

# AUDIT COMMITTEE ANNUAL SELF-EVALUATION FORM

Dave Tate, Esq.  
San Francisco, CA  
<http://davidtate.us>; [tateatty@yahoo.com](mailto:tateatty@yahoo.com)

These materials are updated periodically—this version is dated 10.25.09

## **CONTENTS**

- I. INTRODUCTION
- II. THE AUDIT COMMITTEE ANNUAL SELF-EVALUATION
- III. SAMPLE LIST OF ISSUES OR TOPIC AREAS TO CONSIDER
- IV. THE SELF-EVALUATION PROCESS & INTERACTIVE FORM

### **I. INTRODUCTION**

This paper is part of a series of papers that cover public company, private company and nonprofit audit committee functions, responsibilities and tasks in a quick-read summary format. This paper discusses the annual audit committee self-evaluation, and includes a form with text boxes in which you can insert comments and information. Please also pass this paper to other people who may find it beneficial, and email your comments to me.

Although many audit committee functions, responsibilities and tasks are specified by statute, regulation, rule or pronouncement, an audit committee member's standard of care remains significantly dependent on due diligence and prudent judgment. You will find additional materials relating to audit committees and governance at <http://davidtate.us>.

Limitations and Disclaimer. These materials do not provide legal, accounting or other professional advice or services, are not a solicitation for work, and do not apply to any particular person, entity, event, transaction or situation. These materials are only a summary. If you have questions or issues about a particular specific situation, you need to seek your own legal, accounting or other professional assistance, and you absolutely should not rely on the summary materials in this paper. The materials in this paper are updated periodically, and cannot be relied on for that additional reason.

## II. THE AUDIT COMMITTEE ANNUAL SELF-EVALUATION

In the United States only audit committees of companies that are listed on the New York Stock Exchange are required to conduct an annual committee self-evaluation (see NYSE Listed Company Manual §303A.07); however, it is easily worthwhile for audit committees of all public and private companies and nonprofit entities to conduct an annual self-evaluation. An audit committee's job is difficult, ongoing, and technical in nature, and requires the committee members to significantly interact with many people in different capacities within and outside of the entity. It only makes sense that the committee should at least once each year take time to step back and review, evaluate and make improvements to its manner of operation, and also consider helpful actions that can be taken by other people with whom the committee interacts. The annual self-evaluation will be worthwhile even if it results in improving only one area of operation. No specific evaluation process or format is required. However, for many reasons it can be advantageous to have an outside facilitator conduct an interactive interview approach. In any event, I strongly suggest that each audit committee conduct some form of an annual self-evaluation to improve its operations.

Audit committee responsibilities originate from several different sources at least including (1) the responsibilities that the board delegates to the audit committee, and other responsibly that the audit committee voluntarily undertakes; (2) the business judgment rule; (3) the specific laws, regulations and rules that are applicable to the entity's directors and audit committee members; and (4) accounting and auditing pronouncements relating to the outside auditor's activities. Detailed discussions about specific audit committee responsibilities are contained in other materials written by the author, and are beyond the scope of this paper as they tend to be lengthy and technical.

Prudent audit committee processes and diligence are important to reduce audit committee member and entity liability and reputation risk. An increasing number of cases hold that the audit committee members can be liable for failure to exercise sufficient diligence, or failure to spot and respond to red flags. See, e.g., *In re Hollinger International, Inc. Securities Litigation* (N.D. Ill. 2006) 2006 U.S. Dist. Lexis 47173; *In re WorldCom, Inc. Securities Litigation* (S.D. N.Y. 2005) 2005 U.S. Dist. Lexis 4194; and *In re Hayes Lemmerz International, Inc. Equity Securities Litigation* (E.D. Mich. 2003) 271 F. Supp. 2d 1007. Active board and corporate diligence tend to demonstrate prudent business judgment and negate allegations of recklessness, improper intent, intentional wrongdoing, or "scienter" such as in the context of securities litigation, thus reducing the risk of securities liability and damages. See, e.g., *In re Digi International, Inc. Securities Litigation* (8th Cir. 2001) Fed. Appx. 714. In the context of audit committee activities, potential entity, board, and audit committee member liability typically arises in the context of alleged improper accounting practices, written and oral public misrepresentations (such as with respect to financial matters), and improper employment practices.

Although not required, there can be advantages to having a facilitator conduct an interactive interview approach to the self-evaluation process, but without performance grading or rating: it can be difficult to construct a questionnaire with standardized questions that would be similarly understood by each of the participants in the self-evaluation process; different people use

different rating scales; different people express responses in different manners; and certain important issues will change from year to year. A facilitated approach need not be expensive, but it will facilitate better discussion and comment, continuity, follow-up, explanation and compilation. Drop me an email if you are interested in audit committee self-evaluation facilitation assistance as I offer reasonably priced fixed fee assistance to encourage the process.

Issues and topic areas to consider during the self-evaluation process will naturally vary somewhat from entity to entity, and from audit committee to audit committee. Thus, to stimulate discussion, at Part III of this paper I have provided a list of potential broad issues or topic areas to consider for discussion and evaluation, including both successes and possible improvements; and at Part IV below I have outlined a process with an interactive form with text boxes in which you can insert comments and information to assist your audit committee self-evaluation process.

### **III. SAMPLE LIST OF ISSUES OR TOPIC AREAS TO CONSIDER**

The following is a list of issues and topic areas to consider for discussion and evaluation. The list is intended to help trigger thought processes, but, of course, is not exhaustive as areas of discussion and evaluation will vary from entity to entity, and from committee to committee.

- Audit committee meeting agenda preparation and dissemination process.
- Committee member independence, financial literacy, experience and expertise.
- Committee member access to information and/or education pertinent to the functions and responsibilities of the audit committee. Are the needs of the committee members being met, so that they are sufficiently knowledgeable and educated about the company or nonprofit and its industry; relevant significant accounting and auditing issues; relevant legal matters; internal controls, risk assessment and management; governance; and new developments in those and other areas?
- Committee and committee member interactions, including interaction between committee members, and between the committee and the board, the CEO, the CFO, the outside auditor, the internal auditor, legal counsel, compliance and ethics, HR, consultants, and other people.
- The committee's processes for identifying and spotting issues, evaluation and decision making.
- The contents of the audit committee charter, and a mutual understanding of the audit committee's responsibilities and tasks. The charter is a requirement for public companies, and is a good idea for many private companies and nonprofit entities. The charter is a prudent document to identify and clarify the audit committee's responsibilities. In addition to the committee itself, it is important for the board, the executive officers, and other stakeholders to have a correct understanding about the committee's responsibilities and limitations.

-Selection of the outside auditor; audit planning; review of the performance of the outside auditor; and review of the quarterly review and annual audit report and process (or compilation if appropriate).

-Review of recent developments relating to standard of care and acceptable reliance on other people.

-Review of accounting and financial internal and fraud/embezzlement related controls and processes, risk assessment and management, possible entity and individual liability and reputation risk exposure; and compliance assessment and management relating to laws, regulations, and rules that are within the scope of the audit committee's functions and responsibilities including issues relating to the Foreign Corrupt Practices Act.

- Review of the accounting department, and accounting and financial reporting for transactions including all of the subcomponents such as principles and policies applied (quality not just acceptability); judgments, estimates and reserves; timing and cutoff procedures; off balance sheet transactions; related party transactions; contingencies and liabilities; revenue recognition; expenses; inventories; goodwill; insider trading; and other matters relating to accounting and financial statement reports.

-Review of the financial and internal audit functions, and how they can be helpful to the audit committee in the performance of its responsibilities and tasks.

-Review of compliance and risk assessment and management processes that are within the scope of the audit committee's functions and responsibilities.

-Documenting and reporting the audit committee's activities and minutes.

-The audit committee's use of attorneys and consultants.

-The company's investor communication processes.

-Whistleblower, ethics and complaint handling processes; corporate investigations.

-Document retention policies.

-Review of the compliance and ethics function and processes that are within the scope of the audit committee's responsibilities, and how they can be helpful to the audit committee in the performance of its responsibilities and tasks.

-Governance, including tone at the top, financial leadership, transparency and appearance.

-Review of employer, employee and workplace processes that are within the scope of the audit committee's function and responsibilities.

-Review of tax compliance and reporting issues that are within the scope of the audit committee's function and responsibilities.

-Insurance.

-Review of pension and health plan related issues that are within the scope of the audit committee's function and responsibilities.

-Review of billing and accounting relating to the receipt of funds or revenue from governmental sources such as Medicare and Medicaid; compliance with applicable laws, regulations, rules and other requirements; and oversight of expenses relating to these areas.

-Review of the acceptance, receipt, allocation, expenditure or distribution, and accounting for all charitable and donor funds, grants, contributions, pledges and other resources, including compliance with all requirements, restrictions and special uses.

-Review of accounting for collaboration and joint venture arrangements, including the allocation of receipts/income and distributions/expenses between the entities.

-And, in this economic environment, review of the fair value of funds and investments, including loss of value; liquidity concerns; possible going concern issues; estimates for uncollectibles and related reserves; debt/loan covenants; and funding source uncertainties including those that relate to collaboration and joint venture arrangements.

-It is also important for the audit committee to clarify with the board what responsibilities it has, if any, for oversight of the numerous and various areas of taxation and compliance; ERISA, pension and health and welfare plans; investments; tax exempt status including fund raising, dues, solicitation, and political, campaign and lobby activities; and other areas significant to the entity.

-Additional significant topics or issues that should be discussed.

#### **IV. THE SELF-EVALUATION PROCESS & INTERACTIVE FORM**

The following eight primary steps outline a proposed audit committee self-evaluation process using an outside facilitator that is workable for audit committees of public companies, private companies and nonprofit entities. I have also inserted text fields which should allow you to insert comments and information. If you are using this form with adobe reader and you insert text into a text box you will not be able to save your inserted text—you should print the pages in which you have inserted text—additionally, the text that you can print cannot exceed the original boarders of the text box without expansion. Of course, if you are using this form with adobe acrobat you should not have those limitations. It may be more convenient to use this paper if you print a hard copy so that you can more easily refer to the materials in Part III as you complete the steps below. Please contact me if you are interested in discussing the committee

self-evaluation process, or if you would like help with the self-evaluation process at a reasonably priced fixed fee.

**Step 1.** Determine the people who will be participating in the evaluation process, including the audit committee members, and other people, if any, to interview for comment.

Insert below the names of the people who will participate in the evaluation process:

**Step 2.** Determine how the participant interviews will be conducted, individually or in a group, in person or by telephone.

Insert below comments or information about how the interviews will be handled with the various different people who will participate in the evaluation:

**Step 3.** Arrange participant individual or group interview dates and times.

Insert below participant individual or group interview date and time information:

**Step 4.** Provide the participants with pre-interview materials and a list of possible issue or topic areas (broad and specific) for consideration and discussion. Of course, the participants can add additional issues or topics. You may wish to use this paper and interactive form for that purpose.

Insert below comments or information regarding the status of providing pre-interview materials to the people who will participate in the evaluation process:

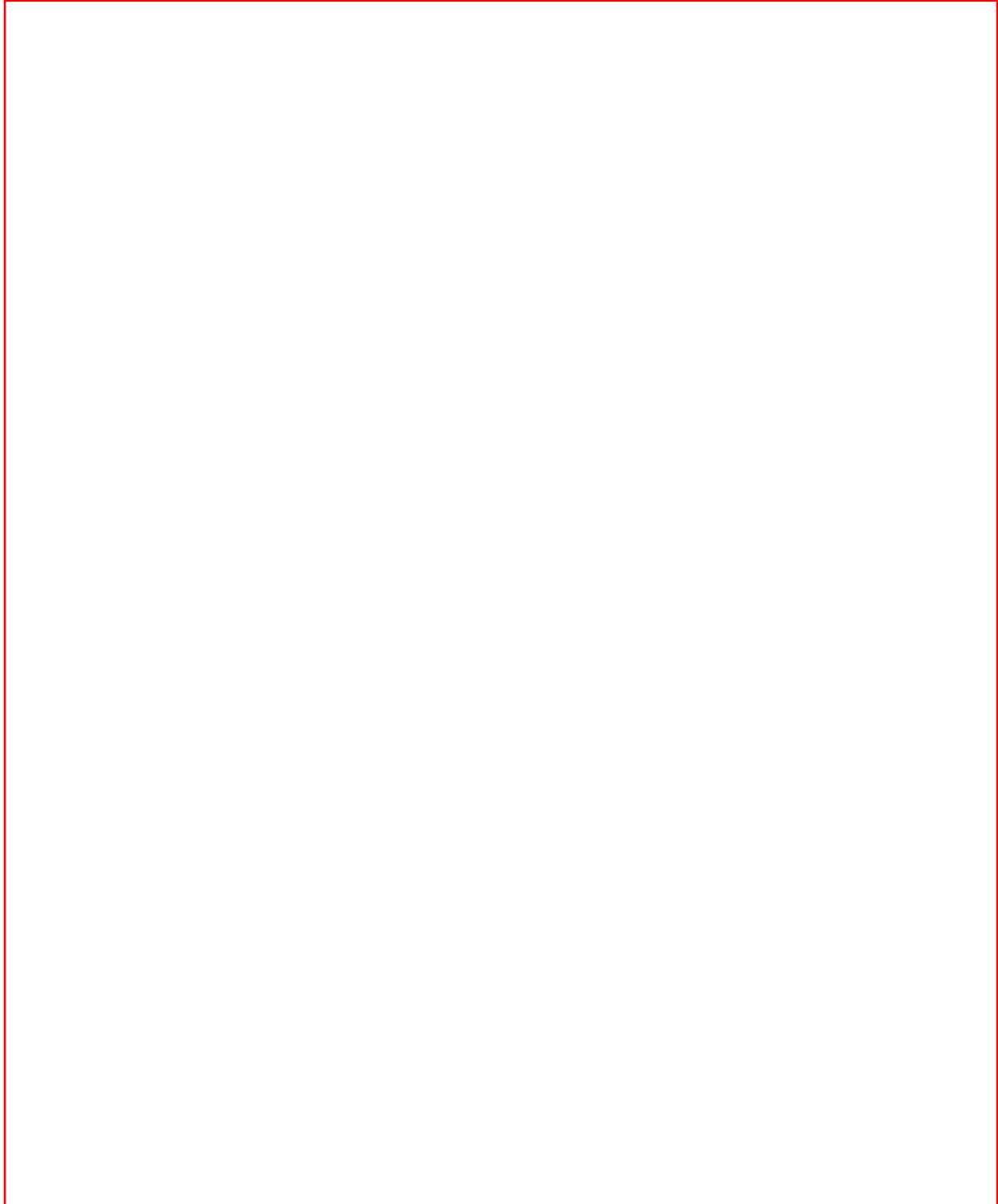
**Step 5.** Request that each participant provide a list of one to five, or more, issues or topic areas that the participant would specifically like to discuss during the evaluation process.

Insert below comments and information regarding receipt of issues or topic areas from the self-evaluation process participants, and the respective issues or topic areas listed:



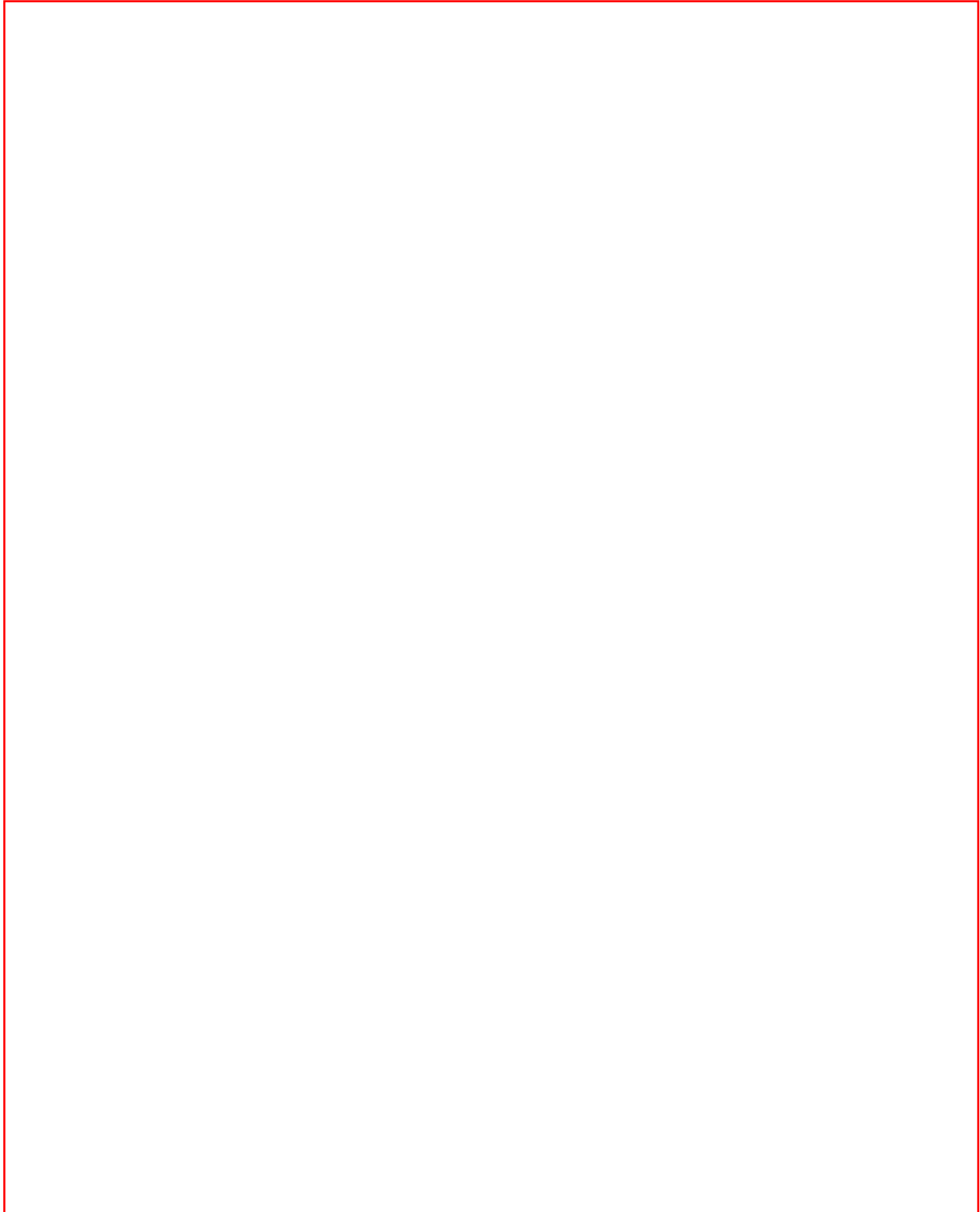
**Step 6.** Conduct the interactive interviews with the participants individually or as a group.

Insert below comments and information regarding the status of conducting the interviews, and information received during the self-evaluation interviews:



**Step 7.** Summarize in a report format the issues and topic areas, information received, and suggestions made during the self-evaluation process.

Insert summary below in a report format:



**Step 8.** Provide a report back to the audit committee, and possibly conduct a committee group review of the self-evaluation process, information obtained, and suggestions made.

Insert below additional comments and information about the self-evaluation process or results:

**Concluding comments.** I hope that you found this paper helpful and at least a good starting point for your audit committee self-evaluation. Feel free to contact me if you are interested in discussing the audit committee self-evaluation process, or if you would like help with facilitation. This paper is updated from time to time. Please also be mindful of the Limitations and Disclaimer at page one of this paper.

Regards,  
Dave Tate, Esq.  
<http://davidtate.us>

\* \* \* \* \*