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AUDIT

The evolving role of Canadian audit committees

2010 Audit Committee Member Survey

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INSTITUTE OF
CORPORATE DIRECTORS
INSTITUT DES ADMINISTRATEURS
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The audit committee's role continues to evolve in importance, and its focus is broadening.

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Survey snapshot

Canadian companies and the audit committees that serve them have felt not only the impacts of the economic crisis, but also several aspects of globalization: country-specific instability; the complexities of doing business in multiple global jurisdictions; and the fact that IT systems have increased the velocity of not only information, but risk. The volatility of this environment and the speed at which change happens have necessitated a greater level of engagement, expertise and focus, making the role of the audit committee more demanding overall.

Audit committee members across Canada have common views about their expanding roles and responsibilities as their companies work to survive and compete in a challenging economic environment:

- Liquidity and access to capital are heightened areas of focus
- Recent cost reduction strategies have unearthed concerns that go beyond the Finance function
- Responsibilities in risk management are expanding, encouraging the implementation of more formal risk systems
- Most perceive drilling down into subjective areas of financial reporting as a key undertaking
- Increasing the focus on financial communications is not seen as a core area of responsibility
- There is some concern that the CFO and Finance group may be overworked, potentially impacting their effectiveness and the quality of the company's financial reporting.

The evolving economy: Implications for audit committee oversight

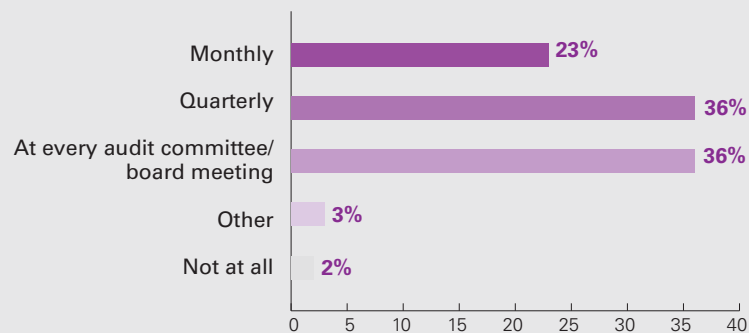
The economic crisis of the last few years has continued to put pressure on Canadian companies and their audit committees. And while many predict that the recovery is on its way, it's clear that the changing business environment has sharpened the focus of audit committees in some areas and broadened their focus in others.

In the past, during booming economies, reviewing a company's debt covenants would have been considered routine and not an area of particular focus by audit committees. However, recent times see company operations being negatively impacted by what is happening to customers and suppliers, which in many

cases is creating deteriorating results and bringing companies close to being out of compliance with their borrowing covenants. Add to this the additional difficulty of finding financing or refinancing debt cost-effectively in a depressed economy, and we begin to understand why audit committees are now increasing their focus on getting

more frequent and robust reports from management. In fact, 23 percent receive reports on their company's liquidity position monthly, 36 percent receive liquidity reports quarterly and another 36 percent receive them at every audit committee/board meeting.

How frequently does your audit committee/board receive reports on the company's liquidity position?





The downturn caused many companies to undertake various cost reduction measures, and while 58 percent of audit committee members are confident that the measures undertaken by their companies were properly targeted and strategic, they are concerned about the potential issues the cost reductions could create in the long run, and not just from a financial perspective. Financial reporting integrity (18 percent)

and internal controls (28 percent) were concerns, but they took a back seat to the impacts on employee talent and training (46 percent) and the quality of the leadership pipeline (30 percent). Audit committees will frequently ask “Do we have the right people to get the job done?”, and usually the question is asked in a financial context: “Do we have the right Chief Financial Officer (CFO) and Finance skills?” But

with the backdrop of the current economic struggle, an environment in which cuts to training and leadership development can have a significant impact on the strategic health of the company, the question of “the right people for the right job” expands to include the company’s ability to compete, meet their growth and performance targets, and adapt for the future.

In what areas are you most concerned about the impact of recent cost reductions undertaken by your company? (Select three)

	Response
Employee talent and training	46%
Leadership pipeline	30%
Internal controls	28%
Financial reporting integrity	18%
Management of outsourcing/extended supply chain	16%
Fraud risk	9%
Compliance with anti-bribery/corruption laws and regulations	3%
Not concerned	30%

Risk management

One area of responsibility that has developed significantly across most audit committees is risk management. The process of identifying, mitigating, monitoring and reporting on risks that a company faces, including not just financial risks, but broader risks around operations, reputation, strategy, and legal and regulatory issues, has broadened the role that audit committees play within a company.

While 88 percent of audit committees say they have primary responsibility for financial risks, 66 percent indicate they also are responsible for legal/regulatory risks, and 63 percent have additional responsibility for IT, security and privacy risks. Operational (37 percent), strategic (31 percent) and HR/labour (14 percent) are other key areas of risk responsibility. And while many have been areas of responsibility for audit committees in the past, the economic challenges of the last few years have sharpened their focus.

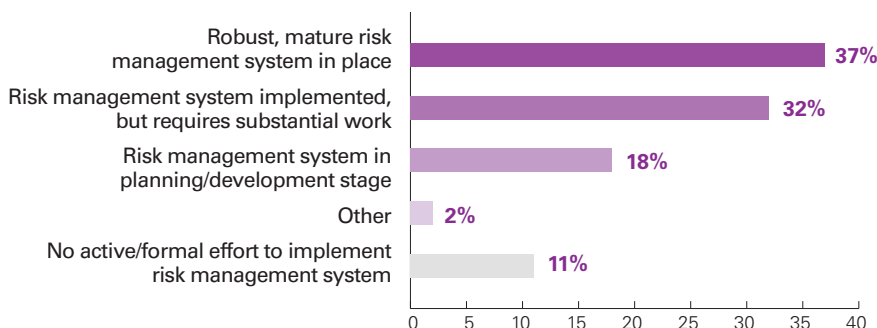
In addition to financial reporting risks, for what categories of risk does your audit committee have primary oversight responsibility? (Select all that apply)

	Response
Financial risks (e.g., cash flow, access to capital, debt covenants)	88%
Legal/regulatory compliance risks	66%
IT, security and privacy risks	63%
Operational risks	37%
Strategic risks	31%
HR/labour risks	14%
None of the above	7%

This is underscored by the 37 percent of audit committees representing companies that have implemented a robust, mature risk management system. A further 32 percent of the companies have put in place a risk management system, but it requires

substantial work, and 18 percent are planning to implement a risk management system. One-quarter of respondents indicate that their company has appointed a Chief Risk Officer to support their risk management position.

What is the status of your company's risk management system/program?



When it comes to discussing the company's risk appetite, however, there appears to be room for improvement. Only 17 percent of audit committees approve a formal, written statement of the company's risk appetite, and just over one-quarter (26 percent) approve risk appetite in general but do not receive a formal statement. The majority of respondents do not focus on this area of risk management—36 percent discuss it only once per year and 21 percent do not discuss it at all.

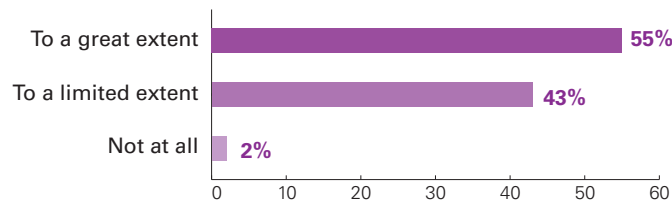
While there is no regulatory requirement for risk identification, mitigation and monitoring, there are disclosure requirements around risks and trends facing the company. In certain industries, these risk and trend disclosures can be "boilerplated" based on a standard suite of industry-specific risks. But companies that are doing a better job on the risk management front are having their audit committees prioritize and focus on risks that are customized and specific to the company, so that there is some degree of comfort that the company's risk issues are being addressed.

Almost three-quarters of respondents indicate that the full board has primary responsibility for the oversight of the company's strategic risks, including risks that threaten the company's strategy, business model or existence. Twenty percent of respondents mention it is the audit committee's primary responsibility.

Financial reporting

Financial reporting is clearly a core area in which audit committees provide expertise and insight. One of their key roles is to drill down and review the key assumptions underlying management's accounting judgments and estimates, and 55 percent say they delve into this important financial reporting area to a great extent, which is encouraging. Note, however, that 43 percent drill down only to a limited extent and 2 percent not at all. This is an area that should receive more focus from audit committees and one which could help to enhance the value that they bring to the companies they serve.

To what extent does your audit committee "drill down" and review the key assumptions underlying management's material accounting judgments and estimates?



Financial communications provides another area in which audit committees could enhance their role. Amid the current economic challenges, companies may be exposing themselves to risks by not increasing their scrutiny of financial communications such as earnings estimates, earnings press releases

or scripts for analysts calls, but 64 percent of Canadian audit committees surveyed say they have not focused more attention on these communications. Compare this to the 47 percent of audit committees globally who say they have not increased their scrutiny of these financial communications.

In light of the economic crisis, has your audit committee increased its scrutiny of the company's financial communications in any of the following areas?

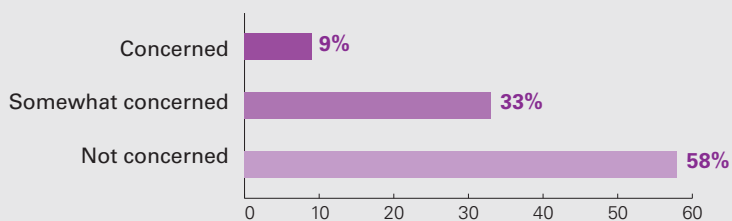
(Select all that apply)

	Canada	Global
Earnings estimates	27%	40%
Earnings press releases	22%	36%
Scripts for analyst calls	3%	12%
None of the above	64%	47%

Audit committee effectiveness

Even before the economic crisis, CFOs and audit committees have had to deal with significant changes, including new accounting standards, regulatory changes and public company requirements. These changes have increased the profile of the CFO, but also the breadth of the work required by the CFO and the Finance group. Audit committees understand this, with 42 percent indicating they are concerned that the CFO and Finance group routinely work extraordinary hours, potentially impacting their effectiveness and the quality of the company's financial reporting (9 percent are concerned and 33 percent are somewhat concerned).

How concerned are you that the CFO and Finance group are routinely working extraordinary hours, potentially impacting their effectiveness and the quality of the company's financial reporting?



Creating further risk in the Finance function is the fact that only 44 percent of audit committees or boards have a formal succession plan in place for the CFO. However, on a positive note, 66 percent are confident that the CFO has the necessary resources in order to carry out his or her responsibilities effectively, with another 32 percent indicating they are somewhat confident.

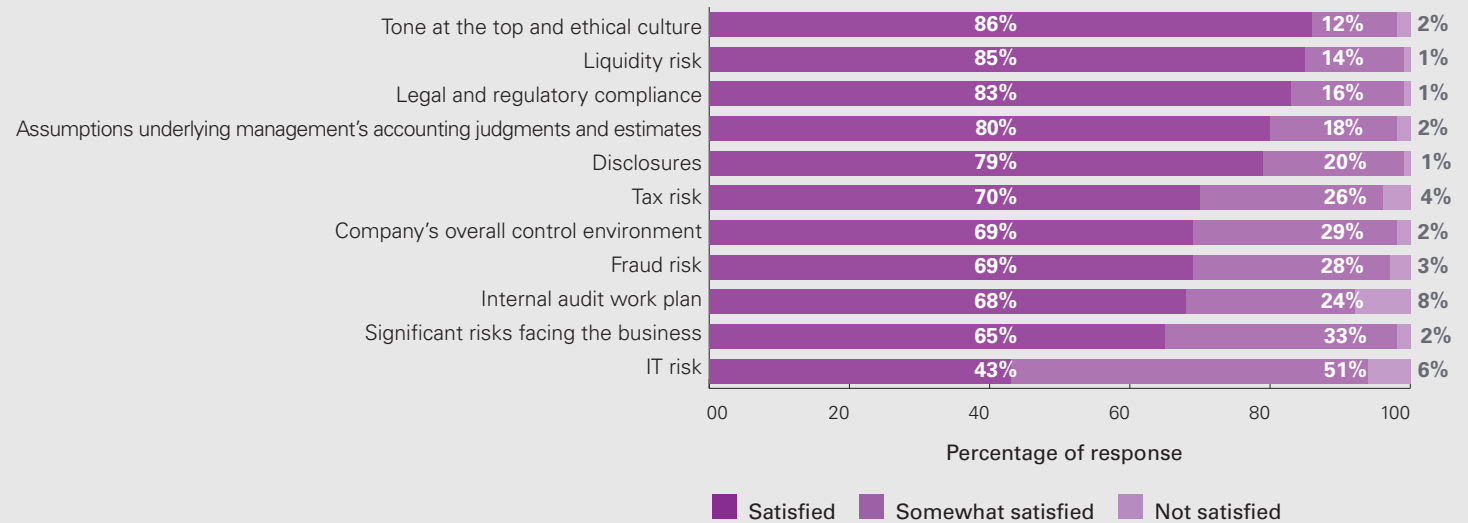
The majority of respondents (91 percent) indicate their audit committee has frequent communications with the CEO, CFO and other senior executives to develop an understanding of the "tone at the top" and ethical culture of the company. When it comes to the quality of information they receive in connection with various areas of oversight, most respondents are satisfied. For example, 85 percent are satisfied and 14 percent are somewhat satisfied with information related to liquidity

risk, and other financial, legal and control areas of oversight also received high marks. One area that audit committees are less satisfied with, however, is IT risk (43 percent are satisfied and 51 percent are somewhat satisfied). It is not surprising that respondents indicate reduced comfort levels with IT risk since it is rare to have audit committee members with specific IT expertise. Audit committees understand this and are seeking enhanced information quality to assist them with oversight of this area.



How satisfied are you with the quality of the information your audit committee receives in connection with each of the following areas of oversight?

(Select one level of satisfaction for each area)



KPMG's final thoughts: Enhancing audit committee performance

Four key issues emerged from this survey that could be future areas of focus for audit committees:

1. Risk management systems

Companies today need to have robust risk management systems in place. The complexity and global nature of the business environment demands it—and many respondents understand this. While it may be that some of the companies that don't have a robust system in place have reasonably simple operations, it is nevertheless something they should consider implementing.

2. Risk appetite

Considering that almost 60 percent of audit committees indicate they don't focus on the risk appetite of their companies, we feel that this should be a prominent area for audit committee review and discussion—whether it's required by regulation or not. Audit committees that are fulfilling their oversight roles well are those that are prioritizing and customizing the risks specific to their organizations.

3. Financial communications

The financial crisis of the last few years and the ensuing increased scrutiny of financial reporting by regulators, analysts and investors have made audit committees globally focus more closely on their companies' financial communications. However, with less than half of the Canadian audit committees surveyed feeling the need to increase their efforts in this area, we see an opportunity for improvement here.

4. Financial reporting

Drilling down into the more subjective aspects of financial reporting, such as the key assumptions of material judgments and estimates, is one of the areas in which audit committees can add value. They can rely on the statements of management and external auditors and stop there—or they can delve further and ensure that the next level of challenge and assessment is conducted. This is a key area of differentiation for audit committees and one that can help enhance their role and provide that additional layer of scrutiny that companies, boards, investors and other stakeholders are seeking.



About the survey




The Institute of Corporate Directors (ICD) is a not-for-profit, member-based association representing Canadian directors and boards across the for-profit, not-for-profit and government sectors. With more than 4,500 members and a network of nine chapters, the ICD promotes the effectiveness of directors by providing quality director education and professional certification, opportunities for continuous learning and networking through local chapter events, board matching and referral service, and access to timely information on current and emerging governance issues and best practices.

The results of KPMG's 2010 Audit Committee Member Survey are based on the responses of 180 audit committee members across Canada. The survey was conducted between February and May 2010.

All respondents serve on the audit committee or equivalent of at least one company. Respondents were asked to answer survey questions based on the largest company (by revenue) that they represent, with 60 percent of companies having revenues less than \$500 million.* A wide range of industries were surveyed, including Energy & Natural Resources, Banking & Financial Services, Healthcare, Insurance and Technology & Software.

* Respondents were asked to check "all that apply" for several questions; therefore, not all data tallies to 100 percent.

- Slightly more than half (55 percent) of the respondents are audit committee chairs
- 64 percent serve on two or fewer audit committees
- Respondents report that their companies hold on average five audit committee meetings per year
- On average, each audit committee meeting lasts 3 hours
- The majority (78 percent) indicate they spend more than 8 hours on average per month on board and committee matters for the company.



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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