



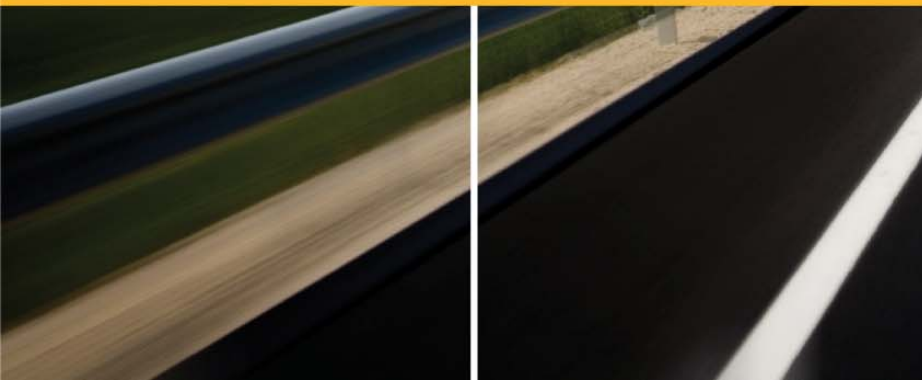
A TM

AUDIT COMMITTEE

SOLUTIONS

■ SERIES ■

STATUTORY AND FIDUCIARY OBLIGATIONS & HOW TO ESTABLISH A SOLID FOUNDATION



 **SingerLewak**
Accountants & Consultants

&

 **Stubbs
Alderton &
Markiles, LLP**
BUSINESS & TECHNOLOGY LAW

INDEX

- **Introduction Of Presenters**
STUBBS ALDERTON
- **Audit Committee Overview**
- **SEC and Stock Exchange Requirements**
- **Fiduciary Duties of Corporate Directors**
SINGERLEWAK
- **Audit Committee Process & Procedures**
- **Oversight of Financial Reporting**
- **Oversight of Internal Audit**
- **Oversight of Auditors**



INTRODUCTION



Before We Begin...



Stubbs
Alderton &
Markiles, LLP
BUSINESS & TECHNOLOGY LAW

- We have provided a copy of the AICPA's Audit Committee Tool Kit
- On occasion, we will be referring to it during the course of this presentation
- This presentation is only meant to identify some key best practices and to provide a framework for audit committees from which to begin to design effective operating processes
- We will be having more in-depth seminars on Audit Committee topics in the future



WORKSHOP LEADERS

Jim Pitrat, CPA- Partner, SingerLewak

Jim Pitrat leads SingerLewak's Assurance & Advisory practice where he oversees firm-wide assurance & advisory initiatives. Jim has experience with both private and publicly traded companies and has also advised on cost management, internal controls, corporate restructurings, and mergers and acquisitions. Jim has client service responsibilities in the business sectors of investor-backed private companies and public companies.

John McIlvery - Partner, Stubbs Alderton & Markiles, LLP

John McIlvery is a founding partner of Stubbs Alderton & Markiles, LLP, a corporate, securities and intellectual property law firm in Los Angeles. John serves as Chair of the firm's public securities practice group, where he focuses on the representation of small and middle market public companies with respect to their SEC disclosure obligations, corporate governance matters, mergers & acquisitions activities, equity and debt financing, and general corporate and business matters.

AUDIT COMMITTEE OVERVIEW



Audit Committee Overview

The Audit Committee

The Audit Committee is an operating committee of a company's Board of Directors, to which is delegated primary responsibility for discharging the Board's oversight responsibilities with respect to:

- Integrity of the company's financial statements;
- Internal control over the financial reporting process;
- Independent auditor's qualifications, independence and performance;
- Performance of the internal audit function, if present; and
- Compliance with legal and regulatory requirements (e.g., disclosure obligations).

Audit Committee Overview

The Audit Committee's Role

The Audit Committee is one of three principal parties involved in corporate accounting and financial reporting:

- **Management, including the Internal Auditor** – principally responsible for company accounting policies and the preparation of the financial statements.
- **Outside Auditors** – responsible for auditing and attesting to the company's financial statements and evaluating the company's system of internal controls.
- **Audit Committee** – as the delegate of the full Board of Directors, responsible for overseeing the entire process.

Audit Committee Overview

Must a Board Have an Audit Committee?

- An Audit Committee ***is not*** required by state corporation laws. A Board may, but is not required, to establish an audit committee.
- An Audit Committees ***is*** required, however, to qualify shares for listing on a national securities exchange or national securities association, which includes:

New York Stock Exchange

NASDAQ Capital Market

NASDAQ Global Market

NASDAQ Global Select

NYSE Alternext USA (formerly AMEX)

Audit Committee Overview

Audit Committees Prior to Sarbanes-Oxley

- Prior to the adoption of the Sarbanes-Oxley Act of 2002 (SOX), the listing standards of the primary U.S. securities exchanges did require issuers to have an Audit Committee.
- These listing standards, however, did not stipulate with much specificity how an Audit Committee should be comprised and how it should function.
- State corporate law and federal securities laws similarly did not lend much guidance on Audit Committee structure or its role within the organization.
- Prior SOX, commentators, including then SEC Chairman Arthur Levitt, were increasingly vocal about the problems with Audit Committee effectiveness.
- In response, in September 1998 the Blue Ribbon Committee (BRC) on Audit Committee Effectiveness was established jointly by the NYSE and NASD, and made its recommendations in February 1999.
- The substantial majority of the recommendations of the BRC were ultimately adopted in one form or another by Congress, the SEC and the Stock Exchanges commencing with the passage of SOX in 2002.

Audit Committee Overview



Stubbs
Alderton &
Markiles, LLP
BUSINESS & TECHNOLOGY LAW

The Blue Ribbon Committee's Recommendations

- **Independence of Audit Committee Members** – critical to fulfilling objective oversight role.
- **Financial Literacy of Audit Committee Members** – the ability to understand fundamental financial statements.
- **Audit Committee Structure and Process** – memorializing the Audit Committee's role, responsibilities and process in a charter, which is publicly disclosed.
- **Clarifying the Committee's Relationships** – with management, including the internal auditor, and the outside auditors. The outside auditors must be independent of management, and report directly to the Audit Committee.
- **Outside Auditors Communications with Audit Committee** – requiring communication of a qualitative evaluation by the outside auditors of management's preparation of the financial statements.
- **Disclosure of an Audit Committee Report** – in the company's annual report with respect to the Audit Committee's oversight role.
- **Outside Auditor Review of Quarterly Financials** – and a discussion of such review with financial management and the Audit Committee.



SEC AND STOCK EXCHANGE REQUIREMENTS



Securities Exchange Act § 10A(m) and Rule 10A-3

The Sarbanes-Oxley Act of 2002 added new Section 10A(m) of the Securities Exchange Act of 1934, governing Audit Committees. The SEC subsequently adopted Rule 10A-3, which prohibits a national securities exchange or national securities association from listing any security of an issuer that is not in compliance with the following requirements.

- **Independence** -- Each member of the Audit Committee of the issuer must be independent according to the specified criteria in Section 10A(m).
- **Outside Auditors** -- The Audit Committee must be directly responsible for the appointment, compensation, retention and oversight of the work of any registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the issuer, and the registered public accounting firm must report directly to the Audit Committee.
- **Complaint Procedures** -- The Audit Committee must establish 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 regarding questionable accounting or auditing matters.
- **Independent Professionals** -- The Audit Committee must have the authority to engage independent counsel and other advisors, as it determines necessary to carry out its duties.
- **Adequate Funding** -- The issuer must provide appropriate funding for the Audit Committee.

SEC And Stock Exchange Requirements

Independence Requirements under Rule 10A-3

Under Rule 10A-3, to be considered independent, a member of an Audit Committee may not, other than in his or her capacity as a board or committee member:

- Accept directly or indirectly any consulting, advisory, or other compensatory fee from the issuer or any subsidiary thereof, or
- Be an “affiliated” person of the issuer or any subsidiary thereof.
“Indirect” compensatory payments include:
 - Payments to spouses, minor children or stepchildren, or children or stepchildren sharing a home with the member; and
 - Payments made to certain entities in which the audit committee member is affiliated and which provides accounting, consulting, legal, investment banking or financial advisory services to the company or any of its subsidiaries.

The Stock Exchanges may impose greater requirements to establish Audit Committee independence.

NASDAQ Marketplace Rule 5605

As directed by the SEC, the national securities exchanges and national securities associations adopted listing requirements governing the establishment, composition and requirements of Audit Committees of listed issuers. NASDAQ presently has Marketplace Rule 5605, which governs Audit Committees for NASDAQ Global Select, NASDAQ Global Market, and NASDAQ Capital Market companies. Other exchanges such as the NYSE and the NYSE Alternext US (formerly the American Stock Exchange) have adopted comparable rules.

NASDAQ Rule 5605(c) – Audit Committee Requirements

Consistent with SEC Rule 10A-3, the NASDAQ Audit Committee Requirements include the following:

- **Audit Committee Charter** -- Each issuer must adopt a formal written Audit Committee charter and reassess the adequacy of the charter on an annual basis.
- **Audit Committee Composition** -- Each issuer must have an Audit Committee of at least three members, each of whom must:
 - (i) be independent as defined under NASDAQ Rule 5605(a)(2);
 - (ii) meet the criteria for independence set forth in SEC Rule 10A-3, unless exempt;
 - (iii) not have participated in the preparation of the financial statements of the issuer or any current subsidiary of the issuer at any time during the past three years;
 - (iv) be able to read and understand fundamental financial statements, including a balance sheet, income statement, and cash flow statement.

SEC And Stock Exchange Requirements

NASDAQ Rule 5605(c) – Audit Committee Requirements (continued)

- **Audit Committee Financial Expert** -- Each issuer must have at least one member of the Audit Committee who is financially sophisticated.
- **Audit Committee Responsibilities and Authority** -- Audit Committees must have the specific Audit Committee responsibilities and authority necessary to comply with SEC Rule 10A-3, concerning responsibilities relating to registered public accounting firms; complaints relating to accounting; internal accounting controls or auditing matters; authority to engage advisors; and funding.
- **Cure Periods** – NASDAQ Rule 5605 also includes cure periods for issuers that fail to comply with the Audit Committee composition requirements because an Audit Committee member ceases to be independent.

NASDAQ Rule 5605(a)(2) – Independence Determination

NASDAQ Rule 5605(a)(2) defines an independent director to mean:

“. . . a person other than an Executive Officer or employee of the Company or any other individual having a relationship which, in the opinion of the Company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. For purposes of this rule, "Family Member" means a person's spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in such person's home."

SEC And Stock Exchange Requirements

NASDAQ Rule 5605(a)(2) – Independence Determination (continued)

The NASDAQ Rule then specifies which persons shall **not be** considered independent, as follows:

- A director who is, or at any time during the past three years was, employed by the Company;
- A director who accepted or who has a Family Member who accepted any compensation from the Company in excess of \$120,000 during any period of twelve consecutive months within the three years preceding the determination of independence, other than the following:
 - (i) compensation for board or board committee service;
 - (ii) compensation paid to a Family Member who is an employee (other than an Executive Officer) of the Company; or
 - (iii) benefits under a tax-qualified retirement plan, or non-discretionary compensation.

Audit Committee Members, however, are subject to the more stringent requirements under NASDAQ Rule 5605(c) (?)

SEC And Stock Exchange Requirements

NASDAQ Rule 5605(a)(2) – Independence Determination (continued)

- a director who is a Family Member of an individual who is, or at any time during the past three years was, employed by the company as an Executive Officer;
- a director who is, or has a Family Member who is, a partner in, or a controlling Shareholder or an 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 more, other than the following: (i) payments arising solely from investments in the Company's securities; or (ii) payments under non-discretionary charitable contribution matching programs.
- a director of the Company who is, or has a Family Member who is, 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 serve on the compensation committee of such other entity; or
- a director who is, or has a Family Member who is, a current partner of the Company's outside a auditor, or was a partner or employee of the Company's outside auditor who worked on the Company's audit at any time during any of the past three years.

SEC And Stock Exchange Requirements

Audit Committee Financial Expert

NASDAQ Rule 5605(a)(2) requires that one member of the Audit Committee be financially sophisticated. The SEC requires that issuers disclose whether or not it has at least one audit committee financial expert serving on the Audit Committee.

An audit committee financial expert means a person who has the following attributes:

- An understanding of generally accepted accounting principles 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 registrant's financial statements, or experience actively supervising one or more persons engaged in such activities;
- An understanding of internal control over financial reporting; and
- An understanding of audit committee functions.

SEC And Stock Exchange Requirements



Stubbs
Alderton &
Markiles, LLP
BUSINESS & TECHNOLOGY LAW

Audit Committee Financial Expert -- Safe Harbor

In response to concerns over increased liability for audit committee financial experts, the SEC adopted a safe harbor in Regulation S-K, which provides:

- A person who is determined to be an audit committee financial expert will not be deemed an expert for any purpose, including without limitation for purposes of section 11 of the Securities Act, as a result of being designated or identified as an audit committee financial expert pursuant to this Item 407.
- The designation or identification of a person as an audit committee financial expert pursuant to this Item 407 does not impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the audit committee and board of directors in the absence of such designation or identification.
- The designation or identification of a person as an audit committee financial expert pursuant to this Item does not affect the duties, obligations or liability of any other member of the audit committee or board of directors.



FIDUCIARY DUTIES OF CORPORATE DIRECTORS



Fiduciary Duties of Corporate Directors

Audit Committee Members are Fiduciaries

- State corporation laws provide that the business and affairs of a corporation are to be managed under the direction of its Board of Directors. Consequently, the individuals who serve on a Board of Directors are fiduciaries in relation to the corporation and its owners – the shareholders – and in certain circumstances, its creditors.
- As fiduciaries, Board members owe the corporation and its shareholders several important duties, which vary from state to state but typically are described as:

The Duty of Loyalty
The Duty of Care

Fiduciary Duties of Corporate Directors



Stubbs
Alderton &
Markiles, LLP
BUSINESS & TECHNOLOGY LAW

The Duty of Loyalty

The duty of loyalty requires a director, affirmatively and in good faith, to protect the interests of the company and its stockholders, and to refrain from doing anything that would injure the company or deprive the company of profit or an advantage that might properly be brought to the company for it to pursue. In order to fulfill the duty of loyalty, a director must act in a manner that he or she believes in good faith to be in the best interests of the company and its stockholders.



Fiduciary Duties of Corporate Directors

The Duty of Loyalty (continued)

- Claims typically involve conflicting interests between the director and his fiduciaries.
- The best interests of the Corporation and its shareholders must take precedence over any personal interest or bias of a director that is not shared by shareholders.
- The director's self interest must not conflict with his duties to his fiduciaries.
- The director must not use his corporate office to effectuate a transaction between the corporation and such person or his affiliates where the transaction is not substantively fair to the corporation.
- The duty of loyalty includes the subsidiary duty to act in "good faith". A failure to act in good faith may include:
 - (i) Intentionally acting with a purpose other than that of advancing the best interests of the corporation;
 - (ii) Acting with the intent to violate applicable positive law;
 - (iii) Intentionally failing to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.

Fiduciary Duties of Corporate Directors

The Duty of Care

The duty of care requires a director to perform his or her responsibilities with the care that a reasonably prudent person would exercise under similar circumstances, while acting in an informed manner.

More specifically, in order to fulfill the duty of care, a director must proceed with a “critical eye” in assessing information presented to him or her, and with an inquisitive nature in confirming that he or she has been presented with all relevant material information.

Fiduciary Duties of Corporate Directors

The Duty of Care (continued)

- Directors have an obligation to inform themselves of all material information reasonably available to them before making a business decision and, having so informed themselves, to act with the requisite care in making such decision.
- Directors are entitled to the benefits of the Business Judgment Rule, which is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Under this principal, a court will not substitute its judgment for that of the board if the board's decision can be attributed to any rational business purpose.
- Delaware law permits a corporation to include a provision in its certificate of incorporation limiting or eliminating a director's personal liability for monetary damages for breaches of the duty of care.
- The liability of directors, however, may not be so limited or eliminated in connection with breaches of the duty of loyalty, the failure to act in good faith, intentional misconduct, knowing violations of law, obtaining improper personal benefits, or paying dividends or approving stock repurchases in violation of DGCL § 174.
- Delaware courts have routinely held that, pursuant to these provisions, directors cannot be held monetarily liable for damages caused by alleged breaches of the fiduciary duty of care.

Fiduciary Duties of Corporate Directors

The Duty of Care – What Should Directors Do?

- Attend board meetings regularly.
- Take time to review, digest, and evaluate all materials and other information provided to them.
- Take reasonable steps to assure that all material information bearing on a decision has been considered by the directors or by those upon whom the directors will rely.
- Actively participate in board deliberations.
- Ask appropriate questions, and discuss each proposal's strengths and weaknesses.
- Seek the advice of legal counsel, financial advisors, and other professionals, as needed.
- Where appropriate, reasonably rely upon information, reports, and opinions provided by officers, experts or board committees.
- Take sufficient time (as may be dictated by the circumstances) to reflect on decisions before making them.
- Avoid taking action by unanimous written consent on **material matters**, as this ordinarily does not provide any opportunity for, or record of, careful Board deliberations.

Fiduciary Duties of Corporate Directors

The Impact of SOX on Fiduciary Duties -- Some Brief Observations

Sarbanes-Oxley is blurring the lines that separate the three principal sources of corporate governance guidance in America:

- Federal Government (principally the SEC) -- primary responsibility for fair disclosure and securities market regulation.
- State Government – primary responsibility for the substantive regulation of corporate transactions and board conduct.
- Stock Exchanges -- have played a more mixed role, imposing listing requirements with respect to stockholder votes and audit committee independence.

Some examples:

- SOX's prohibition on director and officer loans.
- The stock exchange rule that requires shareholders to approve all equity compensation plans.

Fiduciary Duties of Corporate Directors

The Impact of SOX on Fiduciary Duties -- Some Brief Observations

- Sarbanes-Oxley addresses boardroom practices traditionally governed by state law, and will inevitably begin to influence state law adjudication.
- Delisting and suspension of trading are unsatisfactory remedies, as they punish stockholders.
- SOX itself does not, with certain limited exceptions, create new causes of actions for stockholders.
- Plaintiff's counsel will not be content to leave enforcement to the SEC and the Stock Exchanges, and will plead SOX and Stock Exchange violations as breaches of fiduciary duties.
- For example:
 - (i) Does delisting, in and of itself, constitute a breach of the duty of care?
 - (ii) Will the Stock Exchange definitions of "independence" establish a floor for "independent director" and "disinterested director" determinations under state law?
 - (iii) Will the rules-based requirements of SOX begin to replace the principles-based, substantive corporation laws?

AUDIT COMMITTEE PROCESS & PROCEDURES



Audit Committee Process & Procedures

Suggested for Effective Execution of Responsibilities:

1. Review the AC Charter at least annually
2. Develop Integrated Calendar of audit committee meetings and responsibilities
 - Based on Charter
3. Develop Reporting Framework
 - Management Reports
 - Internal Audit Reports
 - Reporting to board
 - Timeliness, format, required information
 - Report for Proxy Statement

Audit Committee Process & Procedures

Suggested for Effective Execution of Responsibilities:

4. Set agenda(s) for Audit Committee meetings
 - Based on (a) Charter, and
 - (b) Relevant financial and audit related issues
 - See example Agenda
5. Develop process for reporting and dealing with problems, including the whistleblower hotline
 - Review the process at least annually
6. Develop process for dealing with “special investigations”
 - Whistleblower complaints
 - Discovery of financial reporting errors
 - Fraud or Illegal acts discovery or allegation
 - Process should be developed in consultation with counsel

Audit Committee Process & Procedures

Suggested for Effective Execution of Responsibilities:

7. Develop Process for reviewing sub certification process and compliance with Sarbanes Oxley Section 404 assessments.
8. Develop Process for reviewing compliance with financial reporting rules and audits of the financial statements
9. Conduct Annual Self Assessment

OVERSIGHT OF FINANCIAL REPORTING



Understanding Financial Reporting

- Should be familiar with the company's:
 - Critical Accounting Policies
 - What they mean,
 - How management has decided on their policies
 - How business transactions are reflected in the financial statements
 - Judgments and estimates in the financial statements
 - How they are calculated and management's methodologies
 - Unusual Items in the financial statements
 - Other complex issues
 - Significant business arrangements
 - Reporting Requirements under regulatory and contractual obligations

Financial Statements and other Financial Information

- Review and approve annual and interim financial statements
 - Sufficiency of disclosure
 - Appropriateness of the financial statements
- Review and approve “Management’s Discussion & Analysis”
 - Adequacy of disclosure
 - Consistency with understanding
- Review and approve earnings releases and information provided to analysts and rating agencies
 - Adequacy and appropriateness of information
 - Consistency with understanding
- Facilitate disagreements between management and the Auditors

Financial Statements and other Financial Information

- Management's report to the audit Committee:
 - Should be performed at least quarterly, as part of the quarterly audit committee meeting, or as needs arise
 - Usually given by the CFO or other appropriate exec.
 - Discussion of major transactions during the period, including:
 - Accounting implications
 - Significant judgments used in accounting for transactions
 - “Look-forward” to upcoming transactions and issues
 - Accounting implications
 - Issues that may impact the accounting
 - Description of the cause of major variances or changes from (a) budgets, and (b) prior period, and
 - Expected impact on future reporting

Financial Statements and other Financial Information

- Management's report to the audit committee (Continued):
 - Significant changes in judgments and estimates used in critical accounting policies, and
 - why changes were made
 - Substance of the change in methods for making changes in judgements
 - New Critical Accounting Policies and what gave rise to them
 - New Accounting Pronouncements and their impact on the company's financial statements
 - Current period, and future expected impact
 - Liquidity and financing disclosures and transactions
 - Changes in the reporting environment, the economic environment and the internal control environment, including:
 - Staffing issues, internal control breakdowns and changes, suspected liquidity issues, industry trends and their expected impact on the company

Executive Sessions

- Consider Exec session that include (s):
 - CEO, CFO, Independent Auditor, Internal Audit, General Counsel, other business leaders, as necessary
 - Internal Audit and Independent Auditors
 - Independent Auditors only
 - Audit Committee Members only
 - Use executive sessions to discuss sensitive and critical issues
 - We will be talking about effective management of the meetings in later seminars.

OVERSIGHT OF INTERNAL AUDIT & ADEQUACY OF INTERNAL CONTROLS



Oversight of Internal Audit & Adequacy of Internal Controls



Stubbs
Alderton &
Markiles, LLP
BUSINESS & TECHNOLOGY LAW

- Understand the Internal Control Environment
 - See checklist in the ToolBox
- Approve the hiring of the Chief Internal Auditor
 - There is a checklist for a suggested interview process in the ToolBox
- Approve the scope of the internal auditor's audit plan and SOX 404 assessment
 - Should understand the Financial Reporting Risks of the Enterprise
 - Should understand the Risk Assessment process
 - Should understand the process of assessing effectiveness of controls
 - Consider the SEC guidance on Management's Assessment.



Oversight of Internal Audit & Adequacy of Internal Controls



Stubbs
Alderton &
Markiles, LLP
BUSINESS & TECHNOLOGY LAW

- Oversee the system of risk assessment and risk management
 - As delegated by the Board of Directors
 - Focus primarily on Financial risk, as a general rule, but can be (and often is) expanded by BOD
 - Include in Quarterly Meetings (or Annual meetings) in some cases – risk assessment presentations by management
- Evaluate Internal Audit team (or system of internal audit and Management's assessment)
 - Checklist in Toolbox
 - Best practice -- Perform at least annually



Oversight of Internal Audit & Adequacy of Internal Controls



- Periodic Reporting to the Audit Committee by the Internal Audit group (or those responsible for Management's assessment):
 - Consider including as part of management's report to the audit committee
 - Consider quarterly reporting similar to the CFO's report
 - Status of Management's assessment and other projects
 - Time line for completion of internal control work
 - Consider required reporting as issues arise, such as:
 - Identification of Material Weaknesses or significant deficiencies in Internal Control
 - Material Changes in Internal control Structure
 - Identified issues with Management
 - Changes in identified significant Risks
 - Changes in the Internal Audit Plan

Oversight of Internal Audit & Adequacy of Internal Controls



- Small Organization Considerations:
 - No Separate Internal Auditor
 - IF CFO has authority, Consider controls to mitigate conflicts of interest
 - Is there another individual in the organization that can oversee?
 - If not, what is reporting requirement?
 - Consider level of Audit Committee scrutiny in approving the assessment
 - Consider top level controls and level of CEO oversight
 - Ultimately, the AC has responsibility in oversight of management's assessment of ICFR and sufficiency of Internal Controls

A photograph of several small green seedlings with two leaves each, growing in clear plastic pots filled with dark brown soil. The image is divided into a 2x3 grid by thin white lines. The text 'OVERSIGHT OF AUDITORS' is overlaid in large, bold, yellow letters with a dark outline.

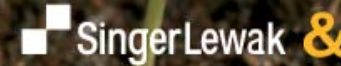
OVERSIGHT OF AUDITORS



Oversight of Auditors

- Responsible for appointing or replacing the independent auditors
 - Before appointing, might ask:
 - Key audit team members
 - Quality Control policies, and their ability to conduct the audit
 - Clients recently lost and why
 - Peer review and PCAOB reports
 - Approach to the audit and communication with the committee
 - Investigations and civil litigation against the firm
 - Industry and public company experience

Oversight of Auditors



Stubbs
Alderton &
Markiles, LLP
BUSINESS & TECHNOLOGY LAW

- Once appointed, Responsible for:
 - Facilitating disagreements between management and Auditors
 - Confirm independence
 - Communicate fraud
- Review Audit Plan with the Auditors
 - Ask questions and make suggestions regarding scope and extent of the audit plan



Oversight of Auditors

- Communicate with Auditors (required communications from auditors)
 - Critical Accounting Policies
 - Management Judgments and Accounting estimates
 - As well as methods used by management
 - Basis for conclusions about reasonableness
 - Audit Adjustments
 - Disagreements with management
 - Consultations between management and other accountants
 - Issues discussed with management prior to retention
 - Illegal acts and Fraud
 - Internal control Matters

Oversight of Auditors

- Meeting with Auditors—suggested best practice at a minimum:
 - Quarterly before release of the 10Q
 - Annual to review the audit plan – before the beginning of the audit
 - Annual before release of the 10K
 - When other events arise that require communication with auditors

Fraud Communications – Public Co's.

- If Auditor detects evidence of fraud, must:
 - Determine whether likely an illegal act occurred
 - Determine the possible effect on the financial statements
 - Promptly inform management, the AC and the Board.
- If after informing the company, and the following are true, the Auditor must inform BOD as soon as practicable about the fraud:
 - Illegal act is material to the financial statements
 - Senior management has not taken (and BOD has not required it to take action
 - The failure may warrant a departure from standard audit report.
- BOD has one day to inform the SEC.
- If auditor does not receive a copy of the correspondence in one day, the auditor is required to inform the SEC.

QUESTIONS

