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AUDIT COMMITTEE INSTITUTE

Ten To-Do's for Audit Committees in 2010

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Today's changing business and economic conditions provide an opportunity for the audit committee to reassess its priorities and refocus its agenda.

KPMG works with many audit committees. Our involvement with audit committees for public companies, public sector entities, not-for-profits, and private companies gives us a window into the issues audit committees are currently addressing.

We have identified what we consider may be the top 10 to-do's for 2010. Of course, the needs and issues of individual organizations will vary. Use the following ideas as a starting point in reviewing your audit committee's agenda and workload.

When considering their 2010 agendas, audit committees should …

1. Regain control of the audit committee agenda.

The challenges of the economic downturn (access to capital, cash flow, liquidity, counterparty risks, impairments, etc.) have dominated audit committee agendas. As signs of recovery emerge, take the opportunity to develop more focused (yet flexible) agendas, with an eye on the company's key financial reporting risks, including the rapidly approaching changeover to IFRS. To improve the efficiency of committee meetings, insist on quality pre-meeting materials, spend less time on low-value or checklist activities, and engage in discussions rather than listening to presentations. Do not let compliance activities crowd out substantive discussion.

2. Actively oversee the enterprise's changeover to IFRS.

Understand how the changeover to IFRS will affect the organization and its stakeholders, and remember that the board and the compensation committee must also understand the implications of this change. Closely monitor the enterprise's progress in its conversion plan and whether work needs to be accelerated to meet key milestones.

Committee members need to have achieved appropriate levels of IFRS financial literacy, enabling them to clearly understand the financial reporting impact of management's choices of accounting policies and elective exemptions. Clearly understand how the enterprise's financial statements will change, and review management's communications plan for helping financial statement users to understand the impact of adopting IFRS.

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Consider regulators' expectations for IFRS-related disclosures, and examine the company's ongoing MD&A to ensure they provide appropriate disclosures, compared with those of the enterprise's peers and competitors.

3. Understand the risks posed by cost reductions made in response to the economic downturn.

Many companies have engaged in cost cutting as the economy declined. Every board and audit committee should now be asking whether the company's delivery model has been changed permanently, and whether a 'cost-reduced' business model can be sustained. Did we cut too much? What are the implications for our IFRS conversion project? How quickly can we restore critical infrastructure such as IT and sales force? How far have we extended the organization through outsourcing and offshoring?

As companies cut costs and reduce their workforce, the control environment becomes even more critical. Now is not the time to cut back on internal audit's budget.

4. Focus closely on all financial communications.

Narrative reporting (such as MD&A and the new Compensation Disclosure and Analysis referred to as CD&A), earnings releases and analyst briefings can pose difficult issues because they contain important business information that often does not come from the financial reporting system, is not audited, and is not subject to internal controls. If you have not already done so—given the uncertainties created by the economic downturn—reconsider the company's narrative reporting and the earnings guidance it issues. Engage early on in reviewing the 2010 disclosures, particularly new disclosures regarding the company's changeover to IFRS, risk, compensation, and corporate governance. Understand the company's policy on the use of Twitter and other social media networks to reach investors and customers.

5. Continue to monitor fair value issues, impairments, and management's assumptions underlying critical accounting estimates.

These issues, together with pension funding shortfalls and going-concern challenges, will continue to be major areas of focus for audit committees. No new changes are expected this year. To enable Canadian enterprises to focus on the January 1, 2011 changeover to IFRS, Canadian standard setters are working to minimize any new financial reporting developments that would require the committee's attention.

6. Rethink the audit committee's role in risk oversight.

The tremendous focus on risk today provides an opportunity for the board to reassess the oversight role of the audit committee, the full board, and the other standing committees such as the risk committee. Does the audit committee have the expertise and time to deal with strategic, operational, and other risks? Is the expertise of other board members being leveraged? Audit committees already have a lot on their plates with oversight of financial reporting risks.

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7. Make sure internal audit is properly focused and fully utilized.

Help refine internal audit's role, and focus internal audit's activities on key areas of risk, as well as risk management generally. Internal audit is not accountable or responsible for risk management, but it should provide added assurance to the audit committee regarding the adequacy of the company's risk management processes. Internal audit is most effective when it is focused on risk: ensure that the internal audit plan is risk-based and focuses on the critical risks to the business and not just compliance and financial risks.

8. The economy continues to put pressure on compliance and anti-fraud programs.

Be vigilant. The economic downturn has placed tremendous pressure on management to achieve operating results; at the same time, cost cutting and workforce reductions have exacerbated the pressure on these programs. How has the company treated its employees? How do they think they have been treated? A comprehensive review of the company's anti-fraud and compliance programs may be in order. The right tone at the top and throughout the organization is critical.

9. Help reduce the risk of misalignment as the company undergoes change.

Change creates risk. During times of dramatic change, the risk of misalignment—of the company's strategy, goals, risk, controls, compliance, incentives, and people—goes up exponentially. Given the audit committee's role in overseeing risk, internal controls, compliance and, ultimately, the impact of significant changes including the changeover to IFRS on the company's financial statements, the committee is in a unique position to help reduce the risk of misalignment.

10. Take a fresh look at the audit committee's composition and leadership.

The audit committee's effectiveness and accountability hinges on meaningful self-assessment of the audit committee as a group as well as individual members. Take a hard look at the committee's composition, independence, and leadership. Is there a need for a 'fresh set of eyes'? Do board directors have adequate IFRS financial literacy to support succession planning for the audit committee?

Remember, this is not a prescriptive list; individual boards will find value in setting aside time to reassess and reflect on their own priorities, taking into account their unique circumstances and needs.

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