

Audit Committee Roundup

More Focused, Intense Oversight Marks New Era

By Mary Pat McCarthy

Crisis tends to be a catalyst; crisis and uncertainty together can trigger a sea change. Dealing with this uncertainty is now a top priority—and a major challenge—for boards and audit committees.

At our recent Audit Committee Issues Conference (see page 50), more than 130 audit committee members from around the country discussed these and other key oversight challenges. The overarching theme was clear: Because of the gravity and urgency of the situation, board oversight today is—or needs to be—very different than it was a year or two ago. Whether it's the nature of the board's interactions with management, discussions at executive sessions, or review of disclosures and earnings releases, audit committees and boards are applying greater focus and intensity to their oversight activities. Accountability and vigilance are the hallmarks.

Suggesting that they were perhaps overly focused on “process” in recent years, a number of audit committee members reported a renewed focus on the “basics” of effective oversight. Among these basics:

1. Know the people. Develop strong, personal relationships with the CEO and CFO—understand how they think, what drives them, and whether they are optimists, pessimists, or realists. Some audit committee chairs have weekly calls with the CEO or CFO, as well as periodic calls “whenever the information changes.” In a time of crisis, a director's effectiveness is enhanced by such informality.

Similarly, participants stressed that audit committee members—particularly the chair—should get to know other members of the finance team, the internal and external audit teams, and business-unit heads. Frequent, informal com-

munication with management and auditors is critical. Listen to what they say—or don't say; read between the lines. Talk to them between meetings and make sure they know to contact you promptly about significant developments, or when they find that the information they have previously provided to you is wrong or incomplete. Set clear expectations regarding the timing, frequency, and nature of these communications.

2. Understand the business. Effective oversight, including a constructive dialogue with management, cannot take place unless directors have an understanding—a solid understanding—of the company's business and industry, and are diligent in staying abreast of the issues and developments affecting the company.

- Find the time to read about the business, the industry, and the competition. Carefully read analysts' reports from both the buy and sell side about the company and its competitors, as well as their SEC filings.

- Have each business-unit head meet with the audit committee once a year to discuss strategy and the risks of that strategy.

- Visit foreign offices to meet with local business-unit leaders, internal and external auditors, and even local regulators.

- Ensure that time is set aside—whether formal agenda time or informal time—to educate audit committee members about the critical issues and risks.

3. Exercise skepticism. Business leaders today understand that we are at an inflection point for corporate governance and that effective oversight often requires that directors question, challenge, and sometimes test management. Healthy skepticism can be an important tool for discovering the facts, integrating disparate pieces

of information, and understanding the company's risk profile. On critical issues, consider the views of an independent third party.

Audit committees should pay particular attention to accounting judgments and estimates that may be impacted by the financial crisis and to models that drive important information. Directors need to know who is developing the models and who is making the assumptions, what is (or is not) in the models that could go wrong, and the historical accuracy of the models.

4. Insist on accountability for management and the board. It is important for directors to remind management and themselves “who works for whom:” the CEO works for the board and is accountable to the board. As a result, every board must define its relationship, or “the rules of engagement,” with the CEO. (The audit committee has a similar relationship with the CFO.)

While the board is the shareholders' gatekeeper, all shareholders—pension funds, mutual funds, private equity, etc.—may not have common interests and goals. As a result, it's important for every director to have a clear understanding of what that gatekeeper role means to him or her.

Key to the audit committee's effectiveness and accountability is a critical self-assessment—of the audit committee as well as each individual member. A focus on the committee's composition, independence, and leadership is essential.



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