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Audit Committee Brief

What are audit committees doing differently in the current environment?

A recent Deloitte survey[1] found that current market conditions have caused audit committees to change their focus. Today, audit committees are examining liquidity, impairments, enterprise risk management, and financial reporting disclosures more closely.

Virtually every company has been affected by the financial crisis, whether directly or indirectly. Several concerns are likely to loom on the minds of management and audit committees alike—particularly during the Form 10-K season. These concerns include liquidity, sources of credit, and the solvency of customers and suppliers.

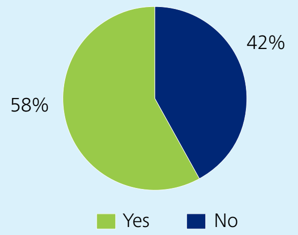
With the continuing risk that market conditions may erode further, one unfortunate side effect is that more organizations may be facing going-concern issues—particularly if they depend on traditional bank lending or commercial paper markets for liquidity. Liquidity is one condition that auditors consider when evaluating whether there is substantial doubt about an entity's ability to continue as a going concern. "Audit committees have always been careful in considering resources to address liquidity sources," says William C. Freda, vice chairman and managing partner of Deloitte LLP.

Being careful comes down to the fundamentals. In these situations, the audit committee may want to review its company's operational needs and debt by size of exposure and maturities. This analysis can provide a high-level view of existing or potential liquidity concerns. Audit committees may also want to examine the size of material exposures so that they are in a better position to consider management's assessment of the likelihood that the company's creditors might renew credit lines as they mature. Freda notes that "audit committee members with current experience in dealing with debt maturities and refinancings at other enterprises can add significant value by sharing market observations."

Questions audit committees may ask management

- How exposed is the company to a further downturn in the economy?
- What lessons were learned from previous downturns?
- What are the key assumptions in forecasting operations during the next operating cycle?
- What are the company's contingency plans for dealing with varying degrees of economic distress?
- How sensitive are the company's expansion plans to the recession?
- Is the company positioned to take advantage of distressed situations that occur in a recession?

Have current market conditions caused the audit committee which you serve to operate differently?



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1 *The survey consisted of a nonstatistical sample of 123 responses made by lead client service partners of Deloitte LLP and its subsidiaries in January 2009. The results may not be indicative of those that would have been obtained had a statistical method been used to conduct the survey.*

It should be noted that debt or financing issues in today's economy represent conditions that could raise substantial doubt about a company's ability to continue as a going concern. To the extent the current trends continue, companies may need to explore alternative debt and equity packages, which could require difficult tradeoffs. Freda adds that, "sources of capital—at least in today's marketplace—may be nontraditional, including pension funds, hedge funds, private equity funds, and high-net-worth families."

Although companies have sought ways to economize over the past year or so, they may need to repeat the exercise by taking an even closer look at operations and assets. For instance, are there additional opportunities to better manage working capital or to cut SG&A expenses? In more challenging circumstances, should companies shed noncore assets to raise cash and/or reduce costs as a way to protect core business lines?

In the current environment, some of these options will be challenging to develop and costly to execute. For companies to survive and eventually thrive, audit committee members will need to be even more vigilant and thorough and to ask tough questions. Difficult choices may have to be made, but, as the saying goes, timing is everything.

More information. Deloitte's *Global Economic Outlook – First Quarter 2009*, *Putting Risk in the Comfort Zone: Nine Principles for Building the Risk Intelligent Enterprise*, and *2009 Industry Outlook: Challenging Times, Emerging Opportunities*, as well as the *Directors Monthly* article, *"Effective Corporate Governance in Turbulent Times,"* are available on Deloitte's Center for Corporate Governance Web site.

The auditor's responsibility

The auditor considers whether the results of procedures performed in completing the audit identify matters that indicate there could be substantial doubt about the company's ability to continue as a going concern for a reasonable period of time. If these types of matters are present, the auditor obtains information about management's plans to mitigate the effect of these matters and assesses the likelihood that such plans can be implemented. The auditor then concludes whether there is substantial doubt about the company's ability to continue as a going concern and considers the adequacy of disclosure in the financial statements and whether an explanatory paragraph is needed in the audit report.

If the current conditions have caused the audit committee to operate differently, has the focus of discussion topics changed? Which topics have been the focus?

Responses	Total	Percentage*
Company liquidity	60	85%
Impairments/goodwill	51	72%
Increased awareness of enterprise risk management	38	54%
Financial reporting disclosures	27	38%
Financial projections	22	31%
Other – valuation of financial instruments, adequacy of reserves, impact on regulatory capital, pensions, political and economical environment, board governance, ability to finance projects and refinance debt	19	27%
N/A – topics have not changed	5	7%

Note: This question asked respondents to "check all that apply." As a result, the responses exceed the total number of respondents.

**Percentages are based on the 71 respondents who indicated that the current environment has caused the audit committee to operate differently.*

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