

*The role of the Audit  
committee in Corporate  
Governance - Audit  
committee leading  
practices*

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## *For today's discussion*

- Setting the stage: current regulatory environment
- What we are hearing from audit committee members
- Selected leading practices

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## ***Setting the stage: current regulatory environment***

- Global economic crisis – has generated increased focus on risk management and whether companies properly reported the state of their economic health to investors
- International focus on anticorruption; greater cross-border cooperation between judicial and regulatory authorities, as well as significant rules, e.g.
  - US: Foreign Corrupt Practices Act; new SEC whistleblower rules approved May 2011
  - UK: Bribery Act, effective July 1, 2011
- Complexity of and ongoing changes to accounting standards - e.g., IFRS major projects for revenue recognition, leasing, financial instruments, etc.

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## ***Setting the stage: current regulatory environment (continued)***

- International developments on the role of auditors
  - European Commission Green Paper , with focus on auditor independence; possible approaches to develop smaller accounting firms
  - US: PCAOB working on cross-border inspection rights/cooperation; examining auditor's report; expanding auditor communications with audit committees; considering mandatory auditor rotation
- Increased level of emerging regulation – particularly for financial services companies – with greater expectations of audit committees
- Greater focus (by regulators and investors) on the role of compensation incentives in risk-taking

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**The pressure from the regulators on audit committees has increased**

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## ***What we are hearing from audit committee members***

- Concern over extent of role in risk management oversight
  - Need to look up and down the supply chain for risks
  - Ability of company management to cope with expanding regulatory demands
  - No desire to be charged with overseeing all key risks facing the company
- Information technology concerns
  - Oversight of major new projects
  - Security - cyber attacks and move toward cloud computing
  - Social media – strategic opportunities and risks

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## ***What we are hearing from audit committee members (continued)***

- Concern over intensity of enforcement agenda – across all agencies and geographies
  - Role of audit committee in investigations
  - When company should self-report issues to regulators

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## ***Audit committee effectiveness:*** ***Selected leading practices – financial reporting***

- Invest the time to understand the business, supply chain, distribution channels and visit company facilities
- Understand critical accounting policies and key accounting estimates
  - Impact of management's decisions on financial results
  - Degree to which management is aggressive or conservative in its choices, and whether it changes over reporting periods
  - Whether auditors or regulators have concerns about the company's decisions
- Understand other financial and related information being report – e.g., in Management's Discussion and Analysis
  - Consistent with information audit committee knows
  - Whether it completely reveals the company's transactions, challenges and results



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## ***Audit committee effectiveness:***

### ***Selected leading practices – risk management and internal control***

- Understand and maintain skepticism for key areas of greatest fraud risk for the company, including those from
  - Pressure being exerted from the CEO
  - Preparation for major transactions, including mergers or public offerings
  - Compensation plans – particularly what level of financial results will lead to bonuses
- Clearly define the audit committee’s risk responsibility relative to the entire board – so even if audit committee is overseeing the risk assessment process, other board committees or the full board participate in oversight of key risks

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## ***Audit committee effectiveness:***

### ***Selected leading practices – company culture and compliance***

- Take needed steps to ensure tone at the top is adequate
  - Review results of any employee surveys about ethical conduct
  - Review results of any 360 degree assessments of CFO /Finance Director by his or her staff
- Understand whether compliance programs are effective at promoting proper conduct and behavior through the company, especially in light of
  - Current enforcement activity (e.g., US Foreign Corrupt Practices Act)
  - Expectations for what constitutes an effective compliance regime (e.g., as set out in the US Federal Sentencing Guidelines which cover any company that operates in the United States )

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## ***Audit committee effectiveness:***

### ***Selected leading practices – internal audit***

- Reach consensus on what role internal audit should play to provide maximum value - recognizing that management may have different objectives than the audit committee
- Ensure internal audit is empowered throughout the organization to perform its role
  - Ensure the internal audit director has right capability/standing/status to be respected by senior management team
  - Ensure internal audit has adequate resources – whether internal or “rented” – to carry out its role and to address emerging risks (e.g., cloud computing)
- Insist on effective internal audit reporting at the right level of detail (i.e., executive summaries, most significant findings, cumulative listing of reports, and status of past key recommendations)
- Make the audit committee’s support for internal audit visible to management
  - Private sessions with internal audit as part of most audit committee meetings
  - Periodic contact with the internal audit director between meetings

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## ***Audit committee effectiveness:***

### ***Selected leading practices – external auditors***

- Ensure clarity of reporting relationship is directly with the audit committee, and there is candid and ongoing communication
  - Also critical for engagement team to work well with company management
- Engage in selecting new audit partner (during mandatory partner rotation) or new audit firm (if current firm not meeting your needs)
- Evaluate audit fees through peer company comparisons and understand reasons for overruns

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## ***Audit committee effectiveness:*** ***Selected leading practices – investigations***

- Recognize need for greater involvement in selected situations
- If errors are found in previously-issued financial statements
  - Decide with management on materiality of error and need for restatement; ensure auditors' concurrence
  - Ensure full scope of errors are identified during the investigation
- If allegations of fraud or illegal acts surface
  - Determine if they require further investigation and consider whether the audit committee should lead
  - Ensure investigation conducted appropriately: right participants, process, communications, documentation

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## ***Audit committee effectiveness:***

### ***Selected leading practices – committee meetings***

- Ensure that committee agendas and briefing materials focus on the right topics, have the right level of detail and are received at least a week before meetings
- Hold private sessions, typically at every face-to-face meeting, and ensure they are scheduled as part of the agenda
- Communicate regularly to the board by providing a report on issues and decisions discussed at the meeting, minutes are usually provided to the board
  - Minutes should provide insight on the topics discussed and not be bare bones

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## ***Audit committee effectiveness: Selected leading practices – other processes***

- Committee evaluations
  - Compare the committee's performance against charter and leading practices focusing on true improvement opportunities versus compliance
- Committee training
  - Consider whether members receive appropriate ongoing training, given the velocity of changes to financial reporting and governance standards
  - Provide robust orientation program for new members

# *Questions & Answers*

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