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Audit Committee Alert

KPMG Audit Committee Institute

SINGAPORE

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Ten To-Do's for Audit Committees in 2009

Companies of every size and industry are wrestling with the challenges posed by the current financial crisis. Their audit committees are focused on ensuring that management addresses key financial risks, that risk management processes are effective, and that the company's strategy — and the board's oversight practices — can stand up to scrutiny in the emerging business and governance environments.

About the KPMG Audit Committee Institute

Recognising the importance of audit committees, the KPMG Audit Committee Institute (ACI) has been created to help provide audit committee members and members of boards with a resource to help them keep up to date on current and emerging issues.

The KPMG ACI offers thought leadership on trends and current topics and provides a range of resources including publications, topical forums and roundtables to host the exchange of views and insights on audit committee best practices and processes, and other topics of interest to members of boards and audit committees.

Visit our website on: www.kpmg.com.sg/aci or email us: aci@kpmg.com.sg

In 2009, the audit committee (AC) agenda must now perhaps zero in on survival rule number one: helping their companies' get through the next 18 months. The following to-do's are KPMG Audit Committee Institute's recommendations:

1. Monitor closely the impact of the financial crisis on the company; focus on financial forecasts and early-warning indicators.
   ACs need to understand the crisis's impact on the company's earnings, cash flow, liquidity, and compliance with debt covenants, and monitor key indicators of trouble. It is recommended that management assemble a crisis management team to monitor the impact of the crisis on a 'real-time' basis, and develop, with stress-test, worst-case scenarios. A strategic and timely response to this crisis is critical.

2. Assess the company's exposure to third-party risks in times of financial distress.
   ACs should ensure that management monitors the impact of the crisis on the company's key customers, suppliers, insurers, partners, banks, underwriters, counterparties, and other third parties that may be experiencing financial difficulty (or have filed for bankruptcy). ACs should also see that management maintains an up-to-date inventory of the company's potential exposure to third parties.

   ACs must discuss with management the potential impact of third-party exposure as it may, among others, impair the company's cash flow, liquidity, ability to obtain funding and refinancing, collectibility of receivables. These may in turn impact the ability of the company to survive the crisis. It is imperative that a discussion takes place with management on whether the existing business model is still relevant and effective in achieving the company's mandate to survive in turbulent times.

3. Understand the impact of the financial crisis on the company's financials—particularly on the balance sheet and off-balance sheet.
ACs need to focus on the company's investment portfolio, including debt and equity securities, to identify declines in value or impairments that should be reflected in the financials. They should also help ensure that management has identified possible impairments of goodwill, deferred taxes, patents, and other intangibles, and that fair values determined by management and valuation experts are reasonable.

In addition, ACs should assess how changes in financial markets have impacted the valuation of the company's assets and how the application and impact of fair value accounting is described in the Management Discussion and Analysis (MD&A) and other periodic filings. There is also a need to consider whether the description of the company's liquidity risks is sufficiently robust and specific to the company.

4. Focus on the importance of preserving good corporate governance to reinforce market integrity and boast investor confidence.
In this uncertain environment, it is crucial that the company has a robust governance process to preserve the value that has been created over the years. In the leadership's cost containment agenda, it is important that the cost cutting measures do not include cutting corners in governance and compliance.

Compromising governance can destroy the value built over the years and damage investor confidence. A strong recommendation is to ensure that management continues to focus on enhancing the state of governance practices in the organisation by taking guidance from the recently released ACGC Guidebook by the Audit Committee Guidance Committee, available from the Monetary Authority of Singapore's website.

5. Monitor the tone from leadership and throughout the organisation.
Immense pressure from bad times may bring out the worst in some companies. There are increased temptations for fraud at the highest level. There is a need to be acutely sensitive to the tone and attitude from the top and the examples set by leadership. ACs should aim to reinforce a culture of compliance and a commitment to financial reporting integrity throughout the organisation. They should also focus on the review of the control environment and fraud risk management framework; recognise the fraud risk factors, and pay attention to red-flags and warning signs. Where necessary, ACs should watch out for and dig deeper into specific areas of suspected malpractices.

6. Ensure timely communication with shareholders.
   ACs need to monitor closely management's processes to ensure timely and adequate disclosure of material information to shareholders. ACs also need to respond to the regulator's call to raise vigilance in ensuring the integrity and clarity of information disclosed to shareholders.

7. Be a catalyst in the risk management efforts of the company.
   It is important that ACs heighten their vigilance in identifying, addressing and managing risks that may have a material impact on financial statements. ACs should consider the adequacy and effectiveness of the company's governance processes for managing risk. ACs need to ask the right questions to management. These include: Is management aware of the key risks that will severely impact the company's survival in the next 12 months? Is management aware of the company's blind spots and emerging risks? Are the top risks facing the company understood and agreed upon? How rigorously does management stress-test key risk assumptions? Are the board's information sources sufficiently varied and objective? How does culture — including incentive compensation — impact the company's risk profile?

8. Take a hard look at audit committee effectiveness – focus on getting the basics right.
   ACs should pay attention to the basics like having the right mix of committee members' experience and skill sets, committee independence and leadership. ACs must have an understanding of the company's strategy and financial risks, and the adequacy of AC support. It is crucial that AC members stay abreast of new accounting standards and emerging complex issues in the challenging environment to be adequately equipped to discharge their roles and responsibilities. The ability to ask the right questions and challenge management effectively will help the company navigate through turbulent times.

9. Be instrumental in helping the company and the board prepare for change in the new post crisis business landscape.
   Globalisation and the financial crisis has changed the world in dramatic ways. These changes include: a less-leveraged economy, a restructured banking and finance industry, an increase in regulation and shareholder activism on issues like executive compensation, and new business models driven by technology. ACs must step back and consider what the emerging business environment will look like. ACs need to ensure that management considers how this new environment will impact the company's risk profile. ACs also need to discuss with management how the post-crisis business landscape may impact the company's existing business model.

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10. Expand the audit committee's information sources.
    ACs should consider whether the information received comes from a balanced variety of sources rather than relying too heavily on information from management. They should also take into account whether the information flow promotes sufficient internal transparency. Getting the right information is essential to providing effective oversight of the company's financial reports, its risks, internal controls, and finance team.

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