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REPORT

Audit Committees

Audit Committees Should Home In On Unique Risks in Current Market

In the current troubled economic environment, audit committees must make extra efforts to identify and account for ''long-tail risks''—risks that are generally not likely to occur but that could have a devastating impact on a company if they were to surface, Mark T. Plichta, a partner at the Milwaukee, Wis., office of Foley & Lardner LLP, told BNA Jan. 20.

''At an oversight level, audit committees need to understand the key risks facing the company as well as risks in actual audits,'' according to Plichta. ''This includes considering the appropriateness of subjective judgments in accounting and audits,'' he said.

Plichta, along with other audit and accounting specialists, spoke in a Jan. 13 Foley & Lardner LLP Web conference on audit committee issues. The discussion is part of the firm's annual National Directors Institute, a series of 13 Web conferences on timely corporate finance and governance issues. ''Risk is a big topic, but is not necessarily concentrated on the audit committee,'' Plichta said in the conference. ''However, risk is definitely a significant current issue that everyone is trying to measure and control in the current environment,'' he said.

Other issues facing audit committees in the current environment include the pending conversion from U.S. generally accepted accounting principles to international financial reporting standards, increasing balance sheet liabilities, and fair value accounting issues, according to speakers in the Web conference.

Risk Oversight Should Be Shared Task. Every board member should participate in risk oversight, because audit committees may not possess all the necessary resources to oversee every single risk, Isaac Kaufman, the audit committee chairman and a member of the governance and nominating committee at Kindred Healthcare in Louisville, Ky., said in the Web conference.

''There is no doubt that audit committees already have a lot on their plates. There may be other committees that can take on certain risk oversight tasks to make overall risk management more effective,'' Kauffman said.

Audit committees are often perceived as experts on risks, Plichta said. However, there is lots of room for overlap with other committees—such as compensation committees and risk committees—when it comes to risk oversight, he said.

''Audit committees must make sure they have the resources to handle any additional responsibilities in risk oversight and that they are not duplicating any efforts with other committees,'' Plichta said.

How companies decide to allocate risk oversight responsibilities will differ with each company's structure and needs, Plichta said. ''There is no one-size-fits-all approach to this,'' he said.

Audit Committee Communication Is Crucial. The audit committee is, in a sense, a delegee of the board of directors, according to Plichta. ''Issues that audit committees should be reporting to the board include items that may have a significant material impact on the company's financial performance,'' he said.

''For instance, there might be a new Financial Accounting Standards Board pronouncement that may potentially impact the company's bottom line or restatement—this is something the full board should know about,'' Plichta said.

Audit committees must communicate to their boards any issues that may have an impact beyond a company's financial statements—specifically issues that might impact, for example, compensatory arrangements and loan covenants, Plichta said.

''For example, proposed changes to lease accounting made by FASB would impact not only the audit committee, but will also impact different areas of the company as well,'' Plichta said. ''As a result of these accounting

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changes, the compensation committee may have to re-evaluate its targets for executive compensation,'' he said.

Management Must Provide Good Information. The audit committee should be receiving from management information that consists of more than just financial highlights, Plichta said.

Audit committees should have ample opportunity to review the management discussion and analysis and other financial statements details, Plichta said. ''The main issue, however, is whether the audit committee is receiving information in a form that it can digest,'' he said.

''Hopefully, good communication already exists between management and the audit committee,'' Plichta said.

''I think there is a tendency for management to provide audit committees with too much information,'' Plichta said. ''This makes it more difficult for the committee to sort through the information and effectively identify key items. Audit committees are already taking on increasingly more responsibilities, so it would be best if management provided relevant information in a manageable fashion,'' he said.

IFRS Conversion Is Looming Event. Another issue that may grow in importance for audit committees in the near future is the conversion from GAAP to IFRS, Plichta said. ''However, the issue is currently pending, so I do not think audit committees need to consult their boards about this right now,'' he said.

When the SEC actually lays out a proposed rule identifying a timeline for the IFRS transition, companies will need to brace themselves for significant systemic changes, Plichta said. ''Again, these changes would involve more than just the audit committee,'' he said.

It may be premature to be thinking about the IFRS conversion right now, but companies would be wise to prepare for changes ahead of time, Plichta said.

''When the conversion does take place, companies will have to coordinate their accounting, legal, tax, information technology, and other departments,'' he said.

Some Companies Choosing to Wait. Some companies are actually waiting for developments in regulations on the IFRS conversion before taking their own actions, John Wozniak, corporate vice president and chief accounting officer of Motorola Inc. in Schaumburg, Ill., said in the Web conference.

''It is very difficult to gear up for a conversion as major as this when one does not know what the conversion timeline will be,'' Wozniak said. ''Given this uncertainty and the current economic conditions, it is hard to justify an investment today to make large scale system changes when nothing has been concretely defined yet,'' he said.

''I think most large companies currently share this mindset,'' Wozniak said. ''It is still, nonetheless, important that companies clearly understand the differences between GAAP and IFRS and are aware of the changes required,'' he said.

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