INSTITUTE OF DIRECTORS

Audit Committee Forum™ Alert

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Considerations related to the current financial crisis

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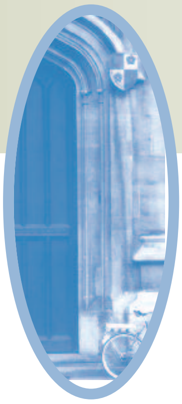

Audit committees top ten to do's: Considerations related to the current financial crisis

The Audit Committee Forum™ points to ten items for audit committees to keep in mind as they consider — and carry out — their 2009 agendas.

1. Closely monitor the impact of the financial crisis on the company; focus on financial forecasts and early-warning indicators.

Understand the impact of the financial crisis on the company's earnings, cash flow, liquidity, and compliance with debt covenants, and monitor key indicators of trouble. Recommend that management assemble a crisis management team to monitor the impact of the crisis on a 'real-time' basis, and develop (and stress-test) worst-case scenarios. Consider the following: What are the company's plans to raise debt / equity in the short and medium term? How dependent is the company on short-term financing? Are credit lines secure? Is the company at risk of default on debt covenants? A strategic response to this crisis is critical.

2. Assess the company's exposure to third parties in financial distress.

Ensure that management is monitoring 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 locally as well as abroad. An up-to-date inventory of the company's potential exposure to third parties is essential.

3. Understand the impact of the financial crisis on the company's financials — particularly the balance sheet.

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. 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 light of current market conditions. Assess how changes in financial markets have impacted the valuation of pension plan assets and funding requirements.

4. Focus on fair value and liquidity disclosures.

Understand the company's disclosure processes for fair value accounting and liquidity issues — and how the application and impact of fair value accounting is described in the annual report. Consider whether the description of the company's liquidity risks is sufficiently robust and specific to the company.

5. Make sure your risk discussions with management are healthy and productive.

With the benefit of hindsight and possible 'lessons' from the financial crisis, consider the adequacy and effectiveness of the company's governance processes for managing risk (management's processes and the board's). Be a catalyst in helping to pose the right questions, including: Can management provide a holistic view of the company's major risks — both on and off the balance sheet? Are the top risks facing the company understood and agreed upon? How tolerant is management of risk? How frequently does management review the risks associated with its products, particularly high-growth and high-margin products? How rigorously does management stress-test key risk assumptions? Are the board's information sources sufficiently varied and objective? Is there sufficient internal transparency? How does culture — including incentive compensation — impact the company's risk profile?

6. Help the company and the board prepare for change.

With the financial crisis and globalisation changing the world in dramatic ways (a less-leveraged economy, a restructured banking/finance industry, potentially more regulation and shareholder activism on issues like executive compensation, new business models driven by technology, globalisation, and competition — and more), step back and consider what the emerging business environment will look like. Does management understand how this new environment will impact the company's risk profile, and the viability of its strategy and business model?

7. Take a hard look at opportunities to improve the audit committee's effectiveness.

Count on increased expectations for good governance and effective oversight, and focus squarely on opportunities to improve. Pay attention to the basics — like having the right mix of committee member experience and skill sets, committee independence and leadership, an understanding of the company's strategy and financial risks, and the adequacy of support for the audit committee. If you don't get the basics right, your ability to ask the right questions and challenge management is severely limited.

8. Be sensitive to the strains on the CFO, internal auditor, and finance function.

In this highly-charged business environment, the demands of the financial crisis, liquidity and cash flow issues, possible resource constraints, and pressures to meet performance expectations have all exacerbated the normal rigors of the CFO's and finance teams' jobs. Recognising their critical role in guiding the organisation through the financial crisis, support them by helping to maintain the focus on long term financial performance, injecting objectivity into financial disclosures, and ensuring the finance organisation has the right expertise and resources (including the budget) to do their jobs well in this tough environment.

9. Expand the audit committee's information sources.

Consider whether the information the audit committee receives comes from a balanced variety of sources (versus relying too heavily on information from management), and whether the information flow promotes sufficient internal transparency (versus fragmented or partial views). Getting the right information is essential to providing effective oversight of the company's financial reports, its risks, internal controls, and finance team.

10. Monitor the tone from leadership and throughout the organisation.

For most companies, 2009 will likely be a year of tremendous pressure and change — and a good measure of uncertainty. In this environment, it is more important than ever to be acutely sensitive to the tone from — and the example set by — leadership, and to reinforce a culture of compliance and a commitment to financial reporting integrity throughout the organisation.

The business environment has changed dramatically, and we will likely see more changes – perhaps a new wave of legislation and regulation, a less leveraged economy, continued volatility of share prices and markets, and greater expectations for effective oversight. For audit committees, understanding the company's risk profile – and improving governance processes for risk management and oversight – should be a top priority.