AUDIT COMMITTEES AND AUDITOR ENGAGEMENT

As the end of 2003 approaches, we are reminding our public company clients of the recent amendments to existing rules regarding audit committee oversight and control over audit engagements. The goal of these amendments, along with other changes adopted by the Sarbanes-Oxley Act, is to enhance the independence of outside auditors that audit and review financial statements filed with the SEC. The amendments enact provisions of the Sarbanes-Oxley Act of 2002 to:

- require that a company's audit committee pre-approve all audit and permissible non-audit services provided to the company by its auditor,
- revise rules related to non-audit services that, if provided to an audit client, would impair the auditor's independence,
- require that the auditor of a company's financial statements report certain matters to the company's audit committee, and
- require disclosures to investors of information related to audit and non-audit services provided by, and fees paid to, the auditor of the company's financial statements.

Below is a summary of some of these new rules that may affect the preparation of your upcoming annual report and proxy statement:

Pre-Approval of Audit, Review and Attest Services

The audit committee (or the board of directors if the company does not have an audit committee) of a public company must approve all audit, review or attest engagements required under the securities laws.

Audit services include statutory audits, such as those required by regulated businesses, including banks and insurance companies, and include services performed by the auditors which are a necessary part of the audit process, such as a tax partner reviewing the tax accrual in the company's financial statements. Review of a proposed transaction, such as an acquisition, for an evaluation of the appropriate accounting treatment would not constitute audit services and, therefore, require pre-approval by the company's audit committee, as described below.

Pre-Approval of Permissible Non-Audit Services

Any non-audit service that is not a prohibited non-audit service can be provided by the auditor to the company or any of its subsidiaries only if the service has been preapproved by the company's audit committee.

Prohibited Non-Audit Services

An auditor who audits a public company's financial statements may not also provide that public company, contemporaneously with the audit, certain prohibited nonaudit services. Such prohibited non-audit services include:

- bookkeeping and related services
- financial information systems design and implementation
- appraisal or valuation services or fairness opinions
- actuarial services
- internal audit outsourcing
- management functions
- human resources
- broker-dealer, investment adviser or investment banking services
- legal services
- expert services

Generally, tax services are permissible non-audit services.

Pre-Approval Policies and Procedures

As an alternative to the audit committee approving each permissible non-audit service, such services may be pre-approved pursuant to policies and procedures established by the company's audit committee. Such pre-approval policies and procedures, if adopted, must be disclosed in

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the company's annual report. Pre-approval policies and procedures must:

- be detailed as to the particular service so as to safeguard the continued independence of the auditors,
- require that the audit committee is informed of each service not later than at the next scheduled audit committee meeting, and
- not include delegation of the audit committee's responsibilities to the company's management, but may be delegated to one or more audit committee members who are independent board directors.

De minimis exception

The SEC's rules also allow for a de minimis exception to pre-approval of permissible non-audit services. This exception provides that pre-approval by the audit committee is not required for permissible non-audit services provided that such services:

- do not, in the aggregate, exceed 5% of total revenues paid by the company to its auditors in the fiscal year when services are provided,
- were not recognized as non-audit services at the time of the engagement, and
- are promptly brought to the attention of audit committee and approved prior to the completion of the audit by the audit committee or one or more designated representatives.

Transition

The rules requiring pre-approval of both the audit services and permissible nonaudit services became effective on May 6, 2003. For arrangements for non-audit services entered into prior to such date, whether or not they were pre-approved by the audit committee, the outside auditors will have until May 6, 2004 to complete these services.

Communication with Audit Committees

Auditors are required to report to the company's audit committee:

- all "critical" accounting policies and practices used by the company,
- all alternative accounting treatments of financial information within GAAP that have been discussed with management, including the ramifications of the use of such alternative treatments and disclosures and the treatment preferred by the auditors, and
- other material written communications between the auditors and management of the company, such as:
  - o the management representation letter,
  - o reports on observations and recommendations on internal controls, schedules of unadjusted differences (although there are not supposed to be any more unadjusted differences), and a listing of adjustments and reclassifications not recorded, if any, and
  - o the auditor's engagement letter and independence letter.

These reports to the audit committee are in addition to the existing requirements of the auditor to communicate certain matters to the audit committee under generally accepted auditing standards, such as the company's significant accounting policies.

The communications between the auditor and the audit committee must occur prior to the filing of the audit report with the SEC. This means that such communications must occur prior to filing of annual reports and proxy statements, registration statements under the Securities Act of 1933, and other periodic or current reports when audit reports are included.

Additional Annual Report Disclosure

For fiscal years ending after December 15, 2003, each company must include in their Form 10-K or Form 10-KSB or proxy statement a table describing fees paid to their auditor. A sample table is set forth below:

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1	2	3	4	5	6	7	8
Fiscal Year Ending	Audit Fees (fee billed for services rendered by the auditor for the audit of the annual financial statements and review of the quarterly financial statements)	Audit-Related Fees (fees billed for assurance and related services by the auditor that are reasonably related to the performance of the audit or review of the company's financial statements and are not reported under column 2)	Percentage of Audit-Related Services that were approved by the audit committee	Tax Fees (fees billed for server ices rendered by the auditor for tax compliance, tax advice, and tax planning)	Percentage of Tax Services that were approved by the audit committee	All Other Fees (fees billed for products and services provided by the auditor, other than the services reported in columns 2,3 or 5)	Percentage of All Other Services that were approved by the audit committee
Last Fiscal Year							
Prior Fiscal Year							

The nature of the Audit-Related Services, Tax Services and All Other Services must be disclosed in the Form 10-K or Form 10-KSB. Additional disclosure is required if more than half of the time expended by the auditor to audit the financial statements for the most recent fiscal year were attributed to work performed by persons other than the outside auditor's full-time, permanent employees. Finally, if the audit committee has applied the de minimis exception, the company must disclose by category the percentage of the total fees paid to the auditors where the de minimis exception was used.