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Audit Committee Guide

2022

Preface

Few responsibilities in corporate governance are more important than that of service on the audit committee of a public company. Congress, the Securities and Exchange Commission, the New York Stock Exchange, Nasdaq and the Public Company Accounting Oversight Board have placed great responsibilities on—and displayed significant confidence in—the audit committee and its members. Among other things, the audit committee is expected to monitor the integrity of the company's financial statements and internal controls, the qualifications and independence of the company's independent auditor, the performance of both the company's internal audit function and its independent auditor, compliance by the company with legal and regulatory requirements and, for many companies, risk oversight. In light of the significant financial and operational impact on companies of the COVID-19 (Coronavirus) pandemic and the war in Ukraine, the oversight function of the audit committee is as critical as ever, and a well-functioning audit committee plays a crucial part in reassuring investors that corporate governance represents an effective system for controlling large public companies, for enhancing companies' ability to create value and for fairly and completely reporting their financial results to investors and others.

To assist those who serve on the audit committee with their special role, this Guide provides an overview of the key rules applicable to audit committees of NYSE- and Nasdaq-listed companies and describes some of the best practices that audit committees should consider. In addition, attached as exhibits are a Model Audit Committee Charter for NYSE-listed companies, a Model Audit Committee Charter for Nasdaq-listed companies, a Model Audit Committee Responsibilities Checklist, a Model Audit Committee Member Financial Expertise and Independence Questionnaire, a Model Audit Committee Pre-approval Policy, Model Policies and Procedures with respect to Related Person Transactions, Model Whistleblower Procedures and a Model Audit Committee Self-Evaluation Checklist. These models are just that—models that can and should be adapted by a company to fit its own circumstances.

In today's financial and enhanced regulatory enforcement climate, the audit committee must be vigilant not only in monitoring financial reporting and compliance, but also in following appropriate procedures in performing its duties. It is incumbent upon every audit committee to ensure that its policies and procedures are "state of the art." We hope that this Guide will assist audit committees in doing so.

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About this Guide and Exhibits

This Guide provides an overview of the key rules applicable to audit committees of NYSE- and Nasdaq-listed U.S. companies and best practices that audit committees should consider. This Guide outlines audit committee members' responsibilities, reviews the composition and procedures of audit committees and considers important legal standards and regulations that govern audit committees and audit committee members. Although generally geared toward public company audit committee members, this Guide is also relevant to private company audit committee members, especially if the private company may at some point consider accessing the public capital markets.

In particular, this Guide is written to help audit committee members fulfill their duties in the current environment, in which the ongoing Coronavirus pandemic has drastically altered the global economic and business landscape. While the Coronavirus pandemic appears to be moving toward an endemic phase, the disruptions caused by the pandemic are likely to have impacts well beyond the end of the pandemic. At the same time, a ground war in Ukraine and the impact of sanctions on international markets reminds us that risk of disruption comes in many forms. In any event, well-functioning audit committees will help equip companies to address the financial reporting and compliance challenges arising from such disruptions. To this end, this Guide proposes specific practices designed to promote effective audit committees. A well-run audit committee—*i.e.*, an audit committee composed of financially knowledgeable, independent members who are focused on the right areas of inquiry and intent on asking tough questions of management, internal auditors and the independent auditor—can assist the company in its financial reporting, risk management and compliance obligations.

A few necessary caveats are in order. This Guide is not intended as legal advice, cannot take into account particular facts and circumstances and does not generally address individual state corporation laws. That said, we believe that this Guide will offer directors sound guidance in terms of the general rules and practices that audit committee members should follow.

The exhibits to this Guide include sample charters, policies and procedures. All of these exhibits are to some extent useful in assisting the audit committee in performing its functions and in monitoring compliance. However, it would be a mistake to simply copy published models. The creation of charters and written policies and procedures is an art that requires experience and careful thought. In order to be "state of the art" in its governance practices, it is not necessary that a company have everything another company has. When taken too far, a tendency to expand the scope of charters, procedures and policies can be counterproductive. For example, if an audit committee charter or procedure requires review or other action to be taken and the audit committee has not made that review or taken that action, the failure may be considered evidence of lack of due care. Each company should tailor its own audit committee materials, limiting audit committee charters and written procedures to what is truly necessary and what is feasible to accomplish in actual practice. These materials should be carefully reviewed each year to prune unnecessary items and to add only those items that will in fact help directors in discharging their duties.

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Audit Committee Oversight Duties

Since the New York Stock Exchange (NYSE) first mandated in 1978 that each of its listed companies appoint an audit committee of independent directors, the audit committee has played a leading role in corporate governance. That role has become more and more important, as the oversight duties that Congress, the Securities and Exchange Commission (SEC), the NYSE, the Nasdaq Stock Market (Nasdaq), the Public Company Accounting Oversight Board (PCAOB) and federal banking regulators (for financial institutions), as well as the expectations corporate stakeholders, have placed on audit committees and their members have continuously increased in scope and nature.

In a context of increasing regulation and guidance concerning companies' financial reporting and risk management oversight, the audit committee is the principal means by which the board of directors discharges its duty to monitor financial and disclosure compliance. Accordingly, boards should carefully select audit committee members and, to the greatest extent possible, be attuned to the quality of the audit committee's performance. In view of the audit committee's centrality to the board's duties of financial review, it also is important for a board as a whole to receive periodic reports from the audit committee and to be comfortable that the audit committee, the auditors and management are satisfied that the financial position and results of operations of the company are fairly presented in its financial reports. At a minimum, an audit committee is charged with assisting the board in its oversight of the following:

- the qualifications, independence and performance of a company's outside auditor;
- the performance of a company's internal audit function;
- the integrity of a company's financial statements; and
- a company's compliance with legal and regulatory requirements.

This Chapter focuses on key aspects of an audit committee's oversight duties and offers practices that an audit committee might find useful in performing its duties. Additional required functions of an audit committee are discussed in Chapter II: "Audit Committee Charter."

The rapidly changing economic environment, including the conflict in Ukraine and the resulting sanctions, increasing inflationary pressure, supply chain disruptions, the increasing frequency and sophistication of cybersecurity attacks and a historically competitive labor market are creating both financial and operational pressure on companies, making effective oversight more important than ever.

As companies seek to respond to investor and regulatory desire for increased disclosure related to environmental, social and governance (ESG) issues, audit committee oversight duties are critical to ensure market confidence in reported information.

A. Overseeing the Independent Auditor

It is an audit committee's responsibility to select a company's independent auditor. An audit committee, in most instances, will depend to some extent on a company's financial reporting executives for information about an independent auditor's qualifications. However, the retention process should be organized to effectively signal that an independent auditor's client is the audit committee, not company management.

By carefully reviewing an auditor's independence and competence, as well as the auditor's proposed audit plan, the audit committee will highlight to the independent auditor the responsibilities that such independent auditor has toward the audit committee. The SEC has emphasized that an audit committee should also pay close attention to the audit fee, and use the fee to measure and reward the scope of audit work. An audit committee should benchmark the fee of the independent auditor against the fees of auditors of comparable companies. The idea is not to economize on the audit fee but, rather, to spot an audit fee that seems low or high in relation to peer companies. A low fee may signal an inadequately thorough audit. A high fee may indicate inefficiency in the audit or even raise questions regarding an auditor's independence. The factors that an audit committee should evaluate in assessing an auditor's independence and competence are discussed in Chapter V: "Relationship with the Independent Auditor."

No aspect of an audit committee's role is more vital than its oversight of the audit process. An audit committee should have procedures in place to ensure that it stays abreast of evolving standards and best practices in this area. The PCAOB has promulgated strengthened independence and ethics rules and adopted auditing standards relating to the transparency and quality of audit reports, including requirements for enhanced disclosures of certain critical audit matters, and the effectiveness of communications between an audit committee and the independent

auditor. The PCAOB's rules and proposals relating to the audit work are discussed in Chapter V: "Relationship with the Independent Auditor."

Finally, an audit committee should insist that the financial disclosures and the accounting judgments made in preparing financial statements have the independent auditor's support. An audit committee may consult with legal counsel or other accountants if it has questions about the performance of an independent auditor.

B. Supervising Internal Audit

Each NYSE-listed company must have an internal audit function to provide management and the audit committee with ongoing assessments of a company's risk management processes and systems of internal control.[1] Internal auditors, when carefully selected and appropriately managed, are a powerful safeguard against defects in financial controls or financial statements. A strong, well-performing internal audit function also may help to moderate the fees of an independent auditor and to facilitate the independent auditor's audit of a company's internal controls required by Section 404(b) of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) (discussed in Chapter VII: "Internal Controls and Oversight Effectiveness").

Although a company may choose to outsource the internal audit function to a third-party service provider other than its independent auditor, internal auditors typically are full-time employees and should have access to all of the inputs into a company's financial statements and risk assessments. It is important to keep in mind, however, that there are potential weaknesses inherent in the internal audit function because of the typical status of the internal auditors as employees. Accordingly, an audit committee should seek to insulate the internal auditors from undue corporate pressures. It can do this by taking an active role in the selection and evaluation of the performance of the internal auditor. First, although not required, an audit committee should have ultimate authority over the selection of

[1] Rule 303A.00 of the NYSE Listed Company Manual provides a one-year transition period to comply with the internal audit function requirement for certain companies transferring to the NYSE from another national securities exchange and companies newly listed on the NYSE in connection with an initial public offering or carve-out or spin-off transaction. According to the NYSE, the audit committee of a company availing itself of the transition period should review management's plans with respect to the responsibilities, budget and staffing of the internal audit function and the company's plans for the implementation of the internal audit function. In 2013, Nasdaq considered imposing a similar requirement for Nasdaq-listed companies to have an internal audit function, but withdrew its proposed rule as a result of broad opposition by smaller companies. Nasdaq nonetheless stated that it remains committed to the underlying goal of ensuring that listed companies have appropriate processes in place to assess risks and systems of internal controls and that it intends to file a revised proposal that would require Nasdaq-listed companies to have an internal audit function. SEC Release No. 34-69792 (June 18, 2013). However, as of the date of this guide, no revised proposal has been submitted.

the senior internal auditor. Second, an audit committee should be involved in performance reviews of the senior internal auditor and should review compensation levels and structures. In that respect, it should be noted that most forms of incentive pay tied to stock price, sales or other measures of financial performance potentially create a conflict of interest for an internal auditor.

An audit committee should meet regularly and privately with the internal auditor and satisfy itself that the internal auditor has direct access to the audit committee. An audit committee should also be comfortable that the internal audit staff is afforded, and avails itself of, the opportunity to stay professionally current, and otherwise has adequate resources.

As the Coronavirus pandemic is moving toward an endemic phase, companies are adopting varied approaches to long-term hybrid and remote working arrangements. This move toward hybrid and remote work makes it even more important for audit committees to communicate regularly with the internal auditor to ensure that the internal auditor has all the resources it needs to adequately assess the company's risk management processes and systems of internal control and to make sure that their companies build on best practices learned during the Coronavirus pandemic.

C. Integrity of a Company's Financial Statements

The fundamental responsibility for a company's financial statements and disclosures rests with management and the independent auditor. However, audit committee members must have the financial literacy to understand a company's financial reporting in order to pass appropriately on the adequacy and integrity of the company's financial statements and management's discussion and analysis of financial condition and results of operations (MD&A) disclosures in a company's SEC filings.

Given the complexity of the financial statements of large public companies, audit committee members are not required to explain the detailed accounting aspects of each transaction. Still, an audit committee should satisfy itself as to the business purposes, the appropriate accounting and the general risks associated with all major transactions. An audit committee should not hesitate to enlist the services of management and the independent auditor, as well as any outside advisors in special situations where it deems necessary, to help describe for the audit committee—comprehensively and comprehensibly—the financial condition of the company and its results of operations. A thorough presentation of a company's financial condition should be made by senior management to new directors as soon as possible after their election or appointment to the board.

In addition, an audit committee should discuss with the independent auditor the accounting principles and critical accounting policies and judgments made in connection with the preparation of the company's financial statements. An audit committee should discuss possible alternative accounting treatments whenever the independent auditor either has discussed these alternatives with management or believes that these alternative policies would better reflect the underlying economic transactions and values. An audit committee should understand the range of results that would follow if alternative accounting methods had been used and why the method chosen was appropriate. Audit committees, particularly of financial institutions, should also focus on the methods and assumptions used in determining the "fair value" of financial assets and, if applicable, should satisfy themselves as to the reliability of information obtained by third-party pricing services that may be used by management to develop such "fair value" estimates. With the help of the independent auditor, directors should not hesitate to "drill down" into key accounting issues and review a company's financial statements and audit reports critically. While an audit committee is not expected to make any of the assumptions and judgments used in the preparation of a company's financial statements, an audit committee should understand such material assumptions and judgments and assess their basis and their reasonableness.

An audit committee should also discuss with the independent auditor its judgments about the quality, not just the acceptability, of a company's accounting principles as applied in its financial reporting. In that respect, both the PCAOB and the SEC have put an emphasis on significant unusual transactions and complex financial transactions and how they are reflected in a company's financial statements. PCAOB Auditing Standard 2410 (PCAOB AS 2410) requires the independent auditor to (1) identify "significant unusual transactions," *e.g.*, transactions that are outside the normal course of a company's business or that otherwise appear to be unusual due to their timing, size or nature; (2) understand and evaluate the business purpose (or the lack thereof) of these transactions; and (3) consider whether they may have been executed to engage in fraudulent financial reporting or conceal misappropriation of assets.[2] Independent auditors are required to communicate to the audit committee significant unusual transactions identified by them and the policies and practices management used to account for such transactions. Certain SEC initiatives and interpretative guidance have also focused on intra-quarter liquidity fluctuations and transactions such as short-term borrowings, securities lending transactions and repurchase agreements, with a view that financial reporting fairly "tells the story" of a company's financial condition and does not merely reflect such company's period-end position. An audit committee should pay particular attention to these transactions and, as mandated by

[2] SEC Release No. 34-73396 (October 21, 2014); PCAOB Release No. 2014-01 (June 10, 2014).

the PCAOB, discuss with the independent auditor its understanding of the business rationale for such transactions. In this regard, an audit committee should bear in mind its oversight function of both the integrity of a company's financial reporting and a company's risk management and risk exposure and how that function might be affected by significant unusual transactions.

An audit committee should also review the company's internal controls over financial reporting. This is a critical area in light of Sarbanes-Oxley's mandate that a company's independent auditor conduct an audit of the company's internal controls. An audit committee's responsibilities for oversight of internal control over financial reporting and compliance with the SEC and PCAOB requirements are discussed in Chapter VII: "Internal Controls and Oversight Effectiveness."

An audit committee's discussions with the independent auditor should include a period during which management is excused. During these executive sessions, explicit inquiry should be made concerning significant discussions between the independent auditor and a company's chief executive officer (CEO), chief financial officer (CFO), treasurer, comptroller or other senior officers. The NYSE has stated that an audit committee should review with the independent auditor any audit problems or difficulties encountered by the independent auditor, as well as management's response. However, even when there have been no disagreements between the independent auditor and management, an audit committee should inquire as to the nature and extent of issues that the independent auditor and management spent time discussing during the audit.

As a general practice, audit committee members are entitled to rely on presentations, reports and other information provided by management, the internal auditor, the independent auditor, legal counsel and other advisors, absent a reason to doubt their competence or fidelity. Of course, if an audit committee discovers credible evidence that it cannot rely on such information, it must be diligent in pursuing any concerns. SEC regulations require an audit committee to have the power to engage independent counsel and other advisors as it determines necessary to carry out its duties.[3] A company also is required to provide sufficient funding to the audit committee to pay the independent auditor and any advisors employed by the audit committee, as well as the administrative expenses of the audit committee that are incurred in carrying out its duties.[4] While it is important for an audit committee to be able to use this power in appropriate circumstances, it is not

[3] Securities Exchange Act of 1934, as amended (Exchange Act), Rule 10A-3(4).

[4] Exchange Act, Rule 10A-3(5).

necessary, and often counterproductive, for audit committees to routinely, or reflexively, retain separate advisors.

As the Coronavirus pandemic moves toward an endemic phase, audit committees should assess the effectiveness and resilience of their processes in response to the Coronavirus pandemic and evaluate whether any changes would facilitate better communication and oversight in response to future disruptions.

D. Compliance Oversight and Risk Management

Volatile markets, criminal and regulatory enforcement investigations and the ascendancy of other classes of risk such as hacking and cyber intrusions and other ESG-related issues have underscored the need for global, enterprise-wide risk management and compliance oversight processes. The "enterprise-wide risk management" approach aims at developing a robust and holistic top-down view of the key risks a company faces. The SEC has increased disclosure requirements regarding the board's role in company risk oversight, including how the board administers its oversight function and the effect that this has on a company's leadership structure (*e.g.*, whether the persons who oversee risk management report directly to the board as a whole, to the audit committee or to another standing committee of the board) and whether and how the board, or such committee, monitors risk.

Many boards delegate oversight of risk management to the audit committee, which is consistent with the NYSE listing standard that requires an audit committee to discuss policies with respect to risk assessment and risk management.[5] In a January 2022 survey of audit committee members by the Center for Audit Quality (CAQ), 42% responded that enterprise risk management oversight for their organization falls to the audit committee, while 33% and 20% of respondents indicated the full board or a separate risk committee, respectively.[6] Financial companies may be required under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to have dedicated board-level risk management committees. At other companies, the appropriateness of a dedicated risk committee—instead of delegating such task to the audit committee—will depend on industry practice and the specific circumstances of the company. Boards should also bear in mind that the expertise of different committees may be best suited to oversee management of different types of risks—an advantage that may outweigh any benefit from having a single committee specialize in risk

[5] NYSE Listed Company Manual, Rule 303A.07(b)(iii)(D).

[6] Center for Audit Quality, Audit Committee Practices Report: Common Threads Across Audit Committees (Jan. 2022), available at https://www.thecaq.org/wp-content/uploads/2022/01/caq-deloitte-audit-committee-practices-report_2022-01.pdf.

management oversight. For instance, boards are required to oversee risks arising from compensation policies and programs and to discuss such risks in the company's proxy statement to the extent they are reasonably likely to have a "material adverse effect" on the company; such oversight may be best effected by the compensation committee (risks arising from compensation programs are further discussed in our *Compensation Committee Guide*, 2022). The board should implement a coordinated approach toward risk oversight and ensure an effective flow of information among the directors, senior management and risk managers in order to satisfy itself as to the adequacy of the risk oversight function and to understand the company's overall risk exposures. Given the NYSE requirement, if a company oversees some or all risk management through a structure that uses a board committee other than the audit committee, these processes should nonetheless be reviewed in a general manner by the audit committee (but the risk management function of such other committee need not be replaced or duplicated by the audit committee).

If a company charges the audit committee with overseeing risk management, the audit committee should schedule time in its agenda for periodic reviews of risk management outside the context of its role in reviewing financial statements and accounting compliance. The audit committee should also hold sessions in which it meets directly with key executives primarily responsible for risk management and compliance programs. In light of the *Caremark* standard discussed below (see Chapter XI: "Audit Committee Member Liability Issues"), an audit committee charged with overseeing risk management should feel comfortable that "red flags" and "yellow flags" are being reported to it so that key risks may be investigated and reported to the board if appropriate. It is important to build a record demonstrating allocation of sufficient time and focus to the risk oversight role. The goal should be to provide, through one means or another, serious and thoughtful board-level attention to the company's risk management process and system.

Audit committees tasked with risk management should be more vigilant and focused as the economic disruption caused by the Coronavirus pandemic, by increasing the pressure on some companies to meet or exceed performance targets and earnings guidance, has heightened the risk of fraud and improper accounting practices. In a January 2022 survey of audit committee members by the CAQ, 92% of those surveyed believed that fraud risk had increased or stayed the same due to the business environment resulting from the Coronavirus pandemic, while only 2%

believed the risk had decreased.[7] In the same survey, 96% of respondents indicated that financial reporting and internal controls, including fraud risk, was a top area of focus, eclipsing the next closest area of focus (cyber and data privacy) by over 40%.[8] In this environment, audit committees should communicate frequently with CFOs, especially concerning issues such as asset impairment, contract accounting and going concern. Discussions between audit committees and CFOs should also include strategic issues that may impact the business, including risk management and processes for communicating issues between the audit committee, the board and management.

An audit committee that oversees enterprise risk management should review whether management (1) has adequately identified the major categories of risk that the company faces, (2) regularly updates the risk profile of the company, (3) has adopted and implemented proper risk assessment and risk management strategies that are responsive to the company's risk profile, specific material risk exposures and risk tolerance thresholds, and that are consistent with the company's business strategies, (4) integrates consideration of risk and risk management into business decision-making throughout the company and (5) adequately transmits necessary information with respect to material risks to senior executives and the audit committee, as appropriate. For instance, an audit committee should make inquiry as to whether each relevant category of risk is adequately addressed by the company's risk management procedures, and ensure that effective communication and coordination exist between the different departments charged with overseeing each category of risk. In carrying out its responsibilities, an audit committee may rely on the knowledge and expertise of management and other advisors, although it should be wary of any "red flags" regarding their competence or knowledge. An audit committee that oversees enterprise risk management does not have a duty to mitigate risk, nor should it be involved in actual day-to-day risk management, but it is responsible for overseeing the implementation by management of appropriate risk monitoring systems, and taking appropriate action when it becomes aware of a problem and believes management is not properly dealing with it.

Specific types of actions that an audit committee should consider taking include the following:

- review with management the company's risk appetite, the ways in which risk is measured on a company-wide basis, the setting of aggregate and individual risk limits (quantitative and qualitative, as appropriate), the policies and procedures in place to hedge against

[7] *Id.*

[8] *Id.*

or mitigate risks and the actions to be taken if risk limits are exceeded;

- review with management the major categories of risk the company faces, including any risk concentrations and risk interrelationships, as well as the likelihood of occurrence, the potential impact of those risks and mitigating measures;

- review with management the assumptions and analysis underpinning the determination of the company's principal risks and whether adequate procedures are in place to ensure that new or materially changed risks are properly and promptly identified, understood and accounted for;

- review with other board committees and management expectations as to each group's responsibility for risk oversight and management of specific risks to ensure a shared understanding as to accountabilities and roles;

- review, in conjunction with the compensation committee, whether the company's executive compensation structure is appropriate in light of the company's articulated risk appetite and is creating proper incentives in light of the risks the company faces;

- review the risk policies and procedures adopted by management, including procedures for reporting matters to the board and audit committee and providing updates, in order to assess whether they are appropriate and comprehensive;

- review management's implementation of its risk policies and procedures to assess whether they are being followed and are effective;

- review with management the quality, type and format of risk-related information provided to directors;

- review the steps taken by management to confirm adequate independence of the risk management function and the processes for resolution and escalation of differences that might arise between risk management and business functions;

- review with management the design of the company's risk management functions, as well as the qualifications and backgrounds of senior risk officers and the personnel policies applicable to risk management, to assess whether they are appropriate given the company's size and scope of operations;

- review the role of internal audit in validating the effectiveness of risk management systems;

- review with management the means by which the company's risk management strategy is communicated to all appropriate groups within the company so that it is properly integrated into the company's enterprise-wide business strategy;

- review internal systems of formal and informal communication across divisions and control functions to encourage the prompt and coherent flow of risk-related information within and across business units and, as needed, the prompt escalation of information to management (and to the board or board committees as appropriate); and

- review reports from management, independent auditors, internal auditors, legal counsel, regulators, stock analysts and outside experts as considered appropriate regarding risks the company faces and the company's risk management function.

An audit committee should also consider asking its independent auditor the following risk assessment related questions as suggested by the PCAOB:[9]

- whether the PCAOB's inspections or the internal inspections of the independent auditor's firm identified any significant deficiencies in the audit firm's compliance with the PCAOB's risk assessment standards, and if so, what actions has the audit firm taken to address them;

- which audit areas have been identified by the independent auditor as having significant risks of material misstatement and, at a high level, how does the audit plan address those risks; and

[9] PCAOB Release No. 2015-007, *Inspection Observations Related to PCAOB "Risk Assessment" Auditing Standards (No. 8 through No. 15)* (October 15, 2015).

- in the independent auditor's view, how have the areas of significant risk of material misstatement changed since the prior year and why and what new risks has the independent auditor identified.

An audit committee that oversees enterprise risk management should also pay special attention to cybersecurity risks. Online security breaches, theft of proprietary or commercially sensitive information and damage to information technology infrastructure can have a significant financial and reputational impact on companies. The audit committee should ensure that management has implemented effective procedures to track, report and reduce cybersecurity risks and incidents and to benchmark the company's cybersecurity measures. It is also critical to ensure that management has appropriate plans, resources and training to address such risks and react appropriately in the event of a breach. Cybersecurity risks are further discussed in Chapter VII: "Internal Controls and Oversight Effectiveness."

In addition, an audit committee that oversees enterprise risk management should assess whether there exist external pressures that can push a company to take excessive risks and consider how best to address those pressures. In particular, pressure from hedge funds and activist shareholders to produce short-term results may lead to an increase of the company's risk profile (for example, through increased leverage to repurchase shares or to pay out special dividends, excessive cost-cutting or spinoffs that leave the resulting companies with smaller capitalizations). The audit committee should pay attention to the risk impact of those measures.

Where risks facing a company are highly complex, such as those involving complex derivative instruments or financial structures, the audit committee should request that management or other advisors explain for directors the company's positions and risks, including, as appropriate, scheduling risk tutorials. An audit committee should discuss with management a sensitivity analysis or "stress test" regarding the company's exposures and the steps management has taken to prepare for various contingencies. Under the Dodd-Frank Act, regular periodic stress tests are mandated for large banking institutions and the audit (or risk management) committee of such institutions should discuss with management and oversee the integrity of these tests and related communications with regulators. An audit committee also should seek to ascertain whether these risks and plans are adequately described in the company's risk factors and MD&A disclosure in its SEC filings. In this regard, audit committees should be aware that the SEC has adopted rules that changed the disclosure standard from the "most significant" risk factors to the "material" risk factors that make an investment in the company

speculative or risky.[10] Risk management and risk oversight are further discussed in our memorandum *Risk Management and the Board of Directors*, updated August 2021.

Audit committees of regulated financial institutions should understand the principal general risk areas being identified, from time to time, by regulators through supervisory letters, speeches, enforcement or supervisory actions involving peer institutions and the like, and understand how their institutions are positioned with respect to such risks. At many financial institutions, regulators work with company personnel on a daily basis, and the audit committee should satisfy itself that there is an adequate procedure in place to promptly alert senior management, the risk management committee and/or the audit committee itself, as applicable, to problems or tensions that develop in that relationship. The audit committee should periodically review the structure of the company's legal and regulatory compliance departments to ensure proper lines of authority and reporting, as well as to review the structure of the conflict review function. Compliance officers should report to the committee periodically about the company's relationships with its regulators and its compliance with legal and regulatory rules, as well as with the company's internal codes of ethics, conduct and compliance (including disciplinary measures taken due to any failure to comply). Institutions with more complex regulatory profiles should consider prioritizing the development of advanced communication tools, such as dashboards, to facilitate understanding of the state of compliance by directors. If these matters have been delegated to a separate risk management or compliance committee, the audit committee should at least understand the scope of the other committee's processes and ensure that there are no material gaps or inconsistencies between the work of the other committee and its own oversight responsibilities for risk management.

As the Coronavirus pandemic moves toward an endemic phase, audit committees should consider how post-pandemic realities, such as the shift to hybrid and remote work arrangements and the potential for new variants, may put pressure on compliance oversight. Rather than addressing these developments with short-term fixes, audit committees should focus on enhancing their companies' processes and polices that may be impacted by these developments, including whistleblower programs and other reporting channels. By implementing robust processes and policies, audit committees and their companies will be well-positioned to address similar disruptions in the future.

An audit committee should meet regularly with the company's general counsel and chief compliance officer, including in executive session, to monitor

[10] SEC Release Nos. 33-10825 and 34-89670 (August 26, 2020).

compliance with legal and regulatory requirements. An audit committee should oversee an annual review of the company's compliance programs and its information and reporting systems, and receive an opinion from the general counsel as to their adequacy. Where there is a serious investigation or litigation that is being handled by outside counsel, direct reports by such counsel to the board or to the audit committee are desirable. These meetings and reports should be designed to permit an audit committee to monitor a company's overall compliance program. Such monitoring is especially significant, given that the Organizational Sentencing Guidelines issued by the U.S. Sentencing Commission define stringent criteria for effective compliance programs and place significant responsibility on directors and officers for the oversight and management of compliance programs. The guidelines promote comprehensive compliance procedures and careful monitoring by requiring that directors be knowledgeable about compliance programs, be informed by those with day-to-day responsibility over compliance and participate in compliance training. The guidelines also reward with sentencing reductions companies that provide their chief compliance officers with direct reporting responsibility to the company's audit committee (defined as the "express authority to communicate personally" to the audit committee either "promptly" when reporting potential criminal conduct or at least annually when evaluating the implementation and effectiveness of the compliance and ethics program).

E. Managing the Intersection of Management, Internal Audit and Independent Auditor

An audit committee is the critical nexus among the independent auditor, the internal auditors and management. An audit committee must have direct, unmediated access to each of these three groups and must be able to communicate in confidence with them. This permits an audit committee, in overseeing the performance of these three groups, to enlist the services of each in order to assist in monitoring the others. Thus, in separate meetings, each group should be encouraged to offer suggestions as to how the performance of the others can be improved.

II

Audit Committee Charter

Both the NYSE and Nasdaq have specific rules regarding audit committee charters. Also, while not specifically requiring a charter, federal statutes and the rules of the SEC prescribe various specific responsibilities to audit committees. This Chapter discusses key aspects of such requirements.

A. NYSE Requirements

The NYSE requires that each audit committee of a listed company have a formal written charter, approved and adopted by the board. An audit committee charter must provide for an annual performance evaluation of the audit committee. While audit committee evaluations should reflect the particular issues and concerns facing each company, a model audit committee self-evaluation checklist is provided on Exhibit H. It also is good practice for an audit committee to review and reassess the adequacy of its charter on a regular basis.[11]

1. Specific Duties and Responsibilities

An audit committee charter must set out in sufficient detail the specific duties and responsibilities of the audit committee. These specific duties derive in part from outside requirements, such as applicable statutes, the rules promulgated by the SEC and other relevant regulatory bodies, the NYSE's listing rules and best practices derived from suggestions by accounting and other experts, and in part from internal requirements reflecting the company's particular business and corporate structure. These duties and responsibilities must include:

- Being directly responsible for the appointment, compensation, retention and oversight of the company's independent auditor (including resolution of financial reporting disputes between management and the independent auditor) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the company, and ensuring the direct reporting relationship of the independent auditor to the audit committee. Companies still may seek shareholder approval or ratification of the selection of an independent auditor, but the audit

[11] NYSE Listed Company Manual, Rule 303A.07.

committee must be responsible for making the recommendation or nomination of the independent auditor to shareholders.

- Obtaining and reviewing, at least annually, a report from the company's independent auditor describing its internal quality-control procedures, any material issues raised by the most recent internal quality-control review or peer review of the independent auditor or by any inquiry or investigation by governmental or professional authorities within the preceding five years regarding an independent audit carried out by such independent auditor, any steps taken to deal with such issues and all relationships between the independent auditor and the company.

- Reviewing and discussing the annual and quarterly financial statements with management and the independent auditor (including the company's disclosures in its MD&A).

- Discussing earnings, press releases, financial information and earnings guidance provided to analysts and ratings agencies.

- Discussing the company's policies with respect to risk assessment and risk management.

- Holding periodic mandatory executive sessions with each of management, internal auditors and the independent auditor.

- If the company does not yet have an internal audit function, discussing with the independent auditor management's plans with respect to the responsibilities, budget and staffing of the internal audit function and the company's plans for the implementation of the internal audit function.

- Reviewing with the independent auditor any audit problems or difficulties (including any restrictions on the scope of the independent auditor's activities or on access to requested information, and any significant disagreements with management) and management's responses. Among such items an audit committee may want to review with the independent auditor are:

  - any accounting adjustments that were noted or proposed by the independent auditor but were "passed" (as immaterial or otherwise);

- any "management" or "internal control" letter issued, or proposed to be issued, by the independent auditor to the company; and

- responsibilities, budget and staffing of the company's internal audit function.

- Having the authority to engage independent counsel and other advisors, and having available sufficient funding to pay these advisors, as well as the independent auditor and ordinary administrative expenses incurred in the course of carrying out its duties.

- Setting clear hiring policies for employees or former employees of the independent auditor, in view of the pressures that may consciously or subconsciously exist for auditors seeking a job with the company they audit.

- Establishing procedures for receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, including procedures for the confidential, anonymous submission by employees of concerns about questionable accounting or auditing matters.

- Reporting regularly to the full board of directors.

Each NYSE issuer also should conduct an appropriate review of all related-party transactions required to be disclosed in the company's public filings for potential conflicts of interest on an ongoing basis, and such transactions should be subject to the approval of the audit committee or a comparable body. See Chapter VIII: "Audit Committee Report, Disclosure Obligations and Financial Reporting Integrity."

2. Model Audit Committee Charter for NYSE-Listed Companies

Attached as *Exhibit A* is a model audit committee charter for NYSE-listed companies. Note that this audit committee charter is only a model intended to reflect the requirements of an audit committee charter for an NYSE-listed company. Companies should customize the model to their particular needs and circumstances.

B. Nasdaq Requirements

Nasdaq also requires that an audit committee have a formal written charter. In addition, Nasdaq requires that an audit committee review and reassess the adequacy of its charter on an annual basis.[12]

1. Specific Duties and Responsibilities

An audit committee charter must specify the scope of the audit committee's responsibilities, and how it carries out those responsibilities, including structure, processes and membership requirements. These specific responsibilities derive in part from outside requirements, such as applicable statutes, the rules of the SEC and other relevant regulatory bodies, Nasdaq's listing rules, and best practices derived from suggestions by accounting and other experts and in part from internal requirements reflecting the company's particular business and corporate structure. In particular, the charter must provide that the audit committee has the following duties and responsibilities:

- Ensuring that the audit committee receives from the independent auditor a formal written statement delineating all of the relationships between the independent auditor and the company.

- Actively engaging in a dialogue with the independent auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the auditor.

- Taking, or recommending that the full board take, appropriate action to oversee the independence of the outside auditor.

- Overseeing the accounting and financial reporting processes of the company and the audits of the financial statements of the company.

- Being directly responsible for the appointment, compensation, retention and oversight of the independent auditor (including resolution of disputes between management and the independent auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the company, and ensuring the direct reporting relationship of the independent auditor to the audit committee.

[12] Nasdaq Listing Rule 5605(c). See also SEC Rule 10A-3.

- Establishing procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters, including procedures for the confidential, anonymous submission by employees of concerns about questionable accounting or auditing matters.

- Having authority to engage independent counsel and other advisors.

- Having sufficient funding to pay such advisors as well as the independent auditor and ordinary administrative expenses incurred in the course of carrying out its duties.

In addition, each Nasdaq issuer must conduct an appropriate review of all related-party transactions required to be disclosed in the company's public filings for potential conflict-of-interest situations on an ongoing basis, and such transactions should be subject to the approval of the audit committee or a comparable body. See Chapter VIII: "Audit Committee Report, Disclosure Obligations and Financial Reporting Integrity."

2. Model Audit Committee Charter for Nasdaq-Listed Companies

Attached as *Exhibit B* is a model audit committee charter for Nasdaq-listed companies. Note that this audit committee charter is only a model intended to reflect the requirements of an audit committee charter for a Nasdaq-listed company. Companies should customize the model to their particular needs and circumstances.

III

Audit Committee Meetings and Chairperson

An audit committee must meet sufficiently often to address its duties and should devote adequate time to planning the timing and agenda and to notifying participants of its meetings. The precise number of meetings an audit committee should hold depends upon various factors, including the scope of the audit committee's responsibilities and the size and business of the company. Neither the SEC nor the major securities markets have specific guidelines in this regard, although the NYSE requirement that an audit committee meet to discuss the company's annual and quarterly financial statements effectively means that the audit committee of a NYSE-listed company must meet at least quarterly (and meeting at least quarterly is a best practice for audit committees of Nasdaq-listed companies).

The SEC requires that the proxy statement disclose the number of audit committee meetings held during the prior fiscal year, as well as the name of any director who attended fewer than 75% of the aggregate number of meetings of the full board and the committees on which such director served. Corporate governance and proxy advisory firms, such as Institutional Shareholder Services (ISS) and Glass, Lewis & Co. (Glass Lewis), generally recommend that shareholders vote "against" or "withhold" their votes for individual directors who attended less than 75% of the number of full board and committee meetings for the period for which they served, unless an acceptable reason, such as serious illness or extenuating circumstances, is disclosed in an SEC filing.[13]

A. Regular Meetings

An audit committee should meet prior to the filing of the company's quarterly and annual reports to discuss the proposed disclosures in such reports and related earnings announcements. After each of these meetings, an audit committee should meet separately with each of management, the independent auditor and the internal auditors, and in executive session. Note that an audit committee's responsibility to discuss earnings releases, as well as financial information and

[13] See ISS, "United States Proxy Voting Guidelines: Benchmark Policy Recommendations (Effective for Meetings on or after February 1, 2021)." Where a director has served for less than one full year, Glass Lewis will typically not recommend voting against such director for failure to attend fewer than 75% of full board or committee meetings, but will note such director's "poor attendance" with a recommendation to track the issue going forward. Glass Lewis, "2022 Policy Guidelines (United States)."

earnings guidance, may be fulfilled in a general manner (*i.e.*, through discussion of the types of information to be disclosed and the type of presentation to be made).

In addition to reviewing a company's financial information and reports, the audit committee should annually discuss the audit plan and the performance, retention and compensation of the independent and internal auditors. The factors an audit committee should evaluate in assessing the independent auditor's independence and competence are discussed in Chapter V: "Relationship with the Independent Auditor."

An audit committee also should schedule time to address its other responsibilities, including oversight of the functioning of internal controls, risk assessment and management guidelines and review of related-party transactions. See Chapter VII: "Internal Controls and Oversight Effectiveness." Management and the independent auditor should bring to the attention of the audit committee any significant deficiencies in, or problems with, the company's internal controls and any steps that have been taken to remedy these deficiencies and problems. An audit committee also should be apprised of complaints from whistleblowers or communications from regulatory agencies regarding the company's accounting, internal controls or auditing matters. See Chapter IX: "Audit Committee Whistleblower Rules and Ethics Codes."

Audit committee meetings, like board meetings, have become longer and more substantive than was common practice before the enactment of Sarbanes-Oxley and related reforms. Many companies often schedule their audit committee meetings for the day prior to full board meetings to permit adequate time to consider and discuss agenda items.

Given the above, an audit committee should create at the beginning of the fiscal year a responsibilities checklist or calendar that identifies the tasks to be performed and their timing according to its charter to ensure that all tasks identified in the audit committee charter are being performed during the year. Attached as *Exhibit C* is a model audit committee responsibilities checklist. Note that this audit committee responsibilities checklist is only a model intended to reflect the requirements included in the model audit committee charters attached as *Exhibits A* and *B*. Companies should customize the model to their particular needs and circumstances and in accordance with the tasks identified in their audit committee charter.

B. Audit Committee Meeting Minutes

Audit committees typically prepare minutes of their meetings, including their executive sessions where significant matters were discussed. Enough information should be recorded to establish that the audit committee sought the information it deemed relevant, reviewed the information it received and otherwise engaged in whatever actions and discussions it deemed appropriate in light of the then-known facts and circumstances. It bears emphasis that courts and regulators frequently regard minutes as the best record of what happened at a board or committee meeting. As a result, audit committee minutes should reflect the substance of the discussions at audit committee meetings and the time the audit committee spent on significant issues, and make clear reference to the documents that were furnished to the directors before and after an audit committee meeting. Regulated companies such as financial institutions should have due regard for the expectations of examiners and supervisors regarding board and committee minutes. If there were significant discussions with or among directors prior to or after an audit committee meeting, consideration should be given to making appropriate reference to them in the minutes. Drafts of minutes should be prepared promptly after an audit committee meeting and circulated promptly to the directors involved in the meeting.[14]

An audit committee should provide a report or a copy of the minutes of each audit committee meeting to the full board (see Chapter VIII: "Audit Committee Report, Disclosure Obligations and Financial Reporting Integrity"). Directors who do not serve on the audit committee should have the opportunity to ask audit committee members questions, including about financial reporting, audit process, internal controls and other matters relating to the audit committee's responsibilities or the topics covered at audit committee meetings. Some audit committees also prepare an annual report to the full board summarizing the audit committee's activities, conclusions and recommendations of the prior year and the proposed agenda for the upcoming year.

C. Audit Committee Chairperson

While the effectiveness of an audit committee turns on the diligence and energy of each of its members, an audit committee chairperson has a special role. An audit committee chairperson is responsible for ensuring that audit committee

[14] In one Delaware decision, *In re Netsmart Technologies, Inc. Shareholders Litigation*, C.A. 2563-VCS (March 14, 2007), then-Vice Chancellor Leo Strine criticized the common practice of providing drafts of board and committee meeting minutes to directors for approval a substantial period of time (several months in *Netsmart*) after the meeting. In the words of then-Vice Chancellor Strine, this practice is "to state the obvious, not confidence-inspiring."

meetings run efficiently and that each agenda item receives the appropriate level of attention. An audit committee chairperson also often is the key contact person between the audit committee and the other board members, senior management, internal audit staff and the independent auditor.

In choosing an audit committee chairperson, the board should seek to select a director with leadership skills, including the capability of forging productive working relationships (among committee members and with other board members, senior management, internal audit staff and the independent auditor). An audit committee chairperson often is an audit committee financial expert (see Chapter IV: "Audit Committee Membership"). No matter who is appointed audit committee chairperson, as part of the annual review of the audit committee, the audit committee and the board should review the combination of talents, knowledge and experience of audit committee members to assure that the audit committee has the right mix.

D. Consideration of Additional Compensation for Audit Committee Members and Chairperson

The increased time commitment demanded from directors by the current regulatory environment may call for additional director compensation, and this pressure will likely be greatest with respect to service on the audit committee. Although there are reasons that would support a judgment not to discriminate in compensation among directors (*e.g.*, concerns that greater compensation for audit committee members could create or exacerbate a feeling on the part of other directors that financial disclosure and statements in MD&A are not really their responsibility but that of others who are paid more to deal with them), reasonable additional fees for audit committee members are legal and may be appropriate. Additional compensation for committee chairs is another way to give fair compensation for those most burdened with responsibilities. In most public companies, the compensation committee reviews the compensation for board members, including directors serving on audit committees.

IV

Audit Committee Membership

A. Composition of the Audit Committee

An audit committee must be comprised solely of directors who meet the listing standards for director independence of the company's particular securities market, as well as the audit committee independence standards under the federal securities laws.

The major U.S. securities markets require a minimum of three members on an audit committee,[15] and an audit committee typically consists of three to five independent directors. In addition, mindful of the time commitment necessary to be an effective audit committee member, the NYSE discourages directors from serving on too many audit committees. Under the NYSE's listing standards, if a company does not limit to three or fewer the number of public company audit committees on which its audit committee members may serve, and if an audit committee member simultaneously serves on the audit committees of more than three public companies, then the board must affirmatively determine that such simultaneous service does not impair the ability of the director to serve effectively on the company's audit committee. This determination must be disclosed in the company's annual proxy statement. Every prospective audit committee member should evaluate carefully the existing demands on his or her time before undertaking the commitment to serve on an audit committee.

B. Financial Literacy and Financial Expertise

An audit committee should be comprised of individuals or members with sufficient understanding of the language of accounting and corporate finance to act as effective overseers of the integrity of a company's financial reporting process and its financial statements. Indeed, in a 2018 speech, the-then SEC Chief Accountant cautioned that "[j]ust meeting the technical requirements of financial literacy may not be enough to understand the financial reporting requirements fully or to challenge senior management on major, complex decisions."[16] Hence, audit committees should be composed of individuals, who in addition to possessing the

[15] Nasdaq Rule 5605 and NYSE Rule 303A.07(a).

[16] Speech by Wes Bricker, *Institute of Management Accountant's 2018 Annual Conference* (June 19, 2018).

relevant financial literacy and expertise, have the "time, commitment, and experience to do the job well."[17]

1. Financial Literacy

The major U.S. securities markets require that each member of an audit committee be able to read and understand fundamental financial statements.[18]

Under the NYSE listing standards, it is the board's duty to make a determination, in its business judgment, that each member of the audit committee is financially literate. The board's determination of financial literacy may be expressed: "*By reason of education or experience and in light of all of the factors of which the Board of Directors has become aware, it appears that* ***[Name of Director]*** *possesses such degree of financial literacy as is required to select and oversee the performance of the independent and internal auditors; to monitor the integrity of the Company's financial statements; and otherwise to execute the charter of the Audit Committee*."

Members should be adjudged competent when they are selected and agree to serve. Companies should also provide audit committee members during their tenure with professional advice and continuing education in evolving audit committee concepts and responsibilities, including updates on important accounting, auditing, finance and legal developments, and should consider the usefulness of regular tutorials (by internal and external experts) to help keep directors abreast of current industry and company-specific developments and specialized issues (whether legal, accounting or operational).

Although not currently a requirement, companies should also consider whether their audit committees have sufficient technological expertise to properly leverage their financial literacy. Companies should take steps to ensure audit committee members are kept abreast of rapid developments in data analytics, digitization, information technology infrastructure and other audit related technology matters. Companies that are particularly concerned about these issues might consider adding directors with existing technology expertise to their audit committee.

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[17] *Id.* Also see, Speech by SEC Chair Mary Jo White, *American Institute of Certified Public Accountants Conference on SEC and PCAOB Developments* (December 9, 2015).

[18] The NYSE permits members to become financially literate within a reasonable period of time after being appointed to an audit committee, but Nasdaq does not.

2. Financial Expertise

The NYSE requires that at least one member of the audit committee have accounting or related financial management expertise as determined by the board in its business judgment. The expertise requirement generally is fulfilled by a background in finance that permits a board to conclude in good faith that the director is capable of understanding the most complex issues of accounting and finance that are likely to be encountered in the course of a company's business. The NYSE permits a board to presume that an individual who is an "audit committee financial expert" within the meaning of the SEC's rules (described in Section 3 below) has the requisite "accounting or related financial management expertise" to satisfy the NYSE's listing standards.

Nasdaq rules require that at least one member of an audit committee have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background that results in the individual's financial sophistication, including being or having been a CEO, CFO or other senior officer with financial oversight responsibilities. An individual who is an "audit committee financial expert" within the meaning of the SEC's rules is deemed to fulfill this latter requirement.

3. Audit Committee Financial Expert

Under the direction of Sarbanes-Oxley, the SEC issued rules requiring a public company to disclose in its annual reports (or annual proxy statements) whether any member of its audit committee qualifies as an audit committee financial expert (as defined below), as determined by the board in its business judgment. If a board determines that there is at least one audit committee member who is a financial expert, then the company must disclose the name of at least one such member and whether such member is independent. If no audit committee member qualifies, then the company must state why its audit committee lacks a financial expert. If a board determines that the audit committee has more than one member who qualifies as a financial expert, the company may, but is not required to, disclose the names of those additional members. If a company does disclose the names of any such additional financial experts serving on the audit committee, it also must indicate whether they are independent.

ISS's corporate governance scoring product (QualityScore) includes in its scoring model the number of financial experts serving on a company's audit committee (ISS considers whether a company has zero, one or two financial experts on its audit committee). Since most U.S. public companies will have at least one financial expert serving on the audit committee under stock exchange listing

requirements, this scoring factor should have little impact on the overall score of U.S. companies.

The SEC regulations define an "audit committee financial expert" as an individual who has *all* of the following attributes:

- an understanding of U.S. generally accepted accounting principles (GAAP) and financial statements;
- the ability to assess the general application of GAAP in connection with accounting for estimates, accruals and reserves;
- experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that can reasonably be expected to be raised by the company's financial statements, or experience actively supervising persons engaged in such activities;
- an understanding of internal controls and procedures for financial reporting; and
- an understanding of audit committee functions.

An individual must have acquired the five audit committee financial expert attributes listed immediately above through any one or more of the following:

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

In addition to CFOs, chief accounting officers and public accountants, the SEC's definition enables many CEOs and people actively engaged in professions such as investment banking, venture capital investment and financial analysis to qualify as audit committee financial experts. The SEC noted, however, that the mere fact that a CFO reports to a CEO would not necessarily qualify the CEO as an audit committee financial expert unless the CEO engaged in active supervision of the CFO.

It is important to note that there should be no additional liability under federal law for an audit committee financial expert. An individual who is determined by a board to be an audit committee financial expert will not be deemed to be an *expert* (a term that has special legal significance under the Securities Act of 1933) for any purpose as a result of being so designated, and will not be subject to any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such individual as a member of the audit committee and board in the absence of such designation. Nor does the designation of a member of the audit committee as an audit committee financial expert alter or affect the duties, obligations or liability of any other member of the audit committee or the board. Although this safe harbor provision does not expressly apply to state laws, the SEC has stated that it did not believe the designation of a director as an audit committee financial expert would increase that individual's exposure to liability under state law.[19] In 2021, nearly 90% of Fortune 100 companies had two or more financial experts serving on their audit committee, up from 70% in 2012, reflecting both the increasing complexity of audit committee obligations and increased expectations regarding the importance and competence of audit committees and their members.[20]

C. Independence Criteria of the Major Securities Markets

The major securities markets require the audit committees of all listed companies to consist *entirely* of independent directors (with a limited exception under the Nasdaq rules, discussed below). All independent directors must be identified as independent in proxy disclosure. Both the NYSE and Nasdaq have adopted specific rules as to who can qualify as an independent director. The NYSE and Nasdaq independence rules are in addition to the audit committee independence requirements imposed by the federal securities laws (discussed later in this Chapter), and both the NYSE and Nasdaq explicitly require compliance with those independence requirements. Both markets require the board of any listed company to make an affirmative determination, which must be publicly disclosed (along with

[19] SEC Release Nos. 33-8177 and 34-47235 (January 24, 2003) ("Our new rule provides that whether a person is, or is not, an audit committee financial expert does not alter his or her duties, obligations or liabilities. We believe this should be the case under federal and state law.").

[20] EY Center for Board Matters, *Audit committee reporting to shareholders in 2021* (October 2021).

the basis for such determination), that each director designated as "independent" has no material relationship with the company that would impair his or her independence. Such disqualifying relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, among others. However, ownership of a significant amount of stock, or affiliation with a major shareholder, should not, in and of itself, preclude a board from determining that an individual is independent. In addition, the listing standards of both the NYSE and Nasdaq set forth circumstances that constitute *per se* bars to a determination of independence.

As a general matter, a director will be viewed as independent only if the director is a non-management director free of any family relationship or any material business relationship, other than stock ownership and the directorship, with the company or its management, and has been free of such relationships for three years. The following relationships bar a director from satisfying the independence standards of the NYSE or Nasdaq, as applicable:

- the director is, or has been within the last three years, an employee[21] of the company or of any parent or subsidiary of the company;[22]

- an immediate family member[23] of the director is, or has been within the last three years, an executive officer of the company or of any parent or subsidiary of the company;

- the director is a current partner (or employee, under the NYSE rules) of a firm that is the company's external auditor (or internal auditor, under the NYSE rules);

[21] Both the NYSE and Nasdaq provide that former employment as an interim executive officer does not, in and of itself, disqualify a director from being considered independent following such employment. Under the Nasdaq rules, however, such interim employment cannot last for more than one year. The Nasdaq rules emphasize, however, that the board still must consider whether such former interim employment would interfere with a director's exercise of independent judgment in carrying out the responsibilities of a director.

[22] Both the NYSE and Nasdaq define "company" to include a parent or subsidiary in a consolidated group with the company. Any time the term "company" appears in this bulleted list, it also refers to any parent or subsidiary of the listed company.

[23] General Commentary to Rule 303A.02(b) of the NYSE Listed Company Manual defines "immediate family member," and Nasdaq Rule 5605(a)(2) defines "family member," as a person's spouse, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters-in-law, brothers- and sisters-in-law, and anyone (other than domestic employees) who shares such person's home.

- an immediate family member of the director is a current partner of a firm that is the company's external auditor (or internal auditor, under the NYSE rules);

- under the NYSE rules, an immediate family member of the director is a current employee of the company's internal or external auditor and personally works on the company's audit;

- the director or an immediate family member was within the last three years a partner or employee of a firm that is the company's external auditor (or internal auditor, under the NYSE rules) and worked on the company's audit at any time within that time;

- under the NYSE rules, the director or an immediate family member of the director is, or has been within the last three years, an executive officer of another company where any of the company's present executive officers at the same time serves or served on that other company's compensation committee;

- under the Nasdaq rules, the director or an immediate family member of the director is an executive officer of another entity where at any time during the past three years any of the executive officers of the company served on the compensation committee of such other entity;

- under the NYSE rules, the director is a current employee, or an immediate family member of the director is a current executive officer, of a company that has made payments to, or received payments from, the company for property or services in an amount that, in any of the last three fiscal years, exceeds the greater of $1 million, or 2% of such other company's consolidated gross revenues;[24]

- under the Nasdaq rules, the director, or an immediate family member of the director, is a partner, controlling shareholder or

[24] The NYSE specifies that both the payments and the consolidated gross revenues to be measured shall be those reported in the last completed fiscal year of such other company. The look-back provision for this test applies solely to the financial relationship between the listed company and the director or immediate family member's current employer; a listed company need not consider former employment of the director or immediate family member.

executive officer of any organization to which the company made, or from which the company received, payments for property or services, in the current or any of the past three fiscal years, that exceed 5% of the recipient's consolidated gross revenues for that year, or $200,000, whichever is greater;[25]

- under the NYSE rules, the director or an immediate family member of the director has received during any 12-month period within the last three years more than $120,000 in direct compensation[26] from the company (other than in director and committee fees and pension or other forms of deferred compensation for prior service (*provided* that such compensation is not contingent in any way on continued service) and compensation received by an immediate family member for service as a non-executive employee);[27]

- under the Nasdaq rules, the director or an immediate family member of the director accepted any compensation[28] from the company in excess of $120,000 during any 12-month period within the last three years (other than director or committee fees, benefits under tax-qualified retirement plans, or nondiscretionary compensation, and compensation paid to an immediate family member for service as a non-executive employee);[29] and

- under the Nasdaq rules, the director, while serving as an interim executive officer, participated in the preparation of the financial

[25] Nasdaq excludes from the calculation payments arising solely from investments in the company's securities and payments under nondiscretionary charitable contribution matching programs.

[26] The NYSE focuses on direct compensation. Consequently, investment income from the company (such as dividend or interest income) would not count toward the $120,000 threshold. In addition, the NYSE's focus on direct compensation means that *bona fide* and documented reimbursement of expenses also may be excluded. Note, however, that the NYSE considers payments to a director's solely owned business entity to be direct compensation.

[27] The NYSE also permits companies to exclude from the $120,000 threshold compensation received by a director for former service as an interim executive officer of the company.

[28] Unlike the NYSE rule, the Nasdaq rule is not limited to direct compensation. Accordingly, even indirect compensation must be included in the calculation of the $120,000 threshold. For instance, Nasdaq provides that political contributions to the campaign of a director or an immediate family member of the director would be considered indirect compensation, and, as such, must be included for purposes of the $120,000 threshold.

[29] Nasdaq permits companies to exclude from the $120,000 threshold compensation received by a director for former service as an interim executive officer of the company as long as such interim employment did not last longer than one year. The Nasdaq rules emphasize, however, that the board still must consider whether such compensation would interfere with the director's exercise of independent judgment in carrying out the responsibilities of a director.

statements of the company or any current subsidiary of the company at any time during the past three years.

Independence determinations must be based on all relevant facts and circumstances. Thus, even if a director meets all the bright-line criteria set out above, a board is still required to make an affirmative determination that the director has no material relationship with the company. Under the NYSE rules, the principles underlying the determination of independence also must be publicly disclosed in the company's annual report or proxy statement. Under the SEC disclosure rules and the NYSE and Nasdaq rules that mandate compliance with such disclosure rules, for each director that is identified as independent, a company must describe, by specific category or type, any transactions, relationships or arrangements (other than transactions already disclosed as related-party transactions) that were considered by the board under the company's applicable director independence standards (*e.g.*, the NYSE or Nasdaq independence rules).

Under the Nasdaq rules, one director who does not meet its independence criteria may be appointed to the audit committee if the board, under exceptional and limited circumstances, determines that membership on the audit committee by the individual is required in the best interests of the company and its shareholders, *provided* that:

- such individual meets the SEC's independence criteria (discussed below);
- such individual is not a current executive officer or employee or family member of an executive officer;
- the board discloses, either on or through the company's website or in the next annual proxy statement subsequent to such determination, the nature of the relationship and the reasons for that determination; and
- a member appointed under this exception serves no longer than two years and does not chair the audit committee.

D. Audit Committee Member Independence Standards under Federal Securities Laws

In addition to the requirement that all audit committee members be independent as defined by the listing standards of the securities market(s) on which a company's securities are traded, public company audit committee members must

also satisfy the special definition of audit committee independence set forth in Sarbanes-Oxley and SEC Rule 10A-3.

This special definition is, in some respects, more stringent than the major securities markets' definitions of director independence. Audit committee members may not, directly or indirectly, receive any compensation from the company—such as consulting, advisory or similar fees—other than their director fees and certain qualified compensation under a retirement plan for prior service with the company, and may not be affiliates of the company or any subsidiary thereof. The affiliate disqualification covers any individual who, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, the company. The prohibition on accepting compensatory fees precludes audit committee service if the company makes any such payments either directly to the director, or indirectly, to the director's spouse, minor child or stepchild, child or stepchild sharing a home with the director, or to entities providing accounting, consulting, legal, investment banking or financial advisory services to the company or any subsidiary thereof, of which the director is a partner, member, managing director, executive officer or holds a similar position.

Director independence is further discussed in our *Nominating and Corporate Governance Committee Guide*, 2022.

E. Model Audit Committee Member Financial Expertise and Independence Questionnaire

Attached as *Exhibit D* is a model audit committee member financial expertise and independence questionnaire. Companies should customize the model to their particular needs and circumstances.

F. Getting Prospective or New Audit Committee Members Up to Speed

Assuming they comply with the relevant independence and financial expertise requirements outlined in this Chapter, prospective and new audit committee members also should make sure they obtain whatever background information they deem appropriate. At a minimum, they will need to understand the duties and responsibilities of an audit committee, the expected time commitment and an overview of the business and financials of the company. Prospective and new members also should comprehend the key risks, claims and litigation facing the company, and its internal controls and financial reporting systems. Reviewing recent meeting books (given to audit committee members prior to audit committee meetings) and minutes of the audit committee may prove helpful in this regard.

In particular, a prospective or new audit committee member might consider asking the following questions:

- Are the company's public disclosures, especially regarding financial affairs and legal and regulatory compliance, clear, transparent and comprehensible?

- Who are the company's principal advisors and independent auditor and what are their roles?

- What are the audit committee's mandate and responsibilities as set forth in its charter?

- Who are the current audit committee members and what are the procedures followed by the audit committee?

- What skills, knowledge or experience will I bring to the audit committee and what role is intended for me?

G. Term of Service

There is no rule regarding length of audit committee service. When assessing how long a director should serve on an audit committee, the board needs to strike the right balance. An audit committee with high turnover may not be optimal given the investment of time required of audit committee members to understand a company's business, financials and other relevant information. An audit committee with no or very low turnover risks losing the benefits and perspective that a new member might bring. To accommodate these competing goals, a board should consider periodically rotating qualified directors onto the audit committee.

V

Relationship with the Independent Auditor

The PCAOB is the primary regulator of independent public accounting firms. Every public accounting or audit firm that prepares, issues or participates in the preparation or issuance of public company audits must register with the PCAOB, including non-U.S. accounting or audit firms that audit non-U.S. companies listed in the United States or that otherwise file reports with the SEC. The PCAOB has authority to (1) adopt auditing, quality control, ethics, independence and other standards relating to the preparation of audit reports, (2) enforce the applicable SEC and PCAOB requirements and (3) conduct inspections and, where needed, investigations of public accounting or audit firms registered with the PCAOB. Both SEC rules and PCAOB rules regulate the relationship between an audit committee and the independent auditor, mandating the audit committee to oversee an outside auditor's independence and performance.

A. Audit Committee Oversight of Auditor Independence and Performance

An audit committee must make a specific inquiry about an auditor's independence and competence. An audit committee should present its conclusions with respect to auditor independence to the full board.

1. Independence Inquiry

A public company must have its financial statements and internal controls audited by an "independent" auditor under SEC rules. As a general matter, the SEC will not recognize an auditor as independent *vis-à-vis* an audit client if the auditor is not capable of exercising objective and impartial judgment on all issues encompassed within the auditor's engagement. In determining whether or not this standard has been met, the SEC will consider all relevant circumstances, including all relationships between the accountant and the audit client, focusing on whether any such relationship (1) creates a mutual or conflicting interest between an auditor and the audit client, (2) places an auditor in the position of auditing its own work, (3) results in an auditor acting as management or as an employee of the audit client or (4) places an auditor in a position of being an advocate of an audit client. Audit committees should be aware of and ensure that they or management have implemented appropriate policies and procedures to identify and evaluate such relationships and potential conflicts of interest. In June 2016, the Deputy Chief Accountant of the SEC emphasized that it is important for "management and audit committees to have appropriate policies and procedures in place that are

consistently executed to promote a thorough identification and evaluation of potential auditor independence conflicts."[30] In September 2016, Ernst & Young (EY) agreed to pay $9.3 million to settle SEC charges that EY and certain of its audit partners violated auditor independence rules arising from an inappropriately close relationships or excessive entertainment with senior financial executives of clients.[31]

As part of the inquiry concerning an auditor's independence, an audit committee should examine carefully the scope of work that the independent auditor has undertaken for the company and the value of that work to the auditor, including any related fees. An independent auditor also should be vetted carefully for any relationships that might be perceived as affecting its independence, such as the presence of its former employees, or relatives of its employees, on a company's board or audit committee or among a company's management or senior financial staff, as well as any financial or other business relationships between an independent auditor and a company or its officers, directors or substantial shareholders. SEC officials, including then-Chairman Jay Clayton and Chief Accountant Sagar Teotia, have advised that audit committees should also consider whether corporate changes or other events (for example, transactions that create new business relationships) have impacted auditor independence and should timely notify audit firms of these events.[32] Provision of certain non-audit services to a company or services to audit committee members or to a company's senior executives in their personal capacities also may impair the independent auditor's independence.[33] See Chapter VI: "Prohibited Independent Auditor Activities and Pre-approval Policy."

In addition, the PCAOB has adopted ethics and independence rules that require an audit firm to disclose in writing to the audit committee all relationships between the auditor and the company that, in the auditor's professional judgment, may reasonably be thought to bear on its independence and to affirm to the audit

[30] Speech by Wesley Bricker, Deputy Chief Accountant of the SEC, *35th Annual SEC and Financial Reporting Institute Conference*, June 9, 2016.

[31] Exchange Act Release Nos. 78872 and 78873, *In the Matter of Ernst & Young LLP and Gregory S. Bednar, CPA* and *In the Matter of Ernst & Young LLP, Robert J. Brehl, CPA, Pamela J. Hartford, CPA, and Michael T. Kamienski, CPA* (September 19, 2016).

[32] SEC Public Statement, *Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities* (December 30, 2019).

[33] In 2021, about 92% of Fortune 100 companies disclosed that their audit committee considers non-audit fees and services when assessing auditor independence. EY Center for Board Matters, *Audit committee reporting to shareholders in 2021* (October 2021).

committee that the auditor is independent.[34] Such written communication should be discussed with and addressed to the audit committee before the initial engagement of the auditor and on, at least, an annual basis thereafter. The rules also require the audit firm to document the substance of its discussion with the audit committee. Relatedly, a company is required to disclose in its annual proxy statement whether the audit committee received the written disclosures and letters required by these PCAOB rules and whether it has discussed with the auditor its independence.[35]

a. Rotation of Audit Partners (and Audit Firms)

An important aspect of auditor independence is the auditor's partner rotation and other staffing and personnel policies. For each client of a registered public accounting firm, both the lead and concurring audit partners must be rotated at least once every five years, with a five-year cooling-off period. Audit partners who are not lead or concurring partners must be rotated every seven years, with a two-year cooling-off period. The SEC interprets the rotation requirements as covering tax or other specialty (non-audit) partners who serve as the "relationship" partner for a company and have a high level of contact with its management and its audit committee.

There is no U.S. requirement that the auditing firm itself be rotated. The PCAOB has in the past proposed mandating the rotation of audit firms for U.S.-listed companies but after facing forceful opposition from audit firms and other stakeholders (including the approval by the House of Representatives of a bipartisan bill opposing the proposal), the PCAOB indicated that it is no longer pursuing the idea. However, the PCAOB has noted that while "[a]uditors with relevant experience, both in general and with a particular client, may be able to approach the audit in a more knowledgeable and effective manner[,] auditors who spend too much time on a particular team may begin to lose their capacity for skepticism through simple familiarity."[36]

Across the Atlantic, the European Union (EU) has adopted audit regulations that require audit firms to rotate engagements every 10 years for most EU-based public companies.[37] These regulations indirectly impact U.S. companies with

[34] PCAOB, Ethics and Independence Rule 3526, SEC Release No. 34-58415 (August 22, 2008).

[35] SEC Release Nos. 33-10876; 34-90210 (September 26, 2008).

[36] PCAOB Release No. 2015-005, *Audit Quality Indicators* (July 1, 2015).

[37] *Regulation (EU) No. 537/2014 of the European Parliament and of the Council* (April 16, 2014). Individual EU member states may extend the rotation period to 20 years if the public interest entity conducts a public

affiliates that are EU-based public interest entities. Given the small number of large and reputable auditing firms both in the U.S. and in Europe, those U.S. companies may need to consider rotating independent auditors along with their European affiliates so that the number of audit firms available to provide non-audit services is not further limited.

Although rotating the audit firm is not required in the U.S., the NYSE recommends that each audit committee consider whether, in the interest of assuring continuing auditor independence, there should be regular rotation of the independent auditor. Also, the adoption of the PCAOB's Accounting Standard No. 3101 (PCAOB AS 3101)[38] may foster a better public understanding of audit tenure since auditors are now required to disclose, as part of their audit reports, the year in which they began serving consecutively as the company's auditor.

If a change in the independent auditor is being considered, an audit committee should review:

- any disagreements within the past three years between the company's senior financial management and the current independent auditor regarding accounting and financial statements;

- any consultations within the past three years between the company and a proposed new auditor regarding the application of accounting principles; and

- whether, in seeking an engagement, a proposed new auditor has proposed a change in accounting principles, or the manner in which the company has been doing business, which would result in a material increase in reported revenues or earnings or in a material change in assets or liabilities.

bidding process to select an audit firm and to 24 years if the public interest entity appoints more than one audit firm to conduct joint audits. Also see, John C. Coffee, Jr., *Auditing Is Too Important to Be Left to the Auditors!* (January 28, 2019), available at http://clsbluesky.law.columbia.edu/2019/01/28/auditing-is-too-important-to-be-left-to-the-auditors (arguing, among other things, that while "[m]andatory rotation of auditors was intended to protect auditor independence by preventing permanent relationships […], mandatory rotation may actually facilitate the ability of management to seek more frequently the most accommodating auditor (who is willing to face more risk of scandal than its rivals)").

[38] PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements when the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards* (June 1, 2017).

b. Business and Financial Relationships Between the Company and the Independent Auditor

Other than the provision of professional services, an independent auditor is restricted from having any direct or material indirect business relationship with the audit client, its officers or directors who have the ability to affect decision-making at the entity under audit, or the beneficial owners (known through reasonable inquiry) of its equity securities, where such beneficial owners have significant influence over the entity under audit. This restriction extends to certain categories of individuals called "covered persons":

- all audit engagement team members;
- any person who has supervisory authority over the audit (including senior members of the independent auditor), or who evaluates the performance or recommends the compensation of the audit engagement partner, or who provides quality control or other oversight of the audit;
- any other partner, principal, shareholder or managerial employee of the independent auditor who has provided at least ten hours of non-audit services to the company during the audit engagement period or who expects to provide at least ten hours of such services on a recurring basis; or
- any other partner, principal or shareholder from the same office in which the lead audit engagement partner primarily practices in connection with the audit.

Certain financial relationships between an auditor and a company will also prevent an auditor from being considered independent under the SEC rules. Specifically, an independent auditor, a covered person and any immediate family member of a covered person cannot have any direct investment in the company, such as stocks, bonds, notes, options or other securities. In addition, among other limitations, an audit client, its officers or directors who have the ability to affect decision-making at the entity under audit, or beneficial owners (known through reasonable inquiry) of the audit client's equity securities, where such beneficial owners have significant influence over the entity under audit, cannot lend to or borrow from its independent auditor or from any of the individuals referred to in the preceding sentence, subject to limited exceptions for certain automobile loans,

insurance policies, home mortgages, student loans and loans fully collateralized by cash deposits at the same financial institution.[39]

c. Employing Members of the Independent Auditor

Under the SEC rules, a company's auditor will not be independent if a current partner, principal, shareholder or professional employee of the auditor is employed by the company or serves on its board. In addition, the employment by a company, in an accounting or financial reporting oversight role,[40] of a close family member of a "covered person" automatically will cause the auditor not to be considered independent.

An auditor's independence also will be deemed impaired if the company employs a former partner, principal, shareholder or professional employee of the audit firm in an accounting or financial reporting oversight role, and if that person maintains some influence over the audit firm's operations or financial policies, has a capital balance remaining with the audit firm, or has a financial arrangement with the audit firm (other than certain fixed payments, such as pursuant to a retirement plan).

In addition, under PCAOB independence rules, ongoing discussions between a company and a member of the auditor's audit engagement team (or an individual in a position to influence the audit engagement) over potential future employment of such individual by the company taint the auditor's independence. Such individuals must be removed immediately from the audit engagement and the independent auditor then must review such individual's work during the audit engagement. While the PCAOB standard is directed at independent auditors (rather than their clients), public companies should be mindful of this standard and exercise care in approaching any member of their independent auditor about the possibility of employment with the company. It is advisable for companies to establish procedures that company personnel must abide by before approaching, and during discussions with, members of the independent auditor about the possibility of employment with the company. As noted in Chapter II: "Audit Committee Charter," the charter of an NYSE-listed company's audit committee must charge

[39] SEC Release No. 33-10648 (June 18, 2019); SEC Release Nos. 33-10876; 34-90210 (October 16, 2020).

[40] The SEC defines a person in a "financial reporting oversight role" as someone who is in a position to, or does, exercise influence over the contents of the financial statements and related information, including MD&A, or anyone who prepares such statements or information. This would include a director, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer or any equivalent position. The SEC takes the position that every member of an audit engagement team is subject to a one-year "cooling-off" period prior to working in any such position for the audited company or any of its subsidiaries.

the audit committee with the responsibility to set clear hiring policies for employees or former employees of the independent auditor.

A one-year "cooling-off" period is required before members of an audit engagement team for a public company can accept employment with that company in a "financial reporting oversight role." The cooling-off period runs from the date such individual last served on the audit engagement team until one year after the date the company files its annual financial statements for the period in which such individual served on the audit engagement team. In other words, the restriction requires that the independent auditor complete one annual audit subsequent to when the potentially conflicted individual served on the audit engagement team.

In January 2014, the SEC also issued a report reminding public companies and independent auditors that so-called "loaned staff arrangements" between an independent auditor and its audit client (in which the independent auditor "loans" its staff to its audit client) appear inconsistent with SEC independence rules that prohibit independent auditors from acting as employees of their audit client.[41] The SEC's report emphasized that:

- an independent auditor may not provide otherwise permissible non-audit services (such as permissible tax services) to an audit client in a manner that is inconsistent with other provisions of the SEC independence rules;

- an arrangement that results in an independent auditor acting as an employee of the audit client implicates SEC independence rules regardless of whether the independent auditor's staff also acts as an officer or director, or performs any decision-making, supervisory, or ongoing monitoring functions, for the audit client; and

- audit firms and audit committees must carefully consider whether any proposed service may cause an independent auditor's staff to resemble employees of the audit client in function or appearance even on a temporary basis.

An approach for evaluating the independent auditor's non-audit services is discussed in Chapter VI: "Prohibited Independent Auditor Activities and Pre-approval Policy."

[41] SEC Release No. 34-71390 (January 24, 2014).

d. Compensation for Non-Audit Engagements

Under the SEC rules, the independence of an auditor is automatically compromised if, at any point during an engagement period, any audit partner receives compensation (including indirectly, such as through allocation of equity shares in the audit firm) based on the audit partner procuring engagements with the audit client to provide non-audit services. In 2021, about 92% of Fortune 100 companies disclosed that their audit committee considers non-audit fees and services when assessing auditor independence, a dramatic increase from 16% in 2012, illustrating the increased emphasis on and visibility of such decisions.[42]

2. Competence Inquiry

When assessing an independent auditor's competence, an audit committee should pay particular attention to:

- the independent auditor's expertise in the company's industry;
- the independent auditor's experience with other companies comparable in size or complexity;
- the education and experience of the key partners on the audit team and any partners who are expected to replace them in the near future under the partner rotation requirements;
- if a company has significant operations outside the United States, information with respect to an independent auditor's offices or affiliates in the relevant countries;
- the scope, plan and staffing of the independent auditor's audit and attestation services, including whether the proposed staffing and fees are adequate and appropriate relative to the scope of the work contemplated; and
- any recent inquiries or investigations of, or litigations against, the independent auditor by governmental or professional regulators, whether the independent auditor is subject to any orders or consent decrees of the SEC, PCAOB or other regulator, material settlements, adjudications of liability or other involvement in notable private litigation, as well as any other material reputational issues.

[42] EY Center for Board Matters, *Audit committee reporting to shareholders in 2021* (October 2021).

An audit committee should make inquiry as to whether an independent auditor's registration with the PCAOB and its annual reports and other recent materials filed with the PCAOB are in good order. An audit committee should also inquire about the results of an independent auditor's inspection by the PCAOB, noting that such discussions "can have value for an audit committee not only in relation to the audit committee's oversight and evaluation of the audit engagement generally, but also in relation to the audit committee's role in the oversight of the company's financial reporting process."[43] To foster such discussions, the PCAOB has identified questions that an audit committee may wish to ask an independent auditor, both during the inspection and when the PCAOB has issued a final inspection report, including:

- whether the company's audit has been selected for review in an inspection and, if so, information regarding the areas of the audit being reviewed and whether any deficiency in the audit was identified;

- whether anything suggests the possibility that an audit opinion on the company's financial statements is not sufficiently supported or that otherwise reflects negatively on the independent auditor's performance on the audit, and what the auditor has done or plans to do about it;

- whether a question has been raised about the fairness of the company's financial statements or the adequacy of its disclosures;

- whether a question has been raised about the auditor's independence relative to the company;

- whether the PCAOB has identified deficiencies in other audits that involved auditing or accounting issues similar to issues presented in the company's audit; and

- how issues described by the PCAOB in general reports summarizing inspection results across groups of firms relate to the independent auditor's practices, and potentially the audit of the company's

[43] PCAOB Release No. 2012-003, *Information for Audit Committees about the PCAOB Inspection Process* (August 1, 2012).

financial statements, and how the independent auditor is addressing those issues.

Starting from the 2019 inspection cycle, PCAOB inspections have put increased focus on audit firms' systems of quality control and on specific issues across many firms.[44] The PCAOB now issues inspection reports under a new format that seeks to provide insight about the nature and severity of inspections findings and takes a more balanced approach by including both audit deficiencies and best practices. As part of this revamped program, the PCAOB has increased both the number of inspections and the scope of its interactions with audit committees during inspections. In 2021, the PCAOB spoke with 244 audit committee chairs, up from about 88 in 2018, and reviewed 477 audits.[45] The revamped PCAOB inspection program should help audit committees better evaluate their auditors.

PCAOB inspections have highlighted the need to improve auditing firms' quality control systems in order to improve the audit report quality and prevent deficiencies. In particular, the PCAOB has issued an audit practice alert regarding significant audit deficiencies frequently observed with respect to auditing revenue.[46] An audit committee may want to discuss with the independent auditor its approach to auditing revenue and, in general, its quality control systems to detect audit report deficiencies.

In 2020, the PCAOB released guidance for auditors of issuers transacting in or holding cryptoassets.[47] The PCAOB suggests that, when cryptoassets are relevant, audit committee members should probe the auditor's skill and knowledge by pursuing recommended lines of inquiry that include whether specialized technology-based audit tools are needed to identify, assess and respond to risks of material misstatement and whether the audit firm would be able to supplement the engagement team's expertise if necessary (*e.g.*, by engaging relevant specialists). The PCAOB also reminds auditors of their responsibilities when dealing with such new technologies and related risks, and companies should expect enhanced procedures to be put in place by auditors to address a company's exposure to digital assets. More generally, and consistent with the SEC's December 2019 statement[48] encouraging proactive and robust communication among audit committees,

[44] William D. Duhnke, *Keynote Speech to ALI's Accountants' Liability 2018 Conference* (October 18, 2018).

[45] PCAOB, *2021 Conversations with Audit Committee Chairs* (March 2022).

[46] PCAOB, Staff Audit Practice Alert No. 12, *Matters Related to Auditing Revenue in an Audit of Financial Statements* (September 9, 2014).

[47] PCAOB, *Audits Involving Cryptoassets Spotlight* (2020).

[48] SEC Public Statement, *Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities* (December 30, 2019).

auditors and management, public companies should continue to engage proactively with auditors regarding applicable emerging technologies that may affect a company's financial statements or internal control environment. For more information, please see our memorandum *Audit Committee Emerging Risk Issues: Cryptoassets and Auditor Considerations* (June 5, 2020).

The PCAOB has also invited audit committees to view with skepticism partial or unresponsive answers from independent auditors, particularly with respect to findings by the PCAOB of deficiencies in the performance of the audit. As applicable, an audit committee should satisfy itself that appropriate remediation measures are implemented by the independent auditor.

In addition, it is good practice for an audit committee to assess an independent auditor's leadership and integrity. Such an assessment should focus on the performance of the audit partners, whether the audit team is able to work effectively with and challenge management, the independent auditor's compliance with the partner rotation requirements and the possible impact of such rotation on the quality of the independent auditor's services. The evaluation of the lead partner of the independent auditor should take into account the opinions of management and a company's internal auditors.

Evaluating competence also requires an assessment of an independent auditor's system of internal controls and procedures. To satisfy itself that those procedures are adequate, an audit committee should consider (1) how the independent auditor resolves technical issues, including the roles of the reviewing partner and the national office, (2) the results of the most recent peer review and, as discussed above, the PCAOB inspection of the independent auditor, (3) the independent auditor's recent record with respect to restatements and changes in previously issued audit reports and (4) any information regarding any other complaints that the independent auditor has received and its response to such complaints.[49]

3. Avoiding Improperly Influencing an Independent Auditor

Under Section 303 of Sarbanes-Oxley and SEC rules,[50] directors and officers are prohibited from taking any action, direct or indirect, to coerce,

[49] See Center for Audit Quality, *External Auditor Assessment Tool: A Reference for US Audit Committees* (April 2019), https://www.thecaq.org/wp-content/uploads/2020/09/2020_09_CAQ-External-Auditor-Assessment-Tool.pdf, for sample questions for audit committees to consider in evaluating external auditors for: (i) quality of services and sufficiency of resources provided by the auditor; (ii) quality of communication and interaction with the auditor; and (iii) the auditor's independence, objectivity, and professional skepticism.

[50] SEC Release No. 34-47890 (June 26, 2003).

manipulate, mislead or "fraudulently influence" any public accountant engaged in an audit of a company's financial statements if they know or should have known that their action, if successful, could result in rendering the company's financial statements false or materially misleading. Some examples of prohibited actions include actions taken to lead an independent auditor to issue or reissue a report that is not warranted in the circumstances, to prevent an independent auditor from performing audit procedures required by generally accepted auditing standards or from withdrawing an issued report or to obstruct an independent auditor's communication of matters to a company's audit committee. The SEC has taken the position that its rule, which is enforceable only by the SEC and not through a private right of action, may be violated by merely negligent behavior and that an intent to defraud is not required—although the rule is not intended to reach honest and reasonable mistakes or to be triggered by active debate regarding auditing and accounting issues. The prohibition covers not only directors and officers, but also any other person acting under the direction of an officer or director, whether or not directly supervised or controlled by such director or officer. Thus, potential liability under this rule extends to include customers, vendors, creditors, attorneys, securities professionals and other advisors, as well as other partners or employees of the independent auditor on which improper pressure is being exerted.

B. Enhanced Audit Quality and Communications with Auditors

1. Enhanced Review and Transparency of the Audit Report

The Sarbanes-Oxley Act directed the PCAOB to adopt quality and independence standards relating to the preparation of an audit report, including a requirement for each audit firm to "provide a concurring or second partner review and approval of [each] audit report (and other related information), and concurring approval in its issuance."[51] Pursuant to that mandate, the SEC approved PCAOB Auditing Standard 1220 (PCAOB AS 1220), which expands and strengthens the previous practice of many audit firms to perform a concurring partner review prior to issuing an audit report.[52]

Pursuant to PCAOB AS 1220, "engagement quality review" requires that a reviewer evaluate the significant judgments made and related conclusions reached by the auditor's team in forming the overall conclusion on the audit and in preparing the audit report. PCAOB AS 1220 also establishes specific guidance and procedures for the performance of the engagement quality review. When the review is effected in-house (*e.g.*, within the audit firm that performed the audit), the

[51] Section 103 of the Sarbanes-Oxley Act.

[52] SEC Release No. 34-61363 (January 15, 2010); PCAOB Release No. 105-2009-004 (August 11, 2009).

reviewer must either be a partner or in an equivalent position and is subject to the same independence requirement as the audit team conducting the audit. Alternatively, a qualified reviewer from outside the audit firm may be engaged. In December 2018, the PCAOB issued a post-implementation report which found that since PCAOB AS 1220 has gone into effect, the quality, engagement and engagement quality review involvement have improved while increases in direct costs have been insignificant, although the release cautions that the link may not be causal.[53] When reviewing an audit report, an audit committee might find it helpful to review the engagement quality review documentation and to have meaningful discussions with the independent auditor about the engagement quality review component of the audit.

In July 2015, the PCAOB published a concept release on 28 potential audit quality indicators (AQIs) and their potential uses.[54] The AQIs fall into three groups: (i) audit professionals, which includes measures dealing with the availability, competence and focus of those performing the audit; (ii) audit process, which includes measures about an audit firm's "tone at the top" and leadership, incentives, independence, attention to infrastructure and record of monitoring and remediation; and (iii) audit results, which includes measures about financial statements, internal control, going concern, communications between auditors and audit committees and enforcement and litigation. According to the PCAOB, the AQIs are "a potential portfolio of quantitative measures that may provide new insights about how to evaluate the quality of audits and how high quality audits are achieved." The PCAOB envisions that the AQIs may help to inform discussions among those concerned with the financial reporting and auditing process. For example, the AQIs may give audit committees additional relevant data to explore crucial matters related to the audit and enhance dialogue between the audit committee and the independent auditor.

To provide investors with information about the engagement partners and accounting firms participating in audits, audit firms are required to file Form AP, *Auditor Reporting of Certain Audit Participants*, for each of their public company audits. In Form AP, audit firms are required to disclose for each public company audit: (i) the name of the engagement partner and such partner's Partner ID;[55] (ii) for other accounting firms participating in the audit for which the responsibility for the audit is not divided, (A) the names, locations, and extent of participation, and

[53] PCAOB Release No. 2018-004, *Post-Implementation Review of AS 1220, Engagement Quality Review* (December 19, 2018).

[54] PCAOB Release No. 2015-005, *Audit Quality Indicators* (July 1, 2015).

[55] Audit firms are required to assign a unique 10-digit Partner ID number to each of their engagement partners, beginning with the Firm ID (a unique five-digit number based on the number assigned to the firm by the PCAOB at the time of registration) followed by a unique series of five digits assigned by the audit firm.

where applicable, the Firm IDs, of other accounting firms that took part in the audit, if their work constituted five percent or more of the total audit hours and (B) the number and aggregate extent of participation of all other accounting firms that took part in the audit whose individual participation was less than five percent of the total audit hours; and (iii) for other accounting firms participating in the audit for which the responsibility for the audit is divided, the names, and when applicable, the Firm IDs, and location of the offices of such other accounting firms that issued the other auditor's report and the magnitude of the portion of the financial statements audited by such other accounting firms.[56] Form AP has a filing deadline of 35 days after the date the auditor's report is first included in a document filed with the SEC or 10 days after the auditor's report is first included in a registration statement under the Securities Act of 1933 filed with the SEC (such as in the case of an initial public offering). Form AP is publicly available on the PCAOB's website. The PCAOB released additional guidance, most recently updated in December 2021, explaining how to fulfill the requirements of Form AP.[57] In addition to filing the required information on Form AP, the audit firm may voluntarily provide information about the audit partner, other accounting firms or both in the auditor's report.

2. Enhanced Quality of the Audit Report

In October 2017, the SEC approved PCAOB's Accounting Standard No. 3101 (PCAOB AS 3101) and related amendments to other auditing standards (together, the PCAOB AS 3101 Disclosures).[58] The enhanced standards for audit committees focus on critical audit matters and enhanced disclosure, discussed further below.

Critical audit matters. The most significant aspect of the PCAOB AS 3101 Disclosures is the critical audit matter (CAM) disclosure requirement. PCAOB AS 3101 requires the auditor to disclose in the auditor's report any CAMs arising from the current period's audit or state that the auditor determined that there are no

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[56] PCAOB Release No. 2015-008, *Improving the Transparency of Audits: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form and Related Amendments to Auditing Standards* (December 15, 2015); SEC Release No. 34-77787 (May 9, 2016).

[57] PCAOB Staff Guidance: *Form AP, Auditor Reporting of Certain Audit Participants, and Related Voluntary Audit Report Disclosure Under AS 3101*, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (Updated December 17, 2021). See also Center for Audit Quality, *Form AP: Auditor Reporting of Certain Audit Participants* (June 2017), available at https://www.thecaq.org/wp-content/uploads/2019/03/caq_form_ap_tool_for_audit_committees_2017-06.pdf, for additional information regarding Form AP requirements.

[58] SEC Release No. 34-81916 (October 23, 2017).

CAMs. A CAM is "any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment."[59]

In determining whether a matter "involved especially challenging, subjective, or complex auditor judgment," PCAOB AS 3101 requires the auditor to take into account the following list of non-exhaustive factors:

- the auditor's assessment of the risks of material misstatement, including significant risks;
- the degree of auditor judgment related to areas in the financial statements that involved the application of significant judgment or estimation by management, including estimates with significant measurement uncertainty;
- the nature and timing of significant unusual transactions and the extent of audit effort and judgment related to these transactions;
- the degree of auditor subjectivity in applying audit procedures to address the matter or in evaluating the results of those procedures;
- the nature and extent of audit effort required to address the matter, including the extent of specialized skill or knowledge needed or the nature of consultations outside the engagement team regarding the matter; and
- the nature of audit evidence obtained regarding the matter.

If the auditor determines that a CAM arose out of the current period's financial statements audit, the auditor is required to identify the CAM in its audit report, describe the principal considerations that led the auditor to determine that the matter constituted a CAM, describe how the CAM was addressed in the audit and refer to the relevant financial statement accounts or disclosures. If the auditor determines that there are no CAMs, that determination must also be stated in the

[59] PCAOB Auditing Standard 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (June 1, 2017).

report. The PCAOB has indicated that it expects at least one CAM will be identified in most audits.[60]

In a survey of S&P 100 companies in 2020, the most common CAMs related to taxes (16%), goodwill and other intangible assets (14%), contingent liabilities (12%) and revenue (9%).[61] On average, these companies identified 1.98 CAMs in each report.

Audit committees should be engaged with their auditors in the implementation of the CAM disclosure requirements and should continue to learn about the new standard. In a public statement, then-SEC Chairman Jay Clayton and other SEC officials encouraged audit committees to engage in substantive dialogues with their auditors to understand the auditor's basis for identifying a matter as a CAM and how each such identified matter will be described in the auditor's report. Such dialogue is important because these officials "expect that the discussion of the CAM in the auditor's report will capture and be consistent with the auditor-audit committee dialogue regarding the relevant matter."[62]

Audit committees may find the Center for Audit Quality's short guide on CAMs to be a useful resource.[63] This guide provides key definitions, discusses how an auditor will determine whether a matter is a CAM and how it will be reported in the auditor's report, compares U.S. and international standards on expanded auditor reporting and contains answers to frequently asked questions about CAMs.

Enhanced Disclosure. In addition to the CAMs disclosures, the PCAOB AS 3101 Disclosures require a number of additional changes to audit reports intended to provide additional information about the auditor, clarify the auditor's responsibilities regarding its audit and make the audit reports easier to read. These changes include the following:

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[60] PCAOB Auditing Standard 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (June 1, 2017).

[61] CAQ, *Critical Audit Matters: A Year in Review* (December 2020).

[62] SEC Public Statement, *Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities* (December 30, 2019).

[63] Center for Audit Quality, *Critical Audit Matters: Key Concepts and FAQs for Audit Committees, Investors, and Other Users of Financial Statements* (July 24, 2018), available at https://www.thecaq.org/critical-audit-matters-key-concepts-and-faqs-audit-committees-investors-and-other-users-financial.

- *Auditor Tenure*. The audit report must include a statement disclosing the year in which the auditor began serving consecutively as the company's auditor.

- *Independence*. The audit report must include a statement that the auditor is required to be independent.

- *Addressees*. The audit report must include a statement that the auditor report addressees are the company's shareholders and board of directors.

3. Enhanced Communications Between the Independent Auditor and the Audit Committee

The SEC rules mandate that independent auditors make specific disclosures to the audit committees of the companies they are auditing. Prior to the filing of its audit report with the SEC, an independent auditor must report to a company's audit committee:

- all critical accounting policies and practices to be used;

- the alternative accounting treatments in compliance with GAAP available for material items that have been discussed with management, including discussions of the ramifications of the use of such alternative treatments and the treatment preferred by the independent auditor; and

- any material written communications between the independent auditor and management (such as any management letter or schedule of unadjusted differences).

These communication requirements imposed on an independent auditor also enhance an audit committee's oversight responsibility *vis-à-vis* an independent auditor.

PCAOB Auditing Standard 2201 (PCAOB AS 2201) requires an independent auditor, prior to issuing its report on a company's internal controls over financial reporting, to communicate in writing to the audit committee and management all material weaknesses identified during the audit. An independent auditor must also communicate to the audit committee all significant deficiencies and communicate to management all deficiencies (and inform the audit committee when that communication has been made) in internal controls identified during an

audit. In addition, an independent auditor must communicate in writing to the board of directors if it concludes that the oversight of the company's financial reporting and internal control by an audit committee is ineffective. Also, under both the PCAOB standard and Section 10A of the Exchange Act, an independent auditor is required to inform the appropriate level of management and ensure that the audit committee is adequately informed if possible fraud or other illegal acts are detected during the audit.

PCAOB Auditing Standard 1301 (PCAOB AS 1301) requires an independent auditor to identify and discuss with the audit committee, among other topics:

- any significant issues that the independent auditor discussed with management regarding the independent auditor's appointment or retention, including any significant discussions regarding the application of accounting principles and auditing standards;

- an overview of the audit strategy, including the timing of the audit and the significant risks identified during the independent auditor's risk assessment procedures;

- the company's most important accounting policies, practices and estimates;

- significant unusual transactions, and the policies and practices management used to account for significant unusual transactions; and

- whether the audit committee is aware of matters relevant to the audit, including violations or possible violations of laws or regulations.

PCAOB Auditing Standard 4105 (PCAOB AS 4105) provides that when an independent auditor conducts a review of interim financial information, it should determine whether any of the aforementioned matters, among others, have been identified and should communicate such matters to the audit committee in a timely manner and prior to the company's filing of its quarterly report with the SEC.

An audit committee should review with the independent auditor key audit focus areas, as well as items that may require special procedures during the audit. Any findings of an independent auditor regarding such special audit procedures

should be reviewed with an eye toward recommending appropriate modifications of corporate policies and procedures.

VI

Prohibited Independent Auditor Activities and Pre-approval Policy

Sarbanes-Oxley, the SEC rules promulgated thereunder and the PCAOB rules impose a number of restrictions regarding the services that an independent auditor is permitted to provide to its audit clients without tainting its independence. SEC enforcement actions against KPMG, EY and other large accounting firms illustrate the importance of these rules. For instance, in 2014 KPMG and in 2016 EY agreed to pay $8.2 million and $11.8 million, respectively, to settle SEC charges that they violated auditor independence rules by providing prohibited non-audit services, such as lobbying activities on behalf of audit clients, and by providing restructuring, corporate finance, payroll, bookkeeping and expert services to affiliates of audit clients.[64] The restrictions imposed by SEC and PCAOB rules, as well as recommended pre-approval policies and procedures for permitted services, are discussed in this Chapter.

A. Prohibited Independent Auditor Activities

1. SEC Auditor Independence Rules

Under the SEC's auditor independence rules, independent auditors are significantly limited in the types of additional services they can perform for a company. Under the rules, the independence of an auditor will be impaired if, at any point during the audit and professional engagement period, the independent auditor performs any of the following services for a company.

- Bookkeeping and other services related to accounting records or financial statements, unless it is reasonable to conclude that the results of these services would not be subject to audit procedures during an audit of the financial statements.

- Financial information systems design and implementation (*e.g.*, directly or indirectly operating, or supervising the operation of, the company's information system, managing a company's local area network(s), or designing or implementing a hardware or software system that aggregates source data underlying the financial statements, or generates information that is significant to the

[64] SEC Press Release, *SEC Charges KPMG with Violating Auditor Independence Rules* (January 24, 2014); SEC Press Release, *Ernst & Young to Pay $11.8 Million for Audit Failures* (October 18, 2016).

financial statements or other financial information systems taken as a whole), unless it is reasonable to conclude that the results of these services would not be subject to audit procedures during an audit of the financial statements.

- Appraisal or valuation services, fairness opinions or contribution-in-kind reports, unless it is reasonable to conclude that the results of these services would not be subject to audit procedures during an audit of the financial statements.

- Actuarial services that involve the determination of amounts recorded in the financial statements and related accounts for a company, other than assisting company personnel in understanding the methods, models, assumptions and inputs used in computing an amount, unless it is reasonable to conclude that the results of these services would not be subject to audit procedures during an audit of the financial statements.

- Internal audit services that relate to the company's internal accounting controls, financial systems or financial statements, unless it is reasonable to conclude that the results of these services would not be subject to audit procedures during an audit of the financial statements.

- Management functions (*e.g.*, serving, temporarily or permanently, as a director, officer, employee or in any decision-making, supervisory or ongoing monitoring capacity).

- Human resources (*e.g.*, recruiting, testing and evaluation, reference checking, negotiation and referral services). However, an independent auditor is permitted, upon a company's request, to interview candidates and advise a company as to candidates' competence for financial accounting, administrative or control positions.

- Broker-dealer, investment advisor or investment banking services.

- Legal services.

- Expert services unrelated to an audit, such as the provision of an expert opinion or other expert service for the purpose of advocating a company's interests in litigation or in a regulatory or

> administrative proceeding or investigation. For example, an auditor's independence would be impaired if the independent auditor were engaged to provide forensic accounting services to a company's legal counsel in connection with the defense of an investigation by the SEC Division of Enforcement. Additionally, an auditor's independence would be impaired if a company's legal counsel, in order to acquire the requisite expertise, engaged the independent auditor to provide such services in connection with a litigation, proceeding or investigation. However, an independent auditor is permitted to provide factual accounts (including in the form of testimony) of work performed or to explain positions taken or conclusions reached during the performance of any service provided by the independent auditor.

The SEC also will consider an auditor's independence impaired if, at any point during the audit engagement period, the independent auditor provides any service or product for a contingent fee or a commission, or receives a contingent fee or commission from the audit client.

2. PCAOB Rules

PCAOB rules list the services that an independent auditor is prohibited from providing to its audit clients. In particular, PCAOB rules prohibit an independent auditor from providing an audit client any non-audit service during the engagement period that relates to marketing, planning or opining in favor of the tax treatment of transactions that are (1) confidential transactions under Internal Revenue Service regulations or (2) "aggressive tax transactions," which the PCAOB defines as any transaction that was recommended initially by the independent auditor and a significant purpose of which is tax avoidance, unless the proposed tax treatment is at least more likely than not to be allowable under applicable tax laws. The PCAOB has made clear, however, that the prohibition on opining on aggressive tax transactions is limited to opining *in favor of* its tax treatment; it does not restrict an independent auditor from advising an audit client *not* to engage in an aggressive transaction. The PCAOB's rules also preclude independent auditors from providing tax services to members of management who have a financial reporting oversight role at the audit client or a material affiliate of the audit client during the engagement period, or to their immediate family members. The rules provide a transition period for individuals who are hired or promoted into a financial reporting oversight role, which allows for tax services in process at the time of such hiring or promotion to be completed within 180 days.

Moreover, permitted tax services provided by independent auditors have to meet enhanced pre-approval requirements under the PCAOB's rules. The rules require an audit firm to supply the audit committee with detailed documentation regarding the nature and scope of the tax service, and any compensation arrangement or other agreement, such as a referral agreement or a fee-sharing arrangement, between the independent auditor and any person (other than the audit client) with respect to the promoting, marketing or recommending of a transaction covered by the service. In addition, the independent auditor would be required to discuss with the audit committee the potential effects of the service on the auditor's independence and document the substance of that discussion.

The PCAOB rules contain other restrictions, such as a prohibition on contingent fees, which overlap with the SEC's auditor independence requirements.

3. Cautionary Note on Internal Control-Related Services

The provision of internal control-related services by an independent auditor to an audit client is a sensitive area. Given the independent auditor's audit of internal controls required by Section 404(b) of Sarbanes-Oxley, the provision of internal control-related services by an auditor carries with it the risk of compromising the independence of the independent auditor if the independent auditor's own work is the subject of audit procedures. As noted above, the SEC's independence rules prohibit a company's independent auditor from providing internal auditing services, such as those relating to internal accounting controls, financial systems or financial statements, unless it is reasonable to conclude that the results of these services would not be subject to audit procedures during an audit of the financial statements. The SEC has stated, however, that a company's independent auditor may assist management in documenting internal controls, *e.g.*, for purposes of assisting in the preparation of management's assessment of internal controls under Section 404(a) of Sarbanes-Oxley, but only if management is "actively involved"; management's acceptance of responsibility for the documentation and testing performed by the independent auditor will not, in and of itself, satisfy the SEC's auditor independence rules. Given the red flags that have been raised on this point by regulators, audit committees contemplating pre-approving internal control-related services by an independent auditor need to be sure that there is a strong basis and record for doing so and that they clearly understand why this approach is more advisable than obtaining the same services from another source. As a matter of practice, many companies have opted to hire separate providers for internal control-related services.

B. Independent Auditor Activities Requiring Audit Committee Pre-approval

Audit committees must approve in advance all audit services (including comfort letters in connection with securities underwritings) provided by an independent auditor, either specifically or in accordance with established policy and procedures.[65] Similarly, independent auditors may provide non-audit services to their audit clients that are not specifically prohibited (including general tax planning and advice), but only if such services, like all audit services, are approved in advance by the audit committee (either specifically or in accordance with established policies and procedures).[66] A 2019 SEC enforcement action underscores the importance of compliance with these rules. In September 2019, PricewaterhouseCoopers (PwC) agreed to pay approximately $8 million to settle SEC charges that it violated auditor independence rules by designing and implementing software relating to an audit client's financial reporting and failing to obtain proper audit committee pre-approval for non-audit services performed for 15 SEC-registered audit clients between 2013 and 2016.[67]

1. Pre-approval of Permitted Tax Services

As discussed above, PCAOB rules increase the responsibilities of an independent auditor and of an audit committee in pre-approving tax services permitted to be provided by an independent auditor to its audit clients by requiring the independent auditor to supply the audit committee with written documentation of the scope of the proposed tax service and the fee structure for the engagement, discuss with the audit committee the potential effects of the performance of the service on the auditor's independence and document the substance of that discussion.

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[65] For purposes of the approval of both the external audit function and any non-audit services, the audit committee of a parent company may function as the audit committee of wholly-owned subsidiaries that are also issuers for purposes of satisfying the pre-approval requirements. In this situation, the subsidiary's disclosure should include the pre-approval policies and procedures of the subsidiary as well as those of the parent company.

[66] Where a company has foreign subsidiaries that are audited by independent auditors that are members of the same network of international independent auditors as the company's principal independent auditor, any audit services performed by such member independent auditors for the company's foreign subsidiaries are subject to the pre-approval requirements. Likewise, if the company's foreign subsidiaries are audited by independent auditors that are not members of the principal independent auditor's network, audit services performed for the company's foreign subsidiaries by such non-member independent auditors also are subject to the pre-approval requirements. However, failure of an audit committee to pre-approve audit services to be provided by another independent auditor does not affect the independence of the principal auditor.

[67] SEC Press Release, *SEC Charges PwC LLP With Violating Auditor Independence Rules and Engaging in Improper Professional Conduct* (September 23, 2019).

2. Pre-approval of Services Related to Internal Controls

PCAOB AS 2201 does not specifically require case-by-case pre-approval of internal control-related non-audit services. However, as with the rules governing pre-approval of permissible tax services, the rules related to internal control-related non-audit services require an independent auditor to supply the audit committee with a written description of the scope of the proposed service, discuss with the audit committee the potential effect of the proposed service on the auditor's independence and document the substance of that discussion in connection with the pre-approval of any internal control-related non-audit services.

3. *De Minimis* Exception for Non-Audit Services

There is a *de minimis* exception to the pre-approval requirement for non-audit services aggregating less than 5% of an independent auditor's annual revenues from a company. The *de minimis* exception is available only if the services in question (1) were not recognized by the company at the time as non-audit services, (2) were promptly brought to the audit committee's attention and (3) were approved by the audit committee prior to the completion of the audit and disclosed in the company's SEC filings. The *de minimis* exception applies only to non-audit services.

4. Pre-approval Policies

When using established policies and procedures (rather than case-by-case evaluation) to approve any services to be provided by an independent auditor, an audit committee must be especially mindful of the following constraints:

- Such pre-approval policies and procedures must be detailed as to the particular services provided.

- Pre-approval policies and procedures may not provide for broad, categorical approvals—for example, monetary limits may not be the only criterion for the pre-approval. To give another example, licensing or selling income tax preparation software to an audit client is subject to audit committee review and may be pre-approved as a permissible tax service so long as the functionality is limited to preparation of tax returns. However, if the software performs additional functions, each function should be evaluated separately for its potential effect on an auditor's independence.

- An audit committee must be informed about each service. In other words, pre-approval policies must be designed to ensure that an

audit committee knows precisely what services it is being asked to pre-approve so that it can make a well-reasoned assessment of the impact of the service on an auditor's independence. Where applicable, requests for pre-approval should be accompanied by detailed documentation regarding the specific services for which pre-approval is being sought.

- Policies and procedures must not result in the delegation of an audit committee's authority to management. To satisfy this constraint, policies should be sufficiently detailed as to the particular services to be provided so that a member of management is not called upon to make a judgment as to whether a proposed service fits within the pre-approved services.

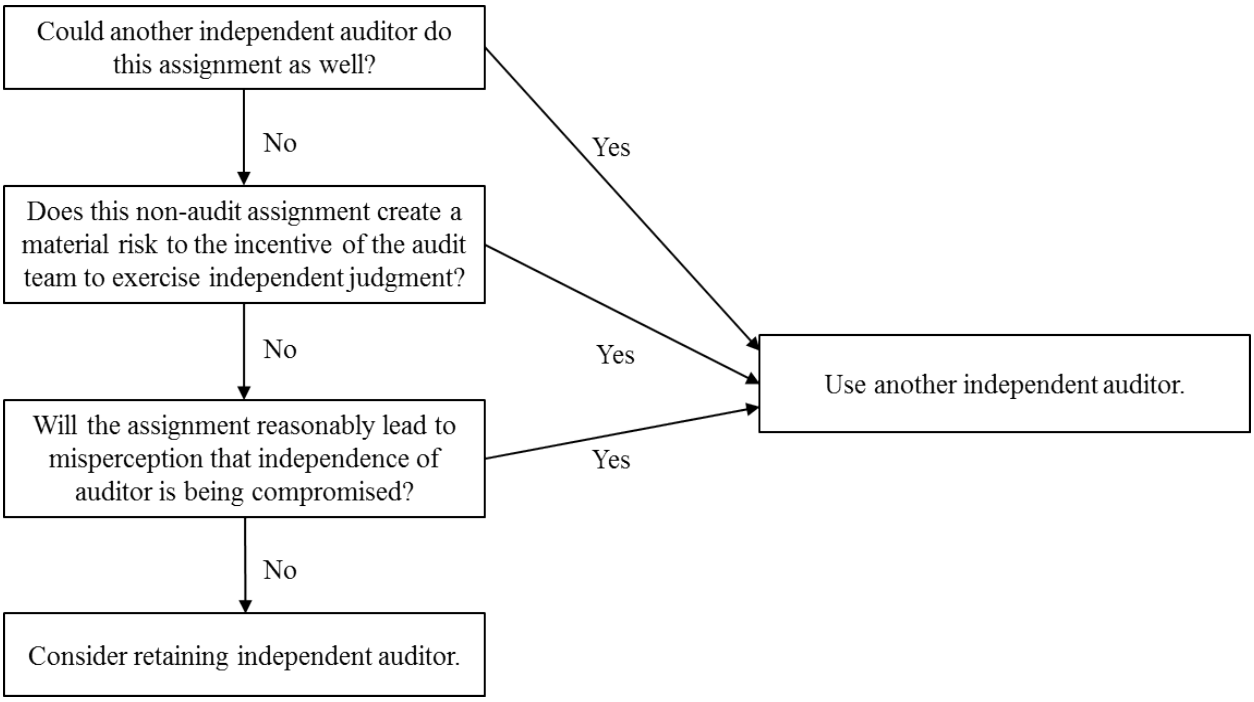
5. When Bills Materially Exceed Estimates, Re-approve

Where the fee for a pre-approved service or group of services is materially in excess of the amount estimated at the time of approval by an audit committee, the audit committee should specifically approve payment of such excess amount prior to payment of the excess amount.

6. Control of Non-Audit Assignments

Ultimately, the audit committee must control all non-audit assignments given to an independent auditor that are not among the prohibited services

discussed in this Chapter. With respect to any such assignment, an audit committee should ask the following questions:



C. Model Audit Committee Pre-approval Policy

Attached as *Exhibit E* is a model audit committee pre-approval policy. Companies should customize the model to their particular needs and circumstances.

VII

Internal Controls and Oversight Effectiveness

Management is primarily responsible for designing and implementing internal controls. This includes establishing and maintaining adequate internal control structures and procedures for financial reporting, evaluating the effectiveness of internal controls at least annually, identifying in a timely manner weaknesses and deficiencies in internal controls, taking appropriate corrective actions where deficiencies or weaknesses exist and notifying the independent auditor and audit committee of significant internal control deficiencies and any acts of fraud.

An audit committee should review the adequacy and effectiveness of a company's internal controls over financial reporting, the process for monitoring compliance with applicable regulations and laws and any other legal matters that could have a significant impact on a company's financial reports (as discussed above, in certain companies operating in highly regulated industries, such as financial institutions, certain compliance oversight responsibilities may be assigned to a dedicated committee of the board rather than the audit committee). This Chapter focuses on an audit committee's oversight of internal controls over financial reporting, as well as an audit committee's monitoring of the compliance and internal controls environment generally.

As part of its review of internal controls over financial reporting, an audit committee should satisfy itself that there is a proper system and allocation of responsibilities for the day-to-day monitoring of financial controls (and that the audit committee understands such system and allocation), but it should not seek to do the monitoring itself. An audit committee may obtain this understanding through reports and discussions with management, an internal auditor and an independent auditor. An audit committee also should understand the extent to which the internal and independent auditors review a company's internal controls protocols, including by understanding the material features of the audit plan of the independent auditor with respect to internal controls. SEC officials, including then-Chairman Jay Clayton and Chief Accountant Sagar Teotia, have stated that audit committees are most effective when they thoroughly understand the identified control issues and proactively engage to support their resolution.[68] If material weaknesses are found in the audit, it is important for audit committees to monitor

[68] SEC Public Statement, *Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities* (December 30, 2019)

remediation and emphasize that effective remediation of such weaknesses should be prioritized.

The accounting fraud at Luckin Coffee illustrates the importance of maintaining an effective system of internal control to ensure the integrity of a company's financial statements. Luckin Coffee, a Chinese rival to Starbucks Corporation, had a market capitalization of over $10 Billion in the months following its 2019 initial public offering. In April 2020, the company made an SEC filing disclosing that an internal investigation had uncovered fraudulent inflation of the company's revenues involving the company's Chief Operating Officer and several subordinates, resulting in a nearly 80% same-day drop in the company's stock price.[69] The fraudulent revenue amounted to about $310 million, accounting for half of the company's reported revenues for 2019. Luckin Coffee was subsequently delisted from Nasdaq, and on December 16, 2020 the SEC announced a settlement, which included a $180 million penalty. Two months later, the company filed for bankruptcy protection in the U.S.[70]

The Coronavirus pandemic significantly impacted how many companies administered internal controls. Business operations and staffing underwent sudden and drastic changes, highlighting the importance of internal control procedures as companies responded to personnel shortages, worksite closures and other drastic and sudden challenges. Now that the pandemic seems to be transitioning toward an endemic phase, best practices and lessons learned over the past few years should be evaluated and retained if appropriate. In addition, audit committees should continually reassess their internal controls processes to ensure continued effectiveness and prepare for similar disruptions in the future.

A. Audits of Internal Controls

Reflecting the importance of effective internal controls, Section 404 of Sarbanes-Oxley and the SEC rules promulgated thereunder require public companies to include in their annual reports both an assessment by management of the company's internal control over financial reporting, and an independent auditor's attestation report on the company's internal controls and financial reporting. Sarbanes-Oxley made clear that an independent auditor's attestation under Section 404(b) must be based on the independent auditor's own audit of the company's internal controls. PCAOB AS 2201 prescribes the standards by which

[69] Luckin Coffee Inc. Form 6-K (filed with the SEC on April 2, 2020).

[70] Luckin Coffee Inc. Form 6-K (filed with the SEC on February 5, 2021).

an independent auditor must conduct the Section 404(b) audit of a company's internal control over financial reporting.

Smaller "non-accelerated" (public float under $75 million) issuers are exempt from complying with Section 404(b) of Sarbanes-Oxley, *e.g.*, from obtaining an independent auditor's attestation report on the effectiveness of the company's internal controls over financial reporting. Also exempt are "emerging growth" companies (generally, companies with annual gross revenues of less than $1.07 billion that have been public for less than five years). While these exemptions may alleviate audit fees for smaller and newly public companies, the duties and responsibilities of management and audit committee members with respect to internal controls remain unchanged.

B. Definition of "Internal Control Over Financial Reporting"

The SEC and the PCAOB define the term "internal control over financial reporting" as a process designed by, or under the supervision of, a company's principal executive and principal financial officers, or individuals performing similar functions, and effected by the company's board, management and other personnel, to provide "reasonable assurance" regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with GAAP. Under the PCAOB's standards, "reasonable assurance" is a high level of assurance, but not absolute assurance—leaving room for the possibility that an audit conducted in accordance with the PCAOB standards may not detect a material weakness in internal controls or a material misstatement in the financial statements on a timely basis.

Internal control policies include those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of a company;

- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of a company are being made only in accordance with authorizations of management and directors of the company; and

- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of a

company's assets that could have a material effect on the financial statements.

C. Disclosure of Deficiencies Depends on Severity

PCAOB AS 2201 uses the concepts of "deficiency," "significant deficiency" and "material weakness" in grading the severity of internal control defects. Under PCAOB AS 2201:

- A "deficiency" exists when the "design" or "operation" of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A deficiency in "design" exists when (1) a control necessary to meet the control objective is missing, or (2) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in "operation" exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or competence to perform the control effectively.

- A "significant deficiency" is a deficiency, or a combination of deficiencies, in internal controls that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of a company's financial reporting.

- A "material weakness" is a deficiency, or a combination of deficiencies, in internal controls such that there is a "reasonable possibility" that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. There is a "reasonable possibility" of an event when the occurrence of the event is either "reasonably possible" or "probable" as those terms are used in Financial Accounting Standards Board (FASB) Statement No. 5, *Accounting for Contingencies*.

In a 2016 enforcement action, the SEC emphasized that the severity of a deficiency in internal control over financial reporting does not depend on whether a misstatement has actually occurred but rather on whether there is a reasonable

possibility that the company's internal control over financial reporting will fail to prevent or detect a misstatement on a timely basis.[71]

PCAOB AS 2201 requires an independent auditor, prior to issuing its report on a company's internal controls over financial reporting, to communicate in writing to the audit committee and management all material weaknesses. In addition, an independent auditor must communicate all significant deficiencies to the audit committee and must communicate to management all deficiencies (and inform the audit committee when that communication has been made) in internal controls identified during an audit.

The PCAOB has expressed concerns about the number and significance of deficiencies identified in independent auditors' audits of internal control over financial reporting.[72] According to the PCAOB, audit committees should consider discussing with the independent auditor the level of deficiencies in the audit of internal controls identified in their internal inspections and PCAOB inspections, requesting information about potential root causes of such findings and discussing the procedures established by the independent auditor to address these issues.[73] The PCAOB has also stated that audit committees should inquire about the involvement and focus of senior members of the audit firm on those matters.

D. Compliance and Internal Controls Environment Generally

In overseeing compliance with applicable laws and regulations and the integrity of the financial statements, an audit committee is encouraged to pay close attention to the compliance and internal controls environment generally. The U.S. Sentencing Commission, as well as the SEC, the U.S. Department of Justice (DOJ)

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[71] Exchange Act Release No. 77345, *In the Matter of Magnum Hunter Resources Corporation* (March 10, 2016) (involving SEC charges against a company for failing to properly implement, maintain and evaluate internal control over financial reporting).

[72] PCAOB, Staff Audit Practice Alert No. 11, *Considerations for Audits of Internal Control Over Financial Reporting* (October 24, 2013); PCAOB, *Observations from 2010 Inspections of Domestic Annually Inspected Firms Regarding Deficiencies in Audits of Internal Control Over Financial Reporting* (December 10, 2012). See also Speech by Jeanette M. Franzel, PCAOB Board Member, American Accounting Association Annual Meeting, *Current Issues, Trends, and Open Questions in Audits of Internal Control Over Financial Reporting* (August 8, 2015) (noting that while the results of the PCAOB's inspections of audit firms indicate that some improvements have been made in the area of auditing internal control over financial reporting, deficiencies by audit firms in the audits of internal control over financial reporting continued to be the most frequent findings in the 2014 inspections).

[73] The PCAOB's Staff Audit Practice Alert No. 11 identifies seven specific aspects of internal control auditing in which PCAOB inspectors frequently identify deficiencies and which an audit committee should consider discussing with the independent auditor: (1) the independent auditor's risk assessment and the audit of internal control, (2) selecting controls to test, (3) testing management review controls, (4) information technology considerations, including system-generated data and reports, (5) roll-forward of controls testing performed at an interim date, (6) using the work of others and (7) evaluating identified control deficiencies.

and the PCAOB, have stressed the singular importance in this area of management's setting the right "tone at the top" and creating an organizational culture that encourages a commitment to compliance with law. To that end, an audit committee may wish to review the following with management.

- Is management setting the right tone at the top? How?
- Is there an appropriate supervisory and compliance structure?
- Is senior management's compliance message communicated throughout the organization?
- Is there a sophisticated understanding of the inventory of ESG, regulatory and reputational risks faced by the company's businesses?
- Is there an early warning system to identify and respond to emerging areas of regulatory focus?
- Is there specialized training for supervisors?
- Is information concerning ESG, regulatory and reputational risks and issues promptly brought to the attention of senior management and compliance personnel?
- Is internal discipline used effectively to reinforce the compliance message?

Additionally, an audit committee should ask management to regularly update the audit committee on the company's overall internal controls protocols, including the timely identification of any significant deficiencies or material weaknesses in the company's internal controls over financial reporting, and should set an expectation with both management and the independent auditor that it will be actively involved as internal control matters arise.[74] In connection with the settlement of the "London Whale" case, the SEC stated that such timely updates are necessary for the audit committee to fulfill its oversight role and to help assure the integrity and accuracy of the information the company discloses in its public filings. In that case, the SEC found that in addition to inaccurate financial reporting and material weaknesses in internal controls over financial reporting (which were ineffective in detecting and preventing mismarking by a derivatives trader), senior

[74] SEC Public Statement, *Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities* (December 30, 2019).

management failed to inform the audit committee of the internal controls failures before the filing of the company's quarterly report and, as a result, hindered the audit committee's ability to assess and ensure the accuracy of the financial statements. The SEC further stated that public companies are required to create and maintain internal controls that ensure that senior management shares important information with key internal decision-makers such as the board of directors and the audit committee.[75]

In 2013, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued an updated Internal Control–Integrated Framework.[76] The updated framework sets forth the same five interrelated elements of an effective internal control system as the original framework developed in 1992: (1) control environment; (2) risk assessment; (3) control activities; (4) information and communication; and (5) monitoring activities. However, the fundamental concepts introduced in the original framework have been formalized into new principles that are associated with the five elements. The updated Integrated Framework superseded the original five elements as of December 15, 2014. According to a May 2017 survey by Audit Analytics, the transition to the updated framework is virtually complete, with 99% of the companies reviewed using the updated framework for their fiscal 2016 annual reports.[77] Of 3,645 companies in the Audit Analytics survey, only 19 companies still used the 1992 framework or did not disclose the information for the survey. Given the impact faulty internal controls can have on the integrity of the financial statements, an audit committee would be well served by reviewing how its company's control systems perform when measured against the updated COSO framework.

In addition, the PCAOB has cautioned auditors and reminded audit committee members that heightened fraud risk factors may exist in some emerging markets, including discrepancies between a company's financial records and audit evidence obtained from third parties, which may affect the ability of a company to "appropriately address significant deficiencies in internal control on a timely basis."[78] In parallel, the DOJ and the SEC have underscored that enforcement of the Foreign Corrupt Practices Act (FCPA) continues to be a top priority.[79] An audit

[75] SEC Release No. 34-70458 (September 19, 2013).

[76] COSO, *Internal Control–Integrated Framework* (May 2013).

[77] Audit Analytics, *Adopting the 2013 COSO Framework: Fiscal 2016 Update*, available at http://www.auditanalytics.com/blog/adopting-the-2013-coso-framework-fiscal-2016-update.

[78] PCAOB, Staff Practice Alert No. 8, *Audit Risk in Certain Emerging Markets* (October 3, 2011).

[79] Criminal Division of the U.S. Department of Justice and the Enforcement Division of the SEC, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* (November 14, 2012).

committee should discuss these risks with senior management as well as the independent auditor.

In response to the Coronavirus pandemic, many companies were forced to take quick actions without following normal protocols and diligence. Around the world, governments have provided emergency aid to companies, often with minimal oversight. More employees are working remotely or in a hybrid work environment with less security and supervision, increasing the potential for fraud. As a result, companies lacking a robust antifraud program and appropriate cybersecurity may face increased compliance risks, including legal action and regulatory fines.

Audit committees should assess how fraud risks may have grown or changed as a result of the pandemic and the rise of hybrid or at-home work plans, and assess whether their current control environment is sufficient to address these changes. Audit committees should verify that companies are looking beyond short-term fixes and enhancing processes and policies, with particular emphasis on identifying and reinforcing risk areas most likely to be impacted by fraud, emphasizing a strong corporate culture and whistleblower programs and considering how to best facilitate these functions in an increasingly remote workforce, utilizing technology to ensure data-driven and up-to-date decision-making, and monitoring and evaluating third-party risk.

E. Financial Risks Oversight

The financial and credit crises, as well as the market impact of the pandemic, highlighted the need for monitoring of financial risks and financial statements. In this environment, audit committees are facing increased expectations to exert enhanced efforts on financial risks oversight, including:

- understanding balance sheet and off-balance sheet exposures (*e.g.*, cash, accounts payable and debt agreements versus ability to access credit and capital, the cost of capital and interest rates);

- placing greater focus on debt and banking covenants, liquidity, available credit under revolving or other lines of credit, access to financing and counterparty risk;

- monitoring of the financial position of counterparties, including the financial conditions of and the company's dependence on key vendors and customers;

- reconsidering critical accounting policies in light of the current environment (*e.g.*, focusing on stock-based compensation, goodwill and intangible asset impairments, receivables, valuation allowances related to deferred tax assets and fair value accounting);

- when necessary, given the recent volatility in the financial markets, considering treasury and cash management policies, including the impact of hedging transactions;

- considering the renewal of credit lines and other financing arrangements; and

- understanding the potential effects of volatility on a company's significant vendors and customers, and thinking through "implicit contingent liabilities," *i.e.*, relationships where a company may be called upon for financial support outside of previously agreed contractual terms (for instance, stepping in to support a key vendor or customer).

A particular emphasis has been placed on the importance of liquidity risk management, both for regulated financial institutions and public companies in general. With respect to financial institutions, the Interagency Policy Statement on Funding and Liquidity Risk Management, issued in 2010 by the federal banking regulators, significantly strengthened requirements relating to liquidity risk management, providing extensive guidelines on how liquidity risks should be monitored and measured. According to the Policy Statement, a company's board of directors and, more particularly, a company's audit committee, should oversee the establishment and approval of liquidity management strategies, policies and procedures, and review them at least annually.

Noting that companies in general have undertaken increasingly diverse and complex types of financing activities, the SEC has provided interpretative guidance to improve the discussion of liquidity and capital resources in the MD&A section.[80] Among other things, the SEC has recommended that companies discuss in the MD&A section instances in which period-end liabilities reflected in a company's financial statements do not adequately communicate the risks and uncertainties attendant to material intra-quarter fluctuations in liquidity, and any types of short-term financings, such as repurchase agreements, securities lending transactions and other off-balance sheet arrangements, that are not otherwise fully captured in period-end balance sheets. In 2020, with effect from February 10, 2021, the SEC

[80] SEC Release No. 33-9144 (September 17, 2010).

amended the requirements for liquidity and capital resources disclosures, reflecting "an enhanced principles-based requirement focused on material short- and long-term cash requirements, including those from known contractual and other obligations."[81] In parallel, PCAOB AS 1301 requires auditors to thoroughly review and identify to the audit committee significant unusual transactions, assess their financial statement presentation and disclosure, and discuss with the audit committee the accounting treatment and disclosure of such transactions as well as the independent auditor's understanding of their business rationale. See Chapter V: "Relationship with the Independent Auditor."

An audit committee, as part of its oversight duty of financial reporting and risk, should review these types of short-term financing, liquidity and exposure risks and discuss the adequacy of their accounting treatment and disclosure with senior management and the independent auditor.

"End-user" derivatives transactions, which are used by many non-financial companies to hedge certain business risks such as changes in interest and currency exchange rates, have also received particular focus. The Dodd-Frank Act created a regulatory regime administered by the Commodity Futures Trading Commission (CFTC) pursuant to which derivatives transactions must be submitted for clearing to a derivatives clearing organization unless they satisfy the "end-user" exception. The "end-user" exception, which is only available to non-financial companies to hedge their "commercial risks," requires a company that files reports with the SEC to have the board of directors or an "appropriate committee" of the board review and approve derivatives transactions.[82] This can be done on a transaction-by-transaction basis or through the approval of a general policy regarding the company's use of derivatives. The CFTC expects that the board or such "appropriate committee" would set appropriate policies regarding the company's use of derivatives transactions and review those policies at least annually or more frequently after a triggering event (for example, the implementation of a new hedging strategy). While the audit committee may appear to be the appropriate body to assume some of these responsibilities, alternatives, including a dedicated risk management committee, should be carefully considered in light of the already substantial workloads borne by audit committee members. If the audit committee is selected, its charter should be revised to reflect this function.

[81] SEC Release Nos. 33-10890; 34-90459 (November 19, 2020).

[82] CFTC, *End-User Exception to the Clearing Requirement for Swaps* (July 10, 2012).

F. Recent Areas of Focus

An audit committee, while overseeing disclosure compliance and the effectiveness of internal controls, should also pay attention to the areas of risks recently highlighted by the SEC, the PCAOB and other sources.

Coronavirus. As the Coronavirus pandemic moves toward an endemic phase, significant economic disruptions either caused or exacerbated by the pandemic remain, including supply chain disruptions, inflation, a shift toward remote and hybrid work arrangements and a more competitive labor market. Additionally, the possibility remains that new variants may emerge and there is uncertainty about whether current vaccines may be effective against such variants. All of this uncertainty presents heightened risk and so audit committees should remain vigilant and proactive regarding potential disruptions and the associated risks to internal controls, financial reporting and other forms of oversight. In general, risk should be viewed through a long-term horizon and risk management priorities must align with business strategy.

Cybersecurity. The prevalence of cybersecurity risks has been highlighted in recent years by unprecedented data breaches, highly damaging cyberattacks and developments in cloud computing, mobile technology and social media. These events have demonstrated the importance of oversight over corporate cybersecurity risk and prompted responses from regulators and Congress. Careful attention to cybersecurity is perhaps more important now than ever, particularly given the increased cybersecurity risks that may result from current tensions with Russia.

The SEC has issued cybersecurity disclosure guidance, encouraging companies to review, on an ongoing and comprehensive basis, the adequacy of their disclosure relating to cybersecurity risks and cyber incidents, including in the risk factors section and the MD&A of their periodic reports. In addition to legal and regulatory mandates and the threat of significant business disruptions, directors may face scrutiny from proxy advisors and the threat of litigation and potential liability if the company suffers a cyberattack.[83]

[83] Following a major data breach at the end of 2013, Target Corporation indicated being under investigation by the SEC, the FTC and states' attorney generals to examine whether it adequately protected data and made appropriate disclosure about potential risks and, following the breach, consequences of the data breach. In 2014, ISS recommended that shareholders of Target vote against all seven of the directors who were on the board at the time of the breach. ISS asserted that Target's audit and corporate-responsibility committees failed to ensure appropriate management of cybersecurity risks and thus set the stage for the data breach. Similarly, shareholder plaintiffs filed derivative actions against Target's directors alleging breaches of their oversight

In February 2018, in keeping with a heightened governmental focus on cybersecurity, as exemplified by the Justice Department's formation of a new Cyber-Digital Task Force earlier in that month,[84] the SEC released guidelines on cybersecurity disclosures by public companies (the Cybersecurity Guidelines).[85] In the Cybersecurity Guidelines, the SEC focused on reinforcing and expanding upon existing interpretive guidance from its Division of Corporation Finance in advising public companies to evaluate the materiality of cyber risks and incidents and make necessary disclosures in a timely fashion. The Cybersecurity Guidelines also addressed new topics, including the following:

- advising that public companies should disclose the role of boards of directors in cyber risk management, at least in cases in which cyber risks are material to a company's business;

- encouraging companies to have controls that ensure important cyber risk and incident information is elevated to senior management and enable informed disclosure decisions;

- advising that required executive certifications regarding the design and effectiveness of disclosure controls include controls governing relevant cyber risk disclosures; and

- reminding companies that cyber risks and incidents may constitute material non-public information implicating insider trading laws and fair disclosure regulations.

In a similar thread, an SEC investigative report, based on the SEC Enforcement Division's investigation of nine public companies that were victims of cyber-related fraud, has cautioned that public companies "should be mindful of the risks that cyber-related frauds pose and consider, as appropriate, whether their internal accounting control systems are sufficient to provide reasonable assurances in safeguarding their assets from these risks."[86]

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duty. In April 2016, Target reported that it had incurred over $200 million in expenses (net of insurance) relating to the data breach, including the costs of settling several litigations. In May 2017, Target agreed to pay an $18.5 million multistate settlement to resolve state investigations following the attack.

[84] Department of Justice Press Release, *Attorney General Sessions Announces New Cybersecurity Task Force* (February 20, 2018).

[85] SEC Release Nos. 33-10459; 34-82746 (February 26, 2018).

[86] SEC Release No. 84429 (October 16, 2018).

As cybersecurity risk continues to rise in prominence, so too has the number of companies that have begun to specifically address cybersecurity and cyber risk within their internal audit function. A 2020 survey conducted by Protiviti revealed that, of the top ten audit plan priorities for 2020, cybersecurity risk was the third biggest priority for internal audit groups, and the number one priority among chief audit executives.[87] In a January 2022 survey of audit committee members by the Center for Audit Quality, 53% and 48% of respondents said that the audit committee is responsible for overseeing cybersecurity and data privacy security, respectively.[88] In the same survey, 69% of those with cybersecurity oversight responsibility indicated that they anticipate spending more time on cybersecurity in the coming year, and 62% listed cybersecurity as one of their top focuses. Audit committee members should assure themselves that their company's internal audit function includes personnel with the necessary technical expertise and sufficient time and resources to devote to cybersecurity risk. Further, the internal audit team should understand and periodically test the company's risk mitigation strategy and provide timely reports on cybersecurity risk to the audit committee. Cybersecurity best practices include:

- Establishing cybersecurity as a key consideration in all board matters;
- Diligently assessing the impact of operational changes, such as remote work, on cybersecurity;
- Reconciling value at risk in dollar terms with the board's risk tolerance, including whether cyber insurance coverage is advisable and an evaluation of the effectiveness of any current policy;
- Making cybersecurity a foundational consideration when evaluating or developing new technology, operations or agreements;
- Procuring robust third-party evaluations of the cybersecurity risk management program and ensuring the results are presented to the board;
- Clearly defining escalation protocols, including when and how the board will be notified of cybersecurity threats;

[87] Protiviti, *Exploring the Next Generation of Internal Auditing* (2020).

[88] Center for Audit Quality, Audit Committee Practices Report: Common Threads Across Audit Committees (Jan. 2022), available at https://www.thecaq.org/wp-content/uploads/2022/01/caq-deloitte-audit-committee-practices-report_2022-01.pdf.

- Ensuring clear and through processes are in place for evaluating third-party risk.

- Providing frequent and up-to-date training for employees and contractors;

- Conducting rigorous testing of the cybersecurity function, including simulated attacks, penetration testing, audits of off-site backups and test runs of any essential protocols that rely on third-party specialists; and

- Staying up-to-date on evolving threats and best practices.

In December 2020, a wide-ranging cybersecurity breach impacted multiple U.S. government agencies and companies. The attack embedded malicious code in software from widely used and trusted suppliers, and as a result went undetected for at least eight months. 2021 brought more cyberattacks, including one that drove the shutdown of one of the U.S.'s largest pipelines for fuel, and another that forced a California-based regional hospital operator to take healthcare IT systems offline in the midst of the pandemic. These developments highlight the importance of technology literacy on boards of directors. A 2020 survey of U.S. board members found that 66% felt that a cyber-security breach would reflect negatively on their company, but only 37% said their board understood the company's crisis management plan, and 32% said their board understood the company's cybersecurity vulnerabilities.[89]

While it is currently common for audit committees to shoulder responsibility for cybersecurity risk oversight,[90] boards should potentially consider, given the already significant burden on audit committees and the increasing importance and magnitude of the cyber risk oversight function, the formation of a cyber-specific committee or sub-committee. In addition, cybersecurity considerations should be a recurring agenda item for full board meetings. Whichever committee is tasked with this oversight responsibility should ensure that adequate resources are devoted to, and high-level personnel are tasked with, managing cybersecurity risks. That committee should receive direct reports from a company's chief information officer (or equivalent officer) on the effectiveness of a company's cybersecurity, how cybersecurity risks could affect a company's operations and whether the company's exposure to cybersecurity risks is being

[89] PwC, *2020 Annual Corporate Directors Survey* (September 2020).

[90] In EY's annual review of voluntary proxy statement disclosures by Fortune 100 companies relating to audit committees, almost 70% of reviewed companies disclosed that the audit committee oversees cybersecurity matters. EY Center for Board Matters, *Audit Committee Reporting to Shareholders in 2021* (October 2021).

effectively managed.[91] Education is a key component of effective oversight of cybersecurity risks. In addition to appointing directors with technology experience, the board and the relevant committee may consider using outside technical consultants on an annual or as-needed basis to be apprised of current developments in cybersecurity and to evaluate the adequacy of a company's internal personnel and processes in anticipating, preventing, detecting and responding to cyberattacks.

For a further discussion of board considerations in relation to cybersecurity risk oversight, please see our memorandum *Cybersecurity Oversight and Defense – A Board and Management Imperative* (May 11, 2021).

In January 2020, the SEC's Office of Compliance Inspections and Examinations (OCIE) released a set of staff observations that catalogue OCIE's assessments of industry practices concerning cybersecurity and resiliency.[92] Although corporate cybersecurity programs should be tailored to a company's individualized needs, these observations highlight robust board and senior leader engagement in cybersecurity risk management and oversight as an indispensable component of such programs. For a summary and analysis of these observations, please see our memorandum, *Insights for All Companies from the SEC-OCIE's Cybersecurity and Resiliency Observations* (January 28, 2020).

In March 2022, the SEC proposed sweeping new cybersecurity disclosure rules for public companies. The proposal represents the SEC's boldest effort yet to set national expectations for cyber-related disclosures, risk management, and corporate governance. If adopted as proposed, the rules would require public companies to disclose cybersecurity incidents more often and with greater specificity; explain the board's role in cybersecurity risk oversight and governance; discuss management's approach to cybersecurity risk mitigation and its impact on corporate strategy; highlight director and management-level expertise on cybersecurity; and describe cybersecurity policies and procedures. The scope of the proposed rules, which echo previously proposed rules for registered investment advisers and funds, is likely to generate substantial interest and comment through the SEC's rulemaking process. In accompanying remarks, SEC Chair Gensler emphasized the importance to investors of having "consistent, comparable, and

[91] See also National Association of Corporate Directors, *NACD Director's Handbook on Cyber-Risk Oversight* (2017), which includes specific guidance regarding the allocation of cyber-risk oversight responsibilities at the board level, expectation-setting with management regarding cybersecurity processes and recommendations for communication between directors and management on cybersecurity issues.

[92] SEC OCIE, *Cybersecurity and Resiliency Observations* (January 27, 2020), available at https://www.sec.gov/files/OCIE%20Cybersecurity%20and%20Resiliency%20Observations.pdf.

decision-useful" information from public companies about cybersecurity practices and incidents.[93] Complementary rules for registered broker-dealers and other market intermediaries are forthcoming. For a more fulsome discussion of these proposed changes, please see our memorandum, *SEC Proposes Sweeping New Cybersecurity Disclosure Rules for Public Companies* (March 10, 2022).

Privacy. In recent years, data privacy has become an essential part of cyber-security, due both to new laws and heightened public scrutiny. Although privacy concerns have traditionally been viewed as legal, compliance or security risks, the potential financial and reputational impacts on companies suffering a data breach have become increasingly severe and difficult to quantify. Audit committees should take an active role in reviewing their company's data-privacy protections and procedures as part of their regular supervision of cyber-security risks generally.

Corporate Sustainability/ESG. Corporate sustainability and ESG issues have become increasingly important. In his annual letter to CEOs, BlackRock Chairman and CEO Larry Fink warned that climate change will lead to a "fundamental reshaping of finance" and that BlackRock will exit investments with high "sustainability-related risk."[94] Mr. Fink encouraged others to follow suit, saying "[c]ompanies and countries that champion transparency and demonstrate their responsiveness to stakeholders... will attract investment more effectively, including higher-quality, more patient capital" and "[w]here we feel companies and boards are not producing effective sustainability disclosures or implementing frameworks for managing these issues, we will hold board members accountable." A similar letter from State Street Global Advisors observed "[w]e see that shareholder value is increasingly being driven by issues such as climate change, labor practices, and consumer product safety."[95] The letter went on to say that about three quarters of companies have made no meaningful progress on ESG issues, and that ESG is "no longer an option for long-term strategy…addressing material ESG issues is good business practice and essential to a company's long-term financial performance—a matter of value, not values."[96] In a nod towards expecting heightened transparency from public companies regarding sustainability-related matters, Vanguard in 2019 emphasized that "[i]nvestors benefit when the

[93] Gary Gensler, *Statement on Proposal for Mandatory Cybersecurity Disclosures*, March 9, 2022.

[94] Larry Fink, *2020 Letter to CEOs* (January 14, 2020).

[95] Cyrus Taraporevala, *CEO Letter to Board Members Concerning 2020 Proxy Voting Agenda* (January 28, 2020).

[96] *Id*.

market has better visibility into significant risks to the long-term sustainability of a company's business."[97]

Institutional investors and other organizations, including the Conference Board Sustainability Center and BlackRock, have asked companies to provide more detailed information about ESG issues and how these issues may affect the long-term sustainability of a company. In October 2018, a significant group of institutional investors, asset managers and state treasurers, including the California Public Employees' Retirement System, the Seattle City Employee's Retirement System, the New York State Comptroller, and the Illinois, Oregon and Connecticut Treasurers, submitted a petition to the SEC to mandate standardized disclosure of environmental, social and governance information by publicly traded companies.[98] A 2021 CAQ survey of S&P 500 companies found that 95% had detailed ESG information publicly available, with 66% issuing a sustainability or ESG-related report, and 69% obtaining or actively discussing obtaining third-party assurance on one or more components of ESG or sustainability data.[99] In a 2022 CAQ survey of audit committee members, 73% of respondents indicated they anticipate spending more time on ESG matters than in the previous year, higher than any other topic.[100]

Investors are also concerned about board oversight of ESG issues. In 2020, Vanguard stressed that "[b]oards should work to prevent risks from becoming governance failures."[101] Vanguard observed that it has seen "increasing evidence that nontraditional but material risks related to environmental and social topics (such as climate change, cybersecurity, and human capital management) can damage a company's long-term value," and that "strong oversight practices enable a board to steer a company through unpredictable crises."[102] In 2021, Glass Lewis announced that it will note as a concern when S&P 500 companies fail to provide disclosure on board-level oversight of environmental and social issues, and it will recommend a vote against the governance chair of such companies beginning in 2022.[103] Further, in 2022, Glass Lewis indicated that it will "note as a concern

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[97] Vanguard, *Investment Stewardship Annual Report* (2019).

[98] Cynthia A. Williams and Jill E. Fisch, *Petition for a Rulemaking on Environmental, Social, and Governance (ESG) Disclosure* (October 1, 2018).

[99] Center for Audit Quality, Audit Committee Practices Report: Common Threads Across Audit Committees (Jan. 2022), available at https://www.thecaq.org/wp-content/uploads/2022/01/caq-deloitte-audit-committee-practices-report_2022-01.pdf.

[100] *Id*.

[101] Vanguard, *Investment Stewardship Annual Report* (2020).

[102] *Id.*

[103] Glass Lewis, *2021 Proxy Paper Guidance* (December 2020).

when boards of companies in the Russell 1000 index do not provide clear disclosure concerning the board-level oversight afforded to environmental and/or social issues."[104] Additionally, in circumstances where Glass Lewis "believe[s] that a company has not properly managed or mitigated material environmental or social risks to the detriment of shareholder value, or when such mismanagement has threatened shareholder value," it may recommend voting against either (1) the members of the board responsible for oversight of environmental and social risks, or (2) where there is no explicit board oversight of such risks, against members of the audit committee.[105]

The SEC is also paying increasing attention to corporate sustainability and ESG disclosures. In 2016, the SEC, as part of its effort to modernize business and financial disclosure requirements, sought comments from the public on, among other things, "which, if any, sustainability and public policy disclosures are important to an understanding of a registrant's business and financial condition and whether there are other considerations that make these disclosures important to investment and voting decisions."[106]

On March 4, 2021, the SEC announced the creation of a Climate and ESG Task Force in the Division of Enforcement.[107] While the task force's initial focus will be inaccurate or incomplete climate-related disclosure, it will also analyze disclosure and compliance issues relating to investment advisers' and funds' ESG strategies, advise other SEC enforcement efforts and investigate ESG-related whistleblower complaints.

In news that has the potential to transform the current system of largely voluntary ESG disclosures, on March 21, 2022 the SEC proposed amendments to Regulations S-K and S-X to require disclosure of certain climate-related information by both domestic and foreign issuers. The mandatory disclosures would relate to board and management climate-related risk oversight and governance, material climate-related risks and opportunities, greenhouse gas (GHG) emissions, climate-related financial statement metrics, and climate-related targets, goals, and transition plans. For further information on these proposed amendments, please see our memorandum *SEC Proposes New Climate-Related Disclosures* (March 22, 2022).

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[104] Glass Lewis, *2022 Policy Guidelines* (November 2021).

[105] *Id*.

[106] SEC Release No. 33-10064 (April 13, 2016).

[107] SEC Press Release, *SEC Announces Enforcement Task Force Focused on Climate and ESG Issues* (March 4, 2021).

The proposed rules would not be effective until fiscal year 2023 at the earliest, but audit committees should begin discussions regarding the steps required to comply with the new requirements, including with the company's legal and internal control functions, along with external auditors. The proposed rules would require, among other things, (1) disclosure of whether the board or a committee will oversee climate-related risks, the processes and frequency with which the board or the responsible board committee discusses climate-related risks, and how the board or a committee considers climate-related risk as part of its business strategy and risk management financial oversight; (2) disclosure of risks and opportunities (including the impact on corporate strategy, the business model, and outlook), Scopes 1 and 2 emissions for all issuers, Scope 3 emissions (if material or if the issuer has set Scope 3 targets, with smaller reporting companies exempted), internal carbon pricing (if used), and transition plans and scenarios analysis (to the extent used by the issuer); (3) a note in the company's audited financial statements concerning the impact of severe weather events, other natural conditions, and transition activities on financial statement line items, and financial estimates and assumptions impacted by such climate-related events and transition activities; and (4) independent attestation on Scopes 1 and 2 emissions for large and accelerated filers (with limited assurance requirements phased in beginning 2024 and reasonable assurance requirements phased in beginning 2026). With respect to item (3), audit committees will need to engage in discussions with management and their companies' independent auditors on what changes will need to be implemented to ensure the effectiveness of internal controls over financial reporting if the SEC's proposed rules are implemented. For a more detailed discussion, please see our memorandum *The SEC's Proposed Climate-Related Disclosure Rules: Thoughts for Audit Committees* (April 4, 2022).

The SEC's Enforcement Division is expected to vigorously pursue ESG-related violations, in particular violations related to exaggeration of compliance with ESG goals, sometimes called "greenwashing." Additionally, with the success of the SEC's whistleblower program and the SEC's and public's focus on ESG, a surge in ESG related tips to the SEC's whistleblower program can be expected in the coming years. Issuers should closely examine how they set ESG goals and how those goals are communicated to investors, and boards should educate directors on ESG matters. Going forward, we may also expect increases in related criminal enforcement. The SEC and DOJ Criminal Division routinely bring parallel proceedings.

Additionally, DOJ's Environment and Natural Resources Division (ENRD) announced this year that "enforcement of the criminal provisions of the environmental laws is a priority." Prioritizing criminal enforcement may lead to an increase in DOJ environmental investigations of public companies and increased

cooperation between SEC and ENRD, resulting in increased parallel enforcement actions. Given this, companies should look to enhance their efforts to establish effective compliance programs related to ESG issues and ensure they routinely review and update those programs.

Reference Rate Reform. LIBOR, which was widely used as a reference rate for various commercial agreements, was generally discontinued after 2021.[108] The SEC has cautioned that the discontinuation of LIBOR may present a material risk for many companies, particularly if companies have not prepared to make a timely transition to an alternative reference rate. In addition to being well-versed in its company's LIBOR transition plan, an audit committee should also be mindful of the disclosures that the company is making to investors in this regard. Disclosures should include the value of contracts that still refer to LIBOR, if those contracts extend beyond 2021, and should describe efforts to transition to a new reference rate and any risks of that transition. Companies should also detail what steps they have taken to identify their exposure to LIBOR and what steps they still face to transition to an alternative rate. These disclosures would be appropriate in several financial report sections, including risk factors or MD&A.

Emerging Market Risks. In a 2020 statement, senior SEC and PCAOB officials reminded issuers and investors that, compared to U.S. issuers, there is a significantly greater risk of incomplete or misleading disclosures with and substantially less access to recourse against issuers based in or with significant operations in emerging economies (including China).[109] This asymmetry persists even when such companies present investor-oriented information in substantially the same form as U.S. issuers do. In emerging markets, among other things, operations face greater risks, financial information may be less reliable, the SEC, DOJ and other authorities face substantial difficulties in pursuing actions, shareholders' ability to seek redress is often limited and, in the case of China, the PCAOB cannot inspect the audit work and practices of PCAOB-registered firms. Audit Committees should discuss these matters with their internal and external auditors and should make sure that these risks, where material, are disclosed prominently, in plain English, and with specificity.

In closing, the enhanced risks oversight required from audit committee members combined with an increased level of financial and operational risk

[108] "[A]ll LIBOR settings will either cease to be provided by any administrator or no longer be representative" immediately after December 31, 2021, for all sterling, euro, Swiss franc and Japanese yen settings, and for one-week and two-month U.S. dollar settings; and immediately after June 30, 2023 for all remaining U.S. dollar settings. Financial Conduct Authority Press Release, *Announcements on the end of LIBOR* (March 5, 2021).

[109] SEC Public Statement, *Emerging Market Investments Entail Significant Disclosure, Financial Reporting and Other Risks; Remedies are Limited* (April 21, 2020).

complexity and the ongoing Coronavirus pandemic call for increased, continuing and specialized tutorials for audit committee members. The content of orientation and training programs for audit committee members should be reviewed to make sure that such programs enable audit committee members to fully understand a company's business environment, and include a detailed picture of all the material risks facing a company as well as the company's processes for managing risk. In performing its monitoring function, an audit committee and the board should be sensitive to "red flags" and "yellow flags." When such warning signs appear, an audit committee should observe and investigate as appropriate and document its monitoring activities in minutes that accurately convey the time and effort directors devote to decision-making, even when the outcome is to take no action. Influential courts have indicated that directors may be held liable for lack of good faith in situations where they utterly fail, in "ostrich-like" fashion, to exercise *any* oversight. See Chapter XI: "Audit Committee Member Liability Issues." However, none of these cases contemplate director liability where directors use common sense and appropriate diligence in performing their oversight function. Directors remain fully protected by the business judgment rule when they make corporate decisions with the exercise of due care.

VIII

Audit Committee Report, Disclosure Obligations and Financial Reporting Integrity

Under the rules of the SEC and major U.S. securities markets, there are several audit committee or audit committee-related disclosure obligations that must be complied with. Key obligations are discussed in this Chapter.

A. Audit Committee Report and Audit Committee-Related Disclosure Obligations

1. Audit Committee Report to the Board of Directors

An audit committee is required to provide a report to the board recommending whether or not a company's audited financial statements should be included in the company's annual report on Form 10-K. This recommendation should be based on:

- the audit committee's review of, and discussions with management about, the financial statements, it being important that the conversations with management include discussions about the quality, and not just the acceptability, of the accounting principles reflected in the financial statements, the reasonableness of significant judgments and the clarity of disclosures in the financial statements;

- the audit committee's discussions with the independent auditor relating to matters required to be discussed by the American Institute of CPAs' Statement on Auditing Standards No. 114;[110] and

- the audit committee's discussions with the independent auditor regarding its independence and receipt of written disclosures and the letter from the independent auditor per PCAOB requirements.

A company's annual proxy statement must include a report from the audit committee discussing the audit committee's actions with respect to the foregoing.

[110] Such matters are (a) the auditor's responsibilities under generally accepted auditing standards, (b) an overview of the planned scope and timing of the audit, and (c) significant findings from the audit. *AU Section 380: The Auditor's Communication With Those Charged With Governance*, available at: https://www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-00380.pdf.

The name of each member of the audit committee must appear below such disclosure.

2. Audit Committee-Related Annual Report and Proxy Statement Disclosure Obligations

An audit committee should also monitor a company's public filings to assure that the company is, as required, disclosing in its annual reports and proxy statements various items that relate to audit committees, including:

- whether the company has a separately designated audit (or functionally equivalent) committee and the identity of each committee member;

- whether or not the audit committee includes at least one member who is an "audit committee financial expert" (and, if not, why not), the individual's name and whether he or she is independent under the listing standards of the company's applicable securities market;

- the audit committee's pre-approval policies and procedures;

- the audit fees, audit-related fees, tax fees and all other fees billed by the independent auditor for each of the last two years (see also "Disclosure of Independent Auditor's Fees" below); and

- if greater than 50%, the percentage of hours expended on the independent auditor's engagement to audit the company's financial statements for the most recent fiscal year attributable to work performed by persons other than the independent auditor's full-time, permanent employees.

In addition, companies are required to disclose in proxy statements additional audit committee-related items, including:

- whether audit committee members are independent under applicable listing standards (and, if they are not, whether the company is utilizing specific independence exemption(s));

- for NYSE-listed companies, if a company does not limit to three or fewer the number of audit committees on which its audit committee members may serve, the board must determine and disclose that the service by an audit committee member on more than three audit

committees would not impair his or her ability to serve effectively on the company's audit committee; and

- whether a current copy of the audit committee charter is available on the company's website, and, if so, the company's website address. If a current copy of the audit committee charter is not available on the company's website, a copy of the audit committee charter must be included as an appendix to the proxy statement at least once every three fiscal years and whenever the audit committee charter has been materially amended since the beginning of the last fiscal year. If a current copy of the audit committee charter is not available on the company's website and is not being included in the company's proxy statement, the company must identify in which of the prior fiscal years the audit committee charter was so included.

In addition to the above disclosure requirements, the SEC proposed in a July 2015 concept release that audit committees be required to make more detailed disclosures in public filings regarding their role in overseeing independent auditors. The SEC proposal could require companies to make additional disclosures in public filings about the nature and frequency of communications between the audit committee and the independent auditor, the audit committee's process for appointing and retaining independent auditors, information about the independent auditor and its qualifications and other details about the relationship between the audit committee and the independent auditor.[111] The corporate community's comments on the concept release were generally opposed to requiring additional mandatory disclosures, which many companies argued would add even more burdens on already overworked audit committees. Investor advocates, on the other hand, were generally supportive, commenting that additional mandatory disclosures would provide investors with more information about companies and their audit processes.

While the SEC's concept release has not translated into additional mandatory disclosures pertaining to audit committee oversight of independent auditors, many companies have been voluntarily disclosing additional information about their audit committees and independent auditors, as the SEC itself noted in its concept release. Among the studies cited by the SEC is EY's annual review of audit committee reporting by Fortune 100 companies. EY's most recent review found that a majority of the companies surveyed disclose more information about

[111] SEC Release No. 33-9862 (July 1, 2015).

their audit committees and external auditors than is required and that there has been a dramatic increase in voluntary disclosures in most categories since 2012, the year EY began tracking such disclosures.[112] For example, in 2021 over 70% of companies disclosed factors used in the audit committee's assessment of the external auditor qualifications and work quality, while only 15% of companies made such disclosures in 2012. Similarly, in 2021, over 90% of companies disclosed that audit committees considered non-audit fees and services when evaluating auditor independence, compared to just 16% of companies making that disclosure in 2012. A similar study published in November 2021 found that a significant percentage of S&P 500 companies voluntarily disclose information in several key audit committee areas, with particularly strong year-over-year growth in the percentage of companies making cybersecurity oversight disclosures.[113]

The SEC has amended the MD&A disclosure requirements to *explicitly* require disclosure of critical accounting estimates.[114] The PCAOB defines a critical accounting estimate as "[a]n accounting estimate where (a) the nature of the estimate is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change and (b) the impact of the estimate on financial condition or operating performance is material."[115] The amendment generally requires companies to disclose, if material and reasonably available, the reason for the uncertainty in an identified critical accounting estimate, the amount by which the critical accounting estimate has changed during the applicable reporting period and the sensitivity of the critical accounting estimate to the methods used to calculate it.

3. Disclosure of Independent Auditor's Fees

Companies must disclose the fees paid to their independent auditors in the two most recent years, segregated into four categories:

(1) audit fees;

(2) audit-related fees;

(3) tax fees; and

(4) all other fees.

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[112] EY Center for Board Matters, *Audit Committee Reporting to Shareholders in 2021* (October 2021).

[113] Center for Audit Quality, *2021 Audit Committee Transparency Barometer* (November 2021).

[114] SEC Release No. 33-10890 (November 19, 2020).

[115] PCAOB, *AS No. 16, Communications with Audit Committees—Appendix A: Definitions*.

"Audit-related fees" are fees for assurance and related services by the independent auditor that are traditionally performed by the independent auditor and that are reasonably related to the performance of the audit or review of the company's financial statements. They include fees for employee benefit plan audits, due diligence related to mergers and acquisitions, accounting consultations and audits in connection with acquisitions, internal control reviews, attest services related to financial reporting that are not required by statute or regulation and consultation concerning financial accounting and reporting standards. Fees for operational audit services are not related to the audit or review of the financial statements and should be included in "all other fees," with a narrative description of such services.

An audit committee should satisfy itself that the company is in compliance with the above requirements.

B. Financial Reporting Integrity

An audit committee should take appropriate steps to satisfy itself that the company's CEO and CFO are meeting their obligations to the audit committee, the independent auditor and the public under the certification requirements established by the SEC, the company's securities market and Sarbanes-Oxley.

1. Section 302 and Section 906 Certifications

Section 302 of Sarbanes-Oxley (Section 302) requires a company's CEO and CFO to certify in each quarterly and annual report that, among other things:

- based on their knowledge, the report is not misleading;
- based on their knowledge, the financial statements and other financial information included in the report fairly present, in all material respects, the financial condition and results of operations of the company;
- they are responsible for establishing and maintaining, and have performed certain specified tasks with respect to, the company's internal controls and disclosure controls and procedures; and
- they have disclosed to the audit committee and auditors all significant deficiencies and material weaknesses in the design or operation of internal controls, as well as any fraud that involves

management or other employees with a significant role in the company's internal controls.

The Section 302 certifications must be filed as exhibits to the periodic reports. The CEO and CFO are required to sign separate Section 302 certificates and amendments to periodic reports that contain financial statements and require new certifications to be filed.

The certification required by Section 906 of Sarbanes-Oxley (Section 906) requires that each periodic report containing financial statements be accompanied by a statement by the company's CEO and CFO that (1) the report fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and (2) the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the company.

While not a substitute for other procedures, it may be appropriate for the CEO and CFO to obtain "sub-certifications" or other affirmations from selected members of management and/or heads of key business or staff units. Sub-certifications may have the salutary effect of reinforcing the importance of financial statement accuracy throughout the management structure of a company. In completing such sub-certifications, these employees need to consider and confirm within their respective areas of responsibility that the report does not contain any material misstatement or omission, that the financial statements and other financial information (to the extent the financial statements and other financial information or elements thereof are within such individual's purview) fairly present, in all material respects, the financial condition of the company and that there is no weakness in the disclosure controls and procedures that has resulted in or could be reasonably likely to result in the disclosure controls and procedures not being effective. Each sub-certification should be tailored to the areas of responsibilities of the individual making the sub-certification. If a company decides to obtain such sub-certifications, a mechanism should also be devised so that reasonable disagreements between individuals asked to give sub-certifications can be resolved, with any resolution appropriately documented.

2. "Fairly Presents" Standard of Disclosure

The CEO/CFO certification requirements have established a standard of financial disclosure above and beyond GAAP. The SEC states specifically that the standard of "fairly presents" is meant to be broader than GAAP. The fairly presents standard is meant to encompass the selection and proper application of accounting policies, the disclosure of financial information that is informative and reasonably reflects the underlying events and the inclusion of other information necessary to

give investors a materially complete picture of a company's financial condition, results of operations and cash flows. The CEO, CFO and all other company employees making accounting or disclosure judgments must base their decisions not just on GAAP but on the "fairly presents" standard. While it might be argued that this was always the case, it was not always the practice. Now it must be.

3. Non-GAAP Financial Information and Reconciliation to GAAP

It also is good practice for an audit committee to review any non-GAAP information released by the company. Under Sarbanes-Oxley, non-GAAP financial information must be reconciled to GAAP in public disclosures. The SEC rules specify that a company that presents material information including a non-GAAP financial measure also must present and give "equal or greater prominence" to the most directly comparable GAAP financial measure and a reconciliation between the two. SEC guidance regarding the use of non-GAAP financial measures has emphasized the "equal or greater prominence" requirement.[116] In December 2018, in what was the first enforcement action for violation of the "equal or greater prominence" requirement, the SEC settled a cease-and-desist proceeding against ADT Inc. for failing to give equal or greater prominence to comparable GAAP financial measures in two of its earnings releases.[117] Notably, this enforcement action stemmed solely from the issue of prominence in presentation, as the settlement suggested neither that the issuer formulated the non-GAAP measure in a misleading way, nor that the issuer used it inconsistently.

Although the rules do not place direct responsibility on an audit committee to ensure that a company's disclosures comply with these regulations, an audit committee should oversee the process by which the company decides whether to present non-GAAP financial measures, and it should understand and approve the reasons for doing so, including by inquiring of management whether the company's presentation of non-GAAP financial measures complies with SEC rules and guidance. In a public statement, then-Chairman Jay Clayton and other SEC officials encouraged audit committees to be "actively engaged in the review and presentation of non-GAAP measures and metrics to understand how management uses them to evaluate performance, whether they are consistently prepared and presented from period to period and the company's related policies and disclosure

[116] *Non-GAAP Financial Measures: Compliance & Disclosure Interpretations*, SEC (updated April 4, 2018).

[117] *In re ADT Inc.*, Exchange Act Release No. 84956 and Accounting and Auditing Enforcement Release No. 4009 (Dec. 26, 2018) (Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Cease-and-Desist Order).

controls and procedures."[118] An audit committee should also inquire as to whether any such disclosure of non-GAAP financial measures adds to investors' understanding of a company's financial position rather than confuses or complicates the picture. A set of questions proposed by the Center for Audit Quality to help audit committees probe whether non-GAAP financial measures are accurate, appropriate and useful to investors may be helpful for this purpose.[119]

4. Management's Reports on Internal Controls

As noted earlier, Section 404 of Sarbanes-Oxley and the SEC rules adopted thereunder require management to report annually on a company's internal controls over financial reporting. The SEC rules also require management to make quarterly disclosures of any material changes in a company's internal controls. While it is not the audit committee but rather management that is responsible for these disclosures, an audit committee will necessarily be involved in their development and should adequately monitor the related proposed disclosures. Also, if there is going to be disclosure that there have been material changes to internal controls over financial reporting during a quarter, an audit committee should inquire whether any significant deficiencies or material weaknesses underlying such changes are proposed to be specially disclosed, and, if it is determined that they will not be, ensure that this has been a properly considered decision and that there is a firm and reasonable basis for the decision not to disclose.

C. Review, Approval and Disclosure of Related-Party Transactions

There is nothing inherently improper about transactions between a company and its officers or directors; such transactions often are in the best interests of a company and its shareholders, offering efficiencies and other benefits that might not otherwise be available. It is entirely appropriate for an informed board, on a proper record, to approve such arrangements through its disinterested directors. An audit committee often serves this function.

As a matter of compliance and best practices, however, a company should give careful attention to all related-party transactions. Full disclosure of all material related-party transactions and full compliance with proxy, periodic reporting and financial footnote disclosure requirements is essential. Management should make sure that all related-party transactions have been fully and carefully reviewed with the board. A board should reevaluate, on both an initial and ongoing basis, a

[118] SEC Public Statement, *Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities*, SEC (December 30, 2019).

[119] Center for Audit Quality, *Questions on Non-GAAP Measures – A Tool for Audit Committees*, available at http://www.thecaq.org/questions-non-gaap-measures-tool-audit-committees.

company's policies and procedures for reviewing such transactions and for determining that all continuing related-party transactions remain in the best interest of the company.

Under the SEC rules, disclosure must be made in a company's annual proxy and annual report on Form 10-K regarding any transaction, since the beginning of the company's last fiscal year, or any currently proposed transaction, in which the company was or is to be a participant and the amount involved exceeds $120,000, and in which any related person (defined below) had or will have a direct or indirect material interest. Subject to certain exceptions, the following must be disclosed regarding any such transaction:

- the name of the related person and the basis on which the person is a related person;

- the related person's interest in the transaction, including the related person's position or relationship with, or ownership in, a firm, company or other entity that is a party to, or has an interest in, the transaction;

- the approximate dollar value of the amount involved in the transaction;

- the approximate dollar value of the amount of the related person's interest in the transaction (computed without regard to profit or loss);

- in the case of indebtedness, disclosure of the amount involved in the transaction must include the largest aggregate amount of principal outstanding during the period for which disclosure is provided, the amount thereof outstanding as of the latest practicable date, the amount of principal paid during the periods for which disclosure is provided, the amount of interest paid during the period for which disclosure is provided and the rate or amount of interest payable on the indebtedness; and

- any other information regarding the transaction or the related person in the context of the transaction that is material to investors in light of the circumstances of the particular transaction.

Under the SEC rules, a "related person" means (1) any person who, at any time during the specified period for which disclosure is required, was a director (or

nominee if disclosure is being presented in the company's proxy statement) or executive officer; (2) any person covered by Item 403(a) of Regulation S-K;[120] or (3) any immediate family member of the foregoing. An "immediate family member" means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law or sister-in-law, and any person (other than a tenant or employee) sharing the household of the director (or nominee), executive officer or security holder.

Under the SEC rules, a company must describe its policies and procedures for the review, approval or ratification of related-party transactions. While the rules acknowledge that a company's policies and procedures will vary depending on the particular circumstances, such description may include, in given cases:

- the types of transactions that are covered by such policies and procedures;
- the standards to be applied pursuant to such policies and procedures;
- the persons or groups of persons on the board or otherwise who are responsible for applying such policies and procedures; and
- a statement of whether such policies and procedures are in writing, and, if not, how such policies and procedures are evidenced.

A company also must identify any related-party transaction since the beginning of the company's prior fiscal year for which such policies and procedures did not require review, approval or ratification, or for which such policies and procedures were not followed.

As noted above, the SEC rules mandate that companies disclose the persons or groups of persons on the board or otherwise who are responsible for applying the company's policies and procedures regarding related-party transactions. The Nasdaq rules and NYSE rules require that an audit committee or another independent body of the board approve all related-party transactions. In light of this, a board should consider assigning to an audit committee, or to another committee consisting solely of directors who are both independent and disinterested with respect to the transaction under consideration, the task of reviewing any newly proposed related-party transactions. The committee should have the authority to hire such outside financial, legal and other advisors as it deems appropriate to assist it in its evaluation of such transactions. If a related-party arrangement is of material

[120] Item 403(a) of Regulation S-K covers any person or "group" who is known to the registrant to be the beneficial owner of more than five percent of any class of the registrant's voting securities.

significance to a company, a board should consider whether additional steps are necessary to ensure that such transactions are properly monitored and evaluated. For example, a board should take active measures to determine that the entities providing related-party services are being held to the same standards the company would demand of unaffiliated third-party service providers and that there is a clear reason for procuring the service from a related party.

On April 2, 2021, the SEC approved changes to the NYSE rule governing related party transactions, and on August 26, 2021, the SEC approved further amendments to that rule. The NYSE's rule previously required a listed company's audit committee or other comparable body to review related party transactions. While the NYSE rule did not previously define related party transactions, the accepted industry practice had been to apply the proxy disclosure requirement specified in Item 404 of Regulation S-K (Item 404), which requires disclosure of transactions with related parties in which the amount exceeds $120,000 and the related party has a "material interest." The revised rule now explicitly defines "related party transactions" as transactions required to be disclosed pursuant to Item 404, after taking into account the $120,000 transaction value threshold and the materiality threshold. The revisions require prior review of transactions by the reviewing body and provide that the reviewing body must prohibit transactions that it determines are inconsistent with the interests of the company and its shareholders. Should an audit committee choose to pre-approve certain categories of transactions following appropriate consideration, those categories should be sufficiently specific so as not to shirk the requirements of the new rule. Companies should review the types of transactions they regularly engage in with related parties in order to ensure continuing compliance with the NYSE rules.

Financial firms affiliated with banks or other FDIC-insured depository institutions are subject to additional extensive restrictions on transactions with affiliated parties, including loans or other extensions of credit to directors and officers and a variety of transactions between an FDIC-insured institution and other affiliates of its bank holding company.

According to the PCAOB, related-party transactions have been contributing factors in numerous financial reporting fraud cases and constitute continuing weaknesses in independent auditors' scrutiny. The PCAOB has adopted PCAOB AS 2410 to strengthen independent auditors' performance in identifying, assessing and responding to the risks of material misstatements associated with related-party transactions. PCAOB AS 2410 requires the independent auditor to communicate with the audit committee its evaluation of the company's identification of, accounting for and disclosure of its relationships and transactions with related

parties and other related significant matters arising from the audit.[121] Recognizing the key role that a company's executive officers may play in the company's accounting decisions or financial reporting, the PCAOB stated that the new procedures are intended to heighten the independent auditor's attention to incentives or pressures for the company to achieve a particular financial position or operating result.

Attached as *Exhibit F* are model policies and procedures with respect to related person transactions. Note that this is only a model for such policies and procedures, and companies should customize the model to their particular needs and circumstances.

[121] SEC Release No. 34-73396 (October 21, 2014); PCAOB Release No. 2014-01 (June 10, 2014).

IX

Audit Committee Whistleblower Rules and Ethics Codes

A. Whistleblower Complaints and Procedures

Under Sarbanes-Oxley, an audit committee must establish procedures for the receipt, retention and treatment of complaints received by a company regarding accounting, internal controls or auditing matters. Employees must be able to submit, on a confidential and anonymous basis, concerns regarding questionable accounting or auditing matters, or any deliberate or unintentional gaps in a company's internal controls.[122] Since audit committees generally do not have their own staff, they require the process of receiving and organizing complaints to be managed by internal or external legal counsel, the director of internal audit, the corporate secretary or another appropriate person.

In May 2011, the SEC adopted a whistleblower program, implemented under the Dodd-Frank Act, with a system of cash incentives to encourage and reward whistleblowers who come forward to the SEC.[123] Whistleblowers may receive between 10% to 30% of any monetary sanction over $1 million that results from their report of "original information" to the SEC. This program is setting records year-over-year. During the tenth full year of operation of the whistleblower program (*i.e.*, fiscal year 2021), the SEC received over 12,200 whistleblower reports, representing the highest number received in a fiscal year, a 76% increase from fiscal year 2020 and a more than 300% increase since the beginning of the program.[124] The SEC has awarded over $1.1 billion to whistleblowers since the inception of the program in 2011, with about $564 million awarded to 108 individuals in fiscal year 2021 alone, as compared to around $562 million to 106 individuals over the *entire* period from inception through fiscal year 2020.[125] On October 22, 2020, the SEC announced its largest single award ever, totaling more than $114 million, more than doubling the previous record award of $50 million set

[122] The white collar and regulatory enforcement environment in general is discussed in our memorandums *White Collar and Regulatory Enforcement: What Mattered in 2019 and What to Expect in 2020*, January 2020 and *White Collar and Regulatory Enforcement in the Era of COVID-19*, April, 2020.

[123] SEC Release No. 34-64545, *Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934* (August 12, 2011).

[124] SEC, Annual Report to Congress on the Dodd-Frank Whistleblower Program, Fiscal Year 2021 (November 2021).

[125] *Id*.

in June 2020.[126] It followed that up in September 2021 with a combined almost $114 million award to two whistleblowers.[127] The largest single category of reports in 2021 was "Manipulation" (25%). Since the beginning of the program, Corporate Disclosures and "Financials", "Offering Fraud" (such as Ponzi, or Ponzi-like, schemes) and "Manipulation" have consistently ranked as the three highest allegation types reported by whistleblowers. Notably, following its addition in the fourth quarter of fiscal year 2018, the "Initial Coin Offerings and Cryptocurrencies" category became the fifth highest allegation type in fiscal year 2021.

Enforcement matters brought based on whistleblower tips have resulted in orders for nearly $5 billion in total monetary sanctions since the program began in 2011.[128] The whistleblower program has become an important source of leads for the SEC, and the SEC will likely continue to look for opportunities to incentivize and offer reassurance to potential whistleblowers, and to publicize the program. In fact, on September 23, 2020, with effect from December 7, 2020, the SEC adopted amendments to the whistleblower rules that, among other things, (1) added a new *presumption* that, under certain conditions, a meritorious award recipient of an award that could not exceed $5 million will automatically receive the statutory maximum 30% of monetary sanctions collected;[129] and (2) permitted awards based on deferred prosecution agreements and non-prosecution agreements entered into by the DOJ or settlement agreements entered into by the SEC outside of a judicial or administrative proceeding.[130] The SEC whistleblower program contains several significant incentives for employees to first report their concerns to the company instead of to the government:

- if an employee first reports to the company, and then reports to the SEC within 120 days of that first internal report, the employee's "place in line" will date from his/her first internal report to the company;

- if a monetary sanction does result, an employee will likely get a larger reward (bearing in mind the statutory 10% to 30% range) if he/she reported first to the company (and less if not); and

[126] SEC Press Release, *SEC Issues Record $114 Million Whistleblower Award* (October 22, 2020).

[127] SEC, Annual Report to Congress on the Dodd-Frank Whistleblower Program, Fiscal Year 2021 (November 2021).

[128] *Id*.

[129] Note that awards of this type made up the vast majority of awards as of these amendments.

[130] SEC Release No. 34-89963 (September 23, 2020).

- if the company ultimately reports to the SEC a broader set of concerns than the employee initially had, based on an internal investigation prompted by the employee's internal report, the employee will get full credit for the entire set of concerns reported by the company.

The SEC's annual whistleblower report stated that over 75% of award recipients who were current or former employees reported their concerns internally to their supervisors, to compliance personnel or through internal reporting mechanisms, or understood that their supervisor or relevant compliance personnel knew of the violations, before going to the SEC.[131] This statistic reinforces the importance of companies maintaining robust processes to respond appropriately to employees' concerns when raised internally.[132] Reminding employees of the incentives discussed above will not only increase the chances that employees will first report their concerns to the company, it will also provide a well-documented record of a company's good faith effort to establish a culture of compliance. Companies should also regularly review the overall structure of their compliance and ethics policies and procedures, with an eye to finding more effective ways to embed a compliance component in day-to-day operations.

Companies are subject to potential civil, and, in some cases, criminal, liability if they retaliate against a whistleblower who is an employee or take any action to impede an individual from communicating directly with the SEC's staff about a possible securities law violation, including by enforcing, or threatening to enforce, a confidentiality agreement with respect to such communication.

The need for carefully handling whistleblower matters was underscored by the SEC's first enforcement actions charging an employer with retaliation against a whistleblower[133] and the SEC's finding that requiring employees to sign a

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[131] *Id*.

[132] Note, however, that the U.S. Supreme Court held in February 2018 that the anti-retaliation whistleblower protections under the Dodd-Frank Act apply only when a whistleblower has actually provided information to the SEC, and not when potential violations were only reported to management. *Digital Realty Tr., Inc.* v. *Somers*, No. 16-1276 (U.S. February 21, 2018). While *Digital Realty* may narrow potential exposure of companies to civil claims for retaliation in cases in which potential violations were only reported to management, it does not diminish the importance of designing and maintaining appropriate mechanisms for facilitating internal reporting to senior management. In 2019, Congress introduced two bills, H.R. 2515 and S. 2529, to address the decision in *Digital Realty*. While neither bill was enacted, a similar bill was introduced in the House, H.R. 5485, on October 5, 2021. This bill would expand whistleblower protections to individuals who report a securities law violation to a person with "supervisory authority" over the whistleblower.

[133] *In the Matter of Paradigm Capital Management, Inc.*, Exchange Act Release No. 72393 (June 16, 2014).

confidentiality agreement at the outset of interviews in internal investigations may deter employees from submitting whistleblower reports.[134] In September 2016, the SEC brought its first standalone whistleblower retaliation case against International Game Technology (IGT). IGT agreed to pay a $500,000 penalty for firing an employee because the employee had reported to senior management and the SEC that the company's financial statements might be distorted.[135] In another whistleblower investigation settled in January 2017, HomeStreet, Inc. (HomeStreet) agreed to pay a $500,000 civil penalty, and its treasurer agreed to pay an additional $20,000 penalty, to settle charges that HomeStreet conducted improper hedge accounting and later took steps to impede potential whistleblowers. According to the SEC, after HomeStreet employees reported concerns about accounting errors to management and the SEC contacted the company, HomeStreet presumed that the SEC communications were in response to a whistleblower complaint. In response, HomeStreet suggested to one individual considered to be a whistleblower that the terms of an indemnification agreement could allow HomeStreet to deny payment for legal costs during the SEC's investigation, and required former employees to sign severance agreements waiving potential whistleblower awards or risk losing their severance payments and other post-employment benefits. In connection with the HomeStreet settlement, the Chief of the SEC's Office of the Whistleblower stated that "Companies simply cannot disrupt the lines of communications between the SEC and potential whistleblowers."[136]

The pandemic has not reduced the SEC's emphasis on the importance of the whistleblower program, and, as noted above, fiscal year 2021 was record-breaking across the board for the SEC's whistleblower program. Audit committees should reevaluate their current rules and procedures for whistleblowers in light of the Coronavirus pandemic. In their evaluation, audit committees should think about how remote work, employee health concerns and the potential for increased fraud impact their whistleblower program. Companies should also consider refreshing their existing reporting systems by prominently reminding employees about how to use them, and ensure that the requisite resources and institutional expertise are available to address complaints in a timely and appropriate fashion.

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[134] *In the Matter of KBR, Inc.*, Exchange Act Release No. 74619 (April 1, 2015). See our memorandum, *The SEC Opens a New Front in Whistleblower Protection* (April 2, 2015).

[135] *In the Matter of International Game Technology*, Exchange Act Release No. 78991 (September 29, 2016); Press Release, *SEC: Casino-Gaming Company Retaliated Against Whistleblower* (September 29, 2016).

[136] Press Release, *Financial Company Charged With Improper Accounting and Impeding Whistleblowers* (January 19, 2017).

A proposed law, the Whistleblower Protection Reform Act of 2021, would, among other things, extend protections against retaliation to individuals who make disclosures with respect to any conduct that they reasonably believe evidences a violation of or is protected under any law subject to the SEC's jurisdiction, including to people with "supervisory authority" over the whistleblower or certain other people at the whistleblower's employer who have the authority to investigate, discover or terminate misconduct.[137] Currently, whistleblower protections apply only to individuals who report information directly to the SEC.

In responding to this legal and regulatory environment, there can be a temptation to establish a special committee of independent directors to investigate every whistleblower complaint. This temptation should be resisted in favor of a procedure that assesses whistleblower complaints and the need for special committees on a case-by-case basis. Such investigations can be extremely disruptive and expensive yet are not necessary in every situation. Boards should determine that management has established an anonymous whistleblower hotline and that a well-documented policy for evaluating whistleblower complaints exists, but they should also be judicious in deciding which complaints truly warrant further action.

An audit committee should, at regular intervals, receive a summary of each complaint that has been submitted with respect to accounting, internal accounting controls, auditing matters or risk management, and discuss with management the necessary or appropriate steps to address any such complaint that is legitimate. Legal counsel or other outside advisors should be retained as needed to resolve any difficult issues. Management should inform an independent auditor of any changes made as a result of these complaints or any significant issues and their resolutions.

1. Up-the-Ladder Reporting by Attorneys

Federal rules also require internal and outside lawyers for public companies to report, in certain circumstances, credible evidence that a material violation of securities laws or a breach of duty or similar violation by the company or any of its directors, officers, employees or agents occurred, is occurring or is about to occur. To the extent an audit committee is determined to be the appropriate committee to receive any such reports, there should be a process in place for receiving, reviewing and responding to such reports. When in doubt, an audit committee should consult with counsel (including outside counsel, if appropriate) for advice.

[137] H.R. 5485 (117th Congress). This bill, similar to a bill passed by the House in 2019 but never enacted, was introduced October 5, 2021. A similar bill, S. 2529, was introduced in the Senate in 2019, but has not been passed.

2. Whistleblower Procedures May Provide Early Warnings

Effective whistleblower procedures can serve as an early warning system, alerting an audit committee to issues when they can be addressed and rectified without undue adverse consequences. For instance, the report of the Examiner in the Lehman Brothers' bankruptcy indicated that, had the whistleblower communication regarding the "Repo 105" transactions been handled effectively by the independent auditor, the audit committee would have learned of the existence and volume of such transactions and been in a position to potentially control or request disclosure of such transactions. The specific procedures will vary depending on what works best within a particular company, and the SEC does not mandate any particular set of procedures. In many cases, a company's general counsel will be the right initial person to receive and handle complaints and concerns on behalf of, and under the supervision of, the audit committee. Procedures should include a system for tracking the handling and disposition of complaints received and for assuring that there is no retaliation against individuals submitting complaints lawfully and in good faith.

In response to the issues raised by the financial crisis and the Lehman Brothers Examiner's Report, the PCAOB adopted a suite of eight auditing standards to enhance the effectiveness of the auditor's assessment of and response to the risks underlying the audit process and procedures.[138] The independent auditor is required, as part of its overall assessment of risks of fraud or material misstatements, to make specific inquiries of management and the audit committee regarding tips or complaints about the company's financial reporting and to determine whether the board or audit committee understands and exercises oversight responsibility over financial reporting.[139] The independent auditor is also required to ask the audit committee whether it is aware of matters relevant to the audit, including any violations or possible violations of laws or regulations. See Chapter V: "Relationship with the Independent Auditor."

3. Civil Right of Action for Employees

Sarbanes-Oxley also provides a civil right of action for employees of public companies who believe they have been discharged or subjected to other adverse employment action because they have provided information to supervisors or the government regarding conduct they reasonably believe to violate securities or antifraud laws.

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[138] SEC Release No. 34-62919; File No. PCAOB-2010-01 (September 15, 2010).

[139] PCAOB Auditing Standard 2110, *Identifying and Assessing Risks of Material Misstatement* (August 5, 2010).

4. Model Whistleblower Procedures

To assist an audit committee, attached as *Exhibit G* are model whistleblower procedures. Note that this is only a model for such procedures and companies should customize the model to their particular needs and circumstances.

B. Codes of Ethics

An audit committee also may be asked to monitor compliance with the Sarbanes-Oxley rule that requires a company to disclose whether it has adopted a code of ethics for its CEO, CFO, principal accounting officer, controller or individuals performing similar functions (and if it has not adopted such a code, why not), as well as compliance with listing standards that also mandate adoption of codes of conduct and ethics.

The code of ethics contemplated by Sarbanes-Oxley, the existence of which (or lack thereof) must be disclosed under the Sarbanes-Oxley rules, should include standards that are 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 the company's SEC reports and other public communications; compliance with applicable governmental rules and regulations; prompt internal reporting of violations of the code to appropriate persons identified in the code; and accountability for adherence to the code.

The NYSE and Nasdaq rules also require companies to have a code of conduct and ethics, which should apply to all directors, officers and employees of a company. The code of conduct required by the Nasdaq rules must comply with the definition of a "code of ethics" set out in the Sarbanes-Oxley rules and thus address the same topics. The code of business conduct and ethics called for by the NYSE rules should specifically address conflicts of interest, corporate opportunities, confidentiality, fair dealing, protection and proper use of company assets, compliance with laws, rules and regulations (including insider trading laws) and encouragement of the reporting of any illegal or unethical behavior. Both the NYSE and Nasdaq require that any waivers given to directors or executive officers must be approved by the board (or, in the case of the NYSE, by the board or a board committee). Furthermore, any such waiver must be disclosed within four business days of its approval by filing a current report on Form 8-K with the SEC (or, in the case of the NYSE, also by press release or website disclosure).

X

Cautionary Note on Disclosures to Government Investigators

A. Audit Committees Must Be Apprised of Possible Material Illegal Acts

Boards of directors—and especially audit committees—are often called upon to conduct internal investigations. Section 10A of the Exchange Act requires an independent auditor to inform the audit committee if, in the course of conducting an audit, the independent auditor becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the company) has or may have occurred. If the independent auditor subsequently determines that the illegal act has a material effect on the financial statements of the company and that the audit committee has not taken timely and appropriate remedial actions to address it, the independent auditor must report to the full board, which must immediately inform the SEC.

Section 10A creates numerous interpretive difficulties for accounting firms. As a consequence, independent auditors have often resolved uncertainties on the side of requesting investigations. It is all too common for an independent auditor that finds an issue even remotely questionable to insist that the audit committee hire outside counsel to investigate. Such investigations may be a waste of resources and time and, in some cases, have interfered with the progress of major corporate transactions, to the detriment of the company and its shareholders.

An audit committee that finds itself facing a request by the independent auditor to hire counsel and investigate a situation should use its own business judgment. Certainly, when circumstances appear to merit a thorough investigation, an audit committee should promptly commit adequate resources and take all appropriate steps. Nonetheless, audit committee members should be aware that, on occasion, independent auditors may go beyond the requirements of Section 10A in their eagerness to protect themselves from exposure, and directors, therefore, should consider the circumstances carefully before bringing in outside counsel and conducting a large-scale investigation.

B. Reports to Government May Be Discoverable

In responding to reports from independent auditors pursuant to Section 10A, and generally in responding to demands for internal investigations, directors should be mindful that any reports they make to government investigators regarding audit

committee findings are likely discoverable by plaintiffs in shareholder lawsuits.[140] A company often will have good reasons for voluntarily sharing its findings with the DOJ, the SEC, state authorities or other regulators. Self-disclosure, however, has to be weighed against the risk that voluntary reports to government investigators may later be subject to discovery by plaintiffs in parallel shareholder class actions or derivative litigation.

C. Privilege Considerations in Connection with Disclosures to Government

Under the DOJ's Principles of Federal Prosecution of Business Organizations (the Principles), credit for cooperation will not depend on whether a corporation has waived attorney-client privilege or work-product protection or produced materials covered by attorney-client or work-product protections. The DOJ has revised the Principles multiple times, making several significant changes concerning cooperation credit in its August 2008 revision. Section 9-28.300 of the U.S. Attorney's Manual continues to provide that prosecutors "should" consider eleven factors "in reaching a decision as to the proper treatment of a corporate target," including the corporation's "timely and voluntary disclosure of wrongdoing" and its "willingness to cooperate, including as to potential wrongdoing by its agents." However, the prerequisites for cooperation credit were changed in 2008.

The Principles now state that credit for cooperation will not depend on whether a corporation has waived attorney-client privilege or work-product protection or produced materials covered by attorney-client or work-product protections. It will depend on the disclosure of pertinent facts. Corporations that timely disclose relevant facts to the government may receive credit for cooperation regardless of whether they waive privilege in the process, though the disclosure of those facts must be done with care to avoid unintentional waiver. The policy forbids prosecutors from even asking for non-factual privileged information. Under the prior version of the Principles, prosecutors were permitted to request, under certain circumstances, that a corporation produce non-factual attorney-client privilege communications and work product.

The Principles also now specify that federal prosecutors are not to consider whether a corporation has advanced attorneys' fees to its employees, officers or directors when evaluating cooperation. Nor may federal prosecutors consider whether the corporation has entered into a joint defense agreement in evaluating

[140] See *Securities and Exchange Commission* v. *Sandoval Herrera*, Case No. 1:17-cv-20301-JAL (S.D. Fla. Dec. 5, 2017) (holding that a law firm waived work product protection over written notes and memoranda from witness interviews by providing oral summaries of those interviews to the SEC).

whether to give the corporation credit for cooperating. However, the government has the right to ask that a company refrain from sharing information the government has provided to the company with third parties.

Federal prosecutors should not consider whether a corporation has disciplined or terminated employees for the purpose of evaluating cooperation; they may only consider whether a corporation has disciplined employees whom the corporation identifies as culpable, and then only for the purpose of evaluating the corporations' remedial measures or compliance program. However, per 2021 revised guidance, companies hoping for cooperation credit "must provide the department with all non-privileged information about individuals involved in or responsible for the misconduct at issue," no longer limiting disclosures to those "substantially involved" in the misconduct.[141]

The SEC's Enforcement Manual similarly provides that the SEC "staff should not ask a party to waive the attorney-client or work product protection without prior approval of the Director or Deputy Director." The Manual makes clear that a party's decision to assert a legitimate claim of privilege should not negatively affect a claim of cooperation credit.

Although the DOJ's and SEC's policies may take waiver of privilege or work-product protection off the table in negotiations, companies facing criminal and regulatory investigations will continue to have significant incentives to cooperate fully with government investigators. It will generally be in the company's best interest to seek cooperation credit by providing relevant business records, identifying relevant personnel and evidence and conveying other pertinent information to government investigators.

D. Disclosure to the Full Board of Directors (But Not Disclosure to the Independent Auditor) May Sometimes Constitute Waiver of Privilege

Although rare, in certain situations, disclosures by a special committee of the board to the company's full board may also vitiate the attorney-client privilege. In particular, in the context of stock option backdating, the Delaware Chancery Court, in *Ryan* v. *Gifford*, Civ. Action No. 2213-CC (Del. Ch. Nov. 30, 2007), held that, when a special committee formed by a company's board of directors shares the findings of its outside counsel's special investigation with the company's full board, which included individual board members who were under investigation for alleged wrongdoing, such special committee waived the attorney-client privilege

[141] Lisa O. Monaco, *Speech by Deputy Attorney General Monaco on Corporate Criminal Enforcement* (October 28, 2021), available at: https://www.justice.gov/opa/speech/deputy-attorney-general-lisa-o-monaco-gives-keynote-address-abas-36th-national-institute.

and the work-product privilege that may have attached to the materials reviewed by the special committee and the communications with the outside counsel. More specifically, the court found that the relationship between the individual defendant board members and the special committee was "adversarial in nature," and that, therefore, the attorney-client privilege did not survive. In the absence of internal conflict, an audit committee does not regularly engage its own separate counsel, but, instead, usually interacts with the general counsel of the company and expects such communications to be privileged. However, if an internal conflict is perceived, an audit committee may find it advisable to retain its own separate counsel and not share such counsel's report with third parties (including, as appropriate, the full board).

With respect to an independent auditor, however, the D.C. Circuit made it clear, in *United States* v. *Deloitte LLP*, 610 F.3d 129 (D.C. Cir. June 29, 2010), that disclosure of work product to an independent auditor, such as reports prepared by the general counsel or an outside counsel, does not constitute a waiver of the work-product privilege. The D.C. Circuit's reasoning was based on the fact that an independent auditor is not a potential litigation "adversary" (as opposed to the aforementioned *Ryan* case) and that the company had a reasonable expectation of confidentiality given an auditor's professional confidentiality obligations.

E. Caution Recommended

The best practice is caution. Boards of directors in general, and audit committees in particular, should do their best to establish from the outset of an internal investigation the basis for a valid claim of privilege and weigh very carefully whether a disclosure to the government (or, if a special committee has been formed, to the full board) is appropriate. If it is necessary or prudent to report to the government, a board should seek to negotiate the strongest possible confidentiality agreement with the government. At all times, companies must act with an understanding of the fact that there is no certainty that a confidentiality agreement will shield a company from a finding that a disclosure to the government effected a waiver of privilege.

XI

Audit Committee Member Liability Issues

Understandably, no subject will be of more concern to one asked to serve on an audit committee than that of any potential for personal liability arising from that service. The good news for an audit committee member is that the risk of liability is very slight if he or she acts conscientiously. Neither Sarbanes-Oxley nor any other development has fundamentally affected the fact that an independent audit committee member who performs his or her duties in good faith is unlikely to be found liable for losses suffered by reason of such performance. It is true that neither the company nor its legal counsel can issue guarantees, but it is equally true that insulations against personal liability are perfectly adequate today, notwithstanding the fact that they are not, nor can they be expected to be, perfect.

A. The Business Judgment Rule Protection Remains

Almost two decades ago, headlines regarding personal liability of corporate directors, such as those describing the Enron and WorldCom settlements[142] and the Emerging Communications case,[143] caused increasing anxiety for directors of public companies. The Enron and WorldCom cases, however, were among the most egregious of the series of scandals that followed the bursting of the Millennium Bubble, involved billions in fraudulent misstatements and were brought under the strict liability provisions of the federal securities laws, not the fiduciary duty requirements of state law. Furthermore, as settlements rather than judicial decisions of liability, they did not have any precedential value for future judicial determinations, and to date, there is no legal reason for directors to be overly concerned. As then-Chancellor Leo E. Strine, Jr. put it, "an informed, disinterested business judgment still commands judicial respect in Delaware."[144]

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[142] The former non-management directors of Enron agreed to pay $13 million out of their own pockets to settle shareholder lawsuits. The WorldCom settlement of securities fraud litigation relating to public offerings of WorldCom securities called for 12 former directors to pay approximately $25 million of their own money and insurers to pay $35 million.

[143] In the 2004 case involving the leveraged buyout of Emerging Communications, *In re Emerging Communications, Inc. Shareholders Litig.*, 2004 WL 1305745 (Del. Ch. May 3, 2004), the Delaware Chancery Court ruled that a director with particularly relevant expertise could not reasonably rely upon the advice of an outside consultant who opined incorrectly on the fairness of the price to be paid per share.

[144] Chancellor Leo E. Strine, Jr., *Big Deals and Independent Directors: Tips for Being a Successful Fiduciary in the Transactional Setting*, Remarks at the Directors' Education Institute, Duke University (March 17, 2005).

Three considerations should give directors of large companies comfort that fear of personal liability is unwarranted in normal circumstances. First, with respect to the fiduciary duties of a director to a company and its shareholders, *the business judgment rule remains available* as a protection to directors who meet its prerequisites: namely, lack of conflicting interests, good faith and reasonable attentiveness. Second, most state corporation laws contain a provision such as Section 141(e) of the Delaware General Corporation Law, which provides that directors may rely in good faith upon the reports of retained experts or corporate officers so long as due care was used in selecting such persons (or, more broadly, that a reasonable director under the circumstances would have relied on such agents).[145] Third, most states have adopted provisions such as Section 102(b)(7) of the Delaware General Corporation Law, which permits companies to adopt charter provisions to waive liability for monetary damages arising from breach of a director's duty of care, and most public companies have adopted amendments incorporating such a waiver into their charter.

While Sarbanes-Oxley signaled toughness by substantially increasing criminal penalties for securities fraud and by creating a criminal offense of knowingly executing, or attempting to execute, a scheme to defraud shareholders of public companies, as well as by prohibiting loans to directors and coercion of auditors (violations of which could result in SEC enforcement actions), it did not otherwise change the elements of civil liability under the securities laws or create new rights of civil actions for which directors may be liable.

B. Audit Committee Members' Duties of Risk Oversight and Personal Liability

With respect to directors' duties for risk management, the Delaware courts developed the basic rule under the *Caremark* line of cases that directors can be liable for a failure of board oversight only where there is "sustained or systemic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists," noting that this is a "demanding test." *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959, 971 (Del. Ch. 1996). Despite increasing political and media focus and criticism of risk assessment and risk management efforts by corporate boards, the decisions *In re Citigroup Inc. Shareholder Derivative Litigation*, 964 A.2d 106 (Del. Ch. 2009) and *In re Goldman Sachs Group, Inc. Shareholder Litigation*, C.A. 5215-VCG (Del. Ch. Oct. 12, 2011) by the Delaware Court of Chancery reaffirm

[145] In the *Emerging Communications* case, the director with relevant expertise who was found to have unreasonably relied on the advice of an outside consultant was not independent; the court determined that he had acted to further his own business interests at the expense of the shareholders. *In re Emerging Communications*, 2004 WL 1305745, at *39-*40.

the fundamental *Caremark* standard and show that the business judgment rule survived the financial crisis intact.

The plaintiffs in *In re Citigroup Inc. Shareholder Derivative Litigation*, decided in 2009, alleged that the defendant directors of Citigroup had breached their fiduciary duties by not properly monitoring and managing the business risks that Citigroup faced from subprime mortgage securities, and by ignoring alleged "red flags" that consisted primarily of press reports and events indicating worsening conditions in the subprime and credit markets. Declaring that "oversight duties under Delaware law are not designed to subject directors, even expert directors, to personal liability for failure to predict the future and to properly evaluate business risk," the court dismissed these claims, reaffirming the "extremely high burden" plaintiffs face in bringing a claim for personal director liability for a failure to monitor business risk and that while directors could be liable for a failure of board oversight, "only a sustained or systemic failure of the board to exercise oversight . . . will establish the lack of good faith that is a necessary condition to liability." Notably, the court drew an important distinction between oversight liability with respect to business risks and oversight liability with respect to illegal conduct, emphasizing that courts will not permit oversight jurisprudence to be distorted by "attempts to hold director defendants personally liable for making (or allowing to be made) business decisions that, in hindsight, turned out poorly."

In *In re Goldman Sachs Group, Inc. Shareholder Litigation*, decided in October 2011, the Delaware Chancery Court dismissed claims against directors of Goldman Sachs based on allegations that they failed to properly oversee the company's alleged excessive risk taking in the subprime mortgage securities market and caused reputational damage to the company by hedging risks in a manner that conflicted with the interests of its clients. Chief among the plaintiffs' allegations was that Goldman Sachs' compensation structure, as overseen by the board of directors, incentivized management to take on ever riskier investments with benefits that inured to management but with the risks of those actions falling to the shareholders. In dismissing the plaintiffs' *Caremark* claims, the court reiterated that, in the absence of "red flags," the manner in which a company evaluates the risks involved with a given business decision is protected by the business judgment rule and will not be second-guessed by judges.

In June 2019, the Delaware Supreme Court reversed a Court of Chancery decision and allowed plaintiffs to proceed with a *Caremark* Claim for the first time in *Marchand v. Barnhill*.[146] In 2015, Blue Bell Creameries distributed ice cream tainted with Listeria monocytogenes (a bacteria found in soil and water). The

[146] 212 A.3d 805 (Del. Jun 19. 2019).

contaminated food killed three people, and the company had to recall its products and suspend operations. To avoid insolvency, the company entered into a highly dilutive transaction. A stockholder sued alleging, among other things, that the directors breached their fiduciary duty of loyalty under the *Caremark* standard. The Court of Chancery dismissed the lawsuit, ruling that Blue Bell's existing compliance programs satisfied the *Caremark* standard. Reversing that ruling, the Delaware Supreme Court observed that, while Blue Bell had certain food safety programs in place and "nominally complied with FDA regulations," it "had no [board] committee overseeing food safety, no full board-level process to address food safety issues, and no protocol by which the board was expected to be advised of food safety reports and developments." This "dearth of any board-level effort at monitoring" the company's risk management supported an inference that the directors had breached their oversight obligations. While this case does not signal a change in Delaware law, it serves to remind audit committees that oversight requires active, ongoing engagement. The mere existence of a management level oversight system, without more, is not enough for directors to avoid breach of fiduciary duty claims: "directors must make a good faith effort to implement an oversight system and then monitor it" themselves.

In October 2019, in *In re Clovis Oncology, Inc. Derivative Litigation*, the Delaware Court of Chancery upheld claims against directors for failing to ensure accurate reporting of trial results for an experimental cancer drug.[147] Stockholders brought a derivative action alleging that the board breached its fiduciary duties by disregarding "red flags" that reports of the drug's performance in clinical trials were inflated. In contrast with *Marchand*, the Court of Chancery recognized that the board had implemented robust reporting procedures regarding drug development and received regular updates. However, the court nevertheless sustained the claims. The Clovis directors argued, and the court accepted, that duty-to-monitor claims require a showing of *scienter*—that is, evidence that the directors knew they were violating their duties. But the court did not require the plaintiff to allege particular facts showing such knowledge. Instead, reasoning that Clovis had a board "comprised of experts" and "operate[d] in a highly regulated industry," the court concluded that the directors "should have understood" the problem and intervened to fix it. Just like the Delaware Supreme Court decision in *Marchand*, the Court of Chancery decision in *Clovis* cautions that the mere existence of a compliance program is not sufficient. Courts will consider whether there is engaged board oversight. Directors should consider implementing procedures to ensure that the

[147] *In re Clovis Oncology, Inc. Derivative Litig.*, C.A. No. 2017-0222-JRS (Del. Ch. Oct. 1, 2019).

board or the audit committee, if applicable, monitors "mission critical" corporate risks.

In April 2020, in *Hughes v. Hu*, the Delaware Court of Chancery sustained a *Caremark* claim against audit committee members.[148] In that matter, the plaintiff alleged that the board failed to implement reasonable audit protocols despite a long history of inadequate internal controls, including improper insider transactions and a restatement of earnings. The complaint alleged that the audit committee met only infrequently and briefly, and routinely overlooked important issues, which the court ruled were "chronic deficiencies [that] support a reasonable inference that the [board], acting through its Audit Committee, failed to provide meaningful oversight." The court held that the Company's failure to produce documents rebutting this inference was telling because "it is more reasonable to infer that exculpatory documents would be provided than … that such documents existed and yet were inexplicably withheld." The decision illustrates that aside from implementing reporting systems that provide directors with timely information regarding key corporate risks and directors reacting promptly when these reporting systems suggest the need for remedial action, it is also essential that these efforts are thoroughly documented to provide inspecting stockholders and reviewing courts a fair picture of the directors' work.

It is important to remember that despite these developments, the high pleading standard for *Caremark* plaintiffs remains, and particularized facts to demonstrate bad faith requires showing that a board either ignored "red flags" or did not implement a board level monitoring system. In this vein, other recent Delaware decisions have also confirmed that the mere presence of a government investigation, by itself, is insufficient to sustain a *Caremark* claim.

Audit committee members can take comfort in the Examiner's Report in the Lehman Brothers bankruptcy. That report highlighted the failure of both the independent auditor and management to disclose to and discuss with Lehman Brothers' directors, and particularly audit committee members, the use and scope of so-called "Repo 105" transactions, which, according to the report, allowed Lehman Brothers to paint "a misleading picture of its financial condition."[149] The report pointed out that Lehman Brothers' independent auditor also failed to apprise Lehman Brothers' audit committee of a senior management whistleblower's allegations about the end-of-quarter use of "Repo 105" transactions to manipulate the quarterly balance sheet. The Examiner concluded that this oversight gave rise

[148] *Hughes* v. *Hu*, C.A. No. 2019-0112-JTL (Del. Ch. Apr. 27, 2020).

[149] The Examiner's report defines a "Repo 105" transaction as a device designed to temporarily remove securities inventory from a balance sheet, similar to standard repurchase and resale transactions used to secure short-term financing.

to a "colorable claim of malpractice" on the part of the auditor, which subsequently paid over $100 million to settle fraud claims. With respect to Lehman Brothers' audit committee, however, the report noted that the audit committee members did not breach their duties, as minutes of meetings showed that they were never informed of the "Repo 105" transactions and had explicitly requested to be apprised of all of such employee allegations.

Overall, these cases reflect that it is difficult to show a breach of fiduciary duty for failure to exercise oversight and that the board, and more particularly, the audit committee of the board, is not required to undertake extraordinary efforts to uncover non-compliance within the company, *provided* a well-documented monitoring system is in place and utilized.

Nonetheless, the SEC has on occasion signaled a more rigorous enforcement posture with regard to audit committee issues. In 2013, the SEC announced the creation of a "Financial Reporting and Audit Task Force," the purpose of which was to expand the SEC's efforts to identify securities law violations relating to the preparation of financial statements, issuer reporting and disclosure and audit failures. Several SEC enforcement actions have underscored the SEC's focus on financial statements and issuer reporting, including in situations that do not involve fraud or material misstatements.[150] In this heightened enforcement context, companies should adhere to reasonable and prudent practices and should not structure their risk oversight practices around the minimum requirements needed to satisfy the business judgment rule.

When complex legal, governance or accounting issues arise, it will be useful for a director to ask the following simple questions:

[150] Exchange Act Release No. 79256, *In the Matter of Powersecure International, Inc.*(November 7, 2016) (involving SEC charges against an energy management company for financial reporting, books and records, and internal control violations related to its segment reporting); Exchange Act Release No. 77345, *In the Matter of Magnum Hunter Resources Corporation* (March 10, 2016) (involving SEC charges against an oil company and several individuals, including a company consultant and the company's external auditor, for deficient evaluation of the company's internal controls over financial reporting); Exchange Act Release No. 75958, *In the Matter of Stein Mart, Inc.* (September 22, 2015) (involving SEC charges against a retailer for materially misstating its pre-tax income due to improper valuation of inventory subject to price discounts and for having inadequate internal accounting controls); and Exchange Act Release Nos. 73750 and 73751, *In the Matter of Hampton Roads Bankshares, Inc.* and *In the Matter of Neal A. Petrovich, CPA* (December 5, 2014) (involving SEC charges against a bank holding company and its former CFO for violating the federal securities laws by improperly accounting for a deferred tax asset that was not fully realizable due to the company's deteriorating loan portfolio and financial condition).

- Have I acted with undivided loyalty to the company and its shareholders, and have all my personal interests in this matter been fully disclosed?

- Have I exercised due care in examining the issues underlying the proposed action, including receiving advice as to whether the action is in compliance with applicable rules and regulations?

- Will the proposed action and the relevant facts and circumstances be candidly disclosed to all affected parties?

If the answers to those questions are yes, a director should be fully protected in exercising his or her business judgment, and, even if, with the benefit of hindsight, the judgment proves flawed, the director should not be faulted.

In a 2019 memorandum, the Department of Justice provided guidance regarding corporate compliance.[151] While the memorandum is extensive and primarily directed toward senior and middle management, it contains important guidance for boards. The board of directors sets the tone for the entire corporation, and the board should promulgate its ethical standards clearly at all levels of the company. Actions as well as words are necessary: when prosecutors are evaluating corporate compliance programs, they will consider whether those responsible for compliance have been empowered through sufficient status, resources, and autonomy. Autonomy may include direct access to the board of directors or a board committee, such as the audit committee.

The DOJ memorandum also suggests that in an investigation into corporate misconduct, one of the first questions prosecutors will ask is what, if any, compliance expertise has been available to the audit committee. They may consider whether the audit committee has held executive sessions with compliance leaders within the company and may inquire as to what types of information the audit committee has examined in its exercise of the oversight function. Key questions will be what types of issues have been reported to the audit committee, and how the audit committee and management have addressed them. Documentation as to committee discussions and decisions will be necessary to show that the audit committee has been diligent in fulfilling its oversight responsibilities.

[151] U.S. Department of Justice Guidance Document, *Evaluation of Corporate Compliance Programs* (April 2019).

C. Liability Protections—Directors and Officers Liability Insurance

All directors should be fully indemnified by the company (including for the advancement of defense costs) to the fullest extent permitted by law. The company also should purchase a reasonable amount of insurance to protect directors against the risk of personal liability for their services to the company.

The nature and extent of directors' and officers' (D&O) insurance coverage is based on the policy language and the size (amount of limits) and type of insurance purchased. Policy terms and conditions can vary in material ways between different policies so it is important to focus on the particular terms and conditions. One should consider the policy period; the retention (or self-insurance) amount; policy exclusions; the severability of knowledge/wrongful acts and policy rescission; and the scope and nature of coverage. With respect to the policy limits, directors should receive sufficient information from either brokers or internal management team members to be comfortable that the overall limits being purchased are adequate for the company's size, industry and risk profile.

It is important that directors (and their counsel) have an opportunity to review on a regular basis the particular terms of the relevant D&O insurance policy(ies), with particular focus warranted on exclusions from coverage. Among other things, counsel should try to ensure that, in the event that a restatement is required at a future time, such restatement does not give the insurer a right to rescind or otherwise limit the coverage. Counsel should also try to ensure that the knowledge of one director or officer is not attributable to any other directors or officers for the purpose of determining coverage.

Another risk to directors in D&O insurance arises from a possible bankruptcy filing. Where the company itself is a beneficiary of the D&O insurance policy, a trustee in bankruptcy may have interests that conflict with those of directors who are named in a suit. This risk can and should be managed by having the company purchase policies known as Side A-only coverage[152] that cover just officers and directors but not the company itself, in addition to the policies that cover both the company and the directors and officers individually.[153]

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[152] Side A-only coverage also provides various other benefits to directors and officers individually, including with respect to derivative actions and the fact that these policy limits are not subject to reduction by claims against the company or claims for which the company makes indemnity payments.

[153] In bankruptcy cases in which the D&O insurance policy covers both individual directors and the company, courts have held that the proceeds will be property of the company if depletion of the proceeds would have an adverse effect on the bankruptcy estate of the company. See *In re MF Glob. Holdings Ltd.*, 515 B.R. 193, 203 (Bankr. S.D.N.Y. 2014). Side A-only coverage is much less likely to be viewed as an asset of a bankruptcy estate.

The D&O insurance market has recently "hardened" significantly. The cost of D&O insurance has increased materially and some companies have experienced difficulty in finding insurance capacity. The difficulties in the D&O market do not diminish the need for adequate D&O insurance, but audit committees may need to consider the availability and practicality of less traditional D&O insurance alternatives. Delaware recently passed legislation to expressly permit companies to consider using captive insurance companies (*i.e.*, an insurance company that is directly or indirectly owned, controlled or funded by the corporation itself) to issue D&O insurance policies. The captive insurance alternative, which is subject to certain statutory safeguards, could give companies additional options for protecting directors and officers, particularly if the traditional D&O insurance market proves to be untenable or unattractive.

As a matter of corporate law, rights to indemnification remain as they have been. The important feature for an audit committee member to understand is that these rights should commit the company to provide indemnification to the fullest extent permitted by law, whether it be for the advancement of defense costs, judgments/verdicts or settlements.

D. Audit Committee Can Be Its Own Best Protection

To be sure, prospective audit committee members must understand that more will be required of them—more time and more effort—than may have been demanded in the past. The legal standard for measuring the duties of audit committee members has not changed in theory. The law always has stated that a corporate director must exercise that degree of diligence that a reasonable person would exercise in all of the circumstances. This vague standard, like all negligence standards, looks to some social context to determine how a hypothetical "reasonable person" would have acted. It seems clear that all aspects of our legal system—from legislatures and regulators to judges and juries—are likely to demand greater attention and involvement (that is to say, greater commitment) from corporate directors in general, but especially from audit committee members, than in the past.

Failure to meet "reasonable person" expectations could in theory result in liability and in reputational injury. Each risk is a serious matter. When reputations earned over a lifetime for probity, diligence and sound judgment are injured, those audit committee members who sustain such injury cannot regard it as minor. Since one cannot prevent suits from being filed, the only protection against some reputational loss is conscientious and effective performance.

The courts understand the importance to corporate America of having candidates who are willing to serve on audit committees and the necessity of providing them with adequate pay, indemnification and insurance. They also understand that directors should not be seen as guarantors of good results or preventers of the malfeasance, misfeasance or nonfeasance of others, but should be entitled to rely in good faith on corporate documents, committees and experts to a significant degree in making their business judgments. Thus, when audit committee members fulfill their duties in good faith, they should not be concerned that they will be held personally responsible for mistakes or bad faith actions of management or independent auditors.

Exhibit Index

Exhibit A

MODEL AUDIT COMMITTEE CHARTER[154]
(NYSE-Listed Company)

Purpose

The Audit Committee is appointed by the Board of Directors (the "Board") to assist the Board in monitoring (1) the integrity of the financial statements of the Company, (2) the independent auditor's qualifications and independence, (3) the performance of the Company's internal audit function[155] and the Company's independent auditors, and (4) the compliance by the Company with legal and regulatory requirements.[156]

The Audit Committee shall prepare the report required by the rules of the Securities and Exchange Commission (the "Commission") to be included in the Company's annual proxy statement.[157]

Committee Membership

The Audit Committee shall consist of no fewer than three members.[158] The members of the Audit Committee shall meet the independence and experience requirements of the New York Stock Exchange (the "NYSE"), Section 10A(m)(3) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and the

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[154] A written audit committee charter must be adopted by the Board pursuant to Section 303A.07(b) of the New York Stock Exchange Listed Company Manual. *See also* Item 7(d) of Schedule 14A, Item 407(d) and Instruction 2 to Item 407 of Regulation S-K, pursuant to which a company must disclose in its annual proxy statement whether it has adopted a written charter for the audit committee and whether a current copy of the audit committee charter is available on the company's website (and, if so, the company's website address). If a current copy of the audit committee charter is not available on the company's website, a copy of the audit committee charter must be included as an appendix to the proxy statement at least once every three fiscal years or if the charter has been materially amended since the beginning of the last fiscal year. If a current copy of the audit committee charter is not available on the company's website and is not being included in the company's proxy statement, the company must identify in which of the prior fiscal years the audit committee charter was so included.

[155] If the Company does not yet have an internal audit function because it is availing itself of a transition period pursuant to NYSE 303A.00, consider including "the design and implementation of the Company's internal audit function."

[156] NYSE Listed Company Manual Section 303A.07(b)(i)(A).

[157] NYSE Listed Company Manual Section 303A.07(b)(i)(B). *See* Item 407(d) of Regulation S-K and Item 7(d) of Schedule 14A.

[158] NYSE Listed Company Manual Section 303A.07(a).

rules and regulations of the Commission.[159] At least one member of the Audit Committee shall be an "audit committee financial expert" (as defined by the Commission).[160] Audit Committee members shall not simultaneously serve on the audit committees of more than two other public companies.[161]

The members of the Audit Committee shall be appointed by the Board on the recommendation of the Nominating & Governance Committee.[162] Audit Committee members may be replaced by the Board.

Meetings

The Audit Committee shall meet as often as it determines necessary, but not less frequently than quarterly. The Audit Committee shall meet periodically in separate executive sessions with management (including the chief financial officer and chief accounting officer), the internal auditors and the independent auditor, and have such other direct and independent interaction with such persons from time to

[159] NYSE Listed Company Manual Section 303A.07(a) requires that each member of an audit committee be (a) "independent" (as defined by the NYSE Listed Company Manual) and (b) "financially literate" (as such qualification is interpreted by the board in its business judgment) or must become financially literate within a reasonable period of time after his or her appointment. In addition, at least one member must have accounting or financial management expertise, as the board interprets such qualification in its business judgment. NYSE Listed Company Manual Section 303A.06 provides that all listed companies must have audit committees that satisfy the requirements of Rule 10A-3 under the Exchange Act. Rule 10A-3 (added by Section 301 of the Sarbanes-Oxley Act) requires the NYSE and Nasdaq to prohibit the listing of any company unless each member of the audit committee is "independent," which is defined to mean that such individual may not, other than in his or her capacity as a member of the audit committee, the board, or any other board committee: (A) accept, directly or indirectly, any consulting, advisory, or other compensatory fee from the issuer or any subsidiary thereof, *provided* that, unless the rules of the national securities exchange or national securities association provide otherwise, compensatory fees do not include the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the listed issuer (*provided* that such compensation is not contingent in any way on continued service); or (B) be an affiliated person of the issuer or any subsidiary thereof.

[160] *See* Item 407(d)(5) of Regulation S-K. Commentary to NYSE Listed Company Manual Section 303A.07(a) provides that a board may presume that an audit committee member possesses "accounting or financial management expertise" if he or she satisfies the Commission's definition of an "audit committee financial expert."

[161] Commentary to NYSE Listed Company Manual Section 303A.07(a) states that, if an audit committee member simultaneously serves on the audit committee of more than three public companies, and the NYSE-listed company does not limit the number of audit committees on which its audit committee members serve to three or fewer, then, in each case, the board must determine that such simultaneous service would not impair the ability of such member to effectively serve on the listed company's audit committee and disclose such determination in the proxy statement.

[162] NYSE Listed Company Manual Section 303A.04 places responsibility for board committee nominations in the independent nominating & corporate governance committee.

time as the members of the Audit Committee deem appropriate.[163] The Audit Committee may request any officer or employee of the Company or the Company's outside counsel or independent auditor to attend a meeting of the Audit Committee or to meet with any members of, or consultants to, the Audit Committee. Written minutes of Audit Committee meetings shall be maintained.

Committee Authority and Responsibilities

The Audit Committee shall have the sole authority to appoint or replace the independent auditor (subject, if applicable, to shareholder ratification).[164] The Audit Committee shall be directly responsible for the compensation and oversight of the work of the independent auditor (including resolution of disagreements between management and the independent auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work.[165] The independent auditor shall report directly to the Audit Committee.[166]

The Audit Committee shall pre-approve all auditing services, internal control-related services and permitted non-audit services (including the range of fees and terms thereof) to be performed for the Company by the independent auditor, subject to the *de minimis* exception for non-audit services described in Section 10A(i)(1)(B) of the Exchange Act that are approved by the Audit Committee prior to the completion of the audit.[167] The Audit Committee shall review and discuss with the independent auditor any documentation supplied by the independent auditor as to the nature and scope of any tax services to be approved, as well as the potential effects of the provision of such services on the auditor's independence.[168] The Audit Committee may form and delegate authority to subcommittees consisting of one or more members, when appropriate, including

[163] NYSE Listed Company Manual Section 303A.07(b)(iii)(E).

[164] NYSE Listed Company Manual Section 303A.06 and Rule 10A-3 under the Exchange Act.

[165] Rule 10A-3(b)(2) under the Exchange Act (added by Section 301 of the Sarbanes-Oxley Act) requires an audit committee of each listed issuer, in its capacity as a committee of the board, to be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged (including resolution of disagreements between management and an independent auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the listed issuer.

[166] Rule 10A-3(b)(2) under the Exchange Act (added by Section 301 of the Sarbanes-Oxley Act) requires each registered public accounting firm to report directly to the audit committee.

[167] Sections 10A(h) and 10A(i) of the Exchange Act (added by Sections 201 and 202 of the Sarbanes-Oxley Act) require such pre-approval with respect to services provided by a registered public accounting firms to its audit clients.

[168] This flows from PCAOB Rule 3524, PCAOB Release No. 2005-014 (July 26, 2005).

the authority to grant pre-approvals of audit and permitted non-audit services, *provided* that decisions of such subcommittee to grant pre-approvals shall be presented to the full Audit Committee at its next scheduled meeting.[169]

The Audit Committee shall have the authority, to the extent it deems necessary or appropriate, to retain independent legal, accounting or other advisors.[170] The Company shall provide appropriate funding, as determined by the Audit Committee, for payment of compensation to the independent auditor for the purpose of rendering or issuing an audit report or performing other audit, review or attest services for the Company and to any advisors employed by the Audit Committee, as well as funding for the payment of ordinary administrative expenses of the Audit Committee that are necessary or appropriate in carrying out its duties.[171]

The Audit Committee shall make regular reports to the Board.[172] The Audit Committee shall annually review the Audit Committee's own performance.[173]

The Audit Committee, to the extent it deems necessary or appropriate, shall:

Financial Statement and Disclosure Matters

1. Review and discuss with management and the independent auditor the annual audited financial statements, including disclosures made in management's discussion and analysis, and recommend to the Board whether the audited financial statements should be included in the Company's Form 10-K.[174]

2. Review and discuss with management and the independent auditor the Company's quarterly financial statements prior to the filing of its Form 10-Q, including disclosures made in management's

[169] Section 10A(i)(3) of the Exchange Act (added by Section 202 of the Sarbanes-Oxley Act).

[170] Rule 10A-3(b)(4) under the Exchange Act (adopted by the Commission pursuant to Section 301 of the Sarbanes-Oxley Act).

[171] Section 10A(m)(6) of the Exchange Act (added by Section 301 of the Sarbanes-Oxley Act).

[172] NYSE Listed Company Manual Section 303A.07(b)(iii)(H).

[173] NYSE Listed Company Manual Section 303A.07(b)(ii).

[174] NYSE Listed Company Manual Section 303A.07(b)(iii)(B); Item 407(d) of Regulation S-K.

discussion and analysis and the results of the independent auditor's review of the quarterly financial statements.[175]

3. Discuss with management and the independent auditor significant financial reporting issues and judgments made in connection with the preparation of the Company's financial statements, including any significant changes in the Company's selection or application of accounting principles.[176]

4. Review and discuss with management and the independent auditor any major issues as to the adequacy of the Company's internal controls, any special steps adopted in light of material control deficiencies and the adequacy of disclosures about changes in internal control over financial reporting.[177]

5. Review and discuss with management (including the senior internal audit executive) and the independent auditor the Company's internal controls report and the independent auditor's attestation report prior to the filing of the Company's Form 10-K.[178]

6. Review and discuss quarterly reports from the independent auditors on:[179]

   (a) all critical accounting policies and practices to be used;

   (b) all alternative treatments of financial information within U.S. generally accepted accounting principles (GAAP) that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditor;[180] and

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[175] NYSE Listed Company Manual Section 303A.07(b)(iii)(B).

[176] General commentary to NYSE Listed Company Manual Section 303A.07(b).

[177] General commentary to NYSE Listed Company Manual Section 303A.07(b).

[178] Implicit in the audit committee's responsibility to oversee a company's internal auditing functions is its review with management and the independent auditor of management's internal control report and the independent auditor's attestation of that report pursuant to Item 308 of Regulation S-K. *See* SEC Release No. 33-8238.

[179] Sarbanes-Oxley, Section 204(k).

[180] General commentary to NYSE Listed Company Manual Section 303A.07(b).

(c) other material written communications between the independent auditor and management, such as any management letter or schedule of unadjusted differences.[181]

7. Discuss with management the Company's earnings press releases, including the use of "*pro forma*" or "adjusted" non-GAAP information, as well as financial information and earnings guidance provided to analysts and rating agencies. Such discussions may be general (consisting of discussing the types of information to be disclosed and the types of presentations to be made), and each earnings release or each instance in which the Company provides earnings guidance need not be discussed in advance.[182]

8. Discuss with management and the independent auditor the effect of regulatory and accounting initiatives, as well as off-balance-sheet structures on the Company's financial statements.[183]

9. Discuss with management the Company's major financial risk exposures and the steps management has taken to monitor and control such exposures, including the Company's risk assessment and risk management policies.[184]

10. [Review and approve the Company's decision to enter into swaps and other derivatives transactions that are exempt from exchange-execution and clearing under "end-user exception" regulations established by the Commodity Futures Trading Commission; and review and approve the Company's policies governing the Company's use of swaps and other derivatives transactions subject to the end-user exception.][185]

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[181] Section 10A(k) of the Exchange Act (added by Section 204 of the Sarbanes-Oxley Act) requires registered public accounting firms to provide such reports on a timely basis; *see also* commentary to NYSE Listed Company Manual Section 303A.07(b)(iii)(F).

[182] NYSE Listed Company Manual Section 303A.07(b)(iii)(C) and the commentary thereto, and the general commentary to NYSE Listed Company Manual Section 303A.07(b).

[183] General commentary to NYSE Listed Company Manual Section 303A.07(b).

[184] NYSE Listed Company Manual Section 303A.07(b)(iii)(D) and the commentary thereto.

[185] To be included if the Audit Committee is selected to review and approve derivatives transactions under the Commodity Exchange Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, and the related regulations of the Commodity Futures Trading Commission. *See* Chapter VII, Section E "Increased Efforts on Financial Risks Oversight."

11. Discuss with the independent auditor the matters required to be discussed by Statement on Auditing Standards No. 114 relating to the conduct of the audit, including any difficulties encountered in the course of the audit work; any restrictions on the scope of activities or access to requested information; and any significant disagreements with management.[186]

12. Review disclosures made to the Audit Committee by the Company's CEO and CFO during their certification process for the Form 10-K and Form 10-Q about any significant deficiencies in the design or operation of internal controls or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Company's internal controls.[187]

13. Review management's use of non-GAAP measures and metrics (including environmental, social and governance measures and metrics), and in particular how these measures are used to evaluate performance, whether they are consistently prepared and presented and what the Company's disclosure controls and procedures relating to these are.

Oversight of the Company's Relationship with the Independent Auditor

14. Before the engagement of an independent auditor and at least annually thereafter, review and discuss with the independent auditor the independent auditor's written communications to the Audit Committee regarding the relationships between the auditor and the Company that, in the auditor's professional judgment, may reasonably be thought to bear on its independence and affirm in writing to the audit committee that the auditor is independent.[188]

15. Review and evaluate the lead partner of the independent auditor team.[189]

16. Obtain and review a report from the independent auditor at least annually regarding: (a) the independent auditor's internal quality-control procedures; (b) any material issues raised by the most recent

[186] Item 407(d) of Regulation S-K and NYSE Listed Company Manual Section 303A.07(b)(iii)(F).

[187] Exchange Act Rule 13a-14 (adopted by the Commission pursuant to Section 302 of the Sarbanes-Oxley Act) requires that the CEO and CFO certify in each 10-K and 10-Q that they have disclosed such information to a company's independent auditors and the audit committee.

[188] Item 407(d)(3)(i)(C) of Regulation S-K. SEC Release Nos. 33-8961; 34-5856 (September 26, 2008).

[189] Commentary to NYSE Listed Company Manual Section 303A.07(b)(iii)(A).

internal quality-control review, or peer review, of the independent auditor, or by any inquiry or investigation by governmental or professional authorities within the preceding five years respecting one or more independent audits carried out by the independent auditor; (c) any steps taken to deal with any such issues; and (d) all relationships between the independent auditor and the Company. Evaluate the qualifications, performance and independence of the independent auditor, including considering whether the independent auditor's quality controls are adequate and the provision of permitted non-audit services is compatible with maintaining the auditor's independence, taking into account the opinions of management and internal auditors. The Audit Committee shall present its conclusions with respect to the independent auditor to the Board.[190]

17. Ensure the rotation of the audit partners as required by law. Consider whether, in order to ensure continuing auditor independence, it is appropriate to adopt a policy of rotating the independent auditing firm on a regular basis.[191]

18. Set policies for the Company's hiring of employees or former employees of the independent auditor.[192]

19. Discuss with the independent auditor material issues on which the national office of the independent auditor was consulted by the Company's audit team.[193]

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[190] NYSE Listed Company Manual Section 303A.07(b)(iii)(A) and the commentary thereto.

[191] Commentary to NYSE Listed Company Manual Section 303A.07(b)(iii)(A). Section 10A(j) of the Exchange Act (added by Section 203 of the Sarbanes-Oxley Act) makes it unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner having primary responsibility for the audit, or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the five previous fiscal years of that issuer.

[192] NYSE Listed Company Manual Section 303A.07(b)(iii)(G). Section 10A(l) of the Exchange Act (added by Section 206 of the Sarbanes-Oxley Act) makes it unlawful for a registered public accounting firm to perform for an issuer any audit service if a CEO, comptroller, CFO, chief accounting officer or any individual serving in an equivalent position for the issuer was employed by that registered public accounting firm and participated in any capacity in the audit of that issuer during the one-year period preceding the date of initiation of the audit; Commission and PCAOB rules further expand upon the impact the hiring of employees or former employees of the independent auditor may have on the auditor's independence.

[193] Commentary to NYSE Listed Company Manual Section 303A.07(b)(iii)(F).

20. Meet with the independent auditor prior to the audit to discuss the planning and staffing of the audit.[194]

21. Engage in a dialogue with the independent auditor on the responsibilities of the auditor in relation to the audit, terms of the audit engagement, overview of the overall audit strategy and timing of the audit, and observations arising from the audit that are significant to the financial reporting process.[195]

22. Engage in a dialogue with the independent auditor to understand the nature of each identified critical audit matter, the auditor's basis for identifying a matter as a critical audit matter and how each such identified matter will be described in the auditor's report.[196]

Oversight of the Company's Internal Audit Function

23. Review the appointment and replacement of the senior internal auditing executive.[197]

24. Review the significant reports to management prepared by the internal auditing department and management's responses.[198]

25. Discuss with the independent auditor and management the internal audit department's responsibilities, budget and staffing, and any recommended changes in the planned scope of the internal audit.[199]

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[194] This is part of an audit committee's responsibility for having sole authority to retain the independent auditor and for approving all audit engagement fees and terms (*see* Rule 10A-3(b)(2) under the Exchange Act).

[195] Under PCAOB AS 1301, *Communications with Audit Committees*, the independent auditor is required to communicate certain matters to the audit committee about the conduct of the audit.

[196] Under PCAOB AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (June 1, 2017), the auditor is required to communicate information about CAMs in the auditor's report.

[197] NYSE Listed Company Manual Section 303A.07(c) requires each listed company to have an internal audit function, although it does not require companies to establish a separate internal audit department. A company may choose to outsource this function to a third-party service provider other than its independent auditor.

[198] This relates to one of an audit committee's principal purposes to assist board oversight of the performance of a company's internal audit function (*see* NYSE Listed Company Manual Section 303A.07(c)).

[199] Commentary to NYSE Listed Company Manual Section 303A.07(b)(iii)(F).

Compliance Oversight Responsibilities

26. Obtain from the independent auditor assurance that Section 10A(b) of the Exchange Act has not been implicated.[200]

27. Obtain reports from management, the Company's senior internal auditing executive and the independent auditor that the Company and its subsidiary/foreign affiliated entities are in conformity with applicable legal requirements and the Company's Code of Business Conduct and Ethics. Review reports and disclosures of insider and affiliated party transactions. Advise the Board with respect to the Company's policies and procedures regarding compliance with applicable laws and regulations and with the Company's Code of Business Conduct and Ethics.[201]

28. Establish procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.[202]

29. Discuss with management and the independent auditor any correspondence with regulators or governmental agencies and any published reports that raise material issues regarding the Company's financial statements or accounting policies.[203]

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[200] Section 10A(b) of the Exchange Act requires an independent auditor, if it detects or becomes aware of any illegal act, to assure that the audit committee is adequately informed and to provide a report if the independent auditor has reached specified conclusions with respect to such illegal acts.

[201] This relates to one of an audit committee's principal purposes to assist board oversight of the company's compliance with legal and regulatory requirements (*see* commentary to NYSE Listed Company Manual Sections 303A.07(b)(iii)(D) and 303A.07(b)(iii)(H)).

[202] Rule 10A-3(b)(3) under the Exchange Act requires listed company audit committees to establish such procedures.

[203] This relates to one of an audit committee's principal purposes to assist board oversight of the integrity of a company's financial statements (*see* general commentary to NYSE Listed Company Manual Section 303A.07(b)).

30. Discuss with the Company's General Counsel legal matters that may have a material impact on the financial statements or the Company's compliance policies and internal controls.[204]

31. Review and approve or ratify all related-party transactions in accordance with the Company's Policies and Procedures with respect to Related Person Transactions.[205]

32. Proactively engage with management and the independent auditor in the implementation of new accounting standards, including assessing whether sufficient time and resources have been devoted to develop sound accounting policies and whether appropriate controls and procedures have been established for the transition to the new standards.

Limitation of Audit Committee's Role

While the Audit Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Audit Committee to plan or conduct audits or to determine that the Company's financial statements and disclosures are complete and accurate and are in accordance with GAAP, applicable rules and regulations. These are the responsibilities of management and the independent auditor.[206]

[204] This relates to one of an audit committee's principal purposes to assist board oversight of the company's compliance with legal and regulatory requirements (*see* general commentary to NYSE Listed Company Manual Section 303A.07(b) and commentary to NYSE Listed Company Manual Section 303A.07(b)(iii)(H)).

[205]Commission rules mandate that companies disclose the persons or groups of persons on the board or otherwise who are responsible for applying the company's policies and procedures regarding related party transactions. Item 404 of Regulation S-K. Section 314 of the NYSE Listed Company Manual recommends that the audit committee or another independent body of the board be responsible for the review and oversight of related-party transactions. The term "related-party transaction" refers to transactions required to be disclosed pursuant to SEC Regulation S-K, Item 404.

[206] General commentary to NYSE Listed Company Manual Section 303A.07(b).

Exhibit B

MODEL AUDIT COMMITTEE CHARTER[207]
(Nasdaq-Listed Company)

Purpose

The Audit Committee is appointed by the Board of Directors (the "Board") to oversee the accounting and financial reporting processes of the Company and the audits of the Company's financial statements.[208] In that regard, the Audit Committee assists the Board in monitoring (1) the integrity of the financial statements of the Company, (2) the independent auditor's qualifications and independence, (3) the performance of the Company's internal audit function[209] and independent auditors, and (4) the compliance by the Company with legal and regulatory requirements.

The Audit Committee shall prepare the report required by the rules of the Securities and Exchange Commission (the "Commission") to be included in the Company's annual proxy statement.[210]

Committee Membership

The Audit Committee shall consist of no fewer than three members.[211] Each member of the Audit Committee shall meet the independence and experience requirements of the Nasdaq Listing Rulebook and the Securities Exchange Act of

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[207] Pursuant to Nasdaq Rule 5605(c)(1), each company must certify that it has adopted a formal written audit committee charter. *See also* Item 7(d) of Schedule 14A, Item 407(d) and Instruction 2 to Item 407 of Regulation S-K, pursuant to which the company must disclose in its annual proxy statement whether it has adopted a written charter for the audit committee and whether a current copy of the audit committee charter is available on the company's website (and, if so, the company's website address). If a current copy of the audit committee charter is not available on the company's website, a copy of the audit committee charter must be included as an appendix to the proxy statement at least once every three fiscal years, or if the charter has been materially amended since the beginning of the last fiscal year. If a current copy of the audit committee charter is not available on the company's website and is not being included in the company's proxy statement, the company must identify in which of the prior fiscal years the audit committee charter was so included.

[208] Nasdaq Rule 5605(c)(1)(C).

[209] Although Nasdaq does not require its listed companies to have an internal audit function, if an internal audit function exists at the listed company, it is appropriate for an audit committee to monitor its performance.

[210] *See* Item 407(d) of Regulation S-K and Item 7(d) of Schedule 14A.

[211] Nasdaq Rule 5605(c)(2)(A).

1934, as amended (the "Exchange Act").[212] All members of the Audit Committee shall be able to read and understand fundamental financial statements.[213] No member of the Audit Committee shall have participated in the preparation of the financial statements of the Company in the past three years.[214] At least one member of the Audit Committee shall be an "audit committee financial expert" as defined by the Commission.[215] However, one director who does not meet the Nasdaq definition of independence, but who meets the criteria set forth in Section 10A(m)(3) under the Exchange Act and the rules thereunder, and who is not a current officer or employee or a family member of such individual, may serve for no more than two years on the Audit Committee if the Board, under exceptional and limited circumstances, determines that such individual's membership is required by the best interests of the Company and its shareholders.[216] Such individual must satisfy the independence requirements set forth in Section 10A(m)(3) of the Exchange Act, and may not chair the Audit Committee. The use of this "exceptional and limited circumstances" exception, as well as the nature of the individual's relationship to the Company and the basis for the Board's determination, shall be disclosed in the annual proxy statement.[217]

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[212] Nasdaq Rule 5605(c)(2)(A) requires that each member of an audit committee be "independent" as defined by Nasdaq Rule 5605(a)(2), and not have participated in the preparation of the financial statements of the company or any current subsidiary of the company at any time during the past three years. Nasdaq Rule 5605(c)(2)(A) also provides that audit committee members must satisfy the independence requirements of Exchange Act Rule 10A-3(b) (subject to the exemptions provided in Rule 10A-3(c)). Exchange Act Rule 10A-3(b)(1) requires the NYSE and Nasdaq to prohibit the listing of any company unless each member of the audit committee is "independent," which is defined to mean that such individual may not, other than in his or her capacity as a member of the audit committee, the board, or any other board committee: (A) accept, directly or indirectly, any consulting, advisory, or other compensatory fee from the issuer or any subsidiary thereof, *provided* that, unless the rules of the national securities exchange or national securities association provide otherwise, compensatory fees do not include the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the listed issuer (*provided* that such compensation is not contingent in any way on continued service); or (B) be an affiliated person of the issuer or any subsidiary thereof.

[213] Nasdaq Rule 5605(c)(2)(A).

[214] Nasdaq Rule 5605(c)(2)(A)(iii). The Rule explains that "financial statements" includes a company's balance sheet, income statement and cash flow statement.

[215] *See* Item 407(d)(5) of Regulation S-K. Nasdaq Rule 5605(c)(2)(A) requires that at least one audit committee member have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background that results in the individual's financial sophistication, including being or having been a CEO, CFO or other senior officer with financial oversight responsibilities. The Nasdaq Interpretive Material states that this requirement will be deemed to be met by anyone who qualifies as an "audit committee financial expert" within the meaning of the Exchange Act Rules. *See* IM-5605-4.

[216] Nasdaq Rule 5605(c)(2)(B).

[217] Or, if the issuer does not file a proxy, in its Form 10-K or 20-F.

In addition, if an Audit Committee member ceases to be independent for reasons outside the member's reasonable control, his or her membership on the Audit Committee may continue until the earlier of the Company's next annual shareholders' meeting or one year from the occurrence of the event that caused the failure to qualify as independent.[218] If the Company is not already relying on this provision, and falls out of compliance with the requirements regarding Audit Committee composition due to a single vacancy on the Audit Committee, then the Company will have until the earlier of the next annual shareholders' meeting or one year from the occurrence of the event that caused the failure to comply with this requirement.[219] The Company shall provide notice to Nasdaq immediately upon learning of the event or circumstance that caused the non-compliance, if it expects to rely on either of these provisions for a cure period.

The members of the Audit Committee shall be appointed and may be replaced by the Board.

Meetings

The Audit Committee shall meet as often as it determines necessary, but not less frequently than quarterly. The Audit Committee shall meet periodically in separate executive sessions with management, the internal auditors and the independent auditor, and have such other direct and independent interaction with such persons from time to time as the members of the Audit Committee deem appropriate. The Audit Committee may request any officer or employee of the Company or the Company's outside counsel or independent auditor to attend a meeting of the Audit Committee or to meet with any members of, or consultants to, the Audit Committee. Written minutes of Audit Committee meetings shall be maintained.

Committee Authority and Responsibilities[220]

The Audit Committee shall have the sole authority to appoint, determine funding for, and oversee the outside auditors (subject, if applicable, to shareholder

[218] Nasdaq Rule 5605(c)(4)(A) provides this cure period for the independence requirement.

[219] Nasdaq Rule 5605(c)(4)(B) provides this additional cure period.

[220] Nasdaq Rule 5605(c)(3) provides that an audit committee must have the specific responsibilities and authority necessary to comply with Rules 10A-3(b)(2), (3), (4) and (5) under the Exchange Act (subject to the exemptions provided in Rule 10A-3(c)) concerning responsibilities relating to: (a) registered public accounting firms, (b) complaints relating to accounting, internal accounting controls or auditing matters, (c) authority to engage advisors and (d) funding as determined by the audit committee.

ratification).[221] The Audit Committee shall be directly responsible for the compensation and oversight of the work of the independent auditor (including resolution of disagreements between management and the independent auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work. The independent auditor shall report directly to the Audit Committee.[222]

The Audit Committee shall pre-approve all auditing services, internal control-related services and permitted non-audit services (including the range of fees and terms thereof) to be performed for the Company by the independent auditor, subject to the *de minimis* exception for non-audit services described in Section 10A(i)(1)(B) of the Exchange Act that are approved by the Audit Committee prior to the completion of the audit.[223] The Audit Committee shall review and discuss with the independent auditor any documentation supplied by the independent auditor as to the nature and scope of any tax services to be approved, as well as the potential effects of the provision of such services on the auditor's independence.[224] The Audit Committee may form and delegate authority to subcommittees consisting of one or more members when appropriate, including the authority to grant pre-approvals of audit and permitted non-audit services, *provided* that decisions of such subcommittee to grant pre-approvals shall be presented to the full Audit Committee at its next scheduled meeting.[225]

The Audit Committee shall have the authority, to the extent it deems necessary or appropriate, to engage and determine funding for independent legal, accounting or other advisors.[226] The Company shall provide appropriate funding, as determined by the Audit Committee, for payment of compensation to the independent auditor for the purpose of rendering or issuing an audit report or performing other audit, review or attest services for the Company and to any

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[221] Rule 10A-3(b)(2) under the Exchange Act requires the audit committee of each listed issuer to be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged (including resolution of disagreements between management and the independent auditor regarding financial reporting) for the purpose of preparing or issuing an audit report, or performing other audit, review or attest services for the listed issuer.

[222] Exchange Act Rule 10A-3(b)(2).

[223] Sections 10A(h) and 10A(i) of the Exchange Act (added by Sections 201 and 202 of the Sarbanes-Oxley Act) require such pre-approval with respect to services provided by the registered public accounting firms to its audit clients.

[224] This flows from PCAOB Rule 3524, PCAOB Release No. 2005-014 (July 26, 2005).

[225] Section 10A(i)(3) of the Exchange Act (added by Section 202 of the Sarbanes-Oxley Act).

[226] Rule 10A-3(b)(4) under the Exchange Act (adopted by the Commission pursuant to Section 301 of the Sarbanes-Oxley Act).

advisors employed by the Audit Committee, as well as funding for the payment of ordinary administrative expenses of the Audit Committee that are necessary or appropriate in carrying out its duties.[227]

The Audit Committee shall make regular reports to the Board. The Audit Committee shall review and reassess the adequacy of this charter annually and recommend any proposed changes to the Board for approval.[228]

The Audit Committee, to the extent it deems necessary or appropriate, shall:

Financial Statement and Disclosure Matters

1. Review and discuss with management and the independent auditor the annual audited financial statements, including disclosures made in management's discussion and analysis, and recommend to the Board whether the audited financial statements should be included in the Company's Form 10-K.[229]

2. Review and discuss with management and the independent auditor the Company's quarterly financial statements prior to the filing of its Form 10-Q, including disclosures made in management's discussion and analysis and the results of the independent auditor's review of the quarterly financial statements.[230]

3. Discuss with management and the independent auditor significant financial reporting issues and judgments made in connection with the preparation of the Company's financial statements, including any significant changes in the Company's selection or application of accounting principles.[231]

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[227] Exchange Act Rule 10A-3(b)(5).

[228] Nasdaq Rule 5605(c)(1). The company must certify that an audit committee will review and reassess the adequacy of the charter on an annual basis.

[229] Under Nasdaq Rule 5605(c)(1)(C), an audit committee must oversee the accounting and financial reporting processes of the company and the audits of the company's financial statements. *See also* Item 407(d) of Regulation S-K.

[230] This flows from Nasdaq's requirement that an audit committee oversee the audits of a company's financial statements. Nasdaq Rule 5605(c)(1)(C).

[231] This responsibility flows from Nasdaq's requirement that an audit committee oversee the accounting and financial reporting processes of a company.

4. Review and discuss with management and the independent auditor any major issues as to the adequacy of the Company's internal controls, any special steps adopted in light of material control deficiencies and the adequacy of disclosures about changes in internal control over financial reporting.[232]

5. Review and discuss with management (including the senior internal audit executive) and the independent auditor the Company's internal controls report and the independent auditor's attestation report prior to the filing of the Company's Form 10-K.[233]

6. Review and discuss quarterly reports from the independent auditors on:

   (a) all critical accounting policies and practices to be used;

   (b) all alternative treatments of financial information within U.S. generally accepted accounting principles (GAAP) that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditor;[234] and

   (c) other material written communications between the independent auditor and management, such as any management letter or schedule of unadjusted differences.[235]

7. Discuss with management the Company's earnings press releases, including the use of "*pro forma*" or "adjusted" non-GAAP information, as well as financial information and earnings guidance provided to analysts and rating agencies. Such discussion may be

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[232] *See* paragraphs 78-84 of Appendix A and paragraph C15 of Appendix C to PCAOB Release No. 2007-005A.

[233] Implicit in an audit committee's responsibility to oversee a company's internal auditing functions is its review with management and the independent auditor of management's internal control report and the independent auditor's attestation report pursuant to Item 308 of Regulation S-K.

[234] Rule 10A-3(b)(2) under the Exchange Act requires that an audit committee assume direct responsibility for the appointment, compensation, retention, termination and oversight of an independent auditor, *including* the resolution of disputes between management and the independent auditor regarding financial reporting.

[235] Section 10A(k) of the Exchange Act (added by Section 204 of the Sarbanes-Oxley Act) requires registered public accounting firms to provide such reports on a timely basis.

general (consisting of discussing the types of information to be disclosed and the types of presentations to be made).

8. Discuss with management and the independent auditor the effect of regulatory and accounting initiatives as well as off-balance sheet structures on the Company's financial statements.[236]

9. Discuss with management the Company's major financial risk exposures and the steps management has taken to monitor and control such exposures, including the Company's risk assessment and risk management policies.

10. [Review and approve the Company's decision to enter into swaps and other derivatives transactions that are exempt from exchange-execution and clearing under "end-user exception" regulations established by the Commodity Futures Trading Commission; and review and approve the Company's policies governing the Company's use of swaps and other derivatives transactions subject to the end-user exception.][237]

11. Discuss with the independent auditor the matters required to be discussed by Statement on Auditing Standards No. 114 relating to the conduct of the audit, including any difficulties encountered in the course of the audit work, any restrictions on the scope of activities or access to requested information, and any significant disagreements with management.[238]

12. Review disclosures made to the Audit Committee by the Company's CEO and CFO during their certification process for the Form 10-K and Form 10-Q about any significant deficiencies in the design or operation of internal controls or material weaknesses therein, and

[236] This flows from an audit committee's duty to oversee the accounting and financial reporting processes of a company and the audits of a company's financial statements (Nasdaq Rule 5605(c)(1)(C)).

[237] To be included if the Audit Committee is selected to review and approve derivatives transactions under the Commodity Exchange Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, and the related regulations of the Commodity Futures Trading Commission. *See* Chapter VII, Section E "Increased Efforts on Financial Risks Oversight."

[238] Item 407(d) of Regulation S-K.

any fraud involving management or other employees who have a significant role in the Company's internal controls.[239]

13. Ensure that a public announcement of the Company's receipt of an audit opinion that contains a going concern qualification is made promptly.[240]

14. Review management's use of non-GAAP measures and metrics (including environmental, social and governance measures and metrics), and in particular how these measures are used to evaluate performance, whether they are consistently prepared and presented and what the Company's disclosure controls and procedures relating to these are.

Oversight of the Company's Relationship with the Independent Auditor

15. Before the engagement of the independent auditor and at least annually thereafter, review and discuss with the independent auditor the independent auditor's written communications to the audit committee regarding the relationships between the auditor and the company that, in the auditor's professional judgment, may reasonably be thought to bear on its independence and affirming in writing to the audit committee that the auditor is independent.[241]

16. Review and evaluate the lead partner of the independent auditor team.[242]

17. Obtain and review a report from the independent auditor at least annually regarding: (a) the independent auditor's internal quality-control procedures; (b) any material issues raised by the most recent internal quality-control review or peer review of the independent

[239] Exchange Act Rule 13a-14 (adopted by the Commission pursuant to Section 302 of the Sarbanes-Oxley Act) requires that the CEO and CFO certify in each 10-K and 10-Q that they have disclosed such information to the company's independent auditors and the audit committee.

[240] Nasdaq Rule 5250(b)(2) provides that an issuer that receives an audit opinion containing a going concern qualification must make a public announcement through the news media disclosing the receipt of such qualification (and, prior to such public announcement, provide notice to Nasdaq's Market Watch Department). The public announcement must be made no later than seven calendar days following the filing of such an audit opinion with the Commission.

[241] Item 407(d)(3)(i)(C) of Regulation S-K. SEC Release Nos. 33-8961; 34-5856 (September 26, 2008).

[242] This flows from the audit committee's responsibility to oversee the external audit process under Nasdaq Rule 5605(c)(1)(C).

auditor, or by any inquiry or investigation by governmental or professional authorities within the preceding five years respecting one or more independent audits carried out by the independent auditor; and (c) any steps taken to deal with any such issues. Evaluate the qualifications, performance and independence of the independent auditor, including considering whether the independent auditor's quality controls are adequate and the provision of permitted non-audit services is compatible with maintaining the auditor's independence, and taking into account the opinions of management and internal auditors. The Audit Committee shall present its conclusions with respect to the independent auditor to the Board.[243]

18. Obtain from the independent auditor a formal written statement delineating all relationships between the independent auditor and the Company. It is the responsibility of the Audit Committee to actively engage in a dialogue with the independent auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the independent auditor and for purposes of taking, or recommending that the full Board take, appropriate action to oversee the independence of the outside auditor.[244]

19. Ensure the rotation of the lead (or coordinating) audit partner having primary responsibility for the audit and the audit partner responsible for reviewing the audit as required by law. Consider whether, in order to assure continuing auditor independence, it is appropriate to adopt a policy of rotating the independent auditor on a regular basis.[245]

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[243] This flows from an audit committee's responsibility to oversee the external audit process under Nasdaq Rule 5605(c)(1)(C).

[244] Nasdaq Rule 5605(c)(1)(B); Item 407(d) of Regulation S-K.

[245] Under Nasdaq Rule 5605(c)(3) and Exchange Act Rule 10A-3(b)(2), an audit committee must have sole authority for appointment, compensation and oversight of the independent auditor. Section 10A(j) of the Exchange Act (added by Section 203 of the Sarbanes-Oxley Act) makes it unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner, having primary responsibility for the audit, or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the five previous fiscal years of that issuer.

20. Recommend to the Board policies for the Company's hiring of employees or former employees of the independent auditor.[246]

21. Meet with the independent auditor prior to the audit to discuss the planning and staffing of the audit.[247]

22. Engage in a dialogue with the independent auditor on the responsibilities of the auditor in relation to the audit, terms of the audit engagement, overview of the overall audit strategy and timing of the audit, and observations arising from the audit that are significant to the financial reporting process.[248]

23. Engage in a dialogue with the independent auditor to understand the nature of each identified critical audit matter, the auditor's basis for identifying a matter as a critical audit matter and how each such identified matter will be described in the auditor's report.[249]

Oversight of the Company's Internal Audit Function

24. Review the appointment and replacement of the senior internal auditing executive.[250]

25. Review the significant reports to management prepared by the internal auditing department and management's responses.[251]

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[246] Section 10A(l) of the Exchange Act (added by Section 206 of the Sarbanes-Oxley Act) makes it unlawful for a registered public accounting firm to perform for an issuer any audit service if a CEO, comptroller, CFO, chief accounting officer or any individual serving in an equivalent position for the issuer was employed by that registered public accounting firm and participated in any capacity in the audit of that issuer during the one-year period preceding the date of initiation of the audit. Commission and PCAOB rules further expand upon the impact the hiring of employees or former employees of the independent auditor may have on the auditor's independence.

[247] This is part of an audit committee's responsibility for having sole authority to retain the independent auditor and for approving all audit engagement fees and terms (*see* Rule 10A-3(b)(2) under the Exchange Act).

[248] Under PCAOB AS 1301, *Communications with Audit Committees*, the independent auditor is required to communicate certain matters to the audit committee about the conduct of the audit.

[249] Under PCAOB AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (June 1, 2017), the auditor is required to communicate information about CAMs in the auditor's report.

[250] This flows from an audit committee's obligation to oversee the external audit of a company.

[251] This relates to one of an audit committee's principal purposes: to assist board oversight of the performance of a company's internal audit function.

26. Discuss with the independent auditor and management the internal audit department responsibilities, budget and staffing, and any recommended changes in the planned scope of the internal audit.[252]

Compliance Oversight Responsibilities

27. Obtain from the independent auditor assurance that Section 10A(b) of the Exchange Act has not been implicated.[253]

28. Obtain reports from management, the Company's senior internal auditing executive and the independent auditor that the Company and its subsidiary/foreign affiliated entities are in conformity with applicable legal requirements and the Company's Code of Business Conduct and Ethics. Advise the Board with respect to the Company's policies and procedures regarding compliance with applicable laws and regulations, and with the Company's Code of Business Conduct and Ethics.

29. Review and oversee all related-party transactions in accordance with the Company's Policies and Procedures with respect to Related Person Transactions.[254]

30. Establish procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.[255]

31. Discuss with management and the independent auditor any correspondence with regulators or governmental agencies, and any

[252] This flows from an audit committee's obligation to oversee the external audit of a company.

[253] Section 10A(b) of the Exchange Act requires the independent auditor, if it detects or becomes aware of any illegal act, to assure that the audit committee is adequately informed and to provide a report if the independent auditor has reached specified conclusions with respect to such illegal acts.

[254] Commission rules mandate that companies disclose the persons or groups of persons on the board or otherwise who are responsible for applying the company's policies and procedures regarding related-party transactions. Item 404 of Regulation S-K. Nasdaq Rule 5630(a) provides that each company that is not a limited partnership shall conduct appropriate review and oversight of all related-party transactions for potential conflict of interest situations on an ongoing basis by a company's audit committee or another independent body of the board. The term "related-party transaction" refers to transactions required to be disclosed pursuant to Commission Regulation S-K, Item 404.

[255] Nasdaq Rule 5605(c)(3) and Rule 10A-3(b)(3) under the Exchange Act.

published reports that raise material issues regarding the Company's financial statements or accounting policies.[256]

32. Discuss with the Company's General Counsel legal matters that may have a material impact on the financial statements or the Company's compliance policies.[257]

33. Proactively engage with management and the independent auditor in the implementation of new accounting standards, including assessing whether sufficient time and resources have been devoted to develop sound accounting policies and whether appropriate controls and procedures have been established for the transition to the new standards.

Limitation of Audit Committee's Role

While the Audit Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Audit Committee to plan or conduct audits, or to determine that the Company's financial statements and disclosures are complete and accurate and are in accordance with GAAP and applicable rules and regulations. These are the responsibilities of management and the independent auditor.

[256] This relates to one of an audit committee's principal purposes: to assist board oversight of the integrity of a company's financial statements (Nasdaq Rule 5605(c)(1)(C)).

[257] This relates to one of an audit committee's principal purposes: to assist board oversight of a company's compliance with legal and regulatory requirements.

Exhibit C

MODEL AUDIT COMMITTEE RESPONSIBILITIES CHECKLIST[258]

	Action	Frequency/Notes	Calendar
1.	Prepare the report required by the rules of the Securities and Exchange Commission (the "Commission") to be included in the Company's annual proxy statement.[259]	Annually	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
2.	The Audit Committee shall consist of no fewer than three members.[260]		☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
3.	The members of the Audit Committee shall meet the independence and experience requirements of the NYSE or Nasdaq (as applicable) , Section 10A(m)(3) of the Securities Exchange Act of 1934 (the "Exchange Act") and the rules and regulations of the Commission.[261]	Annually Review during Audit Committee self-evaluation	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
4.	At least one member of the Audit Committee shall be an "Audit Committee financial expert" as defined by the Commission.[262]	Annually Review during Audit Committee self-evaluation	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
5.	Audit Committee members shall not simultaneously serve on the Audit Committees of more than two other public companies.[263]	Annually Review of Audit Committee self-evaluation	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4

[258] The items in this responsibilities checklist are presented in the order in which they appear in the Model Audit Committee Charter under their respective headings; the numbers (in the first column) are provided for convenience only and do not correspond to any numbering in the Model Audit Committee Charter.

[259] NYSE 303A.07(b)(i)(B); Schedule 14A, Item 7(d); Regulation S-K, Item 407(d).

[260] NYSE 303A.07(a); Nasdaq 5605-4.

[261] Exchange Act 10A(m)(3); Nasdaq 5605(c)(2)(A) and 5605(a)(2). Nasdaq 5603-3 provides an exception which, in narrowly defined circumstances, allows one non-independent director on the audit committee "if the board, under exceptional and limited circumstances, determines that membership on the committee by the individual is required by the best interests of the Company and its Shareholders." The rule imposes additional disclosure requirements for such directors, and any member appointed under this exception may not serve longer than two years and may not serve as the audit committee chair.

[262] Regulation S-K 407(d)(5); NYSE 303A.07(a) Commentary; Nasdaq 5605(c)(2)(A) and Nasdaq IM-5605-4.

[263] NYSE 303A.07(a) Commentary.

	Action	Frequency/Notes	Calendar
6.	Meetings: The Audit Committee shall meet as often as it determines necessary, but not less frequently than quarterly.	At least quarterly	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
7.	Executive Sessions: The Audit Committee shall meet periodically in separate executive sessions with management (including the CFO and chief accounting officer), [the Company's personnel primarily responsible for the design and implementation of the internal audit function,][264] the internal auditors and the independent auditor, and have such other direct and independent interaction with such persons from time to time as the members of the Audit Committee deem appropriate.[265]	Quarterly	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
8.	Independent Auditor: The Audit Committee shall have the sole authority to appoint or replace the independent auditor (subject, if applicable, to shareholder ratification). The Audit Committee shall be directly responsible for the compensation and oversight of the work of the independent auditor (including resolution of disagreements between management and the independent auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work.[266]	Annually Appointment of independent auditor may be undertaken in conjunction with the preparation of the proxy statement	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
9.	Audit, non-Audit, and internal-control related services: The Audit Committee shall pre-approve all auditing services, internal control-related services and permitted non-audit services (including the range of fees and terms thereof) to be performed for the Company by its independent auditor, subject to the *de minimis*	As needed	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4

[264] To be included only if the Company does not yet have an internal audit function because it is availing itself of a transition period pursuant to NYSE 303A.00; Nasdaq 5605-2 recommends executive sessions "at least twice a year".

[265] NYSE 303A.07(b)(iii)(E); PCAOB Release No. 2005-001, paragraphs 24 and 57 of Appendix A and paragraph E68 of Appendix E; Nasdaq 5605(b)(2).

[266] NYSE 303A.06; SEC Rule 10A-3; SOX 301; Exchange Act 10A(m)(2); Rule 10A-3(b)(2).

	Action	Frequency/Notes	Calendar
	exception for non-audit services described in Section 10A(i)(1)(B) of the Exchange Act that are approved by the Audit Committee prior to the completion of the audit.[267]		
10.	Pre-approval of all audit, non-audit, and internal-control related services: The Audit Committee may form and delegate authority to subcommittees consisting of one or more members when appropriate, including the authority to grant pre-approvals of audit and permitted non-audit services, *provided* that decisions of such subcommittee to grant pre-approvals shall be presented to the full Audit Committee at its next scheduled meeting.[268]	As needed	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
11.	Make regular reports to the Board.[269]	Quarterly and as needed[270]	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
12.	The Audit Committee shall review the Audit Committee's own performance.[271]	Annually	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
13.	Meet to review and discuss with management and the independent auditor the annual audited financial statements, including the Company's specific disclosures made in management's discussion and analysis, and recommend to the Board whether the audited financial statements should be included in the Company's 10-K.[272]	Annually	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
14.	Meet to review and discuss with management and the independent auditor the Company's quarterly financial statements prior to the filing of its Form 10-Q, including the Company's specific disclosures made in management's discussion and analysis and the results of the	Quarterly	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4

[267] NYSE 303A.07(b)(iii); SOX 201 and 202; Exchange Act 10A(h) and 10A(i); SEC Release 33-8183; SEC Regulation S-X, Rule 2-01(c)(7); Schedule 14A Item 9(e)(5)(i) (proxy statement); Form 10-K, Item 14.

[268] Exchange Act 10A(i)(3).

[269] NYSE 303A.07(b)(iii)(H).

[270] This should also be a standing item on the Board calendar.

[271] NYSE 303A.07(b)(ii). Nasdaq 5605(c)(1) requires audit committees to annually review and reassess the adequacy of their charters.

[272] NYSE 303A.07(b)(iii)(B); Regulation S-K, Item 407(d); Nasdaq 5605(c)(3).

	Action	Frequency/Notes	Calendar
	independent auditor's review of the quarterly financial statements.[273]		
15.	Engage with management and the independent auditor in the implementation of new accounting standards, including assessing whether sufficient time and resources have been devoted to develop sound accounting policies and whether appropriate controls and procedures have been established for the transition to the new standards.	Quarterly and as needed	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
16.	Discuss with management and the independent auditor significant financial reporting issues and judgments made in connection with the preparation of the Company's financial statements, including any significant changes in the Company's selection or application of accounting principles.[274]	Quarterly in conjunction with the preparation of Form 10-Qs and Form 10-K Quarterly accounting reviews should cover critical accounting policies, significant accounting items and material entries based on management estimates and judgments	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
17.	Review and discuss with management and the independent auditor any major issues as to the adequacy of the Company's internal controls, any special steps adopted in light of material control deficiencies and the adequacy of disclosures about changes in internal control over financial reporting.[275]	Quarterly in conjunction with the preparation of Form 10-Qs and Form 10-K Present SOX 302 evaluation of disclosure controls and procedures Review report on SOX program	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
18.	Review and discuss with management (including the senior internal audit executive) and the independent auditor the Company's internal controls report and the independent auditor's attestation report prior to the filing of the Company's Form 10-K.[276]	Annually, in conjunction with the preparation of Form 10-K Present annual SOX 404 evaluation of internal controls	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4

[273] NYSE 303A.07(b)(iii)(B); Regulation S-K, Item 407(d); Nasdaq 5605(c)(3).

[274] NYSE 303A.07(b) (General commentary); PCAOB Release No. 2004-001, Parag. 58 of Appendix A and Parag. E68 of Appendix E; Nasdaq 5605(c)(3).

[275] NYSE 303A.07(b) (General commentary); PCAOB Release No. 2004-001, Parag. 206 of Appendix A.

[276] Regulation S-K Item 308; SEC Release 33-8183; PCAOB Release No. 2004-001, Parag. 59 of Appendix A and Parag. E61 of Appendix E.

	Action	Frequency/Notes	Calendar
19.	Review and discuss quarterly reports from the independent auditors on: (A) all critical accounting policies and practices to be used; (B) all alternative treatments of financial information within generally accepted accounting principles that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditor; and (C) other material written communications between the independent auditor and management, such as any management letter or schedule of unadjusted differences.[277]	Quarterly prior to the filing of Form 10-K and prior to the filing of each Form 10-Q To be included under the quarterly and year-end financial reporting and review	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
20.	Review management's use of non-GAAP measures and metrics (including environmental, social and governance measures and metrics), and in particular how these measures are used to evaluate performance, whether they are consistently prepared and presented and what the Company's disclosure controls and procedures relating to these are.	Quarterly and as needed	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
21.	Discuss with management the Company's earnings press releases, including the use of "*pro forma*" or "adjusted" non-GAAP information, as well as financial information and earnings guidance provided to analysts and rating agencies. Such discussions may be general (consisting of discussing the types of information to be disclosed and the types of presentations to be made), and each instance in which the Company provides earnings guidance need not be discussed in advance.[278]	Quarterly and as needed	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
22.	Discuss with management and the independent auditor the effect of regulatory and accounting	Quarterly and as needed	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4

[277] NYSE 303A.07(b) (General Commentary); NYSE 303A.07(b)(iii)(F); SOX 204; Exchange Act 10A(k).

[278] NYSE 303A.07(b)(iii)(C); NYSE 303A.07(c) (General Commentary).

	Action	Frequency/Notes	Calendar
	initiatives as well as off-balance sheet structures on the Company's financial statements.[279]	Quarterly accounting review should include critical accounting policies, significant accounting items and material entries based on management estimates and judgment at each quarterly meeting.	
23.	Discuss with management the Company's major financial risk exposures and the steps management has taken to monitor and control such exposures, including the Company's risk assessment and risk management policies.[280]	Quarterly and as needed Review risk management processes and reports (overall risk assessment, IT, audit, fraud, etc.)	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
24.	Discuss with the independent auditor the matters required to be discussed by Statement on Auditing Standards No. 114 relating to the conduct of the audit, including any difficulties encountered in the course of the audit work, any restrictions on the scope of activities or access to requested information, and any significant disagreements with management.[281]	At least annually, in conjunction with proxy statement, and, to the extent there are any difficulties or issues, quarterly follow-ups or updates	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
25.	Review disclosures made to the Audit Committee by the Company's CEO and CFO during their certification process for the Form 10-K and Form 10-Q about any significant deficiencies in the design or operation of internal controls or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Company's internal controls.[282]	Quarterly, in conjunction with the preparation of Form 10-Qs and Form 10-K	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
26.	Before the engagement of the independent auditor and at least annually thereafter, review and discuss with the independent auditor the independent auditor's written communications to	Annually, in conjunction with the preparation of the proxy statement; this should also be	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4

[279] NYSE 303A.07(b) (General Commentary).

[280] NYSE 303A.07(b)(iii)(D) and Commentary.

[281] NYSE 303A.07(b)(iii)(F); Regulation S-K, Item 407(d); Nasdaq 5605(c)(3).

[282] SOX 302; SEC Rule 13a-14.

	Action	Frequency/Notes	Calendar
	the audit committee regarding the relationships between the auditor and the Company that, in the auditor's professional judgment, may reasonably be thought to bear on its independence and affirming in writing to the Audit Committee that the auditor is independent.[283]	done prior to engaging the independent auditor	
27.	Review and evaluate the lead partner of the independent auditor team.[284]	Annually Review should be undertaken during an annual evaluation of overall audit services	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
28.	Obtain and review a report from the independent auditor at least annually regarding: (a) the independent auditor's internal quality-control procedures; (b) any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities within the preceding five years respecting one or more independent audits carried out by the firm; (c) any steps taken to deal with any such issues; and (d) all relationships between the independent auditor and the Company. Evaluate the qualifications, performance and independence of the independent auditor, including considering whether the auditor's quality controls are adequate and the provision of permitted non-audit services is compatible with maintaining the auditor's independence, taking into account the opinions of management and internal auditors. The Audit Committee shall present its conclusions with respect to the independent auditor to the Board.[285]	Annually	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
29.	Ensure the rotation of the audit partners as required by law. Consider whether, in order to ensure continuing auditor independence, it is	As needed	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4

[283] Item 407(d)(3)(i)(C) of Regulation S-K. SEC Release Nos. 33-8961 and 34-5856 (September 26, 2008).

[284] NYSE 303A.07(b)(iii)(A) and Commentary.

[285] NYSE 303A.07(b)(iii)(A) (Commentary).

	Action	Frequency/Notes	Calendar
	appropriate to adopt a policy of rotating the independent auditing firm on a regular basis.[286]	Review process for replacing the lead client partner; review and consider rotation of the independent audit firm	
30.	Set policies for the Company's hiring of employees or former employees of the independent auditor.[287]	Annually	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
31.	Discuss with the independent auditor material issues on which the national office of the independent auditor was consulted by the Company's audit team.[288]	Quarterly and as needed To be included under the quarterly and year-end financial reporting and review	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
32.	Meet with the independent auditor prior to the audit to discuss the planning and staffing of the audit.[289]	Annually Review the independent auditor's client service plan for the next fiscal year	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
33.	Engage in a dialogue with the independent auditor on the responsibilities of the auditor in relation to the audit, terms of the audit engagement, overview of the overall audit strategy and timing of the audit, and observations arising from the audit that are significant to the financial reporting process.[290]	Quarterly and as needed	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
34.	Engage in a dialogue with the independent auditor to understand the nature of each identified CAM, the auditor's basis for identifying a matter as a CAM and how each such identified matter will be described in the auditor's report.[291]	Quarterly and as needed	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4

[286] NYSE 303A.07(b)(iii)(A) (Commentary); Exchange Act 10A(j); SOX 203.

[287] NYSE 303A.07(b)(iii)(G); SOX 206; Exchange Act 10A(l); Nasdaq 5605(c)(3).

[288] NYSE 303A.07(b)(iii)(F) (Commentary); PCAOB Release No. 2004-001, Parag. 58 of Appendix A and Parag. E68 of Appendix E.

[289] NYSE 303A.07(b)(iii)(F) (Commentary); Exchange Act Rule 10A-3(b)(2); Nasdaq 5605(c)(3).

[290] PCAOB AS 1301, *Communications with Audit Committees*.

[291] PCAOB AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (June 1, 2017).

	Action	Frequency/Notes	Calendar
35.	Review the appointment and replacement of the senior internal auditing executive.[292]	Annually	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
36.	Review the significant reports to management prepared by the internal auditing department and management's responses.[293]	Quarterly Review should include findings of key audits and status of internal audit plan	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
37.	Discuss with the independent auditor and management the internal audit department's responsibilities, budget and staffing and any recommended changes in the planned scope of the internal audit or, if the Company does not as yet have an internal audit function, management's plans with respect to the responsibilities, budget and staffing of the internal audit function and the Company's plans for the implementation of the internal audit function.[294]	Annually and as needed	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
38.	Obtain from the independent auditor assurance that Section 10A(b) of the Exchange Act has not been implicated.[295]	Annually	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
39.	(A) Obtain reports from management and the Company's senior internal auditing executive and the independent auditor that the Company and its subsidiary/foreign affiliated entities are in conformity with applicable legal requirements and the Company's Code of Business Conduct and Ethics. (B) Review reports and disclosures of insider and affiliated party transactions. (C) Advise the Board with respect to the Company's policies and procedures regarding compliance with applicable laws and regulations and with the Company's Code of Business Conduct and Ethics.[296]	Quarterly and in conjunction with proxy statement	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4

[292] NYSE 303A.07(c).

[293] NYSE 303A.07(c); Nasdaq 5605(c)(3).

[294] NYSE 303A.07(b)(iii)(F); Nasdaq 5605(c)(3).

[295] Exchange Act 10A(b).

[296] NYSE 303A.10; Nasdaq 5630.

	Action	Frequency/Notes	Calendar
40.	Establish procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.[297]	Quarterly Receive reports on employee complaints, if any, on accounting and auditing matters	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
41.	Discuss with management and the independent auditor any correspondence with regulators or governmental agencies and any published reports that raise material issues regarding the Company's financial statements or accounting policies.[298]	Quarterly	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
42.	Discuss with the Company's General Counsel legal matters that may have a material impact on the financial statements or the Company's compliance policies and internal controls.[299]	Quarterly and as needed	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
43.	Review and approve or ratify all related party transactions in accordance with the Company's Policies and Procedures with respect to Related Person Transactions.[300]	Quarterly and as needed To be included under the quarterly and year-end financial reporting and review	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4
44.	Review the Company's risk management programs and internal corporate risk management reports.[301]	Quarterly and as needed	☐Q1 ☐ Q2 ☐ Q3 ☐ Q4

† The prohibitions on tax shelter advice, aggressive tax planning advice and tax services for certain corporate officers flow from the PCAOB's adoption of certain auditor independence and ethics rules in July 2005. *See* PCAOB Release No. 2005-014 (July 26, 2005).

[297] NYSE 303A.07(b)(iii); Nasdaq 5605(c)(3); SOX 301; Exchange Act 10A(m)(4); SEC Rule 10A-3(b).

[298] NYSE 303A.07(b) General Commentary; SOX 301; Exchange Act 10A(m)(4).

[299] NYSE 303A.07(b); NYSE 303A.07(b)(iii)(H); PCAOB Release No. 2004-001, Parag. 9, Section I.

[300] Regulation S-K Item 404; Nasdaq 5630.

[301] NYSE 303A.07(b)(iii)(D).

Exhibit D

MODEL AUDIT COMMITTEE MEMBER FINANCIAL EXPERTISE AND INDEPENDENCE QUESTIONNAIRE

The following questionnaire seeks information necessary to prepare the Company's annual report and proxy statement. The annual report and proxy statement will be filed with the Securities and Exchange Commission and made available to the public. Specifically, the information provided will be used to assist the Board of Directors of the Company in determining your level of financial expertise/literacy and independence within the meaning of the federal securities laws and the major securities markets listing standards for purposes of eligibility for service on the Audit Committee of the Board of Directors. **It is extremely important that your answers be complete and accurate. Accordingly, great care should be exercised in the completion of this questionnaire and the verification of any information about you that is provided herein.**

Please read the Instructions on Page D-3 before completing this questionnaire. Although the questionnaire is designed to be as direct as possible, certain questions, of necessity, require the use of technical terms. It is important that you understand the meaning of these terms before completing the questions. Definitions of such terms are provided in the Explanatory Note/Definitions on Page D-18. Please read the definitions before answering any question that includes one of these defined terms.

Please return your completed questionnaire to **[Name]** at the address below by **[Date]**. If you have questions regarding this questionnaire, please call **[Name]** at **[Number]**, **[Name]** at **[Number]** or **[Name]** at **[Number]**.

[Name]
[Title]
[Address]

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INSTRUCTIONS

1. Answer All Questions. Please answer fully and completely all questions that apply to you.

2. Date of Response. Your responses should be accurate as of **[Date]**. If you are unable to respond as of such date, please note why you are unable to do so and clearly indicate the date of the information included in your response.

3. Insufficient Space to Respond. If there is insufficient space to respond to any question in this questionnaire, please attach additional sheets of paper to this questionnaire as necessary.

4. Question Not Applicable. If the answer to any question is "No" or "Not Applicable," please so state. Should you fail to provide any answer, it will be assumed such answer is negative.

5. Defined Terms. Bolded and capitalized terms are defined in the Explanatory Note/Definitions (Page D-14).

QUESTIONNAIRE

1. Financial Expertise/Literacy

a. Do you have an understanding of generally accepted accounting principles (GAAP) and financial statements?

Yes ☐ No ☐

If your answer to Question 1.a is yes, please explain how you acquired the above understanding (include relevant positions, organizations, dates and job duties):

b. Do you have the ability to assess the general application of GAAP in connection with the accounting for estimates, accruals and reserves?[302]

Yes ☐ No ☐

If your answer to Question 1.b is yes, please explain how you acquired the above capability (include relevant positions, organizations, dates and job duties):

[302] In considering Question 1.b, please note that estimates, accruals and reserves need not be generally comparable to the estimates, accruals and reserves used in the Company's financial statements (*i.e.*, need not be in the same industry). It is the ability to assess, not experience applying, the accounting principles that is the focus of the question.

c. Do you have experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that generally are comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the Company's financial statements, or experience "**actively supervising**" one or more persons engaged in such activities?[303]

Yes ☐ No ☐

If your answer to Question 1.c is yes, please explain how you acquired the above experience (include relevant positions, organizations, dates and job duties):

d. Do you have an understanding of internal controls and procedures for financial reporting?

Yes ☐ No ☐

If your answer to Question 1.d is yes, please explain how you acquired the above understanding (include relevant positions, organizations, dates and job duties):

e. Do you have an understanding of audit committee functions?

Yes ☐ No ☐

If your answer to Question 1.e is yes, please explain how you acquired the above understanding (include relevant positions, organizations, dates and job duties):

[303] In considering Question 1.c, please note that the relevant experience can include working directly and closely with financial statements in a way that provides familiarity with their contents and the processes behind them. Experience also includes active engagement in industries the same as those engaged in by the Company and significant direct and close exposure to, and experience with, financial statements and related processes. A principal executive officer with considerable operations involvement, but little financial or accounting involvement, likely would not be exercising the necessary active supervision; your experience must be with financial statements that present the breadth and level of complexity of accounting issues generally comparable to the breadth and complexity of the accounting issues that can reasonably be expected to be raised by the Company's financial statements (although such experience need not be either in the same industry or with an Exchange Act reporting company).

f. Have you taken formal courses related to financial or accounting matters?

Yes ☐ No ☐

If your answer to Question 1.f is yes, please describe (include name of course, name of institution and dates):

g. Do you hold any degrees relating to financial or accounting matters?

Yes ☐ No ☐

If your answer to Question 1.g is yes, please describe (include degree, name of institution and date of graduation):

h. Have you taught any courses or published any books or articles relating to financial or accounting matters?

Yes ☐ No ☐

If your answer to Question 1.h is yes, please describe (include name of courses, name of institution, dates of teaching, names of books or articles, publisher and dates of publication):

i. Have you held any positions (such as CEO, CFO, controller, public accountant or auditor, principal accounting officer or any other position involving the performance of similar functions) that involved accounting, financial management or the analysis and interpretation of financial statements?

Yes ☐ No ☐

If your answer to Question 1.i is yes, please describe (include relevant positions, dates of positions and summary of duties of each position):

j. Have you invested in an enterprise that required you to analyze or interpret financial statements?

Yes ☐ No ☐

If your answer to Question 1.j is yes, please describe (include the relevant investments and descriptions of the analyses or interpretations you performed with respect to them):

k. Do you regularly read publications relating to financial or accounting matters?

Yes ☐ No ☐

If your answer to Question 1.k is yes, please describe (include content and length of time that you currently spend, and over the last five years have spent, on such activity):

l. Do you engage, or have you engaged, in any other activities that relate to financial or accounting matters?

Yes ☐ No ☐

If your answer to Question 1.l is yes, please describe:

m. Do you hold any financial or accounting-related professional certificates or licenses or are you a member in good standing of a financial or accounting-related professional association?

Yes ☐ No ☐

If your answer to Question 1.m is yes, please describe (include list of certificates and licenses, dates received and professional associations of which you are a member, including the length of time you have been a member in good standing of such associations):

n. Please describe any other relevant qualifications or experience that would assist you in understanding and evaluating the Company's financial statements and other financial information and other information that you believe would be appropriate for the Board of Directors of the Company to consider in determining your "**Financial Literacy**" or whether you are a "**Financial Expert**" within the meaning of the federal securities laws.

2. Independence

a. Since [insert first day of last fiscal year], have you accepted, directly or indirectly,[304] any consulting, advisory or other compensatory fee[305] from the Company or any of its subsidiaries, other than fees for services rendered as a member of the Company's Audit Committee, the Board of Directors or any other committee of the Board of Directors?

Yes ☐ No ☐

If your answer to Question 2.a is yes, please describe:

[304] "Indirect" acceptance of payments includes fees paid to your spouse, minor child or stepchild or a child or stepchild sharing a home with you. "Indirect" acceptance of payment also includes fees paid to an entity that provides accounting, consulting, legal, investment banking or financial advisory services to the company in which you are a partner, a member, an officer such as a managing director occupying a comparable position or executive officer, or you occupy a similar position (other than serving as a limited partner, non-managing member or similar position if, in each such case, you do not have an active role in providing services to the company).

[305] You do not need to report any compensation paid to you under a retirement plan (including deferred compensation) for prior service to the Company so long as that compensation is not contingent in any way on continued service.

b. Are you an "**affiliate**"[306] of the Company or any of its subsidiaries, other than in your capacity as a director of the Company? (Note: If you are not an executive officer or a holder of more than 10% of any class of the Company's voting securities, you should check "No.")

Yes ☐ No ☐

If your answer to Question 2.b is yes, please describe:

2A. Independence – NYSE-Listed Companies

a. Are you now or have you at any point been within the last three years an employee of the Company (references to "the Company" in this Section 2A include any parent or subsidiary in a consolidated group with the Company)?

Yes ☐ No ☐

b. Is any member of your immediate family, or has any such individual been within the last three years, an executive officer of the Company?[307]

Yes ☐ No ☐

c. Have you or any member of your immediate family received more than $120,000 during any 12-month period within the last three years in direct compensation (other than in director and committee fees and retirement or deferred pay for prior service (*provided* that such compensation is not contingent in any way on continued service) and compensation received by an immediate family

[306] You are an "affiliated person" of the Company if you, directly, or indirectly through one or more intermediaries, control, are controlled by, or are under common control with, the company. For purposes of this definition, "control" is defined as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of the company, whether through the ownership of voting securities, by contract or otherwise.

[307] For purposes of this question and the immediately following question, former service as an interim Chairman or CEO or other executive officer is not considered former service as an executive officer or employee of the company. If you are currently employed as an interim executive officer, you are considered a current executive officer and an employee of the company. Please separately disclose and describe in an attachment any former service to the company as an interim executive officer.

member for service as a non-executive employee) from the Company?[308]

Yes ☐ No ☐

d. Are you or any member of your immediate family currently a partner of a firm that is the Company's internal or external auditor?

Yes ☐ No ☐

e. Are you currently an employee of a firm that is the Company's internal or external auditor?

Yes ☐ No ☐

f. Is any member of your immediate family a current employee of a firm that is the Company's internal or external auditor and who participates in the firm's audit, assurance or tax compliance (but not tax planning) practice?

Yes ☐ No ☐

g. Have you or has any member of your immediate family been a partner or employee of a firm that is the Company's internal or external auditor and personally worked on the Company's audit within the past three years?

Yes ☐ No ☐

h. Have you or any member of your immediate family been employed within the last three years, or are you or any member of your immediate family currently employed, as an executive officer of another company where any of the Company's present executive officers at the same time served or serves on that company's compensation committee?

Yes ☐ No ☐

[308] Compensation you received for former service as an interim Chairman or CEO or other executive officer need not be included in the calculation, but please separately disclose and describe such compensation in an attachment.

i. Are you now a current employee, or is any member of your immediate family a current executive officer, of an enterprise that has made or received payments to or from the Company for property or services in an amount that, in any of the last three fiscal years, exceeds the greater of $1 million or 2% of the consolidated gross revenues of such enterprise?

Yes ☐ No ☐

2B. Independence – Nasdaq-Listed Companies

a.

i. Are you now or have you at any point within the past three years been an employee of the Company or any parent or subsidiary of the Company?[309]

Yes ☐ No ☐

ii. Have you or any member of your immediate family received during any 12-month period within the past three years more than $120,000 in direct compensation (other than in director and committee fees, payments arising solely from investments in the Company's securities, compensation paid to a family member who is a non-executive employee of the Company or an affiliate and tax-qualified retirement or non-discretionary pay)?[310]

Yes ☐ No ☐

iii. Is any member of your immediate family, or has any such individual been at any point within the past three years, an

[309] For purposes of this question, former service as an interim Chairman or CEO or other executive officer is not considered service as an employee of the Company as long as such interim employment did not last longer than one year. If you are currently employed as an interim executive officer, you are considered a current employee of the Company. Please separately disclose and describe in an attachment any former service to the Company as an interim executive officer.

[310] Compensation you received for former service as an interim Chairman or CEO or other executive officer need not be included in the calculation as long as such interim employment did not last longer than one year. Please separately disclose and describe in an attachment any compensation received while serving as an interim executive officer of the Company.

executive officer of the Company or any parent or subsidiary of the Company?

Yes ☐ No ☐

iv. Are you, or is any member of your immediate family, a partner in, a controlling shareholder of or an executive officer of an enterprise that makes or receives payments to or from the Company in the current or any of the past three fiscal years in an amount that exceeds the greater of $200,000 or 5% of the recipient's consolidated gross revenues in that fiscal year?[311]

Yes ☐ No ☐

v. Are you, or is any member of your immediate family, employed as an executive officer of another entity where at any time during the past three years any of the executive officers of the Company served on the compensation committee of such other entity?

Yes ☐ No ☐

vi. Are you, or is any member of your immediate family, a current partner of the Company's independent auditor, or were you or any member of your immediate family a partner or employee of the Company's independent auditor who worked on the Company's audit at any time during any of the past three years?

Yes ☐ No ☐

vii. Have you participated at any point within the past three years in the preparation of the financial statements of the Company or any current subsidiary of the Company?

Yes ☐ No ☐

[311] Payments arising solely from investments in the Company's securities or payments under non-discretionary charitable contribution matching programs need not be included in the calculation.

3. Membership on Boards and Board Committees

a. Other than the Company, list any **Entity** (including any publicly held company and investment company registered under the Investment Company Act of 1940) of which you are or have been a member of such **Entity**'s board of directors and the relevant dates for your service on such board of directors.

b. Other than the Company, list any **Entity** (including any publicly held company and investment company registered under the Investment Company Act of 1940) of which you are or have been a member of any committee (including audit committee) of such **Entity**'s board of directors and the relevant committees and dates for your service on any such committee.

c. If not described above, please list all the audit committees on which you currently serve or have been selected to serve in the future.

4. Other

a. Are you now or have you ever been the subject of any disciplinary action that could bear on your suitability as a Company Audit Committee member?

Yes ☐ No ☐

If your answer to Question 4.a is yes, please describe:

b. Please provide any other information that you believe would be appropriate for the Board of Directors of the Company to consider in determining whether you are independent within the meaning of the federal securities laws and major securities markets listing standards.

5. Name and Business Address

EXPLANATORY NOTE/DEFINITIONS

Active Supervision of a person who prepares, audits, analyzes or evaluates financial statements means:

(1) More than mere traditional hierarchical reporting relationship.

(2) Participation in, and contribution to, the process of addressing, at a supervisory level, the same general type of issues regarding preparation, auditing, analysis or evaluation of financial statements as those addressed by the person or persons being supervised.

(3) Experience that has contributed to the general expertise necessary to prepare, audit, analyze or evaluate financial statements that is at least comparable to the general expertise of those being supervised.

Affiliate means "a person that directly or indirectly, through one or more intermediaries, controls or is controlled by, or is under common control with" a specified person or Entity. Two persons or Entities will be deemed to be affiliates if, by reason of the foregoing definition, they are affiliates of the same person or Entity at the same time. The term "**Affiliate**" includes a subsidiary, sibling company, predecessor, parent company, or former parent company.

Entity means a partnership, joint venture, corporation, trust, limited liability company, company or business entity, or other organization, whether for profit or not-for-profit.

Financial Literacy includes the ability to read and understand fundamental financial statements, including a company's balance sheet, income statement, and cash flow statement.

Immediate Family or Immediate Family Member means an individual's spouse, parents, children, brothers and sisters, mothers- and fathers-in-law, sons- and daughters-in-law, brothers- and sisters-in-law, and anyone (other than employees) who shares such individual's home.

ATTESTATION

After reasonable investigation, I certify that, to the best of my information, knowledge and belief, the answers to these questions are true, correct and complete. I will promptly notify you of any change in the information set forth in this questionnaire after I become aware of any such change.

Signed: _____

Date: _____

Exhibit E

MODEL AUDIT COMMITTEE PRE-APPROVAL POLICY

I. STATEMENT OF PRINCIPLES

The Audit Committee must pre-approve the audit and non-audit services performed by the independent auditor in order to ensure that the provision of such services does not impair the auditor's independence. Before the Company or any of its subsidiaries engages the independent auditor to render a service, the engagement must be either:

(1) specifically approved by the Audit Committee; or

(2) entered into pursuant to this Pre-approval Policy.

The Audit Committee shall review and discuss with the independent auditor any documentation supplied by the independent auditor as to the nature and scope of any tax services to be approved, as well as the potential effects of the provision of such services on the auditor's independence.[312]

The appendices to this Pre-approval Policy describe in detail the particular audit, audit-related tax and other services that have the pre-approval of the Audit Committee pursuant to this Pre-approval Policy.[313] The term of any pre-approval is 12 months from the date of pre-approval, unless the Audit Committee specifically provides for a different period. The Audit Committee shall periodically revise the list of pre-approved services.

II. DELEGATION

The Audit Committee may delegate pre-approval authority to one or more of its members. The member or members to whom such authority is delegated shall report any pre-approval decisions to the Audit Committee at its next scheduled meeting. The Audit Committee may not delegate to management the Audit Committee's responsibilities to pre-approve services performed by the independent auditor.

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[312] This flows from PCAOB Rule 3524, PCAOB Release No. 2005-014 (July 26, 2005).

[313] The services listed in the appendices are for illustrative purposes only.

III. AUDIT SERVICES

The Audit Committee must specifically pre-approve the terms of the annual audit services engagement. The Audit Committee shall approve, if necessary, any changes in terms resulting from changes in audit scope, Company structure or other matters.

In addition to the annual audit services engagement approved by the Audit Committee, the Audit Committee may grant pre-approval for other audit services, which are those services that only the independent auditor reasonably can provide. The Audit Committee has pre-approved the audit services listed in Appendix A. All other audit services not listed in Appendix A must be specifically pre-approved by the Audit Committee.

IV. AUDIT-RELATED SERVICES

Audit-related services, including internal control-related services, are assurance and related services that are reasonably related to the performance of the audit or review of the Company's financial statements and/or the Company's internal control over financial reporting and that are traditionally performed by the independent auditor. The Audit Committee believes that the provision of audit-related services does not impair the independence of the auditor, and has pre-approved the audit-related services listed in Appendix B. All other audit-related services not listed in Appendix B must be specifically pre-approved by the Audit Committee.

V. TAX SERVICES

The Audit Committee believes that the independent auditor can provide tax services to the Company, such as tax compliance, tax planning and tax advice, without impairing the auditor's independence. However, the Audit Committee shall scrutinize carefully the retention of the independent auditor in connection with any tax-related transaction initially recommended by the independent auditor. The Audit Committee has pre-approved the tax services listed in Appendix C. All tax services not listed in Appendix C must be specifically pre-approved by the Audit Committee.

VI. OTHER SERVICES

The Audit Committee may grant pre-approval to those permissible non-audit services classified as other services that it believes would not impair the independence of the auditor, including those that are routine and recurring services.

The Audit Committee has pre-approved the other services listed in Appendix D. Permissible other services not listed in Appendix D must be specifically pre-approved by the Audit Committee.

A list of the Securities and Exchange Commission's (the "SEC") prohibited non-audit services is attached to this Pre-approval Policy as Exhibit 1. The rules of the SEC and the Public Company Accounting Oversight Board (PCAOB), and relevant guidance should be consulted to determine the precise definitions of these services and the applicability of exceptions to certain of the prohibitions.

VII. PRE-APPROVAL FEE LEVELS

The Audit Committee may consider the amount or range of estimated fees as a factor in determining whether a proposed service would impair the auditor's independence. Where the Audit Committee has approved an estimated fee for a service, the pre-approval applies to all services described in the approval. However, in the event the invoice in respect of any such service is materially in excess of the estimated amount or range, the Audit Committee must approve such excess amount prior to payment of the invoice. The Audit Committee expects that any requests to pay invoices in excess of the estimated amounts will include an explanation as to the reason for the overage.[314] The Company's independent auditor will be informed of this policy.

VIII. SUPPORTING DOCUMENTATION

With respect to each proposed pre-approved service, the independent auditor must provide the Audit Committee with detailed back-up documentation regarding the specific services to be provided.

IX. PROCEDURES

The Company's management shall inform the Audit Committee of each service performed by the independent auditor pursuant to this Pre-approval Policy.

[314] It is understood that estimated amounts that are denominated in dollars, but are ordinarily paid in another currency are subject to foreign exchange rate fluctuations. Thus, variances from estimated amounts arising as a result of changes in foreign currency exchange rates from the time of preparation of the relevant approval request will not be considered to be variances from the budgeted amount and payment of the related invoices will not require a subsequent approval.

Requests or applications to provide services that require separate approval by the Audit Committee shall be submitted to the Audit Committee by both the independent auditor and the [CFO, Treasurer or Controller[315]], and must include a joint statement as to whether, in their view, the request or application is consistent with the SEC's and the PCAOB's rules on auditor independence.

[315] Or other designated officer.

Appendix A

Pre-approved Audit Services for Fiscal Year 2022[316]

Dated: , 2022

Service	**Estimated Range of Fees**
Statutory audits or financial audits for subsidiaries or affiliates of the Company	
Services associated with SEC registration statements, periodic reports and other documents filed with the SEC or other documents issued in connection with securities offerings (*e.g.*, comfort letters, consents), and assistance in responding to SEC comment letters	
Consultations by the Company's management as to the accounting or disclosure treatment of transactions or events and/or the actual or potential impact of final or proposed rules, standards or interpretations by the SEC, PCAOB, FASB, or other regulatory or standard-setting bodies (Note: Under the SEC rules, some consultations may be "audit-related" services rather than "audit" services)	

[316] The services listed in these appendices are for illustrative purposes only and may not be applicable to a particular company.

Appendix B

Pre-Approved Audit-Related Services for Fiscal Year 2022

Dated: , 2022

Service	**Estimated Range of Fees**
Due diligence services pertaining to potential business acquisitions/dispositions	
Financial statement audits of employee benefit plans	
Agreed-upon or expanded audit procedures related to accounting and/or billing records required to respond to or comply with financial, accounting or regulatory reporting matters	
Consultations by the Company's management as to the accounting or disclosure treatment of transactions or events and/or the actual or potential impact of final or proposed rules, standards or interpretations by the SEC, PCAOB, FASB, or other regulatory or standard-setting bodies (Note: Under the SEC rules, some consultations may be "audit" services rather than "audit-related" services)	
Attest services not required by statute or regulation	

Appendix C

Pre-Approved Tax Services for Fiscal Year 2022

Dated: , 2022

Service	**Estimated Range of Fees**
U.S. federal, state and local tax planning and advice	
U.S. federal, state and local tax compliance	
International tax planning and advice	
International tax compliance	
Review of U.S. federal, state, local and international income, franchise and other tax returns	
Licensing **[or purchase]** of income tax preparation software[317] from the independent auditor, *provided* that the functionality is limited to preparation of tax returns	

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

Appendix D

Pre-approved Other Services for Fiscal Year 2022

Dated: , 2022

Service	**Estimated Range of Fees**

Exhibit 1

Prohibited Non-Audit Services

- 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
- Human resources
- Broker-dealer, investment adviser or investment banking services
- Legal services
- Expert services unrelated to the audit
- Any services entailing a contingent fee or commission (not including fees awarded by a bankruptcy court when the audit client is in bankruptcy)†
- Tax services to an officer of the audit client whose role is in a financial reporting oversight capacity (regardless of whether the audit client or the officer pays the fee for the services)†
- Planning or opining on the tax consequences of a "listed," (*i.e.*, tax avoidance) transaction†

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* Provision of these non-audit services is permitted if it is reasonable to conclude that the results of these services will not be subject to audit procedures. Materiality is not an appropriate basis upon which to overcome the rebuttable presumption that prohibited services will be subject to audit procedures because determining materiality is itself a matter of audit judgment.

† The prohibitions on tax shelter advice, aggressive tax planning advice and tax services for certain corporate officers flow from the PCAOB's adoption of certain auditor independence and ethics rules in July 2005. *See* PCAOB Release No. 2005-014 (July 26, 2005).

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

- Planning or opining on a transaction that is based on an "aggressive interpretation" of tax laws and regulations, if the transaction was recommended by the audit firm and a significant purpose of which is tax avoidance unless the proposed tax treatment is at least more likely than not to be allowed under current tax laws†

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† The prohibitions on tax shelter advice, aggressive tax planning advice and tax services for certain corporate officers flow from the PCAOB's adoption of certain auditor independence and ethics rules in July 2005. *See* PCAOB Release No. 2005-014 (July 26, 2005).

Exhibit F

MODEL POLICIES AND PROCEDURES WITH RESPECT TO RELATED PERSON TRANSACTIONS[318]

Introduction

The Board of Directors of the Company (the "Board") has adopted this Policy and the related procedures for the evaluation and approval, disapproval or ratification of Related Person Transactions (as defined below). This Policy is intended to establish a framework whereby such Related Person Transactions will be reviewed and approved or ratified by the Company's Audit Committee.[319]

Under this Policy, a Related Person Transaction shall be consummated or continued only if the Company's Audit Committee shall approve or ratify such transaction as in, or not inconsistent with, the best interests of the Company and its stockholders. This Policy is intended to augment and work in conjunction with other Company policies having code of conduct and/or conflict of interest provisions.

The Company's Audit Committee periodically shall review this Policy and may recommend to the Board amendments to this Policy from time to time as it deems appropriate.

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[318] Item 404(b) of Regulation S-K requires a Company to disclose its policies and procedures for the review, approval or ratification of any related person transaction required to be reported under Item 404(a) of Regulation S-K. Item 404(b) further provides that, while the material features of such policies and procedures will vary depending on the particular circumstances, examples of such features may include, in given cases, among other things: (1) the types of transactions covered; (2) the standards to be applied; and (3) the persons or groups of persons on the board or otherwise responsible for its application. The rule also provides that companies should disclose whether such policies and procedures are in writing and, if not, how such policies and procedures are evidenced.

[319] The Nasdaq marketplace and New York Stock Exchange (NYSE) rules require that the audit committee or another independent body of the board approve all related person transactions. *See* NYSE Listed Company Manual Section 314 and Nasdaq Rule 5630(a). As such, a company may allocate such authority to a body of independent directors other than the audit committee.

Definitions

For purposes of this Policy, a "Related Person" is:

1. Any Director or Executive Officer (as such terms are defined below) of the Company, and any individual who was a Director or Executive Officer of the Company at any time since the beginning of the last fiscal year.[320]

2. Any nominee for election as a Director of the Company.[321]

3. Any individual or entity known to the Company to be the beneficial owner of more than five percent (5%) of any class of the Company's voting securities.[322]

4. Any immediate family member of an individual identified in Items 1 through 3 above. An immediate family member would be any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law or sister-in-law of such individual, and any individual (other than a tenant or employee) sharing the household of such individual.[323]

For purposes of this Policy, a "Director" is a member of the Board, and an "Executive Officer" means an employee of the Company that is covered by Section 16a-1(f) of the Securities Exchange Act of 1934, as amended and in effect from time to time.

For purposes of this Policy, a "Related Person Transaction"[324] is any transaction, arrangement or relationship (or series of similar transactions, arrangements or relationships) in which the Company (or any of its subsidiaries)[325] is, was or will be a participant and the amount involved exceeds $120,000, and in

[320] Instruction 1.a(i) to Item 404(a) of Regulation S-K.

[321] Instruction 1.a(ii) to Item 404(a) of Regulation S-K.

[322] Instruction 1.b(i) to Item 404(a) and Item 403(a) of Regulation S-K.

[323] Instructions 1.a(iii) and 1.b(ii) of Item 404(a) of Regulation S-K.

[324] Please note that both the NYSE and Nasdaq rules define a "Related Person Transaction" by reference to the SEC's definition at 17 CFR § 229.404.

[325] SEC Release No. 33-8732A, Section V.A.1, text accompanying footnote 425.

which the Related Person had, has or will have a direct or indirect material interest,[326] other than:

(a) Employment relationships or transactions involving an Executive Officer and any related compensation solely resulting from such employment if (i) the compensation is required to be reported in the Company's annual proxy or (ii) the Executive Officer is not an immediate family member specified in subparagraph 4 in the definitions above and such compensation was approved, or recommended to the Board for approval, by the Compensation Committee of the Company.[327]

(b) Compensation for serving as a Director of the Company.[328]

(c) Payments arising solely from the ownership of the Company's equity securities in which all holders of that class of equity securities received the same benefit on a *pro rata* basis.[329]

(d) Indebtedness arising from ordinary-course transactions such as the purchases of goods and services at market prices, and indebtedness transactions with any individual or entity that is a Related Person only by virtue of subparagraph 3 in the Definitions above.[330]

(e) Transactions where the rates or charges are determined by competitive bids.[331]

(f) Transactions where the rates or charges are fixed in conformity with law or governmental authority in connection with the provision of services as a common or contract carrier or public utility.[332]

[326] Item 404(a) of Regulation S-K.

[327] Instruction 5 of Item 404(a) of Regulation S-K.

[328] Instruction 5 of Item 404(a) of Regulation S-K.

[329] Instruction 7.c of Item 404(a) of Regulation S-K.

[330] Instruction 4 of Item 404(a) of Regulation S-K.

[331] Instruction 7.a of Item 404(a) of Regulation S-K.

[332] Instruction 7.a of Item 404(a) of Regulation S-K.

(g) Ordinary course transactions involving the provision of certain financial services (*e.g.*, by a bank depository, transfer agent, registrar, trustee under a trust indenture or similar services).[333]

Review and Approval of Related Person Transactions

Management shall present to the Audit Committee of the Company the following information, to the extent relevant, with respect to actual or potential Related Person Transactions:[334]

1. *A general description of the transaction(s), including the material terms and conditions.*

2. *The name of the Related Person and the basis on which such individual or entity is a Related Person.*[335]

3. *The Related Person's interest in the transaction(s), including the Related Person's position or relationship with, or ownership of, any entity that is a party to or has an interest in the transaction(s).*[336]

4. *The approximate dollar value of the transaction(s), and the approximate dollar value of the Related Person's interest in the transaction(s) without regard to amount of profit or loss.*[337]

5. *In the case of a lease or other transaction providing for periodic payments or installments, the aggregate amount of all periodic payments or installments expected to be made.*[338]

6. *In the case of indebtedness, the aggregate amount of principal to be outstanding and the rate or amount of interest to be payable on such indebtedness.*[339]

7. *Any other material information regarding the transaction(s) or the Related Person's interest in the transaction(s).*[340]

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[333] Instruction 7.b of Item 404(a) of Regulation S-K.

[334] Section 34.00 of the NYSE Listed Company Manual requires review and pre-approval of related person transactions by the audit committee or a similar independent body of the board of directors.

[335] Item 404(a)(1) of Regulation S-K.

[336] Item 404(a)(2) of Regulation S-K.

[337] Item 404(a)(3)-(4) of Regulation S-K.

[338] Instruction 3.b of Item 404(a) of Regulation S-K.

[339] Item 404(a)(5) and Instruction 3.a of Item 404(a) of Regulation S-K.

[340] Item 404(a)(6) of Regulation S-K.

After reviewing such information, the disinterested members of the Audit Committee of the Company shall approve or disapprove such transaction. No member of the Audit Committee of the Company shall participate in the review, consideration or approval of any Related Person Transaction with respect to which such member or any member of his or her immediate family is a Related Person. Approval of such transaction shall be given only if it is determined by the Audit Committee of the Company that such transaction is in, or not inconsistent with, the best interests of the Company and its shareholders.

If any material information with respect to such transactions shall change subsequent to the Audit Committee of the Company's review of such transactions, management shall provide the Audit Committee of the Company with updated information at its next scheduled meeting.

In the event management becomes aware of a Related Person Transaction that has not been previously approved or ratified under this Policy, it shall be submitted to the Audit Committee of the Company promptly, and the Audit Committee of the Company shall review the Related Person Transaction in accordance with the criteria set forth in this Policy, taking into account all of the relevant facts and circumstances available to the Audit Committee of the Company. Based on the conclusions reached, the Audit Committee of the Company shall evaluate all options, including, without limitation, approval, ratification, amendment or termination of the Related Person Transaction or, with respect to any Related Person Transaction that is no longer pending or ongoing, rescission and/or disciplinary action. Any such determination by the Audit Committee of the Company shall be reported to the full Board.

In the event management determines it is impractical or undesirable to wait until the next meeting of the Audit Committee of the Company to approve a Related Person Transaction, the Chair of the Audit Committee of the Company may review and approve the Related Person Transaction in accordance with the criteria set forth herein. The Chair of the Audit Committee of the Company will report any such approval to the Audit Committee of the Company at its next regularly scheduled meeting.

The Audit Committee of the Company shall report all material Related Person Transactions it has reviewed to the full Board.

Exhibit G

MODEL EMPLOYEE COMPLAINT PROCEDURES FOR ACCOUNTING AND AUDITING MATTERS

Any employee of the Company may submit a good faith complaint regarding accounting or auditing matters to the management of the Company without fear of dismissal or retaliation of any kind. The Company is committed to achieving compliance with all applicable securities laws and regulations, accounting standards, accounting controls, and audit practices. The Company's Audit Committee will oversee treatment of employee concerns in this area.

In order to facilitate the reporting of employee complaints, the Company's Audit Committee has established the following procedures for (1) the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters (Accounting Matters), and (2) the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters.

Receipt of Employee Complaints

- Employees with concerns regarding Accounting Matters may report their concerns to the General Counsel of the Company.

- Employees may forward complaints on a confidential or anonymous basis to the General Counsel of the Company through a hotline, e-mail or regular mail to:

[CONTACT INFORMATION]

Scope of Matters Covered by These Procedures

These procedures relate to employee complaints relating to any questionable accounting or auditing matters, including, without limitation, the following:

- fraud or deliberate error in the preparation, evaluation, review or audit of any financial statement of the Company;

- fraud or deliberate error in the recording and maintaining of financial records of the Company;

- deficiencies in, or noncompliance with, the Company's internal accounting controls;

- misrepresentation or false statement to or by a senior officer or accountant regarding a matter contained in the financial records, financial reports or audit reports of the Company; or

- deviation from full and fair reporting of the Company's financial condition.

Treatment of Complaints

- Upon receipt of a complaint, the General Counsel of the Company will (1) determine whether the complaint actually pertains to Accounting Matters, and (2) when possible, acknowledge receipt of the complaint to the sender.

- Complaints relating to Accounting Matters will be reviewed under the Company's Audit Committee direction and oversight by the General Counsel of the Company, internal audit or such other persons as the Company's Audit Committee determines to be appropriate. Confidentiality will be maintained to the fullest extent possible, consistent with the need to conduct an adequate review.

- Prompt and appropriate corrective action will be taken when and as warranted in the judgment of the Company's Audit Committee.

- The Company will not discharge, demote, suspend, threaten, harass or in any manner discriminate against any employee in the terms and conditions of employment based upon any lawful actions of such employee with respect to good faith reporting of complaints regarding Accounting Matters or otherwise as specified in Section 806 of the Sarbanes-Oxley Act of 2002.

Reporting and Retention of Complaints and Investigations

- The General Counsel of the Company will maintain a log of all complaints, tracking their receipt, investigation and resolution, and shall prepare a periodic summary report thereof for the Company's Audit Committee. Copies of complaints and such log will be maintained in accordance with the Company's document retention policy.

Exhibit H

MODEL AUDIT COMMITTEE SELF-ASSESSMENT CHECKLIST

Topic	1 Strongly Disagree	2	3	4	5 Strongly Agree
Composition of the Audit Committee					
Audit Committee members have the necessary qualifications and financial and other expertise to meet the requirements of the Audit Committee charter.					
Audit Committee members understand their roles and responsibilities.					
Audit Committee members have sufficient time to devote to their responsibilities and are not "over-boarded".[341]					
The Audit Committee has the sufficient depth and breadth of industry and business experience to properly understand the risks facing the Company.					
Every member of the Audit Committee is independent in both form and appearance and annually confirms his or her independence to the Board.					
The Audit Committee members demonstrate strong interpersonal, team work, problem solving and critical thinking skills.					
The chair of the Audit Committee is an effective leader.					
Audit Committee members demonstrate integrity and trustworthiness.					
Audit Committee members participate in continuing education programs on relevant matters and there is an orientation program for new members.					
The Audit Committee has a succession and rotation program and annually considers changes in the composition of the Audit Committee.					

[341] NYSE prohibits serving on more than three public company audit committees. NYSE 303A.07(a) Commentary. Nasdaq does not have a similar requirement, but audit committees should nonetheless consider whether its members are too busy to handle the demands of serving on the committee.

Topic	1 Strongly Disagree	2	3	4	5 Strongly Agree
Audit Committee Meetings					
The Audit Committee meets at least quarterly.					
The Audit Committee meets periodically in separate executive sessions with management (including the chief financial officer and chief accounting officer), the internal auditors and the independent auditor and has the ability to have direct and independent interaction with such persons from time to time as the members of the Audit Committee deem appropriate.					
Written minutes of Audit Committee meetings are maintained.					
Committee Authority and Responsibilities					
The Audit Committee exercises effective oversight of the work of the independent auditor (including resolution of disagreements between management and the independent auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work.					
The Audit Committee exercises effective oversight over all auditing services, internal control-related services and permitted non-audit services (including the range of fees for and material terms of such services) to be performed for the Company by the independent auditor.					
The Audit Committee reviews and discusses with the independent auditor any documentation supplied by the independent auditor as to the nature and scope of any tax services to be approved, as well as the potential effects of the provision of such services on the auditor's independence.					
The Audit Committee has the ability to retain independent legal, accounting or other advisors.					
The Company provides appropriate funding to the Audit Committee for payment of compensation to the independent auditor and to any advisors employed by the Audit Committee, as well as funding for the payment of ordinary administrative expenses of the					

Topic	1 Strongly Disagree	2	3	4	5 Strongly Agree
Audit Committee that are necessary or appropriate in carrying out its duties.					
The Audit Committee makes regular reports to the Board.					
The Audit Committee annually reviews the Audit Committee's own performance.					
Audit Committee's Oversight of Financial Statements and Disclosure Matters					
The Audit Committee reviews, and has discussions with management and the independent auditor regarding, the annual audited financial statements and quarterly financial statements.					
The Audit Committee reviews, and has discussions with management and the independent auditor regarding, significant financial reporting issues and judgments made in connection with the preparation of the Company's financial statements.					
The Audit Committee reviews, and has discussions with management and the independent auditor regarding, any major issues as to the adequacy of the Company's internal controls, any special steps adopted in light of material control deficiencies and the adequacy of disclosures about changes in internal control over financial reporting.					
The Audit Committee reviews, and has discussion with management (including the senior internal audit executive) and the independent auditor regarding, the Company's internal controls report and the independent auditor's attestation report prior to the filing of the Company's Form 10-K.					
The Audit Committee reviews and has discussions on the quarterly reports from the independent auditors on: (a) all critical accounting policies and practices to be used; (b) all alternative treatments of financial information within U.S. generally accepted accounting principles (GAAP) that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditor; and					

Topic	1 Strongly Disagree	2	3	4	5 Strongly Agree
(c) other material written communications between the independent auditor and management, such as any management letter or schedule of unadjusted differences.					
The Audit Committee reviews, and has discussions with management regarding, the Company's earnings press releases, including the use of "*pro forma*" or "adjusted" non-GAAP information, as well as financial information and earnings guidance provided to analysts and rating agencies.					
The Audit Committee has discussions with management and the independent auditor regarding the effect of regulatory and accounting initiatives as well as off-balance sheet structures on the Company's financial statements.					
The Audit Committee has discussions with management about the Company's major financial risk exposures and the steps management has taken to monitor and control such exposures, including the Company's risk assessment and risk management policies.					
The Audit Committee has discussions with the independent auditor regarding the matters required to be discussed by Statement on Auditing Standards No. 114 relating to the conduct of the audit, including any difficulties encountered in the course of the audit work, any restrictions on the scope of activities or access to requested information, and any significant disagreements with management.					
The Audit Committee reviews disclosures made to the Audit Committee by the Company's CEO and CFO during their certification process for the Form 10-K and Form 10-Q about any significant deficiencies in the design or operation of internal controls or material weaknesses therein, and any fraud involving management or other employees who have a significant role in the Company's internal controls.					

Topic	1 Strongly Disagree	2	3	4	5 Strongly Agree
The Audit Committee reviews management's use of non-GAAP measures and metrics (including environmental, social and governance measures and metrics), and in particular how these measures are used to evaluate performance, whether they are consistently prepared and presented and what the Company's disclosure controls and procedures relating to these are.					
The Audit Committee has appropriate procedures in place to ensure that a public announcement of the Company's receipt of an audit opinion that contains a going concern qualification is made promptly.					
Oversight of the Company's Relationship with the Independent Auditor					
Before the engagement of the independent auditor and at least annually thereafter, the Audit Committee reviews and has discussions with the independent auditor about relationships between the auditor and the Company that, in the auditor's professional judgment, may reasonably be thought to bear on its independence and the audit committee receives a written affirmation from the auditor that it is independent and a formal written statement from the auditor delineating all relationships between the auditor and the Company.					
The Audit Committee reviews and evaluates the lead partner of the independent auditor team.					
The Audit Committee obtains and reviews a report from the independent auditor at least annually regarding: (a) the independent auditor's internal quality-control procedures; (b) any material issues raised by the most recent internal quality-control review or peer review of the independent auditor, or by any inquiry or investigation by governmental or professional authorities within the preceding five years respecting one or more independent audits carried out by the independent auditor; and (c) any steps taken to deal with any such issues.					

Topic	1 Strongly Disagree	2	3	4	5 Strongly Agree
The Audit Committee (a) evaluates the qualifications, performance and independence of the independent auditor, including considering whether the independent auditor's quality controls are adequate and the provision of permitted non-audit services is compatible with maintaining the auditor's independence, taking into account the opinions of management and internal auditors and (b) presents its conclusions with respect to the independent auditor to the Board.					
The Audit Committee actively engages in a dialogue with the independent auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the independent auditor.					
The Audit Committee ensures the rotation of the lead (or coordinating) audit partner having primary responsibility for the audit and the audit partner responsible for reviewing the audit as required by law.					
The Audit Committee periodically reviews the policies it has recommended to the Board for the Company's hiring of employees or former employees of the independent auditor.					
The Audit Committee meets with the independent auditor prior to the audit to discuss the planning and staffing of the audit.					
The Audit Committee engages in a dialogue with the independent auditor on the responsibilities of the auditor in relation to the audit, terms of the audit engagement, overview of the overall audit strategy and timing of the audit, and observations arising from the audit that are significant to the financial reporting process.					
The Audit Committee engages in a dialogue with the independent auditor to understand the nature of each identified CAM, the auditor's basis for identifying a					

Topic	1 Strongly Disagree	2	3	4	5 Strongly Agree
matter as a CAM and how each such identified matter will be described in the auditor's report.					
Oversight of the Company's Internal Audit Function					
The Audit Committee reviews the appointment and replacement of the senior internal auditing executive.					
The Audit Committee reviews the significant reports to management prepared by the internal auditing department and management's responses.					
The Audit Committee has discussions with the independent auditor and management regarding internal audit department responsibilities, budget and staffing, and any recommended changes in the planned scope of the internal audit.					
Compliance Oversight Responsibilities					
The Audit Committee obtains from the independent auditor assurance that Section 10A(b) of the Exchange Act has not been implicated.[342]					
The Audit Committee obtains reports from management, the Company's senior internal auditing executive and the independent auditor that the Company and its subsidiary/foreign affiliated entities are in conformity with applicable legal requirements and the Company's Code of Business Conduct and Ethics.					
The Audit Committee periodically reviews the advice it has given to the Board with respect to the Company's policies and procedures regarding compliance with applicable laws and regulations, and with the Company's Code of Business Conduct and Ethics.					
The Audit Committee reviews and oversees all related-party transactions in accordance with the Company's Policies and Procedures with respect to Related Person Transactions.					

[342] Section 10A(b) requires audit firms that become aware that an illegal act that has, or may have, occurred to determine whether the audited entity has taken appropriate remedial action and, if not, to report to the SEC under certain circumstances.

Topic	1 Strongly Disagree	2	3	4	5 Strongly Agree
The Audit Committee establishes procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submission by employees of concerns regarding fraud, questionable accounting or auditing matters.					
The Audit Committee has discussions with management and the independent auditor regarding any correspondence with regulators or governmental agencies, and any published reports that raise material issues regarding the Company's financial statements or accounting policies.					
The Audit Committee has discussions with the Company's General Counsel regarding legal matters that may have a material impact on the financial statements or the Company's compliance policies.					
The Audit Committee proactively engages with management and the independent auditor in the implementation of new accounting standards, including assessing whether sufficient time and resources have been devoted to develop sound accounting policies and whether appropriate controls and procedures have been established for the transition to the new standards.					
Overall					
The Audit Committee is functioning efficiently to meet its objectives.					