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# AUDIT COMMITTEE FUNDAMENTALS GUIDE

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The Audit Committee Fundamentals Guide was created for Corporate Board Member's Board Leadership Program with content provided by PwC's Governance Insights Center.



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Content in this guide is sourced from PwC's Audit Committee Excellence Series and Risk Oversight Series.



# About this Guide

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## Audit Committee Fundamentals Guide

The Audit Committee Fundamentals Guide was created for Corporate Board Member's Board Leadership Program with content provided by PwC's Governance Insights Center. Much of the material in this guide sources from PwC's Audit Committee Excellence Series and Risk Oversight Series.

The variety of topic areas, high volume of information, and ever-changing regulatory environment can make it challenging for audit committee members to stay abreast of the numerous topics which they may be called on to offer oversight.

PwC's Audit Committee Excellence Series strives to educate on timely topics relating to audit committee purpose, responsibilities, and associated subject matter. Whether it relates to the charter of the audit committee, oversight of financial reporting, monitoring compliance and accounting policies, dealing with investigations, or topics relating to overseeing internal and external auditors, this series aims to provide guidance and insights on audit committee essentials.

## Director Fundamentals Knowledge Center

The Audit Committee Fundamentals Guide is part of Corporate Board Member's Director Fundamentals Knowledge Center, an innovative resource for public company boards that provides directors with a multi-faceted learning experience through concise guidebooks and interactive training courses. The goal of the knowledge center is to arm new directors with the fundamental training needed to be an effective director from day one.

The Director Fundamentals Knowledge Center consists of the following suite of resources:

- **Director Fundamentals Guide & Training Course**
- **Audit Committee Fundamentals Guide & Training Course**  
*Content provided to you with support from PwC*
- **Compensation Committee Fundamentals Guide & Training Course**  
*Content provided to you in partnership with FW Cook*
- **Nominating/Governance Committee Fundamentals Guide & Training Course**  
*Content provided to you in partnership with Spencer Stuart*

## SECTION 1:

# AUDIT COMMITTEE RESPONSIBILITIES

The primary role of the audit committee is to ensure the integrity of the company's financial reporting, audit process, and system of internal controls, disclosures, and compliance with laws and regulations.



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# Committee Overview

## AUDIT COMMITTEE RESPONSIBILITIES

The rise of the audit committee in scope and responsibility began occurring immediately after the passage of Sarbanes-Oxley in 2002, when all eyes were focused on the ways in which boards provide checks and balances on financial reporting and risk oversight. Today, audit committees play a vital role in the capital markets' investor protection framework through their oversight of the internal audit function, external audit engagement, and the company's financial reporting process, as well as increasingly being tasked with enterprise-wide risk management.

The primary role of the audit committee is to ensure the integrity of the company's financial reporting, audit process, and system of internal controls, disclosures, and compliance with laws and regulations. Both NYSE and NASDAQ listing requirements require that audit committees be composed of no less than three independent members. The exchanges require members to be financially literate but their definitions and specific requirements differ slightly.



**As corporate risks continue to evolve, so has the breadth of the audit committee's purview.**

As corporate risks continue to evolve, so has the breadth of the audit committee's purview, and it is now often the committee charged with oversight of various risks, including cyber, operational, compliance, and others that could impact shareholder value. Therefore, risk management expertise, along with digital and cyber competencies, have become highly valued skills among audit committee members. Diversity of gender, race, and thought among members is also seen as particularly beneficial to this committee.

**The audit committee sits at the hub of internal and external audit—and is therefore positioned to maximize and oversee the roles of each party where there are intersecting responsibilities. In doing so, the following are the key responsibilities of the audit committee:**

- Oversight of financial reporting;
- Oversight of the external auditor;
- Oversight of internal auditors; and
- Oversight of the company's risk management policies and processes (for companies without a separate risk committee).

In the sections ahead, this publication will take a closer look at SEC and listings requirements for audit committees, committee operations, and these four crucial oversight areas.



# SEC Requirements

Content sourced from PwC Report - "Going public? What you need to know about corporate governance (2018 edition)"

## SEC REQUIREMENTS FOR THE AUDIT COMMITTEE

- Be directly responsible for the appointment, compensation, retention, and oversight of the independent audit firm, including resolution of disagreements between management and the auditor regarding financial reporting.
- Independent auditors report directly to the audit committee.
- Establish procedures for: (i) the receipt, retention, and treatment of complaints received by the company regarding accounting, internal accounting controls, or auditing matters; and (ii) the confidential, anonymous submission by company employees of concerns regarding questionable accounting or auditing matters.
- Have the authority to engage independent counsel and other advisors, as the committee determines necessary to carry out its duties.
- Receive appropriate funding, as determined by the audit committee, to pay: (i) compensation to any auditing firm engaged, (ii) compensation to any advisors employed by the audit committee, and (iii) the committee's ordinary administrative expenses that are necessary for it to carry out its duties.
- Preapprove all audit and allowable non-audit services to be provided by the independent auditor.
- The independent auditor must report to the audit committee on a timely basis: (i) all critical accounting policies used by the company, (ii) alternative accounting treatments that have been discussed with management along with the potential ramifications of using those alternatives, and (iii) other written communications provided by the auditor to management, including a schedule of unadjusted audit differences.
- Disclose the name of at least one member who meets the SEC's definition of an "audit committee financial expert"; if no one does, disclose why not.
- Include a report in the proxy statement outlining whether the audit committee has: (i) reviewed and discussed the company's audited financial statements with management, (ii) discussed with the independent auditors the matters required to be discussed under Public Company Accounting Oversight Board (PCAOB) AU 380, and (iii) received from the auditors disclosures regarding the auditors' independence required under PCAOB Ethics and Independence Rule 3526. Further, the report should include a statement by the audit committee whether, based on the review and discussions noted above, the audit committee recommends to the board of directors that the audited financial statements be included in the company's annual report on Form 10-K or 10-KSB (as applicable) for filing with the SEC.
- Include the audit committee charter in the proxy statement at least once every three years or if major changes are made to the charter.



## AUDIT COMMITTEE FINANCIAL EXPERT DEFINITION

The SEC defines an “audit committee financial expert” as a person who has the following attributes:

- An understanding of generally accepted accounting principles (GAAP) and financial statements;
- The ability to assess the general application of such principles in connection with the 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 are generally 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;
- An understanding of internal controls and procedures for financial reporting; and
- An understanding of audit committee functions.

Under the SEC’s rules, a person must have acquired such attributes 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.

# Listing Exchange Requirements

Content sourced from PwC Report - "Going public? What you need to know about corporate governance (2018 edition)"

## LISTING EXCHANGE REQUIREMENTS FOR THE AUDIT COMMITTEE

	<b>NYSE</b>	<b>NASDAQ</b>
<b>Number of members</b>	At least three	At least three
<b>Number of meetings</b>	Does not specify a number of meetings. Listing rules call for the committee to meet and review the company's annual audited financial statements and quarterly financial statements. This would suggest at least four meetings per year.	Does not specify a number of meetings.
<b>Must be independent directors</b>	Yes, under both the NYSE's listing standards and SEC Rule 10A-3.	Yes, under both the NASDAQ's listing standards and SEC Rule 10A-3; under exceptional and limited circumstances, may have one nonindependent director.
<b>Requirements for financial knowledge</b>	All members are financially literate (or become so within a reasonable period after joining the committee), and at least one member has accounting or related financial management expertise.	All are financially literate, and at least one member has experience in finance/accounting or certification in accounting that results in the individual having financial sophistication.
<b>Other requirements</b>	No audit committee member may serve on the audit committee of more than three public companies unless the board determines that such simultaneous service and related time commitments don't impair the member's ability to serve effectively on the company's audit committee. If this exception is used, the board's determination must be disclosed in the proxy statement.	
<b>Written charter, reviewed annually</b>	Yes, and post on the company's website.	Yes

The listing exchanges also assign specific responsibilities to audit committees in addition to the SEC's requirements. It's worth noting that many NASDAQ companies voluntarily adopt many of the NYSE mandated committee responsibilities.

## NYSE

- At least annually, obtain and review a report by the independent auditor describing: the firm's internal quality-control procedures; 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, and any steps taken to deal with any such issues; and (to assess the auditor's independence) all relationships between the auditor and the company
- Meet to review and discuss the company's annual audited financial statements and quarterly financial statements with management and the independent auditor, including reviewing the company's specific disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations"
- Discuss the company's earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies
- Periodically, meet separately with management, with internal auditors (or others responsible for the internal audit function), and with the independent auditor
- Set clear hiring policies for the employees or former employees of the independent audit firm
- Review with the independent auditor any audit problems or difficulties and management's response
- Periodically discuss with management policies relating to risk assessment and risk management
- Oversee the performance of the internal audit function (An internal audit function is required for companies listed on the NYSE)
- Assist the board in oversight of the company's compliance with legal and regulatory requirements
- Conduct an annual performance evaluation
- Report regularly to the board

## NASDAQ

- Receive from the independent auditor a formal written statement delineating all relationships between the auditor and the company, actively engage in a dialogue with the auditor regarding any disclosed relationships or services that may impact the objectivity and independence of the auditor, and take, or recommend that the full board take, appropriate action to oversee the independence of the outside auditor
- Oversee the company's financial and accounting processes and the audits of the financial statements
- Review related party transactions





# For More Information

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The information in this guide is by no means exhaustive. If you wish to dive deeper into the topics in this guide, Corporate Board Member encourages you to visit PwC's Governance Insights Center's website where you can find more information and also request a meeting for your board or audit committee. We also recommend that you discuss questions and issues with your company's general counsel or corporate secretary.

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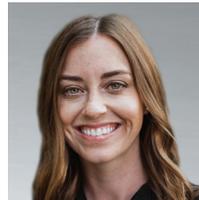
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PwC's Governance Insights Center supports you with the governance knowledge to answer tough questions and tackle complex challenges. We engage with boards of directors, investors, and executives, offer forums on critical current issues, share leading practices and insights, help directors comply with evolving expectations and regulations, and strengthen the bridges between investors, corporate directors, and management.

Learn more at: [www.pwc.com/us/GovernanceInsightsCenter](http://www.pwc.com/us/GovernanceInsightsCenter)

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Corporate Board Member, a division of Chief Executive Group, has been the market leader in board education for 20 years. The quarterly publication provides public company board members, CEOs, general counsel and corporate secretaries decision-making tools to address the wide range of corporate governance, risk oversight and shareholder engagement issues facing their boards. Corporate Board Member further extends its thought leadership through online resources, webinars, timely research, conferences and peer-driven roundtables.

The company maintains the most comprehensive database of directors and officers of publicly traded companies listed with NYSE, NYSE Amex and NASDAQ. Learn more at: [www.BoardMember.com](http://www.BoardMember.com)