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Integrity & Quality

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Deloitte & Touche

Dear Clients and Friends:

The conflicting news, opinions, and proposed reforms circulating in this "Enron-era" make it difficult to maintain a clear perspective about what the real issues are. We have prepared this booklet to help clarify some of the key issues and to explain Deloitte & Touche's IQ—our integrity and quality. We are committed to achieving effective, comprehensive, and long-lasting reform.

We all need to work together to address the challenges facing our capital markets and to restore public confidence in the capital market system. The collapse of Enron, like most business failures, is not simply a matter of accounting and auditing. Such failures typically involve a convergence of factors, including personal integrity and ethics, the substance of legal advice, business and corporate governance practices, the transparency and nature of investment relationships, and the role of equity markets in analyzing and challenging financial data.

Our firm's integrity, tradition of excellence, and record of quality are the manifestation of our commitment and culture. This is not to suggest that there is no room for improving our practices. But as we consider the challenges being raised, our thinking is marked by a sense of caution, balance, and perspective. As Federal Reserve Chairman Alan Greenspan reminded the Senate in a recent pension reform hearing, "…it is very crucial to continuously ask the question, what are the secondary, unintended consequences of the actions you are taking?"

Mandatory Auditor Rotation

It has been suggested that public companies be required to rotate auditors every five to seven years. Such a requirement would likely result in decreased effectiveness and a lower quality of audits, as well as significant inefficiencies in performing those audits. This issue has been investigated many times by organizations such as the Securities and Exchange Commission (SEC) and the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Every time, the same conclusion has been reached—mandatory auditor rotation is neither necessary nor appropriate. Rotation of the lead audit partner on an engagement is required by professional standards and allows a fresh perspective without the upheaval and risk associated with a complete change in audit firms. In this time of significant questioning of our financial reporting system, it would be unwise to implement reforms that may do more harm than good. Improving auditor performance, audit committee effectiveness, and transparency in financial reporting would provide more value to the users of financial statements.

Scope of Services

Doubts have also been raised about an audit firm's ability to maintain its independence when it provides a client with both audit and significant nonaudit services, such as consulting. There is simply no truth to any assertion that we conduct audits solely as a means of obtaining consulting or related work or that we would be willing to compromise our integrity for additional fees. Our reputation for integrity and quality is our most important asset, and its loss would destroy our entire organization.

A recent study conducted by the University of Southern California's Marshall School of Business concluded, "...fees received by accounting firms performing both accounting functions and consulting services for the same company do not impede the ability of auditors to keep these dual roles separate." Regarding the value of the auditor's reputation, the study noted, "The loss of reputation and litigation costs provide strong incentives for auditors to maintain their independence. Our study provides evidence that these incentives outweigh the economic dependency created by higher fees." As one of the world's largest professional services firms, with $12 billion in revenues, our financial strength enhances our independence. No single client's fees are material to the firm or worth jeopardizing our integrity and reputation.

It was partly in response to criticism of the profession more than 30 years ago that audit firms progressively and deliberately expanded their scope of services to bring clients greater depth and breadth of knowledge and to gain the expertise needed to deliver more thorough audits. Contrary to current criticism of the broad scope of services offered by audit firms, an independent review by the Panel on Audit Effectiveness in 2000 concluded that there was no evidence that audit quality was compromised because a firm provided consulting and advisory services. In fact, the Panel asserted that in many of the audits it reviewed, audit quality had been improved by those services. We agree with comments made by SEC Chairman Harvey Pitt to the House Committee on Financial Services on March 20, 2002. Chairman Pitt stated, "We believe that limiting those services that create an inherent conflict with auditing, barring inappropriate compensation mechanisms (such as compensation for cross-selling services) and penalizing firms whose aggregate and individual audit performance is substandard (most likely by limiting the ability to take on new clients for significant periods of time and compelling termination of client relationships) are more likely to prevent audit failures than the suggestion that we increase the reliance of all audit firms on their audit clients."

One of our foremost concerns in the current climate is that reform may force firms such as ours to divest all but the most narrowly defined, audit-specific services. This would make it far more difficult to tap the multidisciplinary range of expertise that clients demand and that we need to meet our professional responsibilities. You can be assured that at Deloitte & Touche, we will do whatever we can to bring the right complement of specialists to our audit services. Our experience leads us to believe that, now more than ever, the audit of a complex company requires a broad array of skills and competencies in areas such as tax, computer technology, and actuarial and regulatory matters.

Hiring Professionals from Audit Firms

Some commentators have suggested a two- to three-year "cooling-off period" before a company would be allowed to employ the partners or staff members of its audit engagement team. Clients have long looked to their audit firms as a potential source of skilled, talented individuals to assist them in improving their controls and financial reporting processes—skilled, talented individuals who already understand their businesses and challenges and who bring solid objectivity and professionalism to their staffs. Restricting access to this valuable labor pool might have an indirect impact on the quality of financial reporting for many companies.

A more reasoned approach, and one that we believe is in place at many companies today, is for companies to establish policies stating when pre-approval or periodic reporting is appropriate with respect to recruitment from a professional services firm or a competitor. Management and boards of directors are accustomed to handling the real and perceived issues of such recruiting, whether it involves competitors, law firms, consulting firms, or audit firms. Companies and their boards are the responsible parties best equipped to evaluate these situations.

A Call for Meaningful Reform

We are committed to achieving effective, comprehensive, and long-lasting reform. There are a number of actions that should be taken to help restore confidence in our capital markets, including the following:

- The profession should continue to enhance its constructive collaboration with the SEC. Only through such a relationship can we eliminate issues before they become problems for the investing public. We need to support recommendations made by Commissioner Harvey Pitt, including the creation of a public accountability board that is independent of the profession and actively participates in processes, rather than simply overseeing them. This organization would also assume responsibility for quality review, replacing the current peer review system, and it would have the authority to put matters of importance on the agendas of standard-setting bodies.

- The profession should also assist in creating a board that would investigate financial disasters in much the same way that the National Transportation Safety Board investigates airline crashes. By quickly and systematically assessing what went wrong, corrective actions can be taken and future disasters averted.

- Management, boards, and external auditors should work together to improve the effectiveness and financial literacy of audit committees and the investing public — a goal to which we are firmly committed.

This booklet is divided into two sections. The first deals with Deloitte & Touche, focusing on our culture, our record of integrity and quality, and why we are a distinctive firm with a distinctive record. The second section considers key responsibilities of the audit committee, management, and the external auditors, and how we can work together to enhance the capital markets system. It also provides information on initiatives we are undertaking to enhance the effectiveness of audit committees, management, and external auditors.

This booklet is part of our broad-based effort to work with all relevant constituencies regarding the challenges facing the capital markets today. Your feedback is extremely important to us, and we ask that you share your thoughts with us.

Sincerely,

Deloitte & Touche

We are **Different**

INTEGRITY
& QUALITY

Today, the quality of financial reporting, auditing, and corporate governance is on the minds of virtually all participants in the capital markets. For years, Deloitte & Touche has been at the forefront of improving audit quality. In our continual effort to remain the quality leader of the profession, we:

- Developed innovative analytical and statistical methods and the first computer audit tools in the 1960s
- Introduced the first comprehensive audit methodology fully integrated with technology support (our AuditSystem/2 software) in the 1990s
- Required timely quarterly reviews of the interim financial statements of our public clients in 1993, years before they became mandated by professional standards.

Our record of quality and distinction is recognized by outside observers such as Jim Emerson, who is widely regarded as the premier independent evaluator of the Big Five professional services firms.

"When one considers the amount of unrest in the markets over the last year, one of the clear positives for FY2001 was the steady, consistent performance of Deloitte & Touche. In every category that we measure, D&T did well. And, while we do not attempt to measure the quality of auditing and accounting services in this report, we certainly have noticed that Deloitte's name has not come up as yet with regard to shoddy accounting and auditing. This could be just lucky, but somehow I don't think this is the case. For anyone who wonders whether a firm can take a conservative, responsible approach to quality issues and still do well financially, Deloitte would seem to be the example that demonstrates it can be done. For anyone who wonders whether a firm can treat its people well and create a great place to work and still do well financially, *Fortune* magazine seems to think Deloitte has accomplished that also. The events of the last year have certainly made me reflect on the fact that many times the reliable, quality performers don't get enough credit and attention. We salute the firm, its leadership, its people, and its clients for being a steady force during these very uncertain times."

Source: Emerson's 2002 **Big Five Annual Report**

How is Deloitte & Touche different?

At Deloitte & Touche, we work to maintain and protect our core values of integrity, objectivity, independence, and technical excellence. We employ outstanding professionals and instill in all our people the sense that we must always act with integrity and always do the right thing. Building on the foundation of outstanding people with strong values, we have created a system of quality controls too comprehensive to discuss here. We believe, however, there are two primary characteristics of our quality system that set us apart: our **distinctive approach to consultation** and a **rigorous, globally consistent audit process that is integrated with technology.** These differentiating factors are supported by our long-standing commitment to continuous improvement.

Consultation Approach

Consultation is one of our most fundamental client service standards: "Ensure that any professional, technical, or client service problem is resolved promptly, with timely consultation in an environment of mutual respect."

When our firm adopts a position on a given accounting issue, we reach our decision through careful deliberations and the involvement of people with the appropriate technical knowledge, skills, and experience. The goal of our consultation approach is to provide the right answer, the answer that will stand up to scrutiny. We strive to achieve this goal by first listening carefully to our clients and engaging in meaningful dialogue to gain a thorough understanding of the facts. We continue to probe for all of the facts throughout the consultation process, and we often find that the complete facts make the answer clear. Only by drawing on the experience and opinions of people with different perspectives can we determine the questions we need to ask to bring out the relevant facts.

A successful culture of consultation requires two other elements: a strong process to analyze the facts and reach the right conclusion and, just as important, assurance that everyone knows when consultation is appropriate. Most accounting and financial reporting issues are resolved by the engagement team using the firm's technical guidance and other authoritative resources. We require consultation on certain complex or unusual issues, and engagement teams often decide to consult on other technical matters. The firm's technical guidance is designed to assist our practitioners in identifying those issues.

Our approach is based on the simple premise that no one can or should know everything. It is an approach that neither breeds nor tolerates "lone rangers."

When a formal consultation process is necessary, it begins with local professional practice directors and continues through our structure to the national office. The research teams and specialists in the national office compare the issue to similar situations, consider the background and intent of the professional standards, and engage in a dialogue that draws on the disciplines most relevant to the issue. Specialists, including our regional professional practice directors, are part of our consultation network. Regardless of where they reside, these professionals report to our national office practice, not to a local office. Accordingly, the answers they reach are the answers of our firm.

Independence and objectivity have always been fundamental to us. Our national office consultation personnel do not have marketing or operations responsibilities. Our consultation approach also safeguards our engagement partners from pressure to provide expedient answers.

Differences of opinion do occur, and we expect each professional to address them throughout the consultation process. That includes challenging decisions with which they disagree. Challenges occur regularly during the consultation process and are welcomed as part of our model and process. We handle them thoroughly and professionally, and respect all points of view. Once a conclusion is reached, it is the final Deloitte & Touche conclusion – no partner may depart from it.

Our Audit Process and Integrated Technology – AuditSystem/2

We ground our audit process in a robust understanding of each client, its industry, and its environment. Based on this understanding, we assess controls and the risks of material misstatement of the financial statements, including those caused by fraud. We then design and perform audit procedures to address risks that may precipitate material misstatements of the financial statements. We determine the need for specialized skills in planning, performing, and evaluating our procedures. We also carefully review the results of our procedures to reach an opinion on the financial statements and determine whether our risk assessment and audit plan were appropriate.

Our global audit process, guidance, programs, and documentation are comprehensive, highly structured, and the result of a significant financial investment by our firm. Since its introduction in the 1990s, we have invested more than $500 million in AuditSystem/2 (AS/2), our audit process and integrated technology. This commitment includes training our employees, building the related infrastructure, and purchasing necessary equipment. Because the audit process is fully integrated with supporting technology, our people have access to detailed guidance that is geared to their level of experience to guide them throughout the process, while also allowing for an appropriate level of professional judgment. We use quantitative and qualitative methods to determine the extent of our work. Our approach is rigorous and delivers a high level of consistency across our practice—when we succeed other auditors, we frequently find that we perform more audit work than they did.

Our audit process assumes the use of specialized skills across a broad spectrum of activities. In today's complex environment, specialization in areas such as information technology controls, data extraction, risk management, income taxes, financial instruments, valuation, and actuarial science may be needed in addition to industry experience. In fact, effective audits of large, complex public entities may require such expertise, and the need for specialists is increasing. For example, the rise of fair value accounting measurements calls for valuation skills in many areas, including the assessment of goodwill impairment. Like our consultation approach, the use of specialists, when appropriate, is fundamental to our audit quality.

Continuous Improvement

When the Panel on Audit Effectiveness conducted its review of the largest accounting firms in 1999, it commended us for having a highly structured and comprehensive audit process. Several of the Panel's subsequent recommendations drew directly from what they learned of our processes. Of the Panel's 52 recommendations, Deloitte & Touche has already implemented 50, of which 32 were in place prior to the Panel's recommendations for improvement.[1]

In 1993, long before it became mandated by professional standards, we established a policy that required timely quarterly reviews of interim financial statements for all our public clients. In 2000, such reviews became mandatory as a result of the recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees. For a number of years, many of our audit teams have been performing expanded audit procedures related to the annual audit during each quarter. This practice became a firm policy for all public clients in 2001, and it is now the subject of a proposed professional standard. These procedures, which are separate from our quarterly review procedures, include tests of controls and risk areas such as estimates, judgments, and revenue recognition, as well as updating our risk assessment. Our objective is to audit significant transactions and events close to the time they occur. By doing so, we can help companies avoid mistakes and identify issues before they become problems.

In an ongoing effort to further enhance our audits, we introduced Deloitte Audit in 1997. This initiative requires a rigorous understanding of each client's business and its environment; a strong focus on risk and control; deeper use of specialized skills, especially as they apply to risk and control; innovative use of technology for data extraction and analysis; enhanced knowledge sharing; greater partner and manager involvement; and more frequent, substantive communication with management and the audit committee. Each year, our experience with Deloitte Audit yields additional best practices.

In February 2002, the Auditing Standards Board established a new standard, "Consideration of Fraud in a Financial Statement Audit." Although the standard will not take effect until 2003, we are adopting the new requirements for our audits of 2002 financial statements.

The most recent chapter in our efforts to achieve continuous improvement began in late 2001 with a comprehensive review of our audit process, technology, and performance support. Lessons we have learned, the experience we have gained on highly successful Deloitte Audit engagements, and the new perspectives opened by innovative uses of technology will all play a significant role in rethinking how we can make our audits even more effective in a highly complex environment.

1 The Panel recommended that firms work with the American Institute of Certified Public Accountants (AICPA) to create performance measures for audit effectiveness. We are willing to work with the AICPA on performance measures should such a project be undertaken. The Panel also recommended that firms advertise the importance of audits. We believe there is a clear understanding of the importance of audits, and that such advertising would be ineffectual.

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Roles and Responsibilities: Management, the External Auditor, and the Audit Committee

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It is difficult to say anything about the state of corporate governance today that does not oversimplify a very complicated and critical situation. Recent events have prompted everyone in the business community to begin asking difficult and necessary questions. As often happens, the public and the media have criticized all of the constituencies responsible for the effective oversight of companies—the accounting profession, audit committees, boards, law firms, and management. This criticism, although sometimes unfounded and based on misinformation, deserves our consideration and response. Investors and their advocates will insist on real changes in the way corporations govern themselves, and the accounting profession must take an active role in determining these changes.

The role of the audit committee has evolved, and our approach to client service has paralleled this evolution. Thought leaders throughout our firm have been meeting regularly to understand how our relationship with clients needs to grow. One important insight we have gained from these sessions is that the objectives of the external auditors, management, and the audit committee are very closely aligned. As the collapse of Enron has made clear, a weak system of corporate oversight yields no winners.

> Management, auditors, and audit committees each must diligently fulfill its own role and effectively work together with the others through proactive communication and information sharing. In working together we can collectively improve the financial reporting process. This requires a renewed commitment by each of the parties to the needs of financial statement users.

Source: **Impact of the Current Economic and Business Environment on Financial Reporting,** issued by the Big Five accounting firms and the AICPA in January 2002

Many of the facts of the Enron situation remain unknown. It is likely that the responsibility for the financial failure will not rest solely with a few unethical individuals, but will involve many honest people who were doing their best to fulfill their roles in the oversight of the company. One conclusion is that the roles themselves must expand and responsibilities must be executed effectively. Those of us charged with representing the interests of investors must work together, with the common goal of improving the process. Key to this process is taking communication among the participants to a new level.

A Multidimensional Relationship

We define the optimal client relationship as one in which the audit committee, management, and the external auditors recognize their interdependency and engage in open, candid dialogue.

As suggested by the illustration on the following page, management, the external auditors, and the audit committee must work together in a spirit of mutual respect and cooperation. In addition, the relationships among these parties must be balanced to be effective. Each party must have the opportunity to meet with each of the other two parties, independent of the third. During these meetings, each party must be prepared to hold candid, and sometimes difficult, discussions. For instance, the audit committee must be willing to challenge management on complex accounting issues, high-risk business areas or practices, and the assumptions behind significant judgments or decisions. Similar challenges must be made by the audit committee in its meetings with the external auditors. The audit committee must ask the external auditors tough questions, including whether they have been subjected to pressure by management to accept less than high-quality financial reporting. The audit committee should also seek the opinion of the external auditors on the depth of experience and sufficiency of staff in the company's finance, accounting, and internal audit organizations.

Best Practice

The audit committee should have exposure to business unit operations and financial leadership as well as to corporate functions and process leaders, including legal, tax, environmental, and technology.

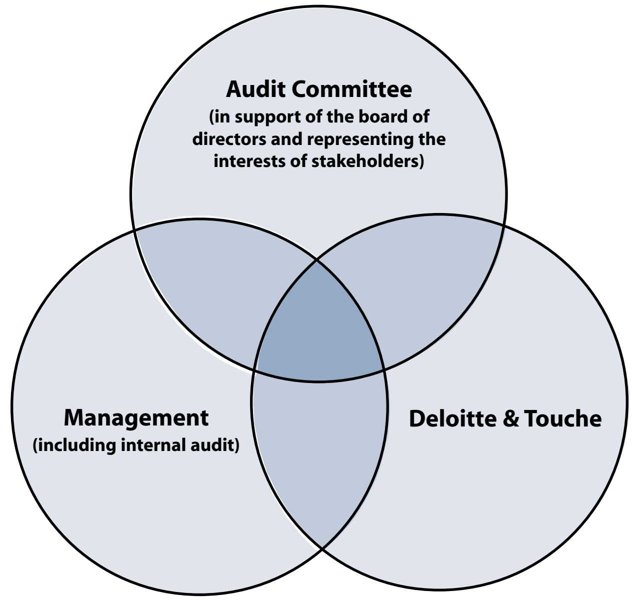
The audit committee should have a thorough understanding of the plans of both the internal and external auditors. The mandate of the external auditors to render an opinion on the company's financial statements is well understood, and the requirements for communication are a matter of professional standards. Conversely, the objectives of the internal audit function are more subject to management's judgment, with audit committee oversight. The audit committee should ensure that the objectives of the internal audit function are well understood; that staffing numbers and competencies are aligned with those objectives; and that processes and reporting are tailored to the needs of management and the audit committee. The committee should demonstrate an active interest in the internal audit function and should understand the degree of coordination and integration between the internal and external auditors.

The audit committee should communicate to senior management the expectation that the external auditors will have open access to the audit committee. Stakeholders should not condone a relationship between the external auditors and the audit committee that is constrained or guarded by management, or one that is too formal, or even ceremonial, in nature. Each party must be prepared to "talk straight" and to engage in difficult conversations that may provoke a certain level of tension and discomfort.

Although the extent and frankness of communication among the audit committee, management, and the external auditors varies from company to company, we believe there are three steps that every audit committee should take immediately.

Step #1: Audit Committee Self-Assessment

Every audit committee should complete a thorough self-assessment,[2] the results of which should be analyzed for areas in need of improvement, benchmarked against peer groups and best practices, and probed for root causes of deficiencies. Audit committees should ask themselves:



- The audit committee meets independently with management, the internal auditors, and the external auditors throughout the year.
- The external auditor and management work closely together throughout the audit, including the quarterly review process.
- Management, the external auditors, and the audit committee work closely together and are accountable to the board of directors, the shareholders, and the investing public.

- Is the audit committee encountering performance gaps, expectation gaps, or communication gaps in its dealings with management, the board, or the internal or external auditors? If so, how can these gaps be addressed and resolved?
- Does the audit committee possess all the skills and attributes needed to be effective?
- Have the expectations of management, the audit committee, and the internal and external auditors been defined adequately? Have these expectations been communicated to the board?

After completing the self-assessment and identifying any areas in need of improvement, the audit committee can focus its activities and those of management and the external and internal auditors on a plan to enhance effectiveness.

Deloitte & Touche is committed to assisting in this process. We are prepared to provide appropriate guidance, including financial literacy training, internal audit and financial reporting assessment, and models for understanding a company's specific

[2] In order to assist audit committees in completing a self-assessment, we have included a self-assessment questionnaire in the appendix. This may be used to evaluate audit committee effectiveness.

risks. Our Audit Committee Effectiveness Services (ACES) group was formed in 2001 with the mission of providing our partners with the tools and knowledge needed to support the audit committees of our clients as they undertake efforts to improve effectiveness.

Step #2: Expanded Interaction with Management and Auditors

In addition to interacting with the CEO and CFO, the audit committee should meet with key members of business unit and corporate management, such as the general counsel, the chief information officer, the director of environmental compliance, the tax director, the director of internal audit, and others to identify significant risks and understand the processes used by management to mitigate and control risks. The audit committee's interaction with the external auditors should include not only the lead audit partner, but also specialists such as tax professionals, actuaries, information technology security specialists, and others who can discuss the processes used by the external auditors.

While collaborating with management and the external auditors to set agendas for the year, the audit committee chairperson should identify key members of management with whom the audit committee would like to meet, and identify the topics to be discussed with each.

Step #3: Commitment to Continuing Education

Education in accounting issues and principles is an ongoing process for both management and the external auditors. This should also be true for the audit committee.

The audit committee should work with management and the external auditors to identify complex accounting issues and areas of significant risk that are most dependent on estimates, judgments, and assumptions. Ongoing educational sessions should be scheduled to cover these matters. The audit committee should also identify which members possess the necessary expertise to understand and evaluate such issues. If the audit committee concludes that no member has the requisite knowledge of the subject matter, it should augment its expertise appropriately.

Our Commitment to Audit Committee Excellence

We have a number of ongoing and planned initiatives that underscore our commitment to improving the effectiveness of audit committees.

Our initiatives include a multifaceted educational program for audit committees and boards of directors that is focused first and foremost on our clients. Our commitment to audit committee education begins with our clients and the promise that we will work closely with management and the audit committee in identifying educational opportunities and developing alternatives tailored to each situation.

The Center for Excellence in Corporate Governance: The cornerstone of our commitment to improving audit committee effectiveness is our Center for Excellence in Corporate Governance (the Center). Each audit committee faces unique challenges. The mission of the Center is to foster an open dialogue between audit committee members and Deloitte & Touche partners that will allow proactive identification of issues and development of a tailored, focused plan for action. We believe that true change can occur only when management, the auditors, and the audit committee work together, face to face. The goal of the Center is to ensure that our partners foster this relationship for all our clients. The specific objectives of the Center include:

- Assisting audit committees in effectively addressing and managing their expanded roles and responsibilities
- Providing multifaceted education for audit committee and board members
- Fostering partnerships with respected professional organizations that are focused on effective corporate governance
- Encouraging innovative thought leadership.

An advisory council comprised of academic representatives, board members, corporate executives, and retired partners will serve as the sounding board for ideas and activities to ensure that the Center's objectives and activities are closely aligned with relevant corporate governance issues. The council will be chaired by an external individual with substantial authority to direct the activities of the Center.

The Center represents a commitment to dedicate the resources necessary to continuously improve the corporate governance systems of our clients. These resources include specialists from our ACES program.

Audit committee members must make the time, and take the time, to achieve an adequate understanding of what the company's financials represent, to have enough time to consult with outside counsel and experts if necessary, to ask the tough and incisive questions, and to obtain answers that make sense. As such, an effective audit committee requires a commitment of quality and quantity time: quality time in that they will give the critical corporate governance and accounting and disclosure issues their full attention, and quantity of time to allow thorough deliberations and discussion.

Source: March 7, 2002 speech by SEC Chief Accountant **Robert Herdman**

The Center for Excellence in Corporate Governance is responsible for various audit committee activities, including those outlined below. Some, like the FEI Research Foundation collaboration, are the continuation of activities we have been committed to for some time. Others, such as the audit committee educational seminars and e-learning program, demonstrate our intensified commitment to the audit committees of our clients.

FEI Research Foundation Collaboration

FEI is a professional association for senior financial executives; its 15,000 members include CFOs, controllers, treasurers, tax executives, and finance and accounting academicians. We commend FEI for its efforts to champion change in corporate governance. The FEI Research Foundation, a nonprofit, independent research organization that relies solely on tax-deductible contributions, has partnered with Deloitte & Touche on a number of audit committee projects, including:

Audit Committee Financial Literacy Executive Report—In a speech on audit committee effectiveness on March 7, Robert Herdman, chief accountant of the SEC, highlighted the need for audit committees to refocus on the financial literacy of their members. Audit committees are seeking guidance on measuring financial literacy, and the FEI Research Foundation/Deloitte & Touche executive report offers a three-step process: define, self-assess, and improve.

Audit Committee Trends and Tools Executive Report—The turbulent environment has caused many audit committees to take a hard look at their activities and procedures. Deloitte & Touche partners collaborated to study the behavioral trends of audit committees, and worked with the FEI Research Foundation to develop several tools to assist audit committees.

Virtual Roundtable Series—The FEI Research Foundation and Deloitte & Touche have and will continue to host Web conferences designed to assist financial management in proactively addressing audit committee concerns.

Audit Committee Education

Deloitte & Touche is proud to announce a seminar series that will begin in June of 2002. The seminars are specifically designed for audit committees. In the spirit of building on our ideal of a balanced relationship among management, the external auditors, and the audit committee, the program will encourage attendance by all three groups. Significant time will be devoted to the specific application of broad concepts and issues.

E-Learning

We will provide Web-based education that will allow audit committees and board members to gain specialized knowledge of topics directly relevant to their oversight responsibilities. This initiative employs a convenient, self-selection format that can be delivered in advance of key meetings and discussions.

Audit Committee Effectiveness Self-Assessment

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The following questionnaire is intended to assist audit committees in completing a thorough self-assessment of their effectiveness. The questions were derived from various sources, including the "Call to Action" items in the January 2002 document entitled, *Impact of the Current Economic and Business Environment on Financial Reporting* prepared by the Big Five accounting firms and the AICPA. The responses should represent the committee's collective view. It is not critical that audit committees follow the format or rating mechanism set forth below, but that they consider each point carefully in determining strengths and areas in need of improvement.

	RATE EFFECTIVENESS 1 = LESS EFFECTIVE 5 = HIGHLY EFFECTIVE	COMMENTS
Risk Management		
1. The audit committee has assessed the effectiveness of the risk management processes used by management.	1 2 3 4 5	
2. The audit committee meets periodically with the chief risk officer or his or her equivalent to better understand the risks facing the organization and how those risks are monitored for possible financial reporting implications.	1 2 3 4 5	
3. The audit committee periodically meets with key members of management, such as the general counsel, the chief information officer, the director of environmental compliance, the tax director, and others to assist in identifying significant risks.	1 2 3 4 5	
4. The audit committee reviews and understands the processes used by management, the external auditors, and the internal auditors to identify and respond to risks related to critical third-party interdependencies (suppliers, customers, outsourced operations, counterparties) that affect the organization's operations.	1 2 3 4 5	
5. The audit committee questions management and the external auditors about how they assess the risk of material misstatement, what the major risk areas are, and how they respond to identified risks.	1 2 3 4 5	
6. The audit committee reviews and understands the processes used by management, the external auditors, and the internal auditors to identify and respond to risks related to subsidiary locations, joint ventures, equity affiliates, off-balance-sheet transactions, and related entities.	1 2 3 4 5	
7. The audit committee has an understanding of the company's critical business continuity risks and management's plans to address such risks.	1 2 3 4 5	

	RATE EFFECTIVENESS 1 = LESS EFFECTIVE 5 = HIGHLY EFFECTIVE	COMMENTS
Financial Reporting and Compliance		
8. The audit committee requests and obtains sufficient information related to important financial reporting issues, such as the use of complex financial instruments, areas of judgment or high subjectivity, unusual transactions, and changes in accounting policies.	1 2 3 4 5	
9. The audit committee reads the company's annual report, financial statements, and MD&A to determine if anything is inconsistent with their knowledge, including areas such as liquidity, unusual transactions, and off-balance-sheet arrangements.	1 2 3 4 5	
10. The audit committee understands why critical accounting principles were chosen and how they were applied, and considers the quality, not just the acceptability, of financial accounting and reporting, including the transparency of disclosures.	1 2 3 4 5	
11. The audit committee understands the process used by management to identify related parties and considers the transparency of the related-party disclosures.	1 2 3 4 5	
12. The audit committee obtains from management and the external auditors an understanding of significant transactions and how they were accounted for, including acquisitions, dispositions, and special-purpose entities.	1 2 3 4 5	
13. The audit committee reviews all unrecorded audit adjustments with management and the external auditors and understands why they were not recorded.	1 2 3 4 5	
14. The audit committee asks the external auditors about pressures on management that may have an impact on the quality of financial reporting, such as earnings targets and performance measures.	1 2 3 4 5	
15. The audit committee makes inquiries of management and the external auditors on the experience and sufficiency of the audit team assigned to the engagement.	1 2 3 4 5	
16. The audit committee considers the level of nonaudit services provided by the external auditors in assessing the external auditors' independence.	1 2 3 4 5	
17. The audit committee reviews the external auditors' scope and audit plan to its satisfaction prior to commencement of the audit.	1 2 3 4 5	
18. The audit committee chairperson meets with the external and internal auditors outside the regularly scheduled meetings to encourage open and frank dialogue.	1 2 3 4 5	
19. The audit committee chairperson communicates to the external auditors the expectation that the external auditors will contact the committee when necessary.	1 2 3 4 5	
20. The audit committee is satisfied that management exhibits the proper "tone at the top" and is committed to promoting high-quality financial reporting and strong internal controls.	1 2 3 4 5	

INTERNAL CONTROL ENVIRONMENT	RATE EFFECTIVENESS 1 = LESS EFFECTIVE 5 = HIGHLY EFFECTIVE	COMMENTS
21. The audit committee receives enough information to review, understand, and assess the organization's system of internal controls, including information technology controls.	1 2 3 4 5	
22. The audit committee makes inquiries of the external auditors and management on the experience and sufficiency of staff in the finance and internal audit organizations.	1 2 3 4 5	
23. The audit committee reviews the internal audit plan annually.	1 2 3 4 5	
24. The audit committee reviews the management recommendation letters, written by the internal and external auditors, to ensure that all significant matters raised are properly addressed.	1 2 3 4 5	
25. The audit committee assesses both the compliance effectiveness and the value of service of the internal audit department.	1 2 3 4 5	
Corporate Governance		
26. The board of directors or the audit committee assesses the financial literacy of audit committee members in accordance with the applicable stock exchange rules.	1 2 3 4 5	
27. The audit committee has an orientation program to educate new members on their responsibilities.	1 2 3 4 5	
28. The audit committee participates in a continuing education program to enhance audit committee members' understanding of relevant accounting and reporting areas.	1 2 3 4 5	
29. Management, the external auditors, and the board of directors provide input on the audit committee charter and meeting agendas.	1 2 3 4 5	
30. Audit committee meetings are scheduled with sufficient time to cover all agenda items.	1 2 3 4 5	
31. The audit committee reviews significant issues with management and the external auditors prior to quarterly and annual earnings releases.	1 2 3 4 5	
32. The audit committee is authorized to retain independent counsel, accountants, or other advisors to assist in investigating any matters within the committee's scope, as appropriate.	1 2 3 4 5	
33. The audit committee is informed of communications received from governmental or regulatory agencies or similar parties relating to areas of alleged violations or noncompliance.	1 2 3 4 5	