Audit Committee Duties and "Best Practices"

March 21, 2002
Audit Committee Duties and "Best Practices"

Public and regulatory attention is focused on the adequacy of public company corporate governance procedures. As a result, this is a good time to evaluate the duties of your audit committee and how well the committee is satisfying its responsibilities. This memorandum outlines applicable legal requirements and presents some audit committee “best practices” for your consideration.

We cover the following topics in this memo:

- Basic Standards of Conduct
  - Fiduciary Duties and Certain Duties Under Federal Securities Laws
  - Exposure to Liability
- Audit Committee Members
  - Independence
  - Financial Literacy
  - Other Important Qualities
  - Additional Considerations
- Principal Functions of the Audit Committee
  - Best Practices - Monitoring the Accounting and Financial Reporting Processes and Systems of Internal Control
  - Best Practices - Monitoring External Auditors
- Audit Committee Charter and Proxy Statement Disclosures

Basic Standards of Conduct

Fiduciary Duties and Certain Duties Under Federal Securities Laws

State corporate laws set forth standards of conduct that apply to members of a corporation’s Board of Directors. The two primary duties of directors are the duty of loyalty and the duty of care. The duty of loyalty requires that directors act in good faith and not in furtherance of their own personal interests at the expense of the company. The duty of care requires that directors take reasonable care and be prudent in managing the affairs of the corporation.

The federal securities laws may also effectively impose duties on members of a corporation’s Board of Directors. In general, the federal securities laws are designed to require disclosure of information to investors. These laws have not historically been focused
on addressing the management responsibilities of a company's representatives. However, the SEC has expressed its views that the Board has an affirmative duty to oversee the conduct and performance of management aggressively and ensure that the company's public statements are candid and complete.

Audit committees help to ensure that the members of the Board of Directors satisfy their duties of care with respect to the adequacy of the company's financial reporting processes. Audit committees also help the Board by overseeing the conduct and performance of management with respect to the preparation of the company's financial statements and financial disclosures.

Day-to-day responsibilities regarding the company's financial statements and reporting processes are generally delegated to the company's management and finance staff. In addition, the company engages independent auditors as experts to audit the financial statements and review the company's financial reporting processes and internal controls. Audit committees generally oversee and monitor the preparation of the company's financial statements by evaluating information obtained from management, the independent auditors and other sources. As explained by The Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees in its 1999 report:

"In its oversight capacity, the audit committee is neither intended nor equipped to guarantee with certainty to the full Board and shareholders the accuracy and quality of a company's financial statements and accounting practices. Proper financial reporting, accounting, and audit functions are collaborative efforts conducted by full-time professionals dedicated to these purposes. The audit committee, as the first among equals, oversees the work of the other actors in the financial reporting process - management, including the internal auditor, and the outside auditors - to endorse the processes and safeguards employed by each. In particular, the audit committee should encourage procedures that promote accountability among these players, ensuring that management properly develops and adheres to a sound system of internal control, that the internal auditor objectively assesses management's accounting practices and internal controls, and that the outside auditors, through their own review, assess management and the internal auditor's practices."

As with corporate governance in general, the audit committee's role has come under scrutiny in recent years. In response, both the minimum qualification requirements for audit committee membership and the required public disclosure about audit committee processes have increased. In light of Enron and similar situations, scrutiny of audit committee performance is likely to increase, so it is more important than ever to ensure that audit committees are satisfying at least the basic standards of conduct.
Exposure to Liability

Under state corporate law, the "business judgment" rule can protect members of the Board from liability. Under the business judgment rule, the Board’s decisions are generally respected, absent bad faith or self-dealing, if members of the Board inform themselves of all material information reasonably available to them prior to making their decisions. This includes overseeing the implementation of procedures that will provide the company with adequate corporate information in order to allow its representatives to make informed judgments and that will provide the company with adequate reporting systems. Failure to satisfy this minimum standard of care can result in liability of the directors for breach of their fiduciary duties.

In addition to liability for breach of state corporate law duties, members of the Board of Directors also face liabilities under the federal securities laws. For example, directors may be liable for material misstatements and omissions in a registered securities offering, unless they can satisfy a "due diligence" defense. Another example of potential securities law liability is fraud liability under Rule 10b-5. The antifraud provisions of the federal securities laws cover statements made by the company in all sorts of communications, including routine communications to investors and periodic filings made by the company with the SEC. Note that the business judgment rule does not protect directors from liability under the securities laws. Liability can arise through an enforcement action from the SEC or through a private plaintiff’s action. Potential remedies can include money damages and penalties, imprisonment (if the fraud is significant enough to warrant criminal prosecution), an SEC cease-and-desist order and injunctions, including being barred from service as an executive officer or director of other publicly traded companies. Securities fraud liability generally depends on the extent of the directors’ knowledge of and participation in the fraudulent conduct. However, reckless conduct may also be sufficient to create liability.

Standards of liability under the securities laws are often different for outside directors from those for inside directors, since outside directors generally do not have access to the same amount of information as inside directors, and do not exercise the same level of control over the company. While the SEC has recognized that outside directors may find it difficult to perform their duties if management seeks to withhold necessary information, the SEC expects that outside directors must nevertheless take steps to remain informed of the corporation’s activities.

It is possible that some courts may in certain circumstances apply higher standards of conduct to members of the audit committee than to other outside directors, given the audit committee’s responsibilities and access to information. As a result, audit committee members may face greater liability in certain circumstances as a result of their service on the audit committee.

Based on the standards described above, audit committee members can minimize their exposure to liability if they oversee implementation of procedures designed to provide them
with adequate information about the company’s financial statements and financial disclosures and if they carefully review those financial statements and financial disclosures in light of that information and other information that is reasonably available. Audit committee members should be proactive and not passive in carrying out their responsibilities. Specific “best practices” suggestions to achieve these objectives are set forth below.

Audit Committee Members

One of the most important aspects of establishing and maintaining an effective audit committee is to make sure that the audit committee members are well-suited to perform their duties. The following sections set forth the current requirements for audit committee members and related considerations.

Independence

For Nasdaq and New York Stock Exchange companies, the audit committee must contain a minimum of three directors, each of whom is "independent" and financially literate. A director is considered “independent” if he or she has no relationship to the company that would interfere with the exercise of independent judgment in carrying out his or her responsibilities. The following directors are not deemed to be independent and therefore may not serve on the company’s audit committee:

- current employees of the company or its affiliates;
- individuals who have been employees of the company or its affiliates in any of the prior three fiscal years;
- immediate family members of a person currently employed as an executive officer of the company or its affiliates or who has been employed in such a capacity within the past three fiscal years;

---

1 NASD Marketplace Rule 4350(d)(5)(B) and NYSE Listing Standard 303.02(D) each permit one member who is not independent (as long as he is not a current employee or an immediate family member of a current executive officer) to serve on the audit committee in “exceptional and limited circumstances.” The Nasdaq rules also make certain exceptions for small business issuers.

2 See NASD Marketplace Rule 4200(a)(14) and NYSE Listing Standard 303.01(B)(2)(a).

3 See NASD Marketplace Rule 4200(a)(14) and NYSE Listing Standard 303.01(B)(3) for precise descriptions of individuals not considered independent.
• directors who have had certain prohibited business relationships with the
  company in the prior three fiscal years;\(^4\) and
• directors employed as executives of another entity where any of the company's
  executives serve on that entity's compensation committee (cross-compensation
  committee links).

Financial Literacy
In addition, each member of the audit committee must be able to read and understand
fundamental financial statements, including the company’s balance sheet, income
statement and statement of cash flows. At least one member of the audit committee must
also have employment experience in finance or accounting, requisite professional
certification in accounting or comparable experience or background with financial oversight
responsibilities.\(^5\) These financial literacy requirements place the audit committee in a better
position to supervise the company's financial reporting processes.

Other Important Qualities
To be effective, audit committee members should also be:

• prepared to devote a significant amount of time to service on the audit committee;
• able, and willing, to inform themselves about the company and its industry so that
  they can thoughtfully and objectively analyze the company's financial reporting
  processes, financial statements and financial disclosures; and
• willing to ask tough, probing questions of management, the internal audit
department (if the company has one) and the independent auditors regarding
  these matters and to be persistent in getting adequate answers to their questions.

Best Practices —Additional Considerations
We recommend that the Board evaluate the following additional considerations when
determining how to increase audit committee member independence and financial literacy:

• implementing training and education programs to ensure that audit committee
  members remain current on recent accounting and finance developments;

---

\(^4\) For Nasdaq companies, these relationships include the following: (i) relationships from which the director
receives more than $60,000 in compensation during the prior fiscal year, excluding compensation for board
service, benefits under tax-qualified retirement plans and non-discretionary compensation; and (ii) relationships
where the director is a partner in, or a controlling shareholder or an executive officer of, any for-profit business
organization to which the company made, or from which the company received, payments (other than those
arising solely from investments in the company’s securities) that exceed 5% of the company’s or business
organization’s consolidated gross revenues for that year, or $200,000, whichever is more, in any of the prior
three fiscal years.

\(^5\) NASD Marketplace Rule 4350(d)(2)(A). NYSE Listing Standard 303.01(B)(2) is similar, but allows the Board
flexibility to decide these qualifications in the exercise of its business judgment.
increasing the number of audit committee members to include more than the minimum number required by Nasdaq and the NYSE;

prohibiting directors who are not considered “independent” from serving on the audit committee, even if permissible under “exceptional and limited” circumstances;

avoiding even the appearance of impropriety by making certain that no member of the audit committee has any business or family relationship with the company or its management team, other than as a director;

distributing to potential audit committee members a written description of the qualifications, responsibilities and time commitments expected;

considering whether it is advisable to limit the term of audit committee members;

evaluating whether audit committee members are receiving an appropriate level of compensation given their responsibilities;

evaluating whether the company’s charter, bylaws and director indemnification agreements provide adequate protections for audit committee members; and

evaluating whether the company’s D&O insurance policy provides adequate coverage to audit committee members.

Principal Functions of the Audit Committee

The audit committee assists the Board in fulfilling its statutory and fiduciary oversight responsibilities relating to the company’s financial accounting, reporting and controls. Its principal functions are to:

- monitor the periodic reviews of the accounting and financial reporting processes and systems of internal control that are conducted by the company’s independent auditors, financial and senior management and internal auditing department (if the company has one); and
- review and evaluate the independence and performance of the company’s independent auditors.

In performing these oversight functions, the Board and audit committee should seek to oversee the adoption of quality accounting policies and internal controls, and hire effective independent auditors, in order to deter fraud, anticipate financial risks and promote accurate, timely and meaningful disclosure of financial and other information to the Board, the public and the SEC.
Each company faces its own unique circumstances, so each audit committee should tailor its practices to address those circumstances. The following "best practices" are suggestions intended as a guide to assist audit committees in establishing practices and procedures that are appropriate for their particular companies.

**Best Practices - Monitoring the Accounting and Financial Reporting Processes and Systems of Internal Control**

In monitoring a company's accounting and financial reporting processes and systems of internal control, an audit committee could consider the following "best practices":

**Conduct and Timing of Meetings**

- hold audit committee meetings without restrictions or time constraints at least quarterly;
- maintain minutes of each meeting;
- schedule audit committee meetings well in advance to coincide with completion of each quarter's financial statements and prior to finalizing the company's quarterly earnings release;
- distribute written materials for review by the audit committee sufficiently in advance of the meeting;
- meet separately with each of the key players involved in the financial reporting process - members of management, the internal audit department (if the company has one) and the independent auditors - at least once per quarter to review internal controls, the fullness and accuracy of the company's financial statements, the financial reporting process and other appropriate matters;
- communicate openly and effectively (in and out of scheduled meetings) with management, the internal audit department (if the company has one) and the independent auditors;
- periodically report to the Board of Directors on significant matters related to the audit committee's responsibilities;

**Set Policies Regarding Required Notifications**

- establish policies for when and how the audit committee will be notified of important events, such as:
  - proposed changes in accounting principles;
  - disagreements between management and the independent auditors;
  - significant changes in management's estimates;
  - use of any non-GAAP accounting principles; and
  - unusual financial statement adjustments above a specified dollar threshold;
Review the Adequacy of Internal Controls at Least Quarterly

- monitor and discuss (with management, the internal audit department (if the company has one) and the independent auditors) the company's internal control structure to determine whether the company's policies are working and are responsive to the current environment;
- evaluate weaknesses or breakdowns in the company's internal control system, monitor control breakdowns of competitors and re-examine relevant areas within the company;
- evaluate whether internal controls are enforced consistently, requiring management to follow the same controls as general staff;
- evaluate the adequacy of the number of personnel devoted to internal control procedures, including whether key functions are segregated, and the quality of personnel in key internal control positions;

Monitor the Company's Internal Audit Function

- review on at least an annual basis, and participate in, the budget and staffing for the internal audit department (if the company has one);
- review the internal audit function on at least an annual basis, including the independence and authority of its reporting obligations and the coordination of the company's internal audit personnel with management and independent auditors;
- review the assignments and priorities for the internal audit team;
- meet with the internal auditors at least quarterly to discuss the preparation of company's financial statements, the adequacy of the company's financial reporting processes, the company's internal control structure, the internal auditors' methods of risk assessments, the results of those assessments and other appropriate matters;

General Review and Discussion of Financial Statements and Financial Disclosures at Least Once Per Quarter

- review and discuss the quarterly and audited financial statements with management before they are released publicly;
- review the content, tone and quality of the text of each earnings release, including the adequacy and presentation of any pro forma earnings disclosures;
- review the company's Forms 10-Q and 10-K before they are finalized and filed with the SEC, in particular Management's Discussion and Analysis ("MD&A");
- review the company's financial disclosures (in press releases and SEC filings) for understandability and transparency;

- in connection with the audit committee's review and discussion of quarterly and annual financial statements and financial disclosures, address the following (among other things) in discussions with management and, where appropriate, the independent auditors:
  - the company's business, overall business environment and risks, including business and industry trends, the company's competitive position and strategy and how the company is affected by current economic conditions;
  - analyst and press reports, and competitors' statements, about the company, its competitors and its industry, and how the company is responding to relevant issues and risks;
  - differences in reported versus planned results;
  - how the company's results differ from its competitors;
  - the impact of the loss of a significant customer or supplier;
  - seasonality effects;
  - the impact of items that are not likely to be recurring;
  - segments of the company's business that have a disproportionate impact on the company's revenue and results of operations;
  - the company's liquidity situation, including the potential effects of off-balance sheet arrangements, covenants in debt and other agreements and trading activities;
  - any related-party transactions;
  - the risk of misstatements in the company's financial statements or in MD&A;
  - risks related to the creditworthiness of the company and its customers;
  - the impact of changes in company sales policies (for example, the level of discounts given to customers or the length of customer payment periods);
  - the volume of sales transactions closed near the end of each quarter;
  - the existence of any reciprocal or barter transactions;
  - the company's investments in customers or suppliers;
  - the existence of any transactions that raise form over substance issues;
  - the company's creation of any special purpose entities;
  - the company's policies about managing and assessing risk; and
  - the status of legal and regulatory matters (also discuss with inside and/or outside legal counsel);
Review and Discuss Accounting Policy Issues at Least Once Per Quarter^6

- discuss with management the company’s selection, application and disclosure of its “critical” accounting policies in MD&A?^7
- discuss significant estimates and judgments made by management in choosing and applying its accounting policies;
- discuss with management and the independent auditors the quality, not just the acceptability, of the accounting principles used by management, including alternative accounting methods within GAAP;
- discuss with management and the independent auditors the likelihood that materially different amounts would be reported under different conditions or using different assumptions in applying the company’s accounting policies;
- consider how management’s accounting choices affect the consistency, clarity and completeness of the financial statements and related disclosures;
- consider how the company’s accounting principles differ from industry norms;
- discuss with management any new accounting policies or proposed changes in accounting policies;
- examine accounting policies relating to the timing of transactions and the period in which they are recorded;
- inquire about and analyze any changes in the way items are accounted for;
- question the guidelines management uses to determine what is and is not material;
- study items deemed "immaterial" and understand why this is so;
- discuss other significant or unusual accounting matters, such as:
  - the company’s revenue recognition policies and compliance with relevant accounting standards, including Staff Accounting Bulletin No. 101, and any trends that are affecting the company’s recognition of revenue (such as an increase in period end shipments, changes in the mix of sales by distribution channel or type of customer and changes in the mix of products and services);
  - restructuring charges;
  - the use of reserves and accruals;

^6 The SEC has recently focused significant attention on the obligations of public companies and their audit committees to review, discuss and disclose in MD&A the company’s critical accounting policies. See Release Nos. 33-8040; 34-45149; FR-60 and Release No. 2002-22.

^7 In Release No. 33-8040, the SEC referred to accounting policies as “critical” where they are both most important to the portrayal of the company’s financial condition and results of operations and where they require management’s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.
- the effect of acquisitions and dispositions on revenues and earnings;
- impairment assessments for inventory, goodwill and other long-lived and intangible assets;
- contingent liabilities; and
- accounting for marketable debt and equity securities;
- discuss with management any second opinions it has sought from other outside auditors;

**Address Risk of Fraudulent Reporting**

- review approval authority for entering into significant transactions;
- assess the risk of fraudulent financial reporting by inquiring about common red flags, including the following:
  - cash flow problems;
  - requests to change the external auditors;
  - large or unusual transactions at or near year end;
  - material transactions with related parties;
  - off balance sheet transactions involving special purpose entities;
  - overly complex transactions which suggest form over substance;
  - missing records of the company;
  - side arrangements;
  - unusual variances in the company's financial results;
  - significant changes in income tax rates;
  - warnings or complaints from employees; and
  - sudden turnover in key management positions;

**Review Duties and Performance of Audit Committee**

- review and reassess at least annually the adequacy of the audit committee's charter;
- review at least quarterly the committee's intention, and ability, to fulfill all of the duties set forth in the audit committee charter;
- review at least annually the audit committee's performance, including an assessment from the Board of Directors as a whole;

**Review and Address Issues Raised in Annual Management Letter**

- promptly review with management, the internal audit department (if the company has one) and the independent auditors all recommendations made by
the independent auditors in their annual management letter;

- approve a schedule for implementing any recommended changes as a result of the annual management letter and monitor compliance with the schedule;

Assess the Audit Committee's Role in Monitoring Compliance with the Company's Code of Conduct and the Law

- consider whether the audit committee should assume responsibilities in connection with monitoring compliance with the company's code of ethical conduct (if it has one) and legal compliance, including the following:
  - reviewing the company's code of ethical conduct;
  - reviewing reports that summarize the company's monitoring of compliance with its code of ethical conduct and legal compliance;
  - reviewing the fairness of any proposed material transaction between management of the company and the company (excluding transactions that are subject to review by the Compensation Committee of the Board); and
  - making recommendations regarding such transactions to the Board;

Other Key Functions and Powers

- review and assess the qualifications and performance of the company's management with respect to financial reporting and disclosure issues;
- ensure that the audit committee has unrestricted access to company personnel and documents;
- ensure that the audit committee has the ability to conduct special investigations into matters within the scope of its duties;
- ensure that the audit committee has the power to retain outside legal counsel, experts and other advisors (such as independent forensic accountants);
- evaluate whether the company has in place processes that will provide audit committee members with adequate information from the company in order for them to be well informed with respect to the company's financial operations, including details regarding the company's operating results, significant press releases made by the company during the relevant time period and disclosures made in company SEC filings;
- discuss with management what policies are in place to promote accurate and timely reporting of financial results; and
- prepare a report to the company's stockholders for inclusion in the company's annual proxy statement as required by SEC rules and regulations (discussed further below).
Best Practices - Monitoring the External Audit Function

In monitoring the company's external audit function, the audit committee could consider the following "best practices:

**Participate in the Retention, Review and Discharge of the Independent Auditors**

- participate in hiring, firing and changing of the independent auditors;
- review the independent auditors' audit plan;
- review the amount of estimated audit fees to be charged by the independent auditors and any other significant compensation to be paid to the independent auditors;  

8 Note that the SEC has indicated that the amount of audit fees are an indicator, in part, of the level of quality of the audit. Therefore, extremely low fees may be a warning sign for the audit committee to pursue.

- inquire about the adequacy of staffing, experience levels and qualifications of the auditors assigned to the company (including experience with the company's industry) and the adequacy of time being spent by the more experienced partner or manager (including total hours and their time as a percentage of total audit hours spent on the company);
- inquire about the adequacy of the time being spent on areas that require judgment or represent the greatest reporting risk, including the adequacy of time being spent by the more experienced partner or manager (including total hours);
- review the performance of the independent auditors;
- communicate with the company's independent auditors about the company's expectations regarding its relationship with the auditors, including the following:
  - the independent auditors' ultimate accountability to the Board and the audit committee, as representatives of the company's stockholders; and;
  - the ultimate authority and responsibility of the Board and the audit committee to select, evaluate and, where appropriate, replace the independent auditors;

**Discuss the Company's Financial Statements and Accounting Policies with the Independent Auditors**

- before public release, review with the independent auditors both the quarterly financial statements (after the independent auditors have completed their review under Statement on Auditing Standards No. 71), and the audited financial statements;
in connection with quarterly and annual reviews, obtain the independent auditors' explanation and analysis of any questions or concerns involving the accounting policies and resulting financial statements, including:
- whether management's approach to accounting is conservative, moderate or aggressive;
- whether management's methods are common practices in the industry;
- the reasoning behind the independent auditors' determinations of the approach and methods used by the company;
- the quality, completeness and clarity of the overall financial disclosure under GAAP; and
- what were the key items that management and the independent auditors focused on during the quarterly and annual reviews;

in connection with the quarterly and annual review of the company's financial statements, discuss with the independent auditors the matters set forth under Statement on Auditing Standards No. 61, including:
- the auditors' responsibility under generally accepted auditing standards;
- the company's significant accounting policies and any new or different accounting policies it has adopted;
- the impact of any significant or unusual transactions and the accounting for such transactions;
- management's judgments and accounting estimates;
- significant audit adjustments that may have an effect on the financial reporting process;
- any disagreements with management;
- the auditors' judgments about the quality, not just the acceptability, of the company's accounting principles;
- major issues discussed with management prior to retention; and
- any difficulties encountered in performing the annual audit or conducting the SAS No. 71 quarterly review;

require the independent auditors to provide the audit committee with a copy of the management letter provided to management, and discuss the letter with the independent auditors;

discuss with the independent auditors their periodic reviews of the adequacy of the company's accounting and financial reporting processes, staffing and systems of internal control;

discuss the independent auditors' methods for risk assessments and the results of those assessments and any changes in the scope of the audit as a result of such risk assessments;
Monitor the Independence of the Independent Auditors

- monitor at least quarterly the independence of the independent auditors by:
  - obtaining from the auditors written disclosure of all relationships between the auditors and the company, including the nature of the services provided to the company and the fees charged for each type of service provided;9
  - confirming that the auditors believe that they are independent from the company; and
  - discussing independence issues with the auditors, scrutinizing consulting services provided by the auditors, reviewing the relationships between the auditors and the company’s management and finance staff (including any prior employment relationships), evaluating whether any of the company’s internal functions have been outsourced to the auditors and evaluating the relative importance of the company’s business to the audit firm;
- consider whether fees billed for information technology services and other non-audit services are compatible with maintaining the auditors’ independence;
- consider requiring pre-approval by the audit committee of non-audit services provided by outside auditors, or those above a specified dollar threshold or involving certain types of services (such as information technology services); and
- inquire about the manner in which the audit partner is compensated for his work on the company, including whether the partner receives any compensation based on the non-audit services provided to the company.

Audit Committee Charter and Proxy Statement Disclosures

Audit Committee Charter

Nasdaq and NYSE listed companies are required to have a formal written charter for their audit committees. The audit committee must review and reassess the adequacy of the charter annually. The charter must at a minimum specify the following:10

- the scope of the audit committee’s responsibilities and how it carries out those responsibilities, including structure, processes and membership requirements;
- the audit committee’s responsibility for ensuring its receipt from the independent auditors of a formal written statement delineating all relationships between the independent auditors and the company, consistent with Independence Standards Board, Standard No. 1;

---

10 See NASD Marketplace Rule 4350(d)(1) and NYSE Listing Standard 303.01(B)(s).
the audit committee's responsibility for actively engaging in a dialogue with the independent auditors with respect to any disclosed relationships or services that may impact the objectivity and independence of the independent auditors and for taking or recommending appropriate action to oversee the independence of the independent auditors; and

- the independent auditors' ultimate accountability to the Board of Directors and the audit committee, and the ultimate authority and responsibility of the Board and audit committee to select, evaluate and, where appropriate, replace the independent auditors.

Audit Committee Report for the Proxy Statement
The audit committee is also responsible for the annual preparation of the audit committee report, which must be included in the company's annual proxy statement to shareholders.11 The audit committee report must include the following disclosures:

- whether the audit committee has reviewed and discussed the audited financial statements with management;
- whether the committee has discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61;
- whether the audit committee has received the written disclosures and letter from the independent auditors required by Independence Standards Board, Standard No. 1;
- whether the audit committee has discussed with the independent auditors the independence of the independent auditors from management; and
- based on the review and discussions above, whether the audit committee recommended to the Board of Directors that the audited financial statements be included in the company's annual report on Form 10-K.

Other Required Proxy Statement Disclosures
In addition, the company must provide the following disclosures regarding its audit committee and its independent auditors in its proxy statement:12

- the names of each audit committee member;
- the number of audit committee meetings held;
- whether the members of the audit committee are independent, as defined by the applicable securities exchange;
- whether the Company's Board of the Directors has adopted a written charter for the audit committee;

12 See Item 7(d)(1), Item 9(e) and Item 7(d)(3) of Schedule 14A under the Securities Exchange Act of 1934.
- a brief description of the functions performed by the committee;
- the fees billed for professional services rendered by the independent auditors, separated according to fees for audit services, for information technology services and for other non-audit services, and whether the audit committee has considered whether fees billed for information technology services and other non-audit services are compatible with maintaining the auditors’ independence;
- if greater than 50%, the percentage of hours spent on the audit of the company’s financial statements by personnel of the independent auditor that are other than full-time, permanent employees of the independent auditor; and
- at least once every three years, the company must include a copy of its written charter as an appendix to the proxy statement mailed to shareholders.

Should you have any questions or concerns regarding the composition or responsibilities of your audit committee, please do not hesitate to contact us.