adopted a written charter for the audit committee. If so, the annual proxy statement must disclose whether a copy of the charter is available on the company's website and provide the address. If it is not available on the company's website, the charter should be included in the annual proxy statement every third year or in any year during which the charter has been materially amended. Privately held financial institutions should also have an audit committee charter that provides the expectations for performance and incorporates best practices and is subject to regular review for necessary updates.

The audit committee charter should define:

- Overall purpose, responsibility and authority
- Composition of the committee
- Frequency of meetings
- Scope of responsibilities, including qualifications and terms of office
- Relationship with independent auditors, including preapproval of services provided
- Relationship with the internal audit function, including outsourced internal audit activities
- Oversight of the corporate compliance function
- Reporting responsibilities
- Authority to conduct special investigations
- Authority to engage experts as needed

In developing a charter, the board of directors should ensure that the audit committee's activities are not unduly restricted. While guiding the audit committee's duties and responsibilities, the charter needs to be flexible enough to allow it to operate effectively. The board of directors should review, approve and revise the charter as necessary to ensure it is responsive to changes in regulatory and legal requirements as well as to other corporate documents such as bylaws or articles of organization.

The audit committee charter should:

- Serve as a guide in planning the audit committee's meeting agendas
- Be reviewed annually by the board to ensure that the audit committee's objectives are met
- Provide a framework for reporting the audit committee's activities to the board of directors
- Serve as a basis for audit committee self-evaluation

While no sample charter can encompass all of the audit committee's responsibilities or the activities that an audit committee could be assigned, an illustration of an audit committee charter is included in Appendix A. The charter should set forth board of director expectations for the performance of the audit committee, which will likely vary from company to company.

The audit committee responsibilities

Audit committee activities have evolved as the business and regulatory environment has changed—and audit committee best practices have also evolved. Audit committees need to continually monitor changes to keep up.

The audit committee's central focus should be protecting shareholders' interests. That means helping shareholders understand financial results through transparent reporting and disclosure of the risks that the company is managing and the impact those risks have on financial performance. Financial statements, annual reports, applicable public filings (e.g., Form 8-K, Form 10-Q), call reports and press releases are the primary means through which organizations disclose the what, when and why behind the numbers.

Companies should maintain an accounting system that is designed to accurately gather and record transactions. Related to this, companies should also maintain a system of internal controls over financial reporting to ensure the system as designed is operating to provide reliable financial statements and financial disclosures and ensuring compliance with applicable standards, laws and regulations.

The audit committee should ensure that there are processes in place to monitor internal controls over financial reporting; comply with applicable standards, laws and regulations; and conform to policy and procedure statements established by the board of directors.

The specific responsibilities assigned to the audit committee will vary for each company. The audit committee charter should clearly assign those responsibilities.

In general, the audit committee responsibilities will include:

- Assessing the adequacy of internal controls over financial reporting and risk management systems
- Overseeing the financial reporting process at interim dates and at the ends of financial periods
- Overseeing both the internal and external audit processes
- Selecting the independent auditor
- Selecting any third-party internal audit provider

When selecting the external auditor and any applicable third-party, nonaudit service providers, the audit committee is responsible for ensuring the auditor's independence from the company. This results in a requirement for the audit committee members to gain an understanding of the applicable independence standards and what constitutes permissible and prohibited nonaudit services. The audit committee should maintain clear lines of communication with the external auditor and any applicable third-party, nonaudit service providers, obtaining their evaluation of independence and challenging whether it is appropriate. Additionally, as necessary per laws and regulations, the audit committee may be required to approve nonaudit services prior to the execution of any engagement letters or the commencement of such services.

To accomplish the specific responsibilities assigned to the audit committee, members should also understand the industry and the external factors that affect it. Issues such as legislation, the changing regulatory environment, cybersecurity, operational risks, the economy, legal actions, competition, changes in accounting and auditing standards, and consolidation should be considered in understanding how the company's operations are being affected and may be affected in the future. Industry studies, surveys and analyses from investment banking firms, trade associations, regulators and other specialized resources can provide a useful perspective regarding markets, technology and regulation. Additionally, a keen understanding of the regulatory parties and their examination process is important in understanding the risks present in the organization. Regulators such as state departments of finance and banking and the Consumer Financial Protection Bureau (CFPB) monitor compliance with consumer lending laws and are generally the primary regulators for nondepository institutions. While these may not appear to have a direct financial statement impact, noncompliance with such laws and regulations and potential enforcement actions by these regulators can ultimately have a significant impact on the entity and its operations. For insured depository institutions, the Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC) and Federal Reserve Board (FRB) are among the primary regulators. They have defined, consistent examination processes with standardized reporting (e.g., CAMELS ratings) and the implications of the ratings can affect all areas of the institution. Audit committee members should be aware of the status of regulatory examinations and monitor the status and results. To the extent there is enforcement action or recommendations made by regulatory agencies, the audit committee should generally be involved in the oversight process.

To maintain the informed perspective that will allow them to execute their duties, all members of the audit committee should understand the company's:

- Structure and organization
- Significant strategies
- Ownership
- Capital and liquidity plans
- Major loan and deposit products and services, including significant customers
- Accounting systems
- Financial reporting systems
- Risk assessments
- Related-party transactions
- Off-balance-sheet activities
- Internal audit plan and assessment of internal audit capabilities
- Attorneys and consultants
- Regulatory framework
- Applicable standards, laws and regulations (including those related to independence)
- Types of transactions (normal and nonrecurring)

Understanding and oversight of the control environment and risk assessment

The audit committee should understand the key components of internal control, including the factors that could allow fraud to occur and go undetected.

In 1992, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) published the Internal Control-Integrated Framework (the 1992 Framework), which has become commonly known as the COSO Framework. In May 2013, COSO issued an updated Internal Control-Integrated Framework (the 2013 Framework) to reflect changes in the business world over the 20 years since the release of the original Framework. While continuing to embrace a principles-based approach, the updated Framework incorporates more guidance illustrating and explaining the concepts in the Framework and is intended to help organizations in their efforts to adapt to today's increasing complexity and pace of change.

The 2013 Framework retains the five components of internal control (i.e., control environment, risk assessment, information and communication, control activities, and monitoring activities); however, it adds 17 principles associated with these five

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components that are necessary for effective internal control. Entities using the Framework need to evaluate the extent to which each of the 17 principles are relevant to its organization and, to the extent a principle is relevant, whether the entity's controls are designed, implemented and operating effectively to achieve the principle. The 2013 Framework also includes 81 points of focus that typically are important characteristics of the 17 principles.

As part of the modernization process, the 2013 Framework contains expanded consideration and guidance with respect to how technology relates to an entity's internal control structure. Since the publishing of the 1992 Framework, technology has rapidly evolved and has been embraced by nearly all companies. The 2013 Framework includes more focus on technology throughout the components of internal control, as well as a broader focus on the impacts of the technology on the internal control structure, rather than on the specific types of technology.

Because more companies are outsourcing key portions of their business activities or control systems to third parties, the 2013 Framework also includes expanded guidance and considerations related to outside resources. These resources may include, for example, third-party processors such as a bank's core processor or a service organization that processes data and produces outputs used in the financial reporting process (e.g., an allowance software or service provider). Additionally, this may refer to business relationships with third parties including banking-as-a-service and partnerships with various nondepository financial institutions (e.g., specialty finance companies) or fintech providers. The 2013 Framework also expands the reporting aspect of internal control to consider more than just financial reporting, including external reporting of nonfinancial information and internal reporting.

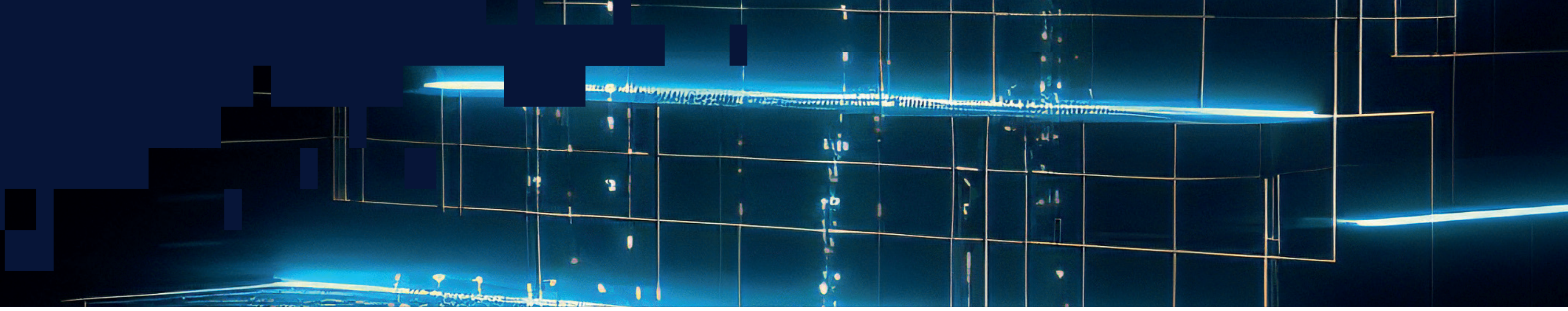
Advances in technology and communications have increased the reach of many companies, both for supply and development as well as sales and service delivery. For many entities, local or national borders no longer serve as significant barriers with respect to customers and business partners. Rather, businesses are increasingly conducted on a multilocation or global basis and via electronic means. It is not uncommon in today's environment that the customer and company never interact face-to-face and that the entire relationship takes place across channels facilitated by technology. The 2013 Framework includes additional guidance and consideration for businesses operating in these environments.

The 17 principles identified within the 2013 Framework are necessary for effective internal control unless they are not relevant to the entity. Although the Framework presumes that all 17 principles are relevant for each entity, management may determine that a principle is not relevant based on its unique circumstances. If a relevant principle is not present and functioning, a major deficiency exists in the system of internal control. The 17 principles are aligned with each of the five components and are discussed in the component sections below.

Control environment

Five principles related to the control environment are included in the 2013 Framework:

1	The organization demonstrates a commitment to integrity and ethical values
2	The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control
3	Management establishes, with board oversight, structures, reporting lines and appropriate authorities and responsibilities in the pursuit of objectives
4	The organization demonstrates a commitment to attract, develop and retain competent individuals in alignment with objectives
5	The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives



These five principles related to control environment demonstrate how the tone at the top is permeated across business lines and activities.

The 2013 Framework provides additional discussion of governance roles in the organization and the notion of risk oversight. Included in the expanded guidance on the control environment are more specific considerations related to outsourced service providers, business partners and external partners. Interestingly, for small businesses, principles 2 and 3 are predicated on the entity having an independent board of directors. As noted above, the principles can be evaluated to determine whether they are relevant for the entity, and this is an area many smaller entities may find themselves evaluating for relevance. Although management may determine, based on the ownership structure or users of the financial statements, that an independent board of directors is not relevant to the entity, they may still determine during this evaluation that strategic oversight or processes similar to those performed by a board of directors may be beneficial and relevant to the entity. In this case, the principles would be deemed relevant and assessed as part of the overall internal control structure.

Risk assessment

Four principles are included related to risk assessment:

6	The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives
7	The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed
8	The organization considers the potential for fraud in assessing risks to the achievement of objectives
9	The organization identifies and assesses changes that could significantly affect the system of internal control

A significant addition to the 2013 Framework is the direct consideration in principle 8 of fraud risks for the organization. Although effective internal control is expected to be a means to address fraud risk, the Framework explicitly addresses the organization's need to consider fraud risks when designing internal control processes to meet its objectives. The failure to adequately assess risks due to fraud for each objective would generally constitute a major deficiency in the entity's internal control structure.

Principle 9 specifically addresses the organization's need to understand and evaluate how changes in internal and external factors affect its internal control system. This will lead the company to remain cognizant of changes that would affect operations internally and externally and to timely reevaluate internal controls to respond to such changes relating to the company's industry, strategic initiatives and regulation, to name a few.

Control activities

Three principles are included related to control activities:

10	The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives
11	The organization selects and develops general control activities over technology to support the achievement of objectives
12	The organization deploys control activities through policies that establish what is expected and procedures that put policies into action

The discussion of technology is prominent throughout the control activities section. This includes discussion of automated control activities and general controls over technology. These concepts are addressed in a broad fashion, not dependent on existing technology, and provide a foundation to consider the impacts on technology for the organization as technology changes over time.

The guidance in this section also clarifies that the control activities that are part of internal control are the actions established by the policies and procedures, not the policies and procedures themselves. This helps to illustrate that there are multiple factors that must be present for a particular control activity to be effective, which include the competency and commitment to quality of the people performing the activities and the actual execution of the policies and procedures themselves, including if they are designed and implemented to mitigate the identified associated risk.

Information and communication

Three principles are included related to information and communication:

13	The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives
14	The organization selects and develops general control activities over technology to support the achievement of objectives
15	The organization deploys control activities through policies that establish what is expected and procedures that put policies into action

There continues to be significant changes in both the quantity and availability of both financial and nonfinancial information used by companies over the last two decades. The 2013 Framework emphasizes the importance of a focus on the quality of information and includes discussions on reliability of the information produced and used in the internal control system. Additionally, the 2013 Framework focuses on the entity's protection of information. Principle 15 highlights the importance of communications outside of the entity, whether with third-party service providers, owners, regulators, auditors or others.

Monitoring activities

Two principles are included related to monitoring activities:

16	The organization selects, develops and performs ongoing and separate evaluations to ascertain whether the components of internal control are present and functioning
17	The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors as appropriate

This component and its related principles treat monitoring as a series of activities undertaken individually and as a part of each of the other four components, rather than as one unique process, and outlines two main categories of monitoring activities: ongoing evaluations and separate evaluations. The 2013 Framework incorporates discussions of how technology and third-party service providers affect an entity's monitoring activities.

81 points of focus

As noted above, the 2013 Framework includes 81 points of focus. The points of focus are typically important characteristics of principles that can be used to facilitate the establishment and evaluation of the design, implementation and operation of the internal control structure and individual control activities. These are items management may consider when determining if the principles are present and functioning. The 2013 Framework is explicit that management is not required to separately evaluate whether each of the points of focus is in place to determine if the principles are present and functioning.

Fraud risk

The tone set by senior management is among the most important factors contributing to the integrity of the financial reporting process because it becomes a core value and a model of appropriate conduct for every level of the organization. To achieve a strong tone at the top, management should:

- Identify and understand the factors that can lead to fraudulent financial reporting
- Assess the risk of fraudulent financial reporting that these factors create within the company
- Design and implement the necessary internal controls for prevention or detection

AU-C section 240, Consideration of Fraud in a Financial Statement Audit, (AICPA, Auditing Standards Codification) and Public Company Accounting Oversight Board (PCAOB) Auditing Standard (AS) 2401, Consideration of Fraud in a Financial Statement Audit, are the primary sources of authoritative guidance to external auditors in fulfilling their responsibility in the consideration of fraud in a financial statement audit and in determining that the financial statements are not materially misstated due to error or fraud.

These standards address, among other items:

- Description and characteristics of fraud
- The importance of exercising professional skepticism
- Discussions among engagement personnel regarding the risks of material misstatements due to fraud
- Obtaining information needed to identify risks of material misstatement due to fraud
- Identifying risks that may result in material misstatement due to fraud
- A presumption that improper revenue recognition is a fraud risk
- A consideration of the risk of management override of controls
- Accounting estimates and retrospective reviews of estimates
- How to effectively assess the identified risks after taking into account an evaluation of the entity's programs and controls that address risks
- The auditor's response to the assessment of risks
- Evaluating audit evidence
- Communication about fraud to management, the audit committee and others
- Documentation of the auditor's considerations of fraud

Senior management is responsible for implementing systems to prevent or deter fraud. The audit committee should understand both the fraud risk factors relevant to the organization and its operations and how the company has responded to those risks.

Three conditions, commonly referred to as the fraud triangle, exist that are generally present when fraud occurs:

1. **Incentive or pressure**. Management or other employees may be pressured or have an incentive to commit fraud.
2. **Opportunity**. Circumstances exist at the organization (e.g., ineffective or no controls in place or ineffective oversight) that provide an opportunity for fraud.
3. **Rationalization**. An individual attitude, character or set of ethical values that allows someone to knowingly and intentionally commit a dishonest act.

National Association of Corporate Directors

The National Association of Corporate Directors Best Practices Council identified four basic principles for protecting shareholders against fraud and other illegal acts:

Setting the tone at the top through conduct and communication. Establish a corporate culture committed to ethical, lawful behavior, both inside and outside the company that begins at the highest level and permeates the entire organization.

Director commitment and independence. Form a board comprised of directors who are willing to devote the necessary time and energy to the job. Directors must be independent in attitude and have no significant affiliations with management or the company.

Explicit focus on fraud risk. Ensure participation in fraud prevention and deterrence by all levels of management.

Effective communication process. Ensure open and continuing communication by the board, CEO, senior managers, other employees and independent auditors.

Understanding and oversight of the financial reporting process

The financial reporting process culminates in management's summarization of the results of the company's operations and is directly affected by how the company manages risks that affect or have the potential to significantly affect the company. The financial reporting process should be supported foundationally by a clear, transparent discussion of the accounting policies that affect the way that financial conditions and results of operations are reported. Management, of course, is responsible for seeing that this information is collected and reported. Implicit in this responsibility is management's assurance that the information is timely, complete, accurate and reliable. This assurance goes beyond printed financial statements; today, financial information is disseminated, and transactions are processed, in different ways and across many different channels, many of which are electronic in nature or through an intermediary such as a third-party service provider. Regulators and users are concerned about a company's controls over these systems, platforms and any third parties involved in the process.

In recent years, cybersecurity risk has become a major focus for regulators and investors and should be an important element of the risk assessment process for all financial institutions. The audit committee's specific involvement with respect to cybersecurity will vary from company to company. Some boards of directors will incorporate oversight and governance related to cybersecurity and data within the audit committee charter, while some will retain such responsibilities. The audit committee should have a clear understanding of its expectations for cybersecurity risk at the company and, if deemed responsible, should consider the expertise of the audit committee members and the need for outside consultants to aid in achieving their objectives. Additionally, audit committee members would need to be aware of applicable standards, laws and regulations, cybersecurity trends, major threats to the company's operations, and how such threats are prevented and detected in a timely manner.

Overall, integrity in the financial reporting process is important to maintain public trust and to be successful in the financial and capital markets. Today's business environment, coupled with the high expectations of investors, creates a situation where missing earnings expectations even by a small amount can lead to significant decreases in share price and market capitalization. As a result, audit committees should focus on current and emerging issues and market trends and their potential impact on financial reporting and disclosure.

The audit committee is responsible for understanding:

- The clarity and completeness of applicable corporate filings (e.g., Form 8-Ks), earnings releases, financial statements and financial disclosures
- Management's selection and application of significant accounting principles
- Critical accounting policies
- Significant or unusual transactions
- Accounting judgments and estimates
- Whether the financial statements present a complete and accurate picture of the financial results
- Whether the financial statements, footnotes and related management discussion provide the reader with a clear understanding of the business risks being managed
- Management's assertion on the controls over financial reporting and disclosure
- Written communications received from the independent auditor related to critical audit matters, significant accounting policies, audit adjustments, uncorrected misstatements, and management's judgments and accounting estimates

The audit committee's review of the financial statements is intended to enhance the quality of communication from management to third parties. The committee should consider not only what is included in the financial statements, but also what was omitted, such as disclosures absent due to immateriality or that are not explicitly required by generally accepted accounting principles (GAAP). The audit committee should pay particular attention to any items that seem unclear and items affected by subjective judgment. Every audit committee member should exhibit an attitude of healthy skepticism and due diligence. The audit committee, though inevitably tied to the company itself, has a duty to remain objective and to keep the best interests of the financial statement users in mind.

The audit committee may consider issuing a report to shareholders to include disclosures that the audit committee has:

- Discussed the financial statements with management. This discussion may include the quality of the accounting principles as applied and significant judgments affecting the company's financial statements.
- Discussed with the independent auditor their judgments regarding the qualitative aspects of the accounting principles as applied and significant judgments, critical accounting policies and practices, and critical accounting estimates. For public companies, this would also include discussion of reported critical audit matters.
- Discussed the independence of the external auditor.
- Recommended to the board of directors that the company's financial statements be included in the annual report.

An illustration of such a report, which is required for a public reporting company, is included in Appendix C.

The independent auditor should discuss its subjective judgments on the qualitative aspects of the company's accounting principles and practices with the audit committee to help the committee draw its conclusions about the quality of the accounting principles selected by management. This discussion may include whether the accounting principles and estimates used are relatively aggressive or conservative and the transparency with which financial disclosures reflect financial performance.

For public companies, the independent auditor's review of interim quarterly financial information can help the audit committee fulfill its oversight responsibility for financial reporting. The interim review of financial information is performed in accordance with AU section 722, Interim Financial Information, as adopted by the PCAOB. With an understanding of the company's internal controls, the independent auditor applies knowledge of the company's financial reporting practices to significant matters identified through the limited interim review procedures. The interim review provides the independent auditor with a basis for determining whether material modifications are required to interim financial information or statements in order for the information to be in accordance with GAAP. However, the objective and scope of the review of interim financial information is different from an audit of financial statements and does not provide assurance that the independent auditor will become aware of all significant matters that would be identified through an audit.

New accounting standards continue to be issued that have the potential to meaningfully affect the way in which a company records financial transactions. While the audit committee is not responsible for the selection, adoption or implementation of the accounting standards, the committee should understand not only the impact of the accounting standards but also how management will implement new standards. This includes not only the implementation process itself, but also key decisions management has made when selecting among various possible methodologies or significant estimates used in the application of the standard.

Similarly, auditing standards continue to be monitored, resulting in new or modified standards. While these are not directly related to the financial records and financial reports that are under the audit committee's purview, they affect the external audit process that is integral to the audit committee's oversight. In certain cases, such as with the PCAOB's reporting standard and critical audit matters (AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion), this can have a direct impact on the audit committee and its responsibilities.

Understanding and oversight of the audit process

The audit committee should provide oversight to both the internal and the external audit processes. The committee should develop communication processes that minimize duplication of effort between the internal and external audit processes and maximize audit coverage through cost-effective use of company resources.

Internal audit process

The internal audit process usually focuses on compliance with board-approved policy statements and procedures, as well as regulatory guidelines. The purpose of the internal audit function is to provide a broad range of audit coverage and feedback on risk assessments, operations and internal control processes to both management and the audit committee. The internal audit function may be comprised of individuals employed by the company (i.e., internal) or outsourced externally, but in any case they should be objective and independent of management and the business processes subject to their review.

In reporting to the audit committee, the internal audit function identifies compliance, operational, financial and control issues that management should address to enable a strong control environment.

The role of internal audit could include any combination of:

- Review of internal controls
- Compliance testing of the internal control processes and controls
- Assessing compliance with board policy statements
- Completing operational audits that identify lapses in controls and improve business processes
- Special audit coverage for high-risk areas, suspected fraud and special projects requested by the audit committee
- Regulatory compliance
- Monitoring operations for emerging risks

The internal audit function should have a charter that is reviewed and approved by the audit committee. The internal audit charter provides the internal auditors with an understanding of the audit committee's expectations for their performance. Internal audit charters will vary from company to company because of the unique nature of each company's business processes and organizational structure. The internal audit charter often will evolve as a company grows and becomes involved in new activities, new products or new types of transactions.

Matters the audit committee should discuss with the internal auditor include:

- The company's risk assessment process
- The planned scope of internal audit work for the upcoming year
- Areas of planned audit coverage in the prior year that were deferred and why they were deferred
- The time budget to accomplish the audit plan
- How the scope of the internal audit plan was determined
- Areas that require follow-up based on the previous internal audit results
- Qualification and training for the internal auditors
- Internal audit coverage of information systems, including internet activity and cybersecurity

With the focus from regulators and the investing public on control systems, the role of internal audit should not be limited to monitoring and oversight, but should also be to provide a consultative service to the company to ensure that risks are identified and controlled.

Given the growing complexity of business transactions and business models, some questions that the audit committee might consider in determining whether adequate resources are allocated to the audit process include:

- Is internal audit a place to train future company leaders?
- Does internal audit have the necessary resources to meet audit committee expectations? Is there a need to supplement the internal audit process with outsourced resources?
- Does internal audit have the appropriate level of independence to properly conduct its purpose?
- Does outsourcing of internal audit affect the audit committee's communication process?
- With the focus on strong control systems, should internal audit perform operational audits to identify profit improvement opportunities?
- Do the internal auditors have the experience and training to provide consultative advice to the department heads regarding internal controls?
- How are issues identified by internal audit communicated to management and monitored for remediation?

The audit committee's responses to these questions will help determine the long-term direction for internal audit.

External audit process

Financial statements provide investors with an understanding of the financial results of the risks the company is managing. The independent auditor provides the company and its investors an opinion on the fairness of the company's financial statements and financial disclosures. The opinion also provides regulatory agencies with a reasonable level of assurance regarding the reliability of the financial reporting process. In addition, the external auditor may also provide assurance related to a company's internal controls over financial reporting if required pursuant to the FDICIA and SOX, which are discussed later in this guide.

The independent auditor provides the audit committee access to a neutral source of information regarding:

- Emerging accounting issues
- Emerging industry trends and risks
- Tax issues
- Regulatory issues
- General business advice

The audit committee should expect the independent auditor to:

- Recognize that they are accountable to the board of directors and that the audit committee, as the board's representative, is their client
- Maintain open communications with the audit committee and provide timely, open and candid discussions with the committee
- Understand the committee's expectations and design their communications to be responsive to those expectations
- Meet privately with the audit committee on a periodic basis in an executive session, without the presence of management or internal auditors, to provide the audit committee input on matters relating to management or the internal auditors

- Discuss any concerns about financial reporting or financial performance promptly with the audit committee
- Communicate significant issues to the audit committee that have been communicated to management, but have not been adequately addressed
- Advise the audit committee about areas believed to require special attention in order to carry out the committee's oversight responsibilities
- Inform the audit committee about any time pressures exerted by management and the degree of management's cooperation in the audit and their potential impact on the effectiveness of the audit
- Meet with the audit committee for an exit conference to discuss the contents of the auditor's formal report to the audit committee

During the executive session with the independent auditor, the audit committee has an opportunity to discuss the independent auditor's assessment of personnel in the financial organization, including number, experience and capabilities for the size and complexity of the company. The audit committee can also discuss the independent auditor's assessment of whether management is actively addressing issues of concern that could have an adverse effect on the financial or operational stability of the company.

In 2014, the Center for Audit Quality (CAQ) published The CAQ Approach to Audit Quality Indicators to document its approach to communicating audit quality indicators (AQIs). This document focuses on the communication, by audit firms, of engagement-specific metrics to audit committees. The CAQ believes these AQIs will provide an opportunity to enhance discussions between auditors and audit committees. The following is a summary of AQIs included in this publication, which should be considered during discussions between the audit committee and audit firm:

- Firm leadership and tone at the top
- Engagement team knowledge, experience and workload
  - Knowledge and experience of key engagement team members
  - Audit firm training requirements
  - Trends in engagement hours and related training
  - Allocation of resources by significant risk areas
  - Specialists and national office personnel involvement by significant risk areas
  - Key engagement team members' workloads
- Monitoring
  - Internal quality review findings
  - PCAOB inspection findings
- Auditor reporting
  - Reissuance restatements and withdrawn auditor's reports

We suggest that you read this publication for more details about information to request and questions to ask that may be tailored to the complexity of your company.

Communications with audit committees

AICPA AU-C section 260, The Auditor's Communication With Those Charged With Governance (for nonpublic companies), and PCAOB AS 1301, Communication with Audit Committees (for public companies), emphasize the importance of two-way communications between the external auditors and audit committees. AU-C section 260 and AS 1301 require external auditors to communicate to the audit committee matters in the following areas:

- Auditor's responsibilities with respect to the financial statement audit
- An overview of the planned audit scope and timing of the audit
- Significant accounting policies and practices
- Management's judgments and accounting estimates
- Significant unusual transactions
- Audit adjustments and uncorrected misstatements
- Disagreements with management

- Management's consultation with other auditors, if any
- Significant issues discussed with management
- Difficulties encountered in performing the audit
- Representations the auditor is requiring from management
- Other findings or issues arising from the audit

PCAOB AS 1301 also requires, among other things, the following additional matters to be communicated:

- Significant risks the auditor identified during planning and, subsequently, any significant changes to the planned audit strategy or identified risks
- Information about the nature and extent of specialized skills or knowledge needed in the audit
- Extent to which the auditor plans to use the work of internal audit, company personnel and third parties working under the direction of management
- Difficult or contentious matters for which the auditor consulted outside of the engagement team
- Other matters as outlined in the standard, including complaints or concerns regarding accounting and auditing matters that have come to the auditor's attention during the audit

Critical audit matters (CAMs)

PCAOB AS 3101, The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, creates a requirement for public company auditors to communicate applicable CAMs in their audit reports.

A CAM is generally identified as any matter arising from the audit of the financial statements that:

1. Was either communicated or required to be communicated to the audit committee
2. Relates to accounts or disclosures that are material to the financial statement
3. Involved especially challenging, subjective or complex auditor judgement

As noted previously, PCAOB AS 1301 governs the matters that are required to be communicated to a company's audit committee. However, items 2 and 3 above are considerations that will require auditors to use their judgement in determining what is material to the financial statements and what constitutes challenging, subjective or complex judgement.

Once identified as a CAM, PCAOB AS 3101 requires the auditor's report to include:

- The matter identified as a CAM
- A description of the principal considerations that led the auditor to determine the matter was a CAM
- A description of how the CAM was addressed in the audit
- A reference to the relevant financial statement accounts or disclosures that relate to the CAM

Given the increased disclosure of audit-related matters included in the auditor's report as a result of the requirement to report applicable CAMs publicly, audit committees of public companies will want to understand the requirements of the audit standard and how independent auditors apply their judgment and the standard. This will include understanding the auditor's viewpoint on materiality and what constitutes challenging, subject or complex judgements. As part of their role in the organization, audit committee members will generally want to review a draft of the CAMs prior to finalizing the audit report.

Selection of an independent audit firm

With audit committees being held more accountable for their role as protectors of shareholder interests, the responsibility to select and retain an independent audit firm becomes an important role. The audit committee should be directly responsible for the selection, evaluation, compensation and dismissal of the company's independent audit firm.

To ensure that the audit committee chooses its independent auditor on an informed basis, the audit committee should develop a list of auditor criteria and expectations. The following questions may provide a framework for the selection process:

- What is the independent audit firm's audit process and how do they determine areas that are considered to be a higher audit risk?
- How will the audit firm handle the unique and difficult aspects of the engagement?
- Is the audit firm independent with respect to the company? How does the firm monitor independence?
- What quality control policies and procedures does the independent audit firm have in place? Obtain a copy of the firm's most recent peer review report.
- Obtain a copy of the independent auditing firm's PCAOB inspection report (available at pcaobus.org) and review and discuss the results with the firm.
- What is the audit firm's relevant experience? What is the expertise of the local office that will be responsible for the engagement, including:
  - The importance of the client and industry to the firm and the local office
  - The audit firm's technical and industry resources
  - The availability of other relevant technical expertise locally and nationally
- What is the quality of the firm's audit practice? Request references and ask them about staff turnover, how responsive the firm is in addressing issues, whether the firm proactively provides ideas and advice and if the firm meets engagement deadlines. Also, ask what they like most and least about the firm and the partners.
- Which partners will be assigned to the client service team?
- What is their ability to develop a working relationship with the proposed engagement team?
- What is the relevant and current industry experience of the client service team on similar clients?
- What level of involvement will the partners have with the engagement?
- How does the audit firm share knowledge and expertise within the firm?
- What are the estimated fees? How are they determined? How will differences between actual and estimated fees be handled?
- What technology tools are available and how will they be used in the audit process?
- How will matters related to the internal control process be communicated?

FDICIA compliance

The FDICIA (as detailed in Part 363 of the FDIC's rules and regulations) requires banks and thrifts with total assets in excess of $500 million as of the beginning of the fiscal year to issue additional reporting (as discussed on the next page). In addition, the FDICIA also establishes various external audit and audit committee requirements.

Audit committee requirements under FDICIA provide that:

- Depository institutions with total assets between $500 million and $1 billion as of the beginning of its fiscal year must establish an audit committee comprised of outside directors in which the majority of the members are independent of management.
- When a depository institution's total assets exceed $1 billion as of the beginning of its fiscal year, the audit committee must be comprised of outside directors that are independent of management. Under certain circumstances, the banking regulators may, by order or regulation, permit relaxation of this rule on audit committee member independence. Appendix A to Part 363 of the FDIC rules and regulations includes considerations when evaluating if audit committee members are independent of management and audit committees may leverage this in their assessments.
- The audit committee of any insured depository institution that has total assets of more than $3 billion, measured as of the beginning of each fiscal year, must include members with banking or related financial management expertise, have access to its own outside counsel and not include any large customers of the institution. If a large institution is a subsidiary of a holding company and relies on the audit committee of the holding company to comply with this rule, the holding company audit committee shall not include any members who are large customers of the subsidiary institution.

The FDICIA requires the audit committee to review with management and the independent auditor the basis for reports filed by the institution. This may be accomplished by formally reviewing the content and conclusions of each report, including the report of the internal auditor, as applicable. Certain matters related to critical accounting policies and practices, alternative accounting treatments, and written communications between management and the independent auditor are required to be disclosed to the audit committee in a timely manner. These matters are the same or in addition to requirements for communications with audit committees set forth in other applicable professional standards.

The duties of the audit committee should be scaled appropriately based on the size of the institution and complexity of its operations. A primary responsibility of the audit committee as outlined in Appendix A to Part 363 of the FDIC rules and regulations is to appoint, compensate and oversee the independent auditor, including ensuring that engagement letters and related agreements are appropriate, timely executed and do not contain certain prohibited provisions (e.g., limitation of liability, indemnification). Other appropriate duties an audit committee may include:

- Reviewing with management and the independent auditor the significant accounting policies of the institution
- Reviewing the audit conclusions regarding significant accounting estimates
- ·Reviewing with management and the independent auditor their assessment of the adequacy of internal controls and the resolution of identified material weaknesses and significant deficiencies in the internal controls, including the prevention or detection of management override or compromise of the internal control system
- Reviewing with management and the independent auditor the institution's compliance with laws and regulations
- Discussing with management the selection and termination of the independent auditor
- Reviewing the scope of services required by the audit
- Discussing with management any significant disagreements between the independent auditor and management
- Overseeing the internal audit function

The FDICIA recommends that the audit committee maintain minutes of all meetings and other relevant records of its meetings and decisions.

FDICIA annual reporting requirements

For insured depository institutions with total assets in excess of $500 million, FDICIA requires the following:

- Management must prepare annual financial statements in accordance with GAAP, and these statements must be audited by an independent auditor.
- Management must prepare a management report signed by its CEO and chief accounting officer (CAO) or CFO that contains:
  - A statement of management's responsibilities for establishing and maintaining an adequate internal control structure and procedures for financial reporting. The term financial reporting is not defined by regulation, but is deemed to encompass the institution's annual financial statements, interim financial statements and bank call reports
  - A statement of management's responsibility for, and an assessment of the institution's compliance with, designated laws and regulations relating to safety and soundness, which are designated by the FDIC and the appropriate federal banking agency during the most recent fiscal year

In addition, insured depository institutions with total assets in excess of $1 billion must include the following:

- Management must make their assessment of the effectiveness of the institution's internal control over financial reporting as of the end of the fiscal year.
- The independent auditor must issue an audit report (i.e., opinion) on the effectiveness of internal control over financial reporting.

Institutions must file an annual report with the FDIC, its primary banking regulator and any appropriate state bank supervisor within 120 days of each fiscal year-end, or sooner if the company or institution is subject to SOX 404 reporting requirements. This report, which will become public information, will contain:

- The institution's financial statements prepared in accordance with GAAP
- The independent auditor's report on the financial statements
- The institution's management report, signed by the CEO and CFO, which includes all management statements and assessments listed above
- For insured financial institutions with total assets in excess of $1 billion, the external auditor's opinion on the effectiveness of the institution's internal control over financial reporting

In addition, any management letter or other report prepared by the external auditor must also be filed with the appropriate regulatory banking agencies.

Institutions must also provide the FDIC with written notice within 15 days of the engagement of an external auditor or the resignation or dismissal of the external auditor.

Section 404 of the SOX legislation requires management of public reporting companies to assess the effectiveness of their internal control over financial reporting. This requirement may be more stringent than the evaluation required for FDICIA. An institution that must comply with section 404 can use that evaluation to comply with FDICIA as long as both the FDIC's requirements and the SEC's requirements are met.

SOX internal control reporting requirements

While the SOX legislation does not directly affect privately held financial institutions, banking regulators consider some of the legislation's provisions to be best practices for the industry. The FDICIA reporting requirements noted previously affect all insured depository institutions subject to regulation by the FDIC with total assets exceeding $500 million, with additional requirements for those with assets exceeding $1 billion. Section 404 of the SOX legislation is applicable to all public reporting entities, although an audit of management's assessment of internal controls over financial reporting is not required for smaller reporting companies and emerging growth companies, as defined by the SEC.

Section 404 of SOX requires public reporting companies to include a report by management on the company's internal control over financial reporting in their annual report. The internal control report must include:

- 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 internal control over financial reporting
- Management's assessment of the effectiveness of internal control over financial reporting as of the end of the most recent fiscal year, including a statement as to whether or not internal control over financial reporting is effective
- If applicable, a statement that the registered public accounting firm that audited the financial statements has issued an opinion on the effectiveness of internal control over financial reporting as of the end of the most recent fiscal year

In addition, SOX makes CEOs and CFOs explicitly responsible for establishing, evaluating and monitoring the effectiveness of internal control over financial reporting and disclosures. Both the CEO and CFO are required to provide a certification as part of their quarterly filings of Form 10-Q and annual Form 10-K.

Quarterly and annual certifications of CEOs and CFOs

As previously noted, the SOX legislation includes certification requirements for the CEOs and CFOs of public reporting
As previously noted, the SOX legislation includes certification requirements for the CEOs and CFOs of public reporting
companies. It is noteworthy that financial institution directors were certifying call financial reports and making internal control over financial reporting certifications under the FDICIA well before SOX. While SOX focuses on public reporting companies, audit committees and boards of private banks may look to it for best practices as they certify those call reports or make management's assertions for FDICIA purposes.

Section 302 of the SOX Act requires CEOs and CFOs to individually and personally certify that disclosure controls and procedures have been implemented and evaluated. Disclosure controls and procedures are designed to ensure that the information required to be disclosed by a company on the reports filed under the SEC rules is recorded, processed, summarized and reported within the time periods specified by the SEC.

With each quarterly and annual filing, both the CEO and CFO must certify that:

- They have reviewed the report.
- The report does not contain any material untrue statements or material omissions necessary to make the statements not misleading.
- The financial statements fairly present the company's financial condition and the results of operations in all material respects.
- They are responsible for establishing and maintaining internal controls.
- They have designed controls to ensure that material information is made known to them.
- They have evaluated the effectiveness of the internal controls each quarter.
- They have presented their conclusions about the effectiveness of internal controls.
- They have disclosed to the audit committee and the independent auditor all significant deficiencies, material weaknesses and acts of fraud that involve management or other employees who have a significant role in the company's internal control.
- They have disclosed any significant changes in internal controls or other factors that could significantly affect internal controls subsequent to the date of their evaluation, including corrective actions for significant deficiencies and material weaknesses.

Section 906 of the SOX Act requires CEOs and CFOs to provide a written statement with each periodic report indicating that the financial statements fully comply with the SEC reporting requirements and the information contained in the financial statements fairly presents, in all material respects, the financial condition and results of operations of the issuer.

The certification required by section 906 is different from the certification required by section 302 and carries fines of up to $5 million and imprisonment for up to 20 years for known or willful failure to comply with its requirements.

Companies that prepare FDICIA internal control documentation or internal control assessments under section 404 of the SOX Act should use this data as a basis for the certifications. Effective oversight of the internal controls and the financial reporting process by the audit committee is one element of the internal controls necessary to provide a basis to allow the CEO and CFO to make these certifications.

Code of ethics

While the audit committee is not directly responsible for establishing, monitoring or enforcing the company's code of ethics, many companies have delegated oversight responsibilities to the audit committee. The board of directors should consider if this an appropriate corporate governance and oversight responsibility of the audit committee and, if so, ensure that it is incorporated into the audit committee charter.

Even though many companies had a code of ethics in place prior to SOX, section 406 requires public reporting companies to disclose whether they have adopted a written code of ethics that applies to their principal executive officers, principal financial officers, principal accounting officers or controllers, or persons performing similar functions. If a written code of ethics has not been adopted, the board of directors must explain the reasons.

Section 406 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 governmental laws, rules and regulations
- The prompt internal reporting of violations to appropriate parties
- Accountability for adherence to the code of ethics

Public reporting companies are required to include a code of ethics disclosure in their annual reports filed on Form 10-K. In addition, a company is also required to make its code of ethics publicly available, with three methods for doing so. It may:

1. File a copy of its code of ethics with the SEC as an exhibit to its annual report
2. Post the text of its code of ethics on its website, provided that the website address and the intention to provide disclosure in this manner is set forth in its annual report on Form 10-K
3. Indicate in its annual report that it will provide a copy of its code of ethics to any person, without charge, upon request

U.S. registrants, other than registered investment companies, are required to make immediate disclosure on Form 8-K or on their websites of any changes to or waivers of the five code of ethics provisions referenced in the rule, including the extent to which the waiver or amendment relates to the CEO or senior financial officers. A company choosing to provide the required disclosure on Form 8-K must do so within four business days after it makes an amendment to its code of ethics or grants a waiver. A company can provide the required disclosure on its website only if it disclosed, in its most recent annual report filed with the SEC, its website address and its intention to disclose these events on its website.

The code of ethics should be tailored to fit the specific circumstances of a company's structure, organization and operations. The following topics are commonly covered in the code of ethics:

- Holding outside employment
- Using corporate assets, information or position for personal advantage
- Receipt of gifts, trips or entertainment from customers or suppliers
- Personal use of customer information
- Participation in political or community activities
- Adherence to policies and procedures
- Compliance with internal controls
- Financial or other conflicts of interest
- Related-party transactions
- Racial, sexual or other types of harassment
- Use of drugs and alcohol
- Procedure for evaluating situations that may create a conflict of interest
- Procedure for communicating potential violations of the code of ethics
- Process for communicating the code of ethics to all employees
- Process for obtaining acknowledgment of receipt and understanding of the code of ethics
- An annual certification that the employee has not violated the code of ethics

While these comments focus on public reporting companies, they represent best practices for all financial institutions.

Resources for the audit committee

The following list of various references may help the members of the audit committee understand their roles and responsibilities, changes in corporate governance and how those changes affect their duties.

Publications

- CAQ, CAQ Approach to Audit Quality Indicators, April 2014
- American Bar Association, Corporate Director's Guidebook, Seventh Edition
- American Institute of Certified Public Accountants, AU-C section 260, Communications with Audit Committees
- Committee of Sponsoring Organizations of the Treadway Commission, Internal Control—Integrated Framework, 2013
- Committee of Sponsoring Organizations of the Treadway Commission, Internal Control over Financial Reporting—Guidance for Smaller Public Companies, June 2006
- National Commission on Fraudulent Financial Reporting, Report of the National Commission on Fraudulent Financial Reporting, 1987
- PCAOB Auditing Standard No. 1301, Communications with Audit Committees

Internet resources

- sec.gov provides press releases, final rules, proposed rules and comment letters
- pcaobus.org provides publications to help audit committees of public companies understand the PCAOB's activities and observations
- thecaq.org provides audit committee members with resources to help enhance effectiveness and assist audit committees in fulfilling their financial oversight responsibilities
- financialexecutives.org provides tools, resources and links to other financial reporting websites
- nyse.com and nasdaq.com provide rules for corporate governance for listed companies
- nacdonline.org provides publications, surveys, research and answers to questions asked by directors
- bankdirector.com provides information for board members and audit committee members
- conference-board.org provides information on corporate governance
- ethics.org provides leading-edge expertise on business and organizational ethics

Regulatory agency and trade association resources

- Board of Governors of the Federal Reserve System federalreserve.gov
- Federal Deposit Insurance Corporation fdic.gov
- Federal Financial Institutions Examination Council ffiec.gov
- National Credit Union Administration ncua.gov
- Public Company Accounting Oversight Board pcaob.org
- Bank Administration Institute bai.org
- American Bankers Association aba.com
- Independent Community Bankers of America icba.org
- Consumer Financial Protection Bureau consumerfinance.gov

RSM can help

We are often asked to provide advice on the appropriate roles and responsibilities of audit committees and general corporate governance issues. In our role as the independent auditor or other professional service provider to over 2,500 financial institutions, we often work closely with audit committees and have assisted them in implementing governance practices that suit their circumstances.

We have assisted with director education programs aimed at enhancing directors' understanding of risk management and financial reporting. We can assist your company in assessing its corporate governance practices and developing an action plan to strengthen the effectiveness of those practices.

We welcome the opportunity to assist you and your company in developing and maintaining an effective audit committee. We would be happy to meet with you to discuss how we can assist you.

Appendix A: Sample audit committee charter

This audit committee charter should be tailored to fit the unique needs of each company. This sample is not a form that can be copied and applied to every situation. Prior to adopting an audit committee charter, your company should gather input and advice from legal counsel and the independent auditor. In the event that laws or regulations impose requirements on audit committee composition and responsibilities (e.g., issuer stock exchanges, FDICIA, SOX), the company should ensure that such provisions are incorporated. The audit committee charter is a living document that will need to be revised as external and internal factors change.

Membership

All members of the audit committee shall be independent of the management of the company and free of any relationship that, in the judgment of the board, would interfere with their exercise of independent judgment as audit committee members. Each member of the audit committee must satisfy all applicable membership and independence requirements established by the agencies whose regulations are applicable to the company. The board must make any affirmative determinations concerning the issue of independence of any director as required under the rules and regulations of the applicable exchange.

Audit committee members will not have an interest in the company or engage in related-party transactions that would have a material adverse effect on their independence or ability to act in the best interest of the shareholders.

If there is any basis for believing an audit committee member is not independent, the facts and circumstances should be reported to the general counsel and the board, and no action should be taken until the board or the nominating or governance committee thereof, has determined whether the audit committee member is truly independent.

Audit committee members cannot vote on any matter in which they, directly or indirectly, have a material interest.

Frequency of meetings

The committee shall meet as frequently as circumstances dictate, but no less than four times annually. The board shall name a chairperson of the committee, who shall prepare and approve an agenda in advance of each meeting. A majority of the members of the committee shall constitute a quorum. The committee shall maintain minutes or other records of meetings and activities of the committee.

The committee shall, through its chairperson, report regularly to the board following its meetings, addressing such matters as the quality of the company's financial statements, compliance with legal or regulatory requirements, the performance and independence of the independent auditors, the performance of the internal audit function, and other matters related to the committee's functions and responsibilities.

Responsibilities of the audit committee

The audit committee shall be directly responsible for the appointment, dismissal, compensation and oversight of the company's independent auditor and may not delegate any of these responsibilities to others. The audit committee shall assist the board in its oversight of:

- The integrity of the company's financial statements and internal controls
- The company's compliance with legal and regulatory requirements
- The independent auditor's qualifications and independence
- The performance of the company's internal audit function and the company's independent auditor
- The audit committee shall also prepare the report to be included in the company's annual proxy statement.

The audit committee shall assist the board in fulfilling its oversight responsibilities by:

- Reviewing any company financial information that will be provided to shareholders

- Working with management to establish, subject to the approval of the board, the systems of internal controls
- Reviewing the systems of internal controls and reports of variance from those controls
- Reviewing all audit processes and results of internal audits
- Reviewing the company's accounting, reporting and financial practices

The responsibilities of a member of the audit committee are in addition to responsibilities as a member of the board.

Each member of the audit committee will be compensated separately for service on the audit committee. The audit committee shall direct the company's general counsel to prepare or obtain from the company's outside counsel on a regular basis a memorandum setting forth the standards applicable to the members of the audit committee under relevant laws and regulations.

The audit committee does not prepare financial statements on behalf of the company or perform the company's audits. Its members are not the company's auditors and do not certify the company's financial statements. These functions are performed by the company's management and the independent auditor.

The audit committee shall perform such other functions as are required by law, the company's articles of incorporation or bylaws, or the board of directors.

Responsibilities and duties

The audit committee:

- Shall meet at the request of the chief financial officer (CFO) or the independent auditor and shall meet at least once every quarter in regular session or more frequently as circumstances dictate
- Shall meet with the CFO separately at least once every quarter to review the accounts of the company and approve the filing of Form 10-Q
- Shall meet with the internal auditor at least once every quarter
- Shall recommend to the board whether the audited financial statements should be included in the company's annual report on Form 10-K
- Shall prepare the audit committee report to be included in the company's annual proxy statement
- May conduct or authorize investigations into any matters within its scope of responsibilities
- Shall review and discuss earnings, press releases, and financial information and earnings guidance provided to analysts and ratings agencies
- Shall review and discuss with management the policies and guidelines for risk assessment and management
- May take any other action permitted by applicable laws, rules and regulations necessary to accomplish any action authorized by this charter or to further the goals of the audit committee as set forth in the charter
- Shall report its actions and budget to the board

All meetings of the audit committee required by this charter shall be held without any other members of the board present. Portions of all meetings with independent accountants and internal audit officers shall be held without any other members of management present. Meetings may be held in person or by telephone at the discretion of the chair of the audit committee.

Assistance from others

The audit committee may request reports from the chief executive officer, CFO, chief accounting officer or other members of the management team. The audit committee may retain (and determine the funding for) experts to advise or assist it, including outside counsel, accountants, financial analysts or others. The company shall provide sufficient funding for such assistance.

Relationships with independent auditors

To retain independent auditors to audit the records and accounts of the company, the audit committee shall:

- Have the sole authority to appoint and dismiss independent auditors to conduct company audits or to perform permissible nonaudit services, with the independent auditor ultimately accountable to the audit committee with respect to all work performed
- Review the independent auditor's risk assessment and audit plan prior to the commencement of the audit
- Determine the scope of the audit and the associated fees to be paid to the independent auditor for both audit and permissible nonaudit work
- Discuss with the independent auditor any relationships that may affect the auditor's independence
- Confirm and oversee the independence of the auditor
- Establish policies for the company's hiring of employees or former employees of the auditor

In its review of the independent auditor, the audit committee shall:

- Review the qualifications and experience of senior members of the audit team
- Ensure that the independent auditor provides the audit committee, for their review, with timely reports of:
  - All critical accounting policies and practices
  - All alternative treatments of financial information within GAAP that have been discussed with management, the effects of using such alternatives and the treatment preferred by the independent auditing firm
  - Other material written communications between the independent auditor and management
  - All corrected and uncorrected misstatements
  - Other matters required pursuant to applicable standards or requested by the audit committee
- Review the independent auditor's reports on the adequacy of the company's internal control over financial reporting
- For New York Stock Exchange–traded companies, obtain and review annually a report from the independent auditor describing
  - The auditing firm's internal quality control procedures
  - Any material issues raised by its most recent quality control review or investigation within the preceding five years and steps taken to resolve those issues
  - All relationships between the independent auditor and the company

Prior to the release or filing thereof, the audit committee shall review documents containing the company's financial statements, including the interim financial reports and filings with the SEC or other regulators. The audit committee shall specifically review:

- With the management and the independent auditor, their processes for assessment of material misstatements and identification of the notable risk areas and their response to those risks
- With management and the independent auditor, the company's annual and quarterly financial statements and related footnotes, as well as all of the company's securities filings prior to their filing and release, paying particular attention to disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations"
- With management and the independent auditor, the effect of regulations, accounting principles and their alternatives that have a significant effect on the company's financial statements
- With the independent auditor, any additions or changes in auditing or accounting principles suggested by the independent auditor, management or the internal auditor
- With the independent auditor, the communications of material weaknesses, significant deficiencies and control deficiencies provided by the independent auditor and the company's response

- With the independent auditor, any significant difficulties or disputes with management encountered during the course of the audit
- The independent auditor's audit of and report on the financial statements and the company's internal controls
- The independent auditor's qualitative judgment about the appropriateness, and not just the acceptability, of accounting principles, use of estimates, basis for determining the amounts of estimates and financial disclosures
- Any material financial or nonfinancial arrangements of the company that do not appear on the financial statements of the company and their related risks
- Any transactions or courses of dealing with parties related to the company that are significant in size or involve terms or other aspects that differ from those that would likely be negotiated with independent parties or that are relevant to an understanding of the company's financial statements
- Any other matters related to the annual company audit, including those matters that are required to be communicated to the audit committee under applicable law and generally accepted auditing standards or items requested by the audit committee

Approval of services provided by independent auditors

The audit committee shall approve any audit services and any permissible nonaudit services prior to the commencement of the services. In making its preapproval determination, the audit committee shall consider whether providing the nonaudit services is compatible with maintaining the auditor's independence. If this preapproval is delegated to an audit committee member or members, such member or members shall present a report of actions or decisions at the next scheduled audit committee meeting.

Prohibited nonaudit services

The following services may not be provided by the independent auditor contemporaneously with the audit:

- Bookkeeping or other services related to the accounting records or financial statements of the company
- Financial information systems design and implementation
- Appraisal or valuation services, fairness opinions or contribution-in-kind reports
- Actuarial services
- Internal audit outsourcing services
- Management functions or human resources
- Broker-dealer, investment service provider or investment banking services
- Legal services
- Expert services unrelated to the audit
- Any other service that the American Institute of Certified Public Accountants, SEC or Public Company Accounting Oversight Board determines is impermissible

Relationships with the internal audit function

The audit committee shall:

- Be solely and directly responsible for the appointment, replacement, reassignment or dismissal of the company's internal auditors
- Establish procedures to assess the effectiveness and performance of the internal auditors
- Establish and control the compensation and benefits of company employees who report directly to the audit committee
- Take steps that are, in the sole judgment of the audit committee, reasonable or necessary to ensure that the internal auditors are competent and objective and the compensation and benefits allocated to the internal auditors are not subject to review or termination without the consent of the audit committee

The audit committee shall consider and review with management and the internal audit leader:

- The company's risk assessment process
- The company's internal control structure and procedures for financial reporting and disclosure
- The results of internal audits, recommendations, reports of variance from the company's internal controls and report of the internal auditor
- Significant findings during the year and management's responses to them
- Significant difficulties encountered during the course of their audits, including any restrictions on the scope of their work or access to required information
- Changes required in the planned scope of their audit plan
- The internal auditing department's compliance with the Institute of Internal Auditors' Standards for the Professional Practice of Internal Auditing

Oversight of corporate compliance function

The audit committee shall:

- Discuss significant risk exposures periodically with the independent auditor, management and internal auditors
- Review the steps and programs that management and the internal auditors have taken to identify, monitor, control and report such exposures
- Establish procedures whereby employees can confidentially and anonymously submit to the audit committee concerns or issues regarding the company's accounting or auditing matters
- Establish procedures for the receipt, retention and treatment of complaints regarding accounting or auditing matters, including their controls
- Review any transactions with related parties and the procedures used to identify related parties
- Periodically require management, the internal auditor and the independent auditor to review, report and comment on significant company risks or exposures and actions needed to minimize such risks or exposures
- Review the company's code of ethics and recommend any changes or additions
- Discuss periodically with management and evaluate the effectiveness of the program that management establishes to monitor compliance with the company's code of ethics and laws and regulations
- Review with management the company's policies to encourage the reporting of potential illegal acts and questionable accounting or auditing matters
- Review management's recommendations to the board to respond to changes in law or policy
- Review with the company's outside legal counsel any legal matters that may materially affect the company
- Consider any emerging issues with which the audit committee should become involved in the future

Audit committee formalities and charter

The audit committee shall:

- Review and reassess annually the adequacy of this audit committee charter and recommend any changes to the board
- Report periodically to the board on the audit committee's activities and findings, including any issues regarding the quality or integrity of the company's financial statements, compliance with legal or regulatory requirements, the performance and independence of the company's independent auditor, or the performance of the internal auditors
- Keep appropriate minutes, with the advice of counsel
- Take action to assess its own performance on an annual basis, such as retaining counsel, the independent auditor or other consultants for the purpose of reviewing its performance

Appendix B: Items to consider in preparing the audit committee agenda

In planning the audit committee meeting agenda, the audit committee chairperson should consider the unique needs of the audit committee members and the responsibilities as outlined in the audit committee charter. Audit committee members may require background information to properly understand risks. This planner provides an example of a format that may be used to coordinate communications. It should be modified for each audit committee to meet the unique needs of each group.

Using the audit committee meeting planner, the audit committee chairperson, with input from management and the auditors, should develop a detailed agenda for each meeting. The chairperson also must keep lines of communications open among the board, external auditors and the committee members.

Quarterly:

Discussions

Planned	Completed	Action
		Discuss with management any significant changes in internal controls, accounting estimates, accounting principles or business activities
		Review Form 10-Q, related press releases, and the report; assess the transparency and clarity of the financial disclosures
		Discuss Form 10-Q with management and the independent auditor
		Discuss any significant changes in internal controls with the internal auditor and independent auditor
		Discuss remediation status of any prior control deficiencies, internal audit or regulatory findings
		Discuss with the independent auditor the financial statement impact of any significant changes in accounting estimates and accounting principles or in the application of accounting principles
		Discuss with senior management any significant variances from the budget
		Report any significant findings to the board

Annually:

Internal audit

Planned	Completed	Action
		Review and revise the internal audit charter, if necessary
		Review and approve the scope of internal audit coverage and risk assessment; determine quarterly agenda items to ensure internal audits are reported timely and establish process for reporting findings and related remediation plans to the committee
		Discuss staffing levels of internal audit with lead internal auditor
		Discuss compliance with rules and regulations with lead compliance officer
		Discuss assistance and coordination of internal audit efforts with the audit process of the independent auditor
		Discuss participation in documenting, evaluating and testing internal control processes

Independent audit

Planned	Completed	Action
		Discuss with the engagement partner the capabilities of the client service team assigned to the annual audit
		Discuss with the engagement partner the process used by the independent audit firm to ensure the independence of all client service team members and the firm
		Discuss with the engagement partner the scope and timing of quarterly reviews and annual audit
		Discuss with the engagement partner the coordination of internal audit and internal loan review with the annual audit
		Review and sign the engagement letter for the annual audit
		Discuss the annual audit plan and areas the independent auditor has identified as critical audit areas and significant risks
		Discuss the process for the attestation regarding internal controls over financial reporting
		Discuss with the engagement partner the process for preapproval of nonaudit-related services as determined by the committee
		Discuss results of the annual audit, where there were variances from the audit plan and why those variances occurred
		Discuss critical accounting estimates and policies
		Review Form 10-K and discuss with the audit partner
		Discuss the contents of the auditor's communication with the audit
		Discuss corrected and uncorrected misstatements identified by the annual audit committee
		Discuss letters from the independent auditor to management
		Discuss any other issues that arise from the annual reporting, including quality of accounting principles used Discuss potential critical audit matters (CAMs) throughout the period and review the final CAM prior to issuance of the auditor's report Discuss new accounting and auditing standards and the potential impact on the financial statements and external audit process

Management

Planned	Completed	Action
		Discuss with senior management the company risk profile and how those risks are managed
		Discuss with senior management the monitoring system in place to ensure all risks are being identified
		Discuss significant accounting estimates, unusual major accounting transactions, related-party transactions and off-balance sheet activities
		Discuss critical accounting estimates and accounting policies with management, including management discussion and analysis disclosure, prior to the release of the annual report and Form 10-K
		Discuss management's response to letters to management from the independent auditor
		Discuss changes in accounting principles, policies or practices to understand the reason and preferability of the changes

Audit committee activities

Planned	Completed	Action
		Prepare an audit committee report for the proxy statement
		Prepare a report on the annual audit for the board, including required communications from the auditor
		Prepare a report for the board regarding the attestation of internal controls over financial reporting and financial disclosures
		Discuss with the board a recommendation for retention or selection of the independent auditor
		Prepare a report for the board regarding internal audit coverage and activity
		Prepare an evaluation of the internal audit function
		Prepare a self-evaluation of the audit committee's effectiveness
		Obtain an understanding from the board regarding their expectations of the audit committee

Executive sessions

The audit committee should have executive sessions as circumstances require with:

Planned	Completed	Action
		Management
		Chief executive officer (CEO)
		Chief financial officer (CFO)
		Chief information officer (CIO)
		Internal auditor (including outsourced providers)
		Independent auditor

Appendix C: Sample audit committee report

Report from the audit committee

The audit committee provides oversight of the company's financial reporting process on behalf of the board of directors. Management is responsible for the financial statements and the financial reporting process, including internal controls.

In fulfilling its oversight responsibilities, the committee discussed the financial statements in the annual report with management, including a discussion of the quality, not just the acceptability, of the accounting principles; the reasonableness of significant judgments; and the clarity of disclosures in the financial statements.

The audit committee discussed with the independent auditors their judgments as to the qualitative aspects of the company's significant accounting policies and practices and such other matters as are required to be discussed with the committee under generally accepted auditing standards. The independent auditors are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles. In addition, the committee has discussed with the independent registered public accounting firm the auditors' independence, including the matters in the written disclosures required by applicable professional standards.

The audit committee discussed with the company's internal and independent auditors the overall scope and plans for their respective audits. The committee meets with the internal auditors and independent registered public accounting firm, with and without management present, to discuss the results of their examinations, their evaluations of the company's internal controls and the overall quality of the company's financial reporting.

Based on these discussions, the audit committee has recommended to the board of directors (and the board has approved) that the audited financial statements be included in the annual report on Form 10-K for the year ended Dec. 31, 20XX, for filing with the Securities and Exchange Commission.

April 1, 20XX

/s/ This report should be signed by all members of the audit committee.

Appendix D: Example questions for audit committee members

Financial reporting—inquiry with management

- What are the most critical accounting policies (i.e., most complex, subjective or ambiguous decisions or assessments) that have the greatest effect on the company's financial position? Was the accounting treatment conservative or aggressive, and how does it compare to previous periods?
- When identifying unusual or nonrecurring items for disclosure, are both gains and losses given equal prominence?
- To what extent was the timing of transactions managed in order to occur (or not occur) in the period being reported upon? What was the purpose of managing that timing? How did it affect reported results?
- Do reported results provide investors with a clear view of how market events and significant transactions affected the institution?
- What areas of the financial reporting are most influenced by your judgment? How does the information in the financial statements allow the reader to understand those aspects and management's assumptions?
- What information in the financial statements communicates the significant estimates and assumptions used to develop the financial information? What is the range of possible outcomes, and how is that range communicated to the investors?
- What were the most significant events of the past year, and how are these communicated to investors? Are both positive and negative events presented?
- How do you assess whether the accounting principles selected will appropriately convey the economics of the transaction? What accounting principles changed during this past year, and how were they assessed?
- What changes have there been in accounting policies or in the application of those policies or in the use of estimates and judgments?
- Do the disclosures go beyond complying with minimum GAAP requirements?
- Did you identify any weaknesses in the company's internal control over financial reporting?
- Are there any material risks and uncertainties that have not been disclosed?
- What is your overall evaluation of the degree of comparability of this year's financial statements with prior years'? What were the causes of significant differences? What reclassifications, if any, were made to prior years' reported amounts?
- Do you believe the internal audit plan properly addresses enterprise risk and significant key risks as outlined in the risk assessment?
- What communications have been made with regulators during the past year and has this had any impact on operations, financial reporting or results of operations?

Oversight of internal accounting controls

- Do the internal control processes provide reasonable assurance that fraudulent financial reporting will be prevented or subject to early detection?
- Are the internal control processes periodically reviewed? By whom?
- How are controls over system-generated financial information tested?
- Have cybersecurity risks been assessed and subjected to testing?
- Have any significant deficiencies or material weaknesses been identified in internal controls? Are there any compensating controls and were they evaluated for design, implementation and operating effectiveness? What are the plans for remediation and the status of such remediation efforts?

- Have the department heads evaluated their department's compliance with the institution's policy statements and control processes? How has that evaluation been documented?
- How are changes in the internal control processes made? Is an internal audit involved in the process?
- How are controls and policies put in place over new services and products?

Review of internal audit function (internal and/or outsourced)

- Does the internal audit department have a written charter? When was it last evaluated?
- Does the internal audit department have the resources to accomplish its objectives? If not, is the internal audit department supplemented by competent, independent outsourced resources?
- Does the department appear to be using its time and resources effectively and efficiently?
- Are the internal audit personnel well-trained in the application of audit procedures in a financial institution? Do they understand day-to-day business activities?
- Is the experience level of the internal auditors adequate?
- Does the internal audit department have a continuing education program?
- Does the internal audit function have a risk-based focus in its frequency schedule and is it consistent with a recent risk assessment?
- Does the internal audit function use written audit plans?
- Does the internal audit function conduct its work in an objective and competent manner?
- Does the internal audit department perform any operational duties that would impair its objectivity?
- Does the internal audit function's reporting process provide for reporting directly to the audit committee?
- What types of reports are issued by the internal audit function, and to whom?
- Are the internal audit reports issued on a timely basis? Do these reports include sufficient detail for effective action by management and the audit committee?
- Does management respond appropriately and in a timely manner to significant recommendations and comments made by the internal auditors?
- Are there department members with sufficient information systems auditing expertise to address the level of technology used by the company?
- Was the department's involvement in the annual audit effective? What could be done in the future to maximize its effectiveness and efficiency?

Selection of the independent auditor

- Is the firm independent relative to the institution?
- What are the firm's independence policies? How is adherence to that policy determined?
- What are the firm's quality control practices?
- What is the firm's level of specialization in financial institutions?
- How are members of the audit team selected? Who are the members and what is their experience level?
- How much partner attention is focused on client service?
- What other services could the firm provide without affecting its independence?
- What level of communication will the firm have with management, the board of directors and the audit committee?
- What is the audit process and what areas receive primary emphasis?
- How does the audit team determine the critical audit areas?
- What level of reliance will the firm have on the internal audit and internal loan review functions?
- What steps does the audit team follow if there are problems identified in the audit process?
- How does the firm use technology and innovation in its audit process?
- What is the firm's commitment to information security and data privacy? How does the firm manage cybersecurity risks?
- Does the firm have a peer review? Describe the results of the latest review.
- Provide a copy of the most recent peer review and PCAOB report.

Review of the audit plan with independent auditors

- Are there any new accounting or auditing standards that will affect the audit this year and, if so, what will the impact be?
- What are the critical audit areas and significant risks this year? How does that compare to prior years?
- What is the process used to determine exposure to fraud risk?
- What do you consider to be high-risk areas?
- How are data processing, wire transfer, Automated Clearing House and internet activities included in the audit process?
- Which locations will the audit team be visiting this year? What audit work will they do at each location?
- How was the audit work coordinated with internal audit, internal and external loan review and financial management?
- What are your plans to identify and report on control deficiencies, significant deficiencies and material weaknesses?
- How will you address general comments to management?
- Will you have an exit conference before your audit team leaves?
- Will your audit team be able to meet the deadlines for the financial statements?
- What changes in accounting rules and regulations have occurred and how does that affect the financial statements?
- What is the process for discussing issues that might require potential adjusting entries?
- Do you have a preliminary listing or draft of the critical audit matters that you plan to disclose?

Executive session with the independent auditor

- Were personnel cooperative? Did they answer your questions? Did you have to push for answers? Were any other difficulties encountered during your audit?
- Were there time pressures on your work, including pressures on the timing of the audit procedures? If so, what was the effect on your audit?
- Are the internal auditors or financial management—at both the corporate and division levels—qualified for what we are asking them to do? Do we need to hire any specialists, such as an information systems auditor for the internal audit department?
- Do you have any other concerns about financial management?
- Did management adequately respond to your suggestions for improvement in operations and controls?
- Does financial management have adequate resources (e.g., experienced personnel and technology resources)?
- For any proposed adjustments that were not recorded this year by management, does management have a reasonable plan to record those adjustments in subsequent periods?
- What is your assessment of the risks of material financial statement fraud or misstatement and your understanding of the controls designed to mitigate such risks?
- What are the areas of greatest concern to you? Have the areas been sufficiently covered with the committee in another context (e.g., audit committee meeting and written materials)?
- Were any changes made in your scope or in planned procedures because of changes in your risk assessments? If so, why did they occur?
- In addition to the matters discussed in your communication to the audit committee as required by standards, are there any other matters that you want to bring to our attention?

Review of regulatory examination reports

- How did the examiners arrive at their conclusions in management, liquidity, capital, asset quality, earnings and interest rate risk?
- Were there any significant violations of regulations or statutes?
- Were there any recurring violations that needed to have immediate attention?
- Does management agree with the examiner's assessment of problem assets?
- Did the examination process identify any differences in classification of loans from the internal loan classification system?
- Does the process used to establish the level of allowance for loan losses meet the FFIEC policy guidelines?

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Appendix E: Questionnaire for assessing audit committee effectiveness

A. Understanding the structure, roles and responsibilities of the audit committee	Effective	Needs improvement	Suggestions for improvement
The responsibilities of the audit committee are set forth in an audit committee charter, which is approved by the board			
The audit committee annually reviews the charter and suggests changes to the board of directors			
The experience and qualifications of audit committee members are compatible with the duties of the committee, including the ability to understand financial reporting			
The size of the audit committee is appropriate for the complexity and operations of the company			
The members of the audit committee are independent of management			
The audit committee completes a self-evaluation of its performance and recommends changes to the board			
The audit committee plans an agenda for each meeting to ensure that it addresses:			
▪ Matters to be discussed at each meeting during the annual cycle			
▪ Communication between the audit committee (or chair) and the independent auditors before the release of financial data			
▪ General topics to be discussed each meeting			
Meeting agendas are prepared and distributed in advance together with sufficient background information to allow the committee members to prepare for meetings			
Minutes of meetings are taken and circulated to members after the meeting			
The audit committee members attend training sessions on accounting, auditing and financial reporting developments and current business and industry issues			
Audit committee members ask tough questions, listen to answers and challenge responses to ensure that they understand the business and financial impact			
The audit committee encourages a "tone at the top" that conveys basic values of ethical integrity, as well as legal compliance and strong financial reporting and control			
The audit committee obtains information on leading practices and other developments in corporate governance and considers ways to improve			

B. Understanding the business operations	Effective	Needs improvement	Suggestions for improvement
The audit committee understands the company's organizational structure and the revenue drivers of the business			
The audit committee discusses the evaluation of the controls over the financial reporting and disclosure process with management, the internal auditors and independent auditors			
The audit committee evaluates whether management exhibits the proper "tone at the top" and fosters a culture and environment that promotes high-quality financial reporting, including appropriate attention to internal control issues			
The audit committee evaluates management's procedures for monitoring compliance with the company's code of ethics			
The audit committee discusses with the internal auditors their adequacy of the company's regulatory compliance programs			
The audit committee receives the management's internal and independent auditors' assessments of the risks of fraud and is alert for risk factors that lead to potential fraudulent financial reporting			
The audit committee is made aware of reports or other communications received from regulators and updates from the general counsel on legal and regulatory matters that may have a material effect on the financial statements or that may affect related company compliance policies or the financial stability or profitability of the company			

C. Understanding risk management	Effective	Needs improvement	Suggestions for improvement
The audit committee receives regular updates from management on operating risks and is involved in risk management by being an advocate for the adoption of a risk and control system for effective risk management			
The audit committee has discussions with the CIO to understand the company's technology strategy, information systems and measures taken to protect resources devoted to information technology			
The audit committee has discussions with the senior management team to understand emerging business risks			

D. Understanding financial reporting	Effective	Needs improvement	Suggestions for improvement
The audit committee reviews financial statements with senior management and discusses the transparency and clarity of the financial reporting and disclosures with the company's internal and independent auditors.			
The audit committee develops an understanding of the business purpose and economic substance of major or unusual transactions			
The audit committee evaluates the quality of earnings and considers any red flags that may indicate that earnings are being managed			
The audit committee discusses the selection, application and disclosure of the company's critical accounting policies with management, the internal auditor and the independent auditor before releasing the annual report			
The audit committee reviews the financial statement disclosures and management's discussion and analysis to determine that the information is not inconsistent with information in the financial statements or elsewhere in the annual report and that the disclosure provides the reader with a concise understanding of the risks being managed			
The audit committee discusses any uncorrected misstatements with management and the auditors, determines why they were not recorded and evaluates the impact on the financial statements and earnings per share if all or only certain misstatements were recorded			

E. Understanding interim financial reporting	Effective	Needs improvement	Suggestions for improvement
The audit committee is provided with material to review prior to the earnings release, including a draft earnings press release and key performance measures			
The audit committee (or the committee chairperson) discusses and reviews the interim financial statements with management and the independent auditors, at least via conference call, prior to filing the company's Form 10-Q.			
The audit committee is briefed by management on how management develops and summarizes quarterly financial information and how the quarterly financial close process may differ from the annual financial close process			
The audit committee reviews with management any significant year-end issues that may affect the financial integrity of interim accounting and reporting practices			

F. Understanding the audit process	Effective	Needs improvement	Suggestions for improvement
The audit committee understands how an internal audit is conducted and understands the independent audit process			
The audit committee reviews any material weaknesses and significant control deficiencies identified by the internal or independent auditors, as well as management's plan and timetable to address those recommendations			
The audit committee reviews the internal audit charter on an annual basis and evaluates it against the current expectations and needs			
The internal audit function reports to the audit committee			
The audit committee reviews the quality, experience and objectivity of the internal auditors			
The audit committee annually reviews the performance of the independent auditor, including the auditor's responsiveness to the audit committee's expectations, and recommends to the board of directors the retention (selection) of the company's independent auditor			
The audit committee discusses audit plans and scopes of internal and independent auditors, the results of their work, any changes in the plans, the extent of control testing to be performed and the extent of the coordination of their activities to ascertain whether the audit coverage is adequate			
The audit committee reviews the independence of the independent auditor and discusses the processes used by the audit firm to monitor the independence of the members of the client service team			
The audit committee approves and signs the engagement letter for the annual audit and approves the audit fee			
The audit committee has a process to identify and approve nonaudit services to be delivered by the independent audit firm			

G. Development of a communication process	Effective	Needs improvement	Suggestions for improvement
The audit committee provides a report to the board of directors after each committee meeting			
The audit committee meets in an executive session, as circumstances require, with the senior management team members			
The audit committee obtains a written report from management on the effectiveness of internal control over financial reporting or written representations from management regarding management's responsibility for integrity of internal control and the financial reporting systems and processes and management's beliefs about the quality of controls and financial reports			
The audit committee has executive sessions with the internal and independent auditors as circumstances require			
The audit committee reviews management's response to audit and regulatory recommendations and whether follow-up audits indicate that corrective action is timely and effective			
The independent auditor provides to the audit committee their assessment of the personnel in the financial organization, including the number, experience and capabilities of such personnel for the size and complexity of the company			

Appendix F: Questionnaire for assessing internal audit

	Effective	Needs improvement	Comments
Does internal audit operate under a charter that sets forth internal audit authority, reporting responsibility and operating guidelines?			
Are the competence and objectivity of internal audit staff evaluated annually?			
Does internal audit report directly to the audit committee?			
Does senior management value the perspective and insight of internal audit input?			
Does senior management respond in a timely and appropriate manner to internal audit findings?			
Does internal audit prepare an annual budget for audit coverage?			
Does the internal audit staff obtain required continuing professional education each year?			
Does internal audit include information technology (IT) specialists? If not, how is the IT internal audit accomplished?			
Does internal audit update or prepare a risk assessment for presentation to the audit committee on an annual basis?			
Do internal audit workpapers support the findings and reports?			
Does internal audit provide the audit committee with reports within 60 days of finishing an audit area?			
Does internal audit include management's response to findings in the internal audit report?			
Does internal audit maintain a list of findings that are awaiting management's attention?			
Does internal audit provide the audit committee insights on emerging business risks or problems in monitoring current risks?			
Does internal audit interact appropriately with external audit personnel?			
Does internal audit challenge areas included for audit coverage by external audit?			

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