

Ten to do's for audit committees

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KPMG's Audit Committee Institute



When considering their 2011 agendas, audit committees should...

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| <p>1. Update your understanding of the significant risks facing the company</p> | <p>Audit committees should have an appropriate understanding of the significant risks facing the organisation and how they, and any resulting vulnerabilities are disclosed to shareholders. Particular attention should be paid to 'scanning the horizon' for the unexpected and consideration of the lessons from the financial crisis and recent events.</p> <p>What's changed in the operating environment? Have there been any failures – or near misses? What are the risks posed by the extended organisation – procurement, outsourcing, sales and distribution channels? How good are our disaster recovery plans? Are emerging risks – whether slow-moving or fast-hitting – getting sufficient agenda time.</p> |
| <p>2. Confirm that the finance function is fit for purpose and working as intended</p> | <p>Particular attention should be placed on the ability of the finance function to get the right information to enable sound business decisions.</p> |
| <p>3. Continue to monitor fair value issues, impairments, and management's assumptions underlying critical accounting estimates</p> | <p>These issues, together with loss contingencies and going-concern challenges, will continue to be a major area of focus for audit committees. Audit committees should recognise that the greatest financial reporting risks are often in those areas where there is a range of possible outcomes, and management is called upon to make difficult judgements and estimates.</p> <p>Has the audit committee considered the processes in place to generate forecasts of cash flow and accounting valuation information, including the choice and consistent use of key assumptions? Are the forecasts and valuation processes supported by appropriate internal controls and reasonableness checks and have those internal controls been tested by internal and/or external audit?</p> |



4. Look beyond the numbers when reviewing corporate reports

Narrative reporting, (such as the Business Review) earnings releases and analyst briefings can pose difficult issues because they contain important business information which often does not come from the financial reporting system, is not audited, and is not subject to internal controls. Ensuring management have processes in place to make sure there is consistency between narrative reporting and the financial statements – particularly with respect to segmental reporting, can prevent unwelcome attention from the regulators.

The audit committee should also seek assurance as to the adequacy and appropriateness of any non-GAAP measures disclosed within corporate reports. The disclosure of risk and uncertainty is also of increasing concern to regulators and other stakeholders. Are the risks clearly and simply stated? Are there many of them and if so, are they really the principal risks? Is it clear how the risks might affect the company?

5. Review whistleblower, anti-bribery and corruption processes

There are an increasing number of investigations around the world. Penalties are higher, profits are being impacted, directors and employees are being laid bare to extradition, reputations damaged and companies disqualified from public sector work. Audit committee's should ensure that management have implemented adequate procedures to prevent bribery with particular attention to 'risky' countries/operations and less well understood areas such as facilitation payments, entertaining costs etc.

Is there a comprehensive and regular evaluation of the nature and extent of the bribery and corruption risks to which the company is exposed? Is there the right 'tone from the top'? Are the policies and procedures clear and practical and appropriately embedded across the organisation? Are they applicable to all employees and to all entities over which the company has control? Does the company engage in appropriate due diligence with respect to all its business relationships? Do whistle blowing and other feedback mechanisms support the continuous improvement of the anti-bribery regime?

6. Prepare for the potential impact of accounting and other regulatory changes

Audit committee's should ensure they are fully apprised regarding the impact of the many changes to Accounting Standards expected in the near future. Some of the proposed new and revised International Financial Reporting Standards (IFRSs) – not least those addressing lease accounting, revenue recognition and financial instruments - will have a potentially profound impact on the financial statements, business systems, bank covenants and performance related remuneration. Audit committee's need to be sufficiently up-to-speed to ensure management is focused on the key issues. Audit committee's should also be mindful of governance developments and other regulatory initiatives including the Dodd-Frank Act in the US, Treasury's strategic review of Audit Quality in Australia and the EU Green Papers on 'Corporate Governance' and 'Audit Policy'.



7. Understand the company's significant tax risks

Tax authorities are ratcheting-up their enforcement efforts and more aggressively sharing information with a view to increasing the effectiveness of their tax audits. Given this tax risk environment, audit committee's should seek to understand the company's tax risk appetite and management's processes for managing tax risk. Who is involved? When did the audit committee last meet the Head of Tax? The committee also needs to be cognisant of changes to the tax regime and the potential impact on both the company and key personnel.

8. Make sure internal audit is properly focused

Help ensure internal audit is adequately resourced and has refined its scope for changes to the company's risk profile. 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.

9. Understand the impact of performance based remuneration on behaviour

While no single governance model has emerged from the financial crisis as being 'better' or more 'robust' than the others – the importance of 'behaviour' has been demonstrated again and again. While remuneration committees have a role in setting the remuneration of executive directors and senior management, audit committees must also understand the impact of performance based remuneration on behaviour and ensure appropriate checks and balances are in place. Particular attention should be paid when results are 'at the margin'. When was the last time the audit committee met the Chairman of the remuneration committee? Is there cross-membership between the two committees?

10. Make time to discuss developments in Audit Committee best practice

Leverage the NACD Blue Ribbon Commission enquiry into Audit Committees and the Financial Reporting Council report on Effective Company Stewardship to benchmark and calibrate your audit committee's oversight practices. The reports offer important insights for every audit committee member and director.

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