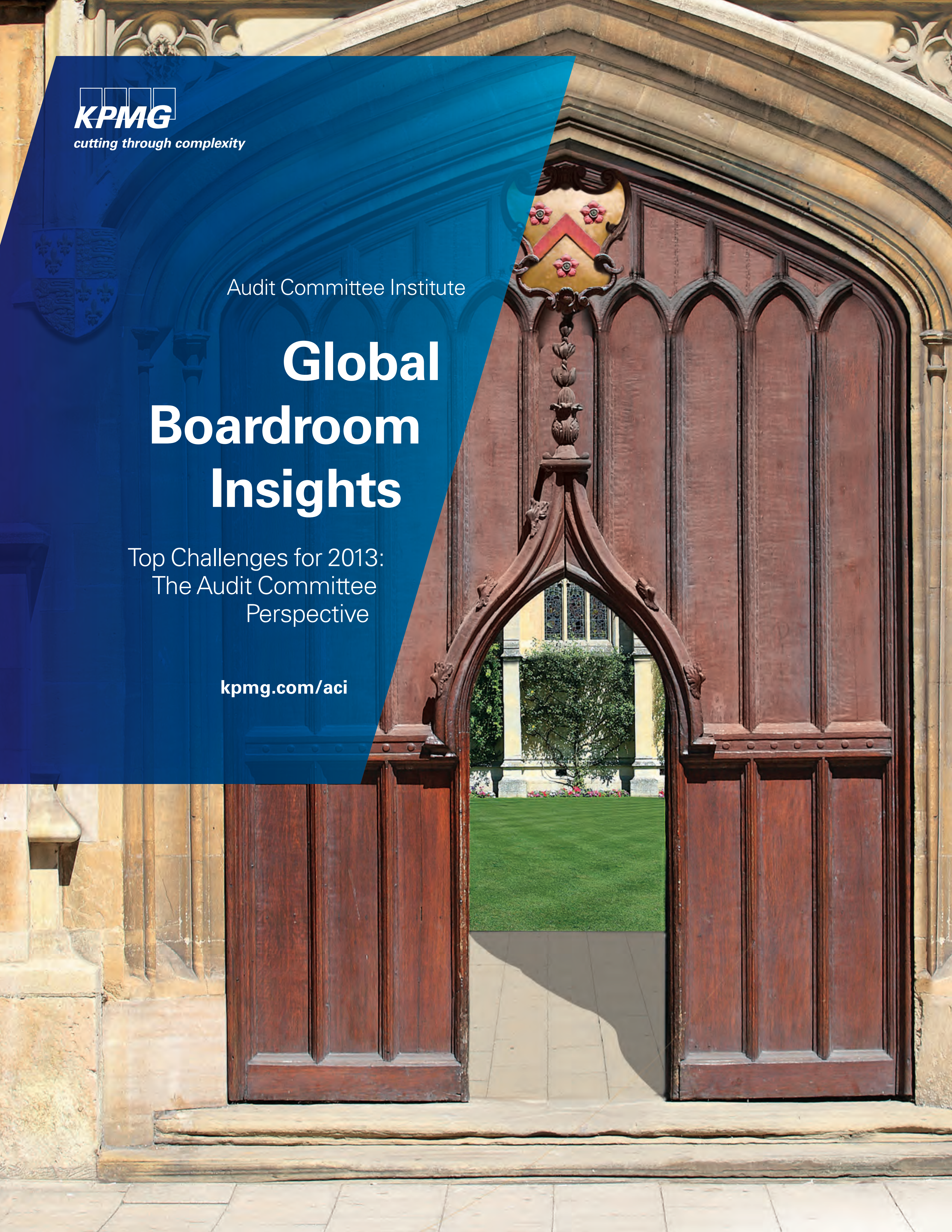

KPMG
cutting through complexity

Audit Committee Institute

Global Boardroom Insights

Top Challenges for 2013: The Audit Committee Perspective

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About KPMG's Audit Committee Institutes

Sponsored by more than 30 countries around the world, KPMG's Audit Committee Institutes (ACIs) provide audit committee and board members with practical insights, resources, and peer exchange opportunities focused on strengthening oversight of financial reporting and audit quality, and the array of challenges facing boards and businesses today—from risk management and emerging technologies to strategy and global compliance. To learn more about ACI programs at resources, contact us at auditcommittee@kpmg.com

Foreword

Global Views


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The Audit Committee's Unique Perspective on 2013

A seasoned audit committee chair recently remarked that every new director should spend time on the audit committee, as it "provides such a rich and comprehensive view of the business and the challenges and risks facing the company." Indeed, audit committees have a unique vantage point.

In their vital oversight role—ensuring financial reporting integrity and audit quality, and often overseeing legal/regulatory compliance, IT and cyber security, and other key risks as well as the risk management process—audit committees offer a valuable perspective on the company's performance and the critical challenges and risks ahead.

In this new global publication from KPMG's Audit Committee Institute (ACI)—the first in a series—we bring together the views of audit committee chairs from significant global organisations on key challenges and priorities shaping audit committee and board agendas in 2013. These seasoned directors share their insights on a range of issues, including lessons learned from the past several years; keys to maintaining strong audit committee/auditor communications; how the speed of technology change and an increasingly complex risk environment are impacting the audit committee and board agenda; and more.

Clearly, no one size fits all. The directors' views presented here are shaped by a number of factors—not least the unique economic, regulatory, and political environments in the countries in which their companies operate. Nevertheless, common themes emerge—including the sharp focus on corporate reporting, accounting and financial control; assessing risk oversight and the role played by the audit committee; and staying focused on regulatory challenges on a global level.

We commend these interviews to all audit committee members in the hope that they help frame your own audit committee (and board) discussions in the months ahead.

Going forward, we hope you find this new global interview series to be another valuable resource from KPMG's ACI, which was founded more than a decade ago—and now spans more than 30 countries worldwide—to support audit committees and boards with practical insights, resources, and peer-exchange opportunities focused on strengthening financial reporting integrity, risk oversight, and governance.

Our sincere thanks to the directors who shared their time and insights with us—Nick Land, Bernd Voss, Celso Giacometti, and Michael Mancuso.

Timothy Copnell
Audit Committee Institute
KPMG in the UK

Sidney Ito
Audit Committee Institute
KPMG in Brazil

Matthias Vogler
Audit Committee Institute
KPMG in Germany

Dennis T. Whalen
Audit Committee Institute
KPMG in the U.S.

A View from the UK

Nick Land, a chartered accountant, retired as chairman of Ernst & Young LLP in 2006 after a career spanning 36 years with the firm. He is now a non-executive director and chairman of the audit and risk committees of Vodafone Group plc, Alliance Boots GmbH, BBA Aviation plc and the Ashmore Group plc. He is also the senior independent director for BBA Aviation plc and Ashmore Group plc. Mr. Land also sits as a non-executive director on the UK's Financial Reporting Council—the UK's independent regulator responsible for promoting high quality corporate governance—and chairs the Audit and Assurance Council.

ACI: *What are the two or three top issues that you see as being particularly challenging for audit committee's next year?*

Land: I'm not sure the priorities have changed dramatically, but we are certainly seeing a migration beyond the financial sector towards audit and risk committees in the UK and in any event many audit committee remits are continuing to widen whether or not the formal transition to take on the oversight of risk is made.

Audit committees are also under greater scrutiny than before, and that scrutiny is increasing. Audit committees might not yet receive the same shareholder, media, and political attention as remuneration committees—the shareholder spring really focused minds in that area—but the aftershock of the financial crisis and the general economic uncertainty means that the spotlight is being focused once again on the audit committee.

Risk continues to be high on the audit committee agenda—in particular, reputational risk. For many of the corporate crises we've witnessed over the past few years, the first impact has been on corporate reputation, with consequences around growth, profitability, brand, etc.

As the current recession continues – whether it is technically a recession or not doesn't really matter – we might well see some companies running into "going concern" problems and refinancing issues. So far UK Plc has seen few corporate casualties during the downturn. Many companies had to refinance in 2008/2009 and managed to do so pretty successfully, but as the global economy continues to be fragile and the Euro crisis remains unresolved, refinancing might well move to the top of the list.

Effective company stewardship is also an issue, and in the UK audit committees and boards are starting to think about the recent changes to the UK Corporate Governance Code. The new disclosures relating to "fair, balanced and understandable" annual reports, the significant financial reporting matters considered by audit committees and the appointment of auditors will not directly impact many companies in 2013, but I think we will see companies starting to get ahead of the game whether or not they go the whole way. This will undoubtedly raise some issues around clarity. Do we really understand what fair, balanced and understandable means? How are we going to define it? How much detail is required? So, while still early, I would be very surprised if this wasn't clearly in the minds of audit committee chairs.

ACI: *Compliance with the Financial Reporting Council's (FRC's) revised Code will require directors to state in the annual report that, taken as a whole, they consider the annual report to be fair, balanced, and understandable and that it provides the information necessary for shareholders to assess the company's performance, business model and strategy. Is there a role for the audit committee here, versus the full board? And is this really a big change or is it just business as usual?*

Land: I think they are both great questions. Clearly, the board has to be happy that the annual report is fair, balanced, and understandable, but I'd be very surprised if most boards don't look for some comfort from the audit committee either in relation to a recommendation to the board that the report is fair, balanced, and understandable; or by at least demonstrating that they are comfortable with the process that was undertaken to give the board the necessary comfort. So I'd be very surprised if *de facto* it didn't fall in whole or in part to the audit committee.

Is it a big change or not? Well of course it shouldn't be a big change. There are some directors that are uncomfortable with the thought that they have to worry about the front end of the annual report, but I find this very strange because frankly the front end of the accounts is more likely to be read by more people than the back end of the accounts. So in one sense I don't think it should be a big change, but having said that, it is in the Code for a reason and the words have been chosen carefully. Clearly, we are seeing more emphasis, quite rightly, put on narrative reporting whether it is around disclosure of the key risks and uncertainties or the new reporting regime proposed by the Government. So I think it is just the time for companies and others to reflect on what goes into the annual report even more closely than they have in the past.

ACI: *I see these new recommendations as a subtle way of using disclosures to change behaviour—at least for those companies that have historically paid little attention to the front half of the annual report. What do you see as the audit committee's role here? To me it appears to be two-fold. The first is process orientated; the second around applying* *some common sense in reviewing the annual report to ensure it includes the information necessary to understand the performance, business model and strategy; and that the presentation does not obscure that analysis.*

Land: I haven't really fully thought it through yet, but I don't think this is particularly about processes other than those around the KPIs (key performance indicators) and some of the key assertions. The disclosure committee or maybe the audit committee would be interested in that. I think it is more about reading the annual report carefully with a watchful eye on how performance, strategy, and the business model are described.

It seems to me it is about being fair, balanced, and understandable. When it comes to being "fair", adjectives like unbiased, reasonable, impartial, prepared properly spring to mind; but I think that it is as much about tone as it is about individual words.

I have a much bigger issue with "understandable"—understanding an annual report in its entirety can be a more difficult challenge. But in a perfect world this should not be much of a change, and I suspect for many companies it won't be. Also, the new Government requirements mandating a strategic report will change the format of many annual reports and require companies to think through their reporting again. This will be another opportunity to think through this fair, balanced, and understandable recommendation a bit more.

ACI: *I agree that any change that encourages starting afresh with a clean sheet of paper often leads to better reporting.*

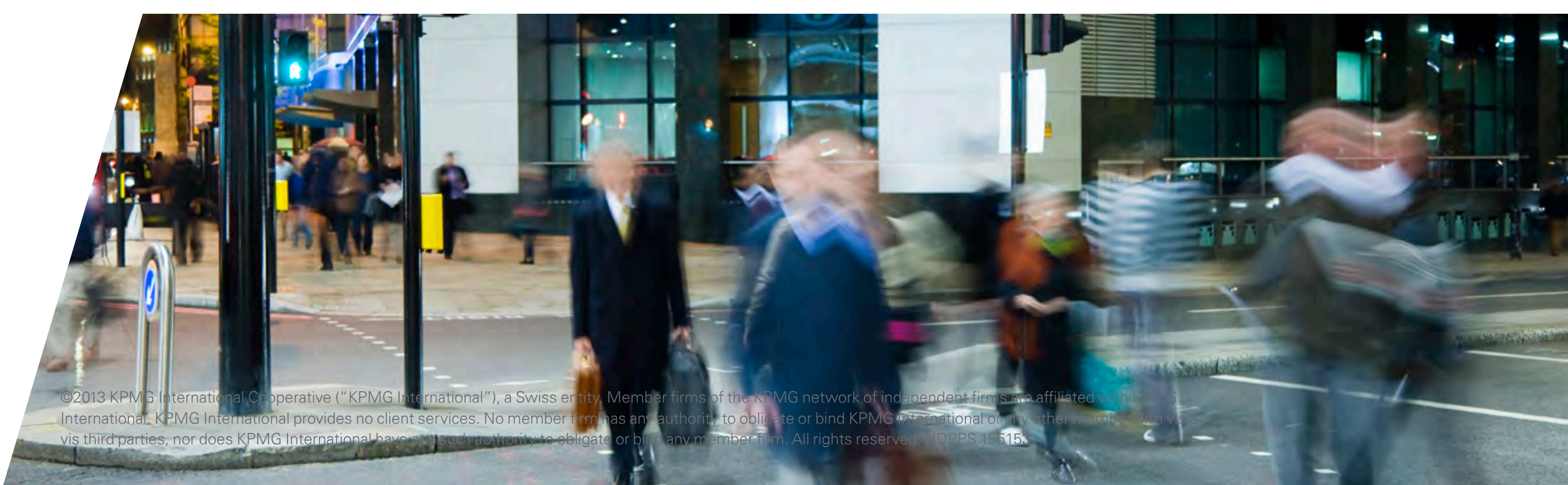
Land: You can argue whether it's a good thing or not, but I think it will make people stop and think a lot more. Annual reports don't very often go through radical change. I think that's understandable and in many ways that's a good thing. On the other hand, I think it can lead to a little complacency around what is said and how it's said.

ACI: *Turning to the new recommendation that the board disclose the significant issues considered by the audit committee in relation to the financial statements and how they were addressed; this could be interpreted as anything from "boilerplate" through to a very granular analysis of the issues and their resolution. Where do you think audit committees will draw the line on this?*

Land: That's a good question. I think the FRC are, understandably, reluctant to provide too much guidance around what these new disclosures should address. Guidance should be guidance, but in today's world guidance all too often ends up being interpreted as rigid rules and this is incompatible with the UK's "comply or explain" framework.

Some companies have already begun to explore this area, but there is more work to be done. We don't want to turn it into a six page discourse on financial reporting and audit issues, but again it will make people stop and think. I am not suggesting that the regulator is thinking that audit committees don't give sufficient thought to the key issues, but a bit more transparency might be useful for investors.

Perhaps the biggest challenge is describing in a succinct manner the inquiries the audit committee makes of both management and the auditor, the extent of the questions they ask, and the degree of scepticism that they apply. Auditor scepticism is, quite reasonably, under the spotlight, but audit committees also need to be challenging and sceptical. Some of the relevant information around key judgements and estimates should already be included in the financial statements. If it is, I would anticipate some form of cross-reference to avoid repetition. It's not just about new disclosure, but also about whether the existing disclosures are properly signposted and easy to understand and assimilate.



ACI: *We talked about risk earlier and the additional responsibilities falling within the remit of audit committees. Do audit committee members have the relevant skills and experience? Or is there an argument to separate the risk role from the audit committee role?*

Land: Beyond the financial sector I don't think there is a need to separate audit and risk. But I do see audit committees increasingly becoming "audit and risk" committees; and risk matters taking up to fifty percent of the committee's time.

All board committees are double edge swords. You clearly have to have them for practical purposes; but on the other hand, there is always a danger that the board will just rely on a committee's view and not really think through the issues fully for themselves.

Risk is quite properly the responsibility of the board; but the board committees can help the board understand, and have confidence in, the risk processes. And not just at the top, but in the subsidiaries and operations too. It's one thing to be reasonably confident that management at the top are focusing on risk, understand what the risks and mitigations are, and can demonstrate that. But it's just as important that the operating companies are going through the same exercise. It is still about process, but it is process in the wider sense of the word—and looking more deeply at how management and risk actually operate in practice. How joined-up and aligned is it? You would be pretty worried if some of the top group risks were not also risks in the operating companies, but equally you would be very surprised and worried if they were identical!

So increasingly we are looking at how risk is really managed throughout the group. Of course at the same time, you look at the risks and say "Hey, why is that one on there and why haven't you got that one on there?" For many companies it makes much more sense to combine this risk role with the audit committee role than to set up another committee which creates further issues around complexity, communication and other matters. No doubt some companies, outside banks, will do that, but I like to think it's all working quite well. I think it might in some instances, over a period of time, have an effect on audit committee membership. Obviously some financial knowledge and expertise is important, but maybe it will lead to a broader skills base on audit committees. I think that is probably quite a good thing.

ACI: *Are there any "lessons learnt" from the last two or three years that would be worth sharing with other audit committee members?*

Land: I think there were lessons learnt by those companies that had to go through refinancing and the height of the financial crisis. Even though most companies seem to have done it pretty successfully—albeit at a price—I imagine that it made management, boards, and audit committees reflect a little bit more or re-reflect around their financing strategies.

The other thing that we haven't touched on yet is that the audit committees and auditors are once more under the spotlight and the calls for increased transparency from the audit committee around why they're reappointing auditors is just one aspect of this. We've also got regular audit retendering in the UK by virtue of the

FRC's Corporate Governance Code and a reasonable possibility of mandatory rotation coming down the line from Brussels.

I think one of the things that audit committees are starting to reflect on—and I've been worried about this for a couple of years now—is the difficulties audit committees have in measuring audit quality. Audit service is pretty easy to measure and of course that's related to quality. A "no surprises" environment; good communication; sector knowledge; and of course the chemistry with the lead team that the audit committee see is absolutely crucial. But whether they're actually doing a good audit or not is a bit more difficult. Are they really hitting revenue recognition as hard as they should be? Are they really are using the latest data analytic techniques—which most audit committee members and directors are only beginning to probe and understand. I think this is increasingly an issue and audit committees are beginning to ask questions and articulate their thinking.

ACI: *We do have the Audit Inspection Unit (AIU)*

Land: That's true, but it's only part of the solution. This will be a real challenge for audit committees and a challenge for the audit firms too. I know audit firms are beginning to work on it, but what are the KPI's from an audit committee perspective? What will give audit committees some comfort that the auditor has carried out a robust "roll up their shirt sleeves" audit such that management feels they have really been audited?

ACI: *Is there a role for someone to audit the auditor; or is that too absurd?*

Land: I hope not. No, auditing the auditor has a horrible feel about it. I think it's the KPI route really.

It's quite difficult to measure audit quality and I think this is one of the advantages of regular retendering or even mandatory rotation. Auditors can sometimes get a bit stuck in the groove and in my experience of audit tenders, limited as that is, they force people to reassess the way they do the audit in a way that somehow doesn't happen as much as it should within the usual audit cycle.

ACI: *Audit highlight memorandums tend to be heavily focused on the financial statements. As an audit committee chairman, would you value more content around the audit methodology and process?*

Land: I think so, though I say that with a bit of caution. We don't want to go from the sublime to the ridiculous. But I do think more around scope would be a good thing.

The other thing that slightly worries me is that it's very rare that the audit committee has anything to add when the auditor presents their audit plan. You can argue that's a good thing—of course it is. It would be worrying if every time the auditor presents the plan the committee thought they haven't got it right and that they want more here and there. But the question remains whether many audit committees spend enough time examining the audit plan. ❖

A View from Brazil

Celso Clemente Giacometti is chairman of Banco Santander Brasil, where he is also a member of the audit, compensation and nomination committees. Mr. Giacometti also serves as president of the Fiscal Council and audit committee at Ambev. He is co-founder of the Brazilian Institute for Corporate Governance and a member of its board, and was president of Arthur Andersen in Brazil until 2001.

ACI: *What are the two or three top issues that you see as being particularly challenging for audit committees and boards in 2013?*

Giacometti: Clearly, 2013 will be a year of economic challenges, with a considerably lower interest rate than we have been used to. The pressure on companies' cash flow, the higher speed of inventory prices and the need for possible higher accruals for pension and other employee obligations under updated actuarial calculations are some of the relevant impacts resulting from this new scenario. Add to that the uncertainty about the GDP growth that can result in under-delivery by companies. These factors may pose a higher risk related to financial management, since there is an inclination to an aggressive use of financial instruments and the use of more creative accounting practices. Audit committees should be particularly alert to these financial reporting risks, and should also play a more prospective role, looking closely to present and future cash flows.

We should also focus on internal controls. In difficult times, companies tend to reduce costs and investments—employee head counts, professional development, technology and others—which might weaken internal controls. It's also important to consider re-adapting the role of internal audit for the new environment, as monitoring should be even stricter considering the higher temptation to use creative solutions.

Issues related to environmental risks, licenses, and authorizations should also be prominent on the audit committee's agenda. Many companies need licenses for installation, operation, and other kinds of authorizations and this issue is often not reviewed by the committee as a matter of routine. The same is true for environmental risks that might create significant problems for companies—lawsuits, fines, or damages to the company's image and brand.

ACI: *Do you see the increasing speed and complexity of the business and risk environment today – i.e., digitization, globalization, government regulation, and increased enforcement – impacting the audit committee's agenda and role in risk oversight? Is there a need to rethink or clarify the audit committee's agenda and risk oversight responsibilities?*

Giacometti: Audit committees are gaining strength and visibility in Brazil before key stakeholders, especially regulators. CVM—which is Brazil's SEC—sees the audit committee as the most important committee and a key to having a strong corporate governance structure. Despite not being a mandatory committee, the creation of audit committees is encouraged by CVM by granting a longer term for the mandatory external auditor rotation (10 years instead of 5) for companies that establish an audit committee (except financial institutions). As a result, audit committees also carry greater responsibilities—and in some cases, members of the audit committee were scrutinized in CVM investigations more closely than other board members. For this reason, there is also an increasing need to properly document and file the committee's activities, communications, and recommendations. Organizations that don't yet have an audit committee, but plan to, should take time to clearly define its charter, role, responsibilities, and reports.

Another issue is that audit committee members must be very careful to avoid the trap of influencing the operation, and ensuring that the committee's independence is not compromised.

I would add that, for the future, with the upcoming scenarios, it is more likely that differences of opinion will emerge between the independent auditors and management about accounting practices which might lead to a more frequent arbitrage role by the audit committee. This might happen also as a consequence of the utilization of fair value accounting under new IFRS principles.

ACI: *Are there one or two "lessons learned" from the past several years that other directors might use to strengthen their oversight?*

Giacometti: The first would be to focus on the improvement of communication and reporting of activities of the audit committee to the board of directors. Today, there is a gap in this communication, partly due to the fact that boards often have such confidence and trust in the work of the committee that they don't always undertake their supervisory role in a robust way. This also happens because, depending of the board's composition, not all members understand financial reports and accounting practices deeply enough to evaluate them, and end up relying on the committee's recommendations.

Another important consideration is management's representation regarding financial information presented to the committee and the board. It must be clear that the responsibility for financial reporting and the preparation of financial statements is a management's responsibility.

ACI: *A number of regulatory initiatives around the world are focused on auditor/audit committee interaction and communication. What, in your view, are some of the keys to quality interaction and communications between the auditor and audit committee—ultimately, to "avoid surprises"?*

Giacometti: The external auditor does not always understand the responsibilities of the audit committee and mistakenly remains reporting solely to the CFO, when the committee is the entity responsible for supervising the auditor's work. In this sense, I also think it would be important that the audit committee conduct a formal assessment of external audit, communicate about areas for improvement, and follow that up with a clear action plan. The same applies to Internal Audit. The committee must be directly involved with this function, to make sure Internal Audit has the right resources, people, and technology to comply with their auditing programs.

There should also be more interaction between internal and external audit. External auditors hardly ever use internal audit's work. If they did, their work could be facilitated, more complete and there would even be opportunities for cost reduction.

Another interesting initiative consists in bringing professionals of the external audit firm specialized in different service areas such as tax or IT to make presentations to the committee and share their perspectives from different areas to help committee members in having a more integrated understanding of the business. In general, the external auditor's contact with the committee seems to be limited to the partner in charge of the financial reports review.

ACI: *In terms of audit committee effectiveness and best practices, what has been most valuable to you – as an audit committee chair – in helping to improve the audit committee's efficiency and performance to keep pace with the business and risk environment?*

Giacometti: First of all, knowledge of the company, its business, the market in which it operates and regulatory aspects involved. In this sense, continuing education is essential—forums, accounting and financial updates, etc. This helps increase members' knowledge and is even more important for members who don't have a financial or accounting background.

I also believe that the spread of good governance practices will result in more companies adopting the audit committee. The search for qualified professionals should improve the quality of audit committees in general, contributing to their efficiency.

Another important step is to structure an area—in addition to internal audit—that is specialized in and responsible for risk management, reporting to the CEO.

Finally, I would recommend considering the use of a governance portal, which helps circulate materials of the committee's or board's interest for meetings or between meetings in a secure and efficient manner. ❖

A View from Germany

Dr. Bernd Voss is chairman of the audit committee at Continental AG. Dr. Voss started his professional career in 1958 with Dresdner Bank AG, which later merged with Commerzbank AG. He served on board of managing directors of Dresdner Bank AG from 1988 to 2001, and has served on a number of supervisory boards.

ACI: *What are the top two or three issues that you see audit committees and boards facing in the year ahead?*

Voss: At the top of our list is digitization, cyber attacks and IT risks. Although no successful attack has been launched so far, the threat of cyber attacks has significantly increased over the last few years, particularly risks related to protection of IP and non-financial information as well as risks to the reputation of the company. We're very focused on maintaining a high level of awareness of such risks at the employee level.

Auditor communications and reporting is also a key area of ongoing focus. We have already set very clear expectations as to audit quality and the auditor's reporting in the audit committee meeting in terms of demanding transparency, quality reporting, two-way communication, and a focus on the relevance and materiality of the information. All of these elements are essential to support the audit committee in carrying out its oversight responsibilities. As such, this priority is unchanged.

Tax risk is another top issue. Oversight of tax risks resulting from globalization and the complexity of operating in different tax regimes is increasingly important—particularly as a reputational risk. Recent cases with significant coverage in the media have raised the awareness of the reputational risks because of aggressive tax planning strategies.

ACI: *Do you see the increasing speed and complexity of the business and risk environment today – i.e., digitization, globalization, government regulation, and increased enforcement – impacting the audit committee's agenda and role in risk oversight? Is there a need to rethink or clarify the audit committee's agenda and risk oversight responsibilities?*

Voss: Yes, the speed and complexity of business and risk has definitely impacted the audit committee agenda and its role. Over the past several years, we have focused on clearly defining the audit committee's oversight role and responsibilities in the context of the roles of the supervisory board and the audit committee. In light of the changing environment, we continue to emphasize the importance of transparent and consistent reporting to the audit committee by the board of directors (CEO and CFO) and by the external auditor as well as close and regular communication with the board of directors and other committees of the supervisory board, including ad hoc and informal communication.

ACI: *Can you share any "lessons learned" from the past year or two that directors can use to strengthen their oversight?*

Voss: I would stress the importance of the external auditor's role in supporting the audit committee. A high level of reliability, based on performance against clearly-defined expectations, meaningful and close communication, as well as delivering high level of audit quality is essential. The audit committee requests frequent, early and quality communication from the external auditor, including very open discussion—whether it's about significant estimates and judgment, or key risks facing the company.

ACI: *Regulatory initiatives in the US (PCAOB), Europe (EC), and around the world have been focused on auditor/audit committee interaction and communication. In your view, what are the keys to quality interaction and communication between the auditor and audit committee—ultimately to "avoid surprises"?*

Voss: As I've mentioned, the key is regular, frequent, quality communication—including open discussion. Meetings are scheduled at least on a quarterly basis with additional communication if required, or if considered necessary or useful.

ACI: *In terms of the audit committee's effectiveness, what has been most valuable practice for you – as an audit committee chair – in helping to improve the audit committee's efficiency and performance to keep pace with the business and risk environment?*

Voss: Close cooperation between the supervisory board, audit committee, board of directors, and the external auditor to openly present and discuss significant issues is very important. We also encourage the participation of key management below the board of directors in audit committee meetings for detailed discussion and direct, detailed feedback. Beyond the regular audit committee meetings, our discussions with these members of management help us better understand the business—its performance, risks, and opportunities.

We also find it valuable to receive regular and focused reporting on issues beyond the financial information, such as key risks, compliance, and internal audit's work plan and results. ❖

A View from the United States

Michael Mancuso serves on the boards of The Shaw Group and SPX Corporation, and chairs the audit committees of both boards. Mr. Mancuso retired in 2012 as corporate vice president and CFO of CSC. He previously served as senior vice president and CFO of General Dynamics Corporation; as vice president and CFO of the commercial jet engine business at Pratt & Whitney Group, United Technologies Corporation; and in various senior financial management positions with the General Electric Company.

ACI: *What do you see as the top challenges facing audit committees and boards in 2013?*

Mancuso: I think the main challenge for boards is to continue to be diligent in assessing business risk, whether it's new product development, acquisitions, global expansion, or new markets. The primary thing pressing on boards is to protect shareholder returns, and that means being able to fully assess a business decision and the associated risks.

ACI: *Continuing on your point about acquisitions – what's the crux of the challenge there? What's the biggest pitfall?*

Mancuso: The problem is that quite often management already has fallen in love with the acquisition, and they're pressing it because they understand the financial ramifications of being able to make the acquisition—increasing revenue, higher income. They become blinded by the endgame, and at the same time are not diligent enough to really examine the financials of the target to be certain. Once the momentum starts to build towards doing a deal, then almost all objectivity starts to lapse. And that's where the board has to be overly diligent with regard to whether or not they have seen everything they need to see to be able to approve the acquisition.

Business by its very nature is risk. No risk, no return. But it's about balanced risk, and it's about understanding those risks. Not every business decision that is made in a proper fashion will result in the financial returns that had been expected—but the decision needs to be made in a proper fashion.

ACI: *Given all the crises and volatility and dramatic changes that companies have been through over the past few years, are there some lessons-learned that stand out to you, from a boardroom perspective?*

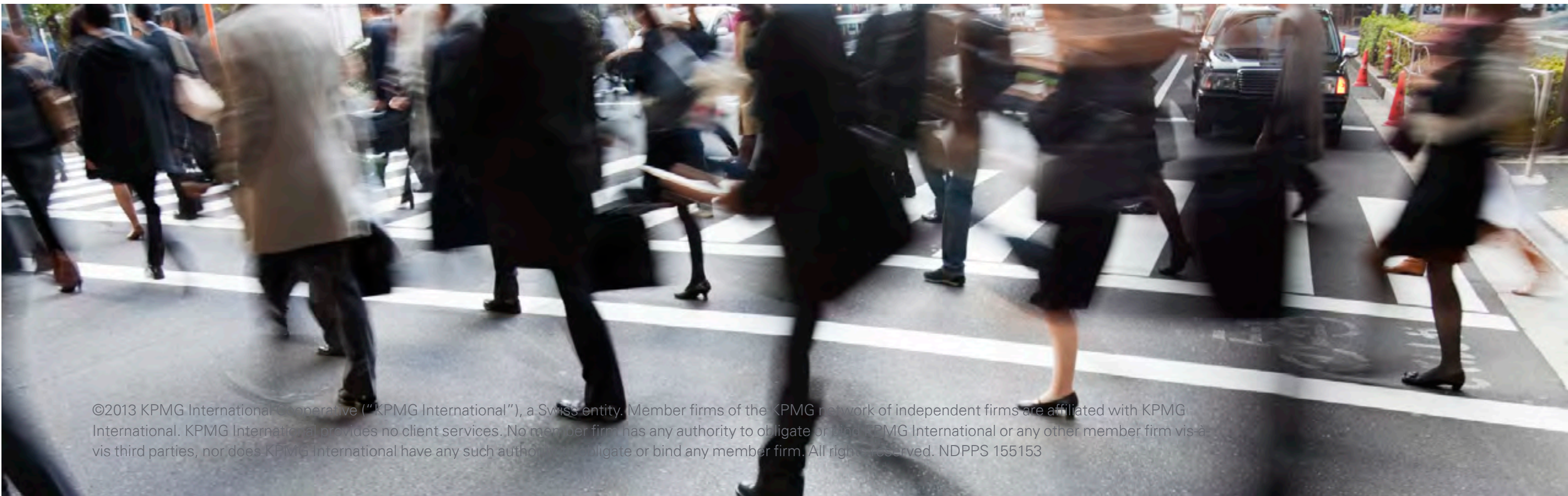
Mancuso: Well, I think it's incumbent upon directors to persevere, to be certain that they are asking the questions that need to be asked, even when it's unpopular—to not readily go along with the crowd, so to speak, but to be totally satisfied at their own level that all of the questions that have been troubling them have been sufficiently addressed.

Too often in a board environment, where a consensus starts to move in a certain direction, board members are reticent to continue probing, and too willing to along with the crowd—not wanting to be viewed as outsiders, obstructionists, etc. Unfortunately, too often the lesson learned is that had they pursued that line of questioning and interrogatories, they may have prevented a financial disaster that otherwise, in hindsight, could have been avoided.

This gets to the quality of board members. They need to be experienced enough in general business practices to understand what needs to be asked and to be satisfied that their questions are being properly answered.

ACI: *Does it also speak to the importance of board skills and composition and structure?*

Mancuso: Yes—board composition, expertise, and size all have to be considered. From a composition standpoint, it doesn't necessarily mean having industry-specific subject matter experts. But the board should be reasonably populated with individuals who are experienced in the company's industry.



In terms of board size, I think an unduly large board can be very difficult. It can get fragmented by too many committees, and typically there's not a lot of cross-communication between committee members on significant topics. So it becomes much more difficult to be truly integrated and up to date on what's happening in all the committees.

ACI: *What other challenges do you see audit committees and boards wrestling with this year?*

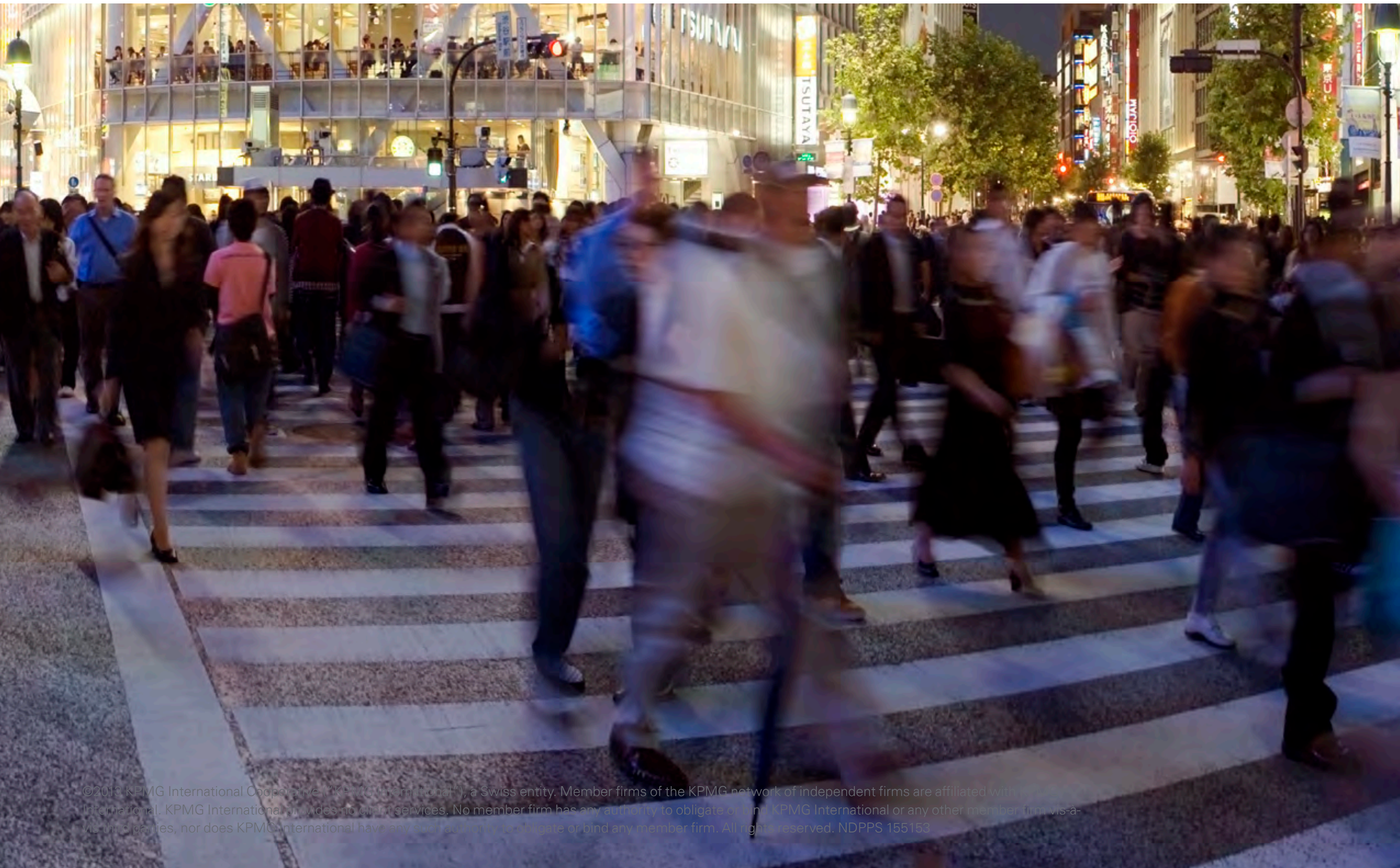
Mancuso: Well, besides the business risk issues that I've mentioned, another big challenge for all boards is the evolving regulatory environment. The potential downside of not complying satisfactorily with current regulations or new ones as they're promulgated going forward can be significant—whether it's Dodd-Frank or updates to Sarbanes-Oxley or new revenue recognition accounting standards from the FASB.

Accounting standards continue to change and evolve, and directors need to stay reasonably abreast of what those standards mean and how they are applied, which isn't easy. Accounting standards are already difficult to understand. The terminology and the application can get very esoteric. Perhaps with the exception of the financial expert who sits on the audit committee, the average director's eyes glaze over when the discussion is about the application of an accounting standard or whether or not a disclosure is fulsome enough to satisfy the regulators, and how much disclosure is really needed.

Compliance and staying abreast of the evolving regulatory environment will be an ongoing challenge.

ACI: *Other "words of wisdom" for directors?*

Mancuso: Boards are more involved than ever, as they should be—a lot is being expected of directors today. But it's important to remember that the board is there to oversee management, not to manage the company. I think those lines are starting to blur, and it's incumbent upon boards to completely understand where that line of demarcation should be drawn and what their roles and responsibilities are. ❖



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