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Audit Committee Brief

Issues for Audit Committees to Consider at Year-End

In today's complex business environment, audit committees are busier than ever and are challenged to focus on what matters most to their organizations. Audit committees of listed companies are expected to work closely with management, the internal auditors, and the independent auditor to oversee risk, financial reporting, compliance, and corporate resources.

Setting the tone at the top has never been more important than it is today. In addition to the questions the audit committee routinely asks management and the auditors at year-end, additional emphasis should be placed on topics such as financial reporting, risk management, strategy, anticorruption measures, and the ongoing impact of legislative and regulatory developments.

Financial reporting

Although there were few new accounting pronouncements implemented in 2010, compliance with existing standards can be challenging in an uncertain economy.

Questions the audit committee may want to consider asking management and the independent auditor regarding the implications of the prolonged economic downturn include:

- How has management addressed accounting issues caused by ongoing economic challenges?
- Has the company appropriately determined, classified, and disclosed any impairment of assets?
  - Are there any significant changes to management's assumptions this year that affect the outcome of impairment testing?
  - Are there any close calls?
- Are there any unusual transactions included in the financial statements that have a significant impact on the company's results?
  - Have these transactions been recorded and disclosed appropriately?
- Are assets and liabilities that are reported at fair value or for which fair value is disclosed appropriately measured at a current exit value?

  - Are there any new assets or liabilities reported at fair value?
  - Are there changes to the methodology used to estimate fair value?

- Are contingencies estimated and disclosed appropriately?
- Are changes in management's estimates of significant accounts communicated and documented adequately and in a timely manner?
- Does MD&A adequately disclose qualitative considerations related to key estimates?

The SEC's decision on incorporating IFRS into the U.S. financial reporting system is expected later this year. The SEC clearly demonstrated its commitment to global accounting standards based on IFRS in a February 2010 statement. At that time, the SEC also directed its staff to execute a work plan to address certain matters related to IFRS. Although the SEC has yet to conclude on the approach to incorporating IFRS into the U.S. financial reporting structure, there are clear benefits to preparing sooner rather than later.

Questions the audit committee may want to consider asking management include:

- What is the company's plan to address the SEC's decision on incorporating IFRS into the U.S. financial reporting structure?
- What are the obstacles to implementation?
- Has management discussed its plans with the independent auditor?
- Is the company's technology platform an enabler or an obstacle?
- What is the impact on technology projects already under way?
- How much of the company is currently IFRS-ready?
- Which IFRS standards are likely to have the most significant impact on the company?

Deloitte's December 16 *Heads Up* article, "Highlights of the 2010 AICPA National Conference on Current SEC and PCAOB Developments," includes more information on financial reporting matters and is available on Deloitte's Center for Corporate Governance Web site.

Risk management

In December 2009, the SEC issued a rule requiring a number of new or enhanced proxy disclosures, including additional discussion about the board's role in risk oversight. With a full year of proxy statements available, it is a good time to evaluate the disclosures of others in the industry and identify leading practices.

Questions the audit committee may want to consider asking management include:

- Do management's disclosures about the board's comprehensive risk oversight process provide stakeholders with a thorough view?
- Based on the disclosures made by competitors and peers, should the company consider implementing changes to its risk oversight processes?
- How does management plan to update the prior-year disclosure?
- Has management received any stakeholder inquiries about risk oversight that should be considered in future proxy filings?

Strategy

During the economic downturn, many companies focused their strategic discussions on short-term challenges. However, as the economy begins a slow recovery, companies are turning their attention to long-term growth strategies; most five-year plans that were developed several years ago are no longer relevant.

Questions the audit committee may want to consider asking management include:

- How much time does management spend on strategic discussions?
- Has management adequately challenged the underlying assumptions of its strategy?

- Does management provide timely and sufficient information to allow the board to fully evaluate the organization's strategic objectives?
- Is the strategic plan aligned with the company's risk appetite and profile?

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Anticorruption Measures

Enforcement of anticorruption laws has increased, and agencies from various jurisdictions are now coordinating their investigative efforts. Most recently, the U.S. Department of Justice and the SEC were able to uncover a complex multinational bribery scheme only because of a high level of international cooperation among enforcement agencies in France, Italy, Switzerland, and the United Kingdom. Audit committees and management may want to discuss the company's anticorruption policies, how risk is assessed, and the effectiveness of compliance programs to determine whether there are any year-end implications.

Questions the audit committee may want to consider asking management include:

- What regulations, guidelines, and laws changed in 2010?
  - What new processes have been put in place to address the changing requirements?
- How effective is management's process for monitoring compliance with anticorruption laws?
- Has management engaged any outside advisers to assist in its efforts?

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Ongoing impact of legislative and regulatory developments

Sweeping legislation related to financial regulatory reform and the health care system—namely, the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Patient Protection and Affordable Care Act—began to have a broad impact on many companies in 2010. In addition, debate is under way on reform of environmental standards. Audit committees, directors, and management will need to monitor these developments and related rulemaking, discuss the possible impacts, and prepare for implementation.

Questions the audit committee may want to consider asking management include:

- What is the likely impact of regulatory activity on the company?
- How prepared is the company for the enactment of new rules and laws?
  - What is the company's plan to address the new requirements of the Dodd-Frank Act?
  - How will the health care reform legislation affect the business?
- What additional disclosures will be included in annual financial reports to reflect the impact of the new legislation?
- What further impact do we expect in 2011, and has management begun assessing and planning for that impact?

Conclusion

The audit committee plays a critical role in focusing management's attention on key issues that may affect the business. It is important for the audit committee to ask management questions that will focus them on what matters most to their organizations. Those discussions will help the audit committee meet its oversight responsibilities with respect to risk, financial reporting, compliance, and corporate resources.