

BANKING ALERT

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A “Not-So-Short” Audit Committee Compliance Checklist

By David F. Scranton, Esq.

Since the enactment of the Sarbanes-Oxley Act of 2002 (SOX), bank and public-company audit committees have seen a huge expansion in the scope of their responsibilities. An audit committee member’s job has become more time-consuming and more complicated. How do we stay on top of these new requirements?

One way is to do a periodic check-up on your audit committee to ensure that the basic parts are in place and functioning well. This article gives you a checklist to help you spot areas for attention.

1. Check Your Corporate Governance Documents:

- What do your bylaws say about the audit committee? Are they consistent with your practices?
- Do you have an audit committee charter?
- Are your audit committee charter, bylaws, code of ethics, disclosure, whistleblower and other corporate governance policies consistent?
- Does your audit committee charter detail the extent to which your audit committee **IS** responsible for:
 - ✓ Appointment, performance review and removal of your independent auditors?
 - ✓ Appointment, performance review and removal of your internal auditors?
 - ✓ Appointment, performance review and removal of your compliance officer?
 - ✓ Review of annual and quarterly financial statements before distribution?
 - ✓ Review of the preliminary and final findings of your auditors?

- ✓ Review of internal control recommendations of management, internal and independent auditors?
- ✓ Review with management and the independent auditors of any significant changes in your company's selection or application of accounting principles?
- ✓ If your company is a reporting public company, review and discussion with management of all Section 302 and 906 certifications required by SOX?
- ✓ If your company is subject to SOX Section 404 (SOX 404), review of management's report on internal controls and the independent auditors' attestation on management's assertions as required by SOX 404?
- ✓ Review of regulatory examination reports and management's proposed responses?
- ✓ Review of securities disclosure documents before filing?
- ✓ Review of the integrity of your internal financial control and financial reporting?
- ✓ Review of your disclosure controls?
- ✓ Supervision and enforcement of your whistleblower policy?
- Does your audit committee charter detail the extent to which your audit committee is **NOT** responsible for:
 - ✓ The preparation of financial statements, which should be the responsibility of management?
 - ✓ Assuring compliance, which should be the responsibility of management?
 - ✓ Auditing your financial statements, which should be the responsibility of the internal and external auditors?
 - ✓ Certifying internal financial and disclosure controls, which is the responsibility of the CEO and CFO?
 - ✓ Overseeing the periodic securities disclosure process, which should be the responsibility

of management, possibly through a disclosure committee?

- Do your corporate governance documents require all audit committee members to be independent?

2. Check Your Audit Committee Practices:

- Do any officers or non-independent board members regularly attend audit committee meetings? If so, you should consider special procedures.
- Does your audit committee meet at least quarterly?
- Do your external audit, internal audit and compliance functions report directly to the audit committee?
- Have you developed audit committee meeting calendars and agendas to keep track of audit committee compliance deadlines?
- Does your audit committee **REGULARLY** meet separately in executive sessions with:
 - ✓ Individual members of senior management?
 - ✓ The internal audit staff?
 - ✓ The independent auditors?
 - ✓ The independent directors?
- Does your audit committee keep minutes of its meetings?
- Have you had your audit committee minutes reviewed for appropriate content and form?
- Have you adopted a policy relating to the keeping or disposal of individual notes by directors relating to board or audit committee meetings?
- Have you reviewed any applicable record retention requirements as they apply to audit committee documents?
- Are your audit committee minutes regularly reviewed and approved by the full board, and does your audit committee otherwise report regularly to the full board?

- Have you reviewed and benchmarked your audit committee director fees to be sure they are appropriate in relation to the members' responsibilities?
- Has your audit committee charter been reviewed and updated since 2002?
- Do you review your corporate governance documents and audit committee practices at least once a year?

3. Check Audit Committee Members' Knowledge Base?

- Do all members of the audit committee have a working familiarity with basic finance and accounting practices?
- Does at least one audit committee member qualify as a "financial expert"?
- Do you provide suitable continuing education to each audit committee member each year?

4. Check How You Manage Relationships with Independent Auditors:

- Does your audit committee obtain an independence letter from the independent auditors every year before engaging them?
- Does your audit committee require your independent auditors to disclose and discuss all relationships between the independent auditors and the company?
- Are auditors' engagement letters addressed to the audit committee and signed by a member of the audit committee?
- If you are a reporting company under the Securities Exchange Act of 1934, has your audit committee confirmed that your independent auditing firm is registered with the Public Company Accounting Oversight Board (PCAOB), and has the audit firm formally confirmed that it is in compliance with the PCAOB rules and is in good standing with the PCAOB?

- Does your audit committee discuss with your independent auditors, at least annually, and note in the audit committee minutes any disclosed relationships or services that may impact or appear to impact the objectivity and independence of the auditors?
- Does your audit committee obtain and review, each year, a management letter from the independent accountants, detailing any issues identified by the auditors and recommending changes in financial accounting practices or controls?
- Does your audit committee annually review the scope of audit services and the audit fees in relation to industry peers?

5. Check Your Audit Committee's Management of Non-Audit Services:

- Does your audit committee review and approve in advance all permitted non-audit services to be provided by your independent auditors?
- Has your audit committee established procedures and policies for approving and monitoring non-audit services by your independent accountants?
- Does your audit committee review payments you make to accounting firms for all services (whether audit or non-audit)?

6. Check Your Whistleblower Policy:

- Has your audit committee established procedures for the receipt, retention and treatment of complaints received by the issuer regarding accounting, internal accounting controls or auditing matters?
- Has your audit committee established procedures for the confidential, anonymous submission by your employees of concerns regarding questionable accounting or auditing matters?
- Are members knowledgeable about the audit committee's authority to engage independent

counsel and other advisers, as it determines necessary to carry out its duties?

- Are members knowledgeable about your company's obligation to provide appropriate funding for the audit committee's independent advisers?
- Is your audit committee and your management familiar with the Occupational Safety and Health Administration's whistleblower regulations adopted under SOX?

7. Check Other Stock Exchange Requirements:

- Are all audit committee members able to read and understand financial statements at the time of their appointment, and is your audit committee chair financially sophisticated?
- Does your audit committee perform an annual self-evaluation?
- Has your audit committee established clear hiring policies, compliant with governing laws or regulations, for employees or former employees of your present or former independent auditors?
- Does your audit committee hold regular and timely discussions with your independent auditors about all alternative treatments of financial information within Generally Accepted Accounting Principles (GAAP) that have been discussed with management, ramifications of the use of such alternative disclosure and treatments, and the treatment preferred by the independent auditors?
- Does your audit committee hold regular and timely discussions with your independent auditors about other material written communications between the independent auditors and management, including the management letter and schedule of unadjusted differences?
- Does your audit committee meet quarterly with management and the independent auditors to discuss the annual audited financial statements and quarterly financial statements, including the company's disclosures under "Management's

Discussion and Analysis of Financial Condition and Results of Operations"?

- Does your audit committee review and discuss with management all earnings press releases, including pro forma or adjusted non-GAAP information, and other financial information or earnings guidance given to analysts and rating agencies?
- Does your audit committee review with management major issues regarding accounting principles and financial statement presentations, the adequacy of the company's internal controls, and any special audit steps adopted in light of material control deficiencies?
- Does your audit committee review analyses prepared by management setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements?
- Does your audit committee review with management the effect of regulatory and accounting initiatives, as well as off-balance sheet structures, on the financial statements of the company?
- Does your audit committee review and give prior approval to all related-party transactions?
- Does your audit committee discuss your company's major financial and accounting risk exposures with management, as well as the steps management has undertaken to control them?



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