

TONe at the TOP

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EXCLUSIVELY FOR SENIOR MANAGEMENT, BOARDS OF DIRECTORS, AND AUDIT COMMITTEES

Getting Serious about Board-level Scrutiny

Inherent in the oversight responsibility owned by a board of directors and its audit committee is awareness of the level of quality that exists throughout the organization, especially in areas that are part of the risk universe. And, of course, that universe includes the board and the audit committee, themselves.

While taking a close look at ourselves in the mirror sometimes reveals things we'd rather not see, it also can call attention to flaws that need attention. Integral to good operations and oversight, the process of measuring

provides information about the quality and viability of a business. And results garnered from assessments can serve as valuable input for making strategic decisions, as well as motivation for enhancing performance and the culture within an organization.

Why assess?

First and foremost, measurement is a tool for building a better board and improving the performance of the audit committee. Self-assessment can help an audit committee identify and implement better procedures in a wide range of areas, from meeting preparation to the nature of presentations and discussions. Self-assessment also can help audit committee members develop over time a better and shared understanding of the committee's mission and role in the overall governance and control structure of the institution. And if conducted in the right way, a self-assessment can promote civility and collegiality, by channeling into a constructive process the sort of candid comments that might otherwise build up, erupt, and become a breeding ground for contempt and the antithesis of cooperation.

Whether to conduct an annual self-assessment is not a question for audit committees at companies with securities listed on The New York Stock Exchange. The NYSE Listing Standards mandates that the audit committee must have a charter, and the charter must require self-assessment. Although audit committees at unlisted or privately held organizations are not required to do so, many of them follow best practices and conduct self-assessments voluntarily. These audit committees are better prepared to defend their performance, as necessary. They also can provide a "roadmap" to the external auditors, who evaluate the effectiveness of the audit committee's oversight of the company's external financial reporting and internal control over financial reporting.



QUESTIONS FOR CONSIDERATION

If it's true that you get what you measure, then perhaps each and every audit committee should ask:

- *What is our real reason for measuring? Is it simply to have metrics or is it to learn about our performance?*
- *Are we measuring the right things, or just those we can quantify?*
- *What can we do to we improve our measurement processes, and ultimately, to improve the quality of our performance?*

What if you don't like what you learn?

In his white paper, "Audit Committee Self-assessment: Why and How?" Peter Rossiter of Schiff Hardin LLP points out that engaging in audit committee self-assessment is not without risk. To the extent that it focuses on individual performance, it sometimes can generate ill will and actually has the potential of undermining the group's ability to work together. In addition, conducting a good self-assessment is time-consuming. And ensuring recommended changes are implemented requires additional time. A self-assessment also may create a body of evidence that the audit committee has performed poorly, which can cast a shadow on the institution, the board, and members of the audit committee.

Some of these risks can be mitigated by structuring the process properly, phrasing evaluation questions so as to elicit helpful suggestions and not mere criticism, following up as appropriate, and – at least at the beginning – focusing on evaluating the audit committee's work, methods, and processes, rather than on individual members.

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The attorney-client privilege is widely recognized and well established, and many institutions use a lawyer as an integral part of the process of gathering information, evaluating the information, deciding upon recommendations, and organizing implementation and follow-up. It should be made clear to all participants that the attorney's role is to provide legal advice on audit committee functions and legal compliance. Still, a court may view the attorney as a mere conduit, and refuse to protect some or all of the information gathered in a self-assessment from discovery in civil litigation.

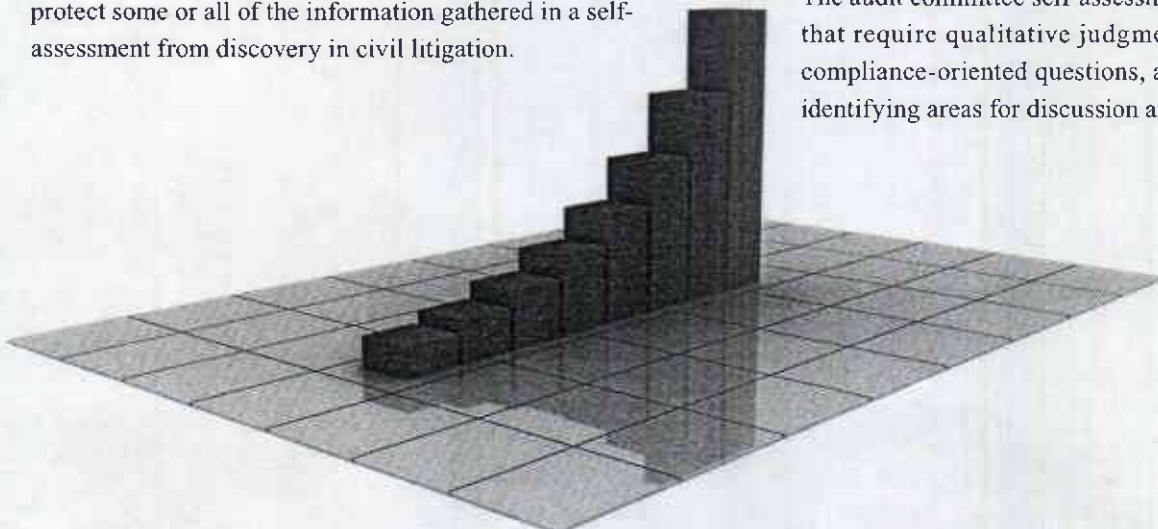
A Self-assessment Protocol

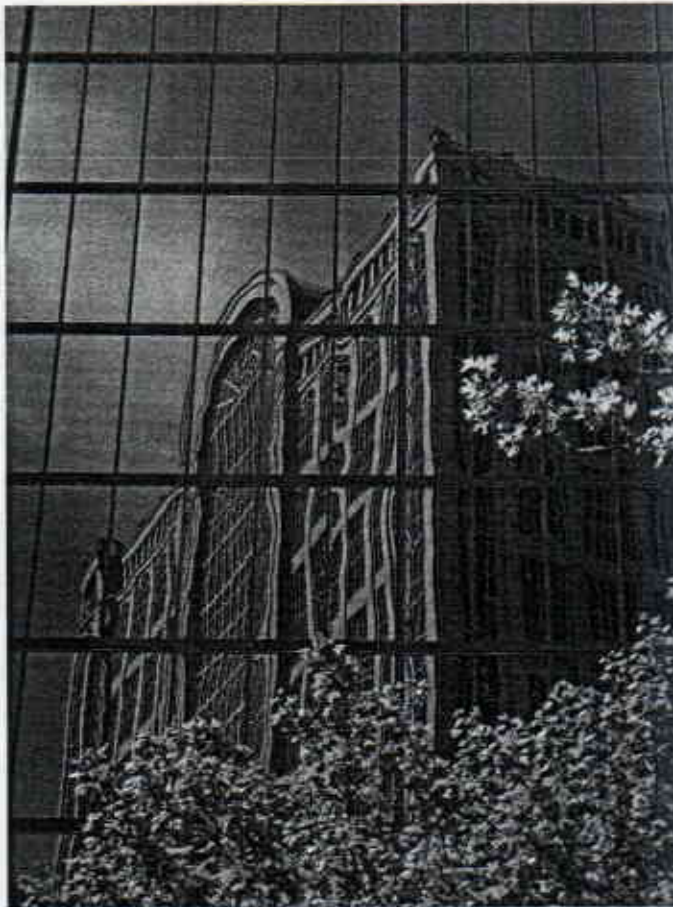
There are a number of ways to organize and conduct a self-assessment. It is a good practice to document in writing the protocol and have the audit committee or the board approve it in advance of the self-assessment. The protocol should reflect not only what the audit committee agrees to do, but also why it decided to do it that way.

The process begins with the preparation of a questionnaire. The purpose of the questionnaire is to raise issues with the goal of process improvement. Questionnaire topics include:

- *Number and schedule of meetings.*
- *Agenda-setting process.*
- *Format, timing, and usefulness of the materials sent to committee members in advance of the meetings.*
- *Conduct of the meetings, including whether enough time is devoted to the right subjects.*
- *Quality of the presentations by management and the external auditors, both written and oral.*
- *Quality of the discussion at meetings.*
- *Unencumbered access to key individuals such as the external auditors, the internal auditors, and the CFO.*
- *Processes for identifying problems, agreeing upon solutions, and tracking implementation.*
- *Audit committee orientation, training, and educational programs.*
- *Nature and adequacy of resources.*
- *The committee's effectiveness in carrying out its responsibilities, from evaluating the external auditors to overseeing the audit process.*
- *Whether the audit committee charter needs modification.*

The audit committee self-assessment should focus on matters that require qualitative judgment. It should avoid asking compliance-oriented questions, and should focus instead on identifying areas for discussion and improvement.





Most questionnaires have a rating scale. From a legal perspective, it probably is safest to use a scale that goes from “STRONG” through “ADEQUATE” to “NOT AS STRONG,” and to avoid (for example) a scale that ends with “INADEQUATE” or “WEAK.” Some questionnaires are cast as a series of statements, with which the respondent is asked to strongly agree, agree, disagree or strongly disagree; or indicate that he or she doesn’t know. Regardless of the scale, adequate space should be left for comments, which can be at least as helpful as the ratings.

In addition to recording their own views, audit committee members may find it beneficial to obtain feedback from management, the chief audit executive, general counsel, and the external auditors. Variations on the self-assessment questionnaire include interviews, checklists, opinion polls, and performance evaluations. Minutes should record discussions on the self-assessment findings, the agreed-upon resolutions, and the plan and timing for implementing solutions. Once the minutes are drafted and approved by the audit committee, they should be circulated to respondents with the next year’s questionnaire. This should prompt an evaluation of how well the changes that were previously agreed upon have been implemented.

Ensuring Internal Audit Quality

In its oversight role, the audit committee should have an intimate understanding of the internal audit activity’s processes and operations. But how can the committee ensure that the quality is what it should be?

Internal audit shops that are in conformance with the *International Standards for the Professional Practice of Internal Auditing (Standards)* have in place a Quality Assurance and Improvement Program. The internal auditors should keep the audit committee abreast of the program and where the internal audit activity fits on the quality maturity model. This level of knowledge about internal audit quality is critical to oversight and to ensuring the audit committee and the internal auditors meet performance goals.

AUDIT COMMITTEE RESOURCES

The Institute of Internal Auditors (IIA) provides a variety of audit committee resources free of charge:

- *Sample self-assessment guide for audit committees*
- *The Audit Committee: Discussions on Performance*
- *The Audit Committee: Internal Audit Oversight* (brochure)
- *The Audit Committee: Purpose, Process, Professionalism* (brochure)
- *The Audit Committee: A Holistic View of Risk* (brochure)
- *20 Questions the Audit Committee Should Ask about Internal Auditing*

For links to the guides and brochures listed above, please contact PR@theiia.org or visit www.theiia.org.

For many companies, audit committee self-assessments are here to stay. For others, they are something well worth considering. A proper self-assessment can increase the committee’s effectiveness, benefiting the organization and its stakeholders. It requires an investment of time to plan and execute an appropriate self-assessment. But if you get what you measure, measuring audit committee quality through a qualitative and quantitative self-assessment should be a given.

TONEat the TOP



Mission

To provide executive management, boards of directors, and audit committees with concise, leading-edge information on such issues as ethics, internal control, governance, and the changing role of internal auditing; and guidance relative to their roles in, and responsibilities for, the internal audit activity.

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Established in 1941, The IIA is an international professional association with global headquarters in Altamonte Springs, Fla. The IIA has more than 150,000 members in internal auditing, risk management, governance, internal control, IT auditing, education, and security.

The IIA is the global voice, recognized authority, chief advocate, principal educator, and acknowledged leader in certification, research, and technological guidance for the internal audit profession worldwide. The IIA enhances the professionalism of internal auditors and is internationally recognized as a trustworthy guidance-setting body. It fosters professional development, certifies qualified audit professionals, provides benchmarking, and through The IIA Research Foundation, conducts research projects and produces educational products.