

# *How can audit committees grow through new ways of thinking?*

**Audit  
Committee  
Matters**

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*What would you like to grow?*

# Grow your interest in financial reporting – key questions for CFOs at June

Diligent audit committee members (ACMs) will want to understand the impacts of the financial reporting developments that apply for the first time in their business's annual June 2011 financial statements.

Included in the table below is a description of the key pronouncements issued by the accounting standard-setters that affect for-profit entities at June and their likely impact on business. We have also included some suggested questions ACMs might like to ask their CFO or management team in respect of how they are responding to these developments in a broader business context.



Questions for ACMs to ask the CFO and/or management team	Relevant pronouncement	Types of entities affected	Key issues
<p>Would the payment of a dividend cause assets to be lower than liabilities?</p> <p>Does the constitution include a requirement for dividends to only be paid out of profits?</p>	<p>Corporate Reporting Reform Act – changes to the payment of dividends.</p>	<p>All entities that prepare financial reports under the <i>Corporations Act 2001</i>.</p>	<p>Entities (excluding companies limited by guarantee) can only pay a dividend if they satisfy a solvency test. Further, assets must exceed liabilities immediately before a dividend is declared and paid.</p> <p>Some constitutions require a profit before a dividend can be paid; these constitutions may restrict an entity from taking advantage of the new rules.</p>
<p>Has management considered removing the separate financial statements of the parent entity (if not already removed in 2010)?</p>	<p>Corporate Reporting Reform Act – changes to separate parent entity financial statements and the statement of compliance with IFRS.*</p>	<p>All entities that prepare financial reports under the <i>Corporations Act 2001</i>.</p>	<p>Parent entities within a consolidated group no longer need to prepare separate parent entity financial statements in addition to consolidated financial statements.</p> <p>If the notes to the financial statements include an explicit and unreserved statement of compliance with IFRS, this must be mentioned in the directors' declaration.</p>

Questions for ACMs to ask the CFO and/or management team	Relevant pronouncement	Types of entities affected	Key issues
How have the reporting requirements changed for the business? For example, what is management's rationale for getting the financial report reviewed rather than audited and how does this compare to competitors?	Corporate Reporting Reform Act – changes affecting companies limited by guarantee.*	Companies limited by guarantee.	Companies limited by guarantee are now subject to a three-tier differential reporting framework. There are specific requirements for companies with revenue: less than \$250,000; more than \$250,000 but less than \$1 million; and more than \$1 million. Companies with revenue more than \$250,000 but less than \$1 million can choose to have their financial report reviewed rather than audited.  Companies limited by guarantee are no longer permitted to pay dividends.
Has management considered changing financial year-end?  What are the advantages to changing year-end (e.g. synchronisation with an overseas parent entity, a major overseas subsidiary, or a major associate, or the opportunity to align the tax and financial reporting year-end where there is a mismatch)?	Corporate Reporting Reform Act – financial year-ends.	Companies, registered schemes and disclosing entities.	Entities can change their financial year-end at any time provided the change is made in good faith; is in the best interests of the entity; and the entity has not already changed its financial year-end in the past five years.  If an entity opts to move from a June year-end to a December year-end, it will need to have a six month financial year (e.g. from January 2011 to June 2011) as opposed to an 18 month financial year.
<i>Relevant for listed registered schemes</i>  What additional disclosures does the business need to provide and is this information readily available?	Corporate Reporting Reform Act – listed registered schemes.	Listed registered schemes.	All disclosing entities preparing reports under the Corporations Law now need to disclose information about their operations, financial position and business strategies and prospects for future financial years. Currently only listed public companies are required to disclose this level of information.
Has the business repaid any debt through the issue of shares?  If so, how has management determined the fair value of the shares?	Interpretation 19 <i>Extinguishing financial liabilities with equity instruments.</i>	Entities that settle their debt by issuing equity.	Entities must measure the shares they issue to settle debt at fair value (not at the carrying amount of the liability).  Any difference between the carrying amount of the debt and the fair value of the shares must be recognised as a gain or loss in the income statement when the liability is settled.
Have there been any rights issues in foreign currency?  If so, how will the commercial impacts of the accounting changes be communicated to shareholders?	AASB 2009-10 Amendment to AASB 132 <i>Classification of rights issues.</i>	Entities that issue rights to existing shareholders on a pro-rata basis and in a currency that is not the functional currency of the entity.	Rights denominated in a foreign currency that are distributed pro-rata to all existing shareholders must be classified as equity (not derivatives).
Has the group's share-based payment arrangements been reviewed to determine whether they have been correctly accounted for in the individual financial statements of the subsidiaries?	AASB 2009-8 <i>Amendments to group cash-settled share based payments (AASB 2).</i>	Entities that receive goods or services in exchange for cash-settled share-based payments that are made by another entity in the group.	Entities that receive goods or services in a share-based payment arrangement must recognise, in their separate financial statements, an expense for those goods or services regardless of which entity in the group settles the transaction and how (ie, using shares or cash).

\* These changes applied at June 2010; however, some entities may not have been aware of their application due to their late release.

# Are you creating growth through diversity?

With new ASX governance principles now in effect, boards around Australia are re-examining their people management policies and putting diversity strategies in place. But strong diversity policies aren't simply a matter of good corporate governance — they could also boost profitability and help your organisation grow.

## Are you ready to report?

On 1 January 2011, new ASX governance principles came into effect, requiring listed companies to either report on the diversity of their workforces in their annual reports or explain why they have departed from the recommendations. Companies complying with the recommendations now need to establish and disclose a diversity policy with measurable objectives, then disclose their progress in achieving those objectives.

While a diverse workforce includes staff with a range of ages, cultural backgrounds and ethnicities, the ASX recommendations have a particular focus on gender diversity. They recommend specific disclosure on the proportion of women employed in an organisation, including the proportion of women in senior executive positions and the proportion of women on the board.

The reason for this is simple. While women make up more than half of Australia's population, their representation in management positions in companies is very limited. In the private sector, women hold only around 12% of management jobs, according to Federal Government data. The same data also shows that in contrast, women hold around 36% of senior executive positions in the Australian public service.

Audit committees of Australian listed companies may need to develop appropriate procedures, including an internal review process, to ensure effective implementation of, and compliance with, the ASX recommendations. The ASX recommendations include a provision that these companies make their diversity policies available to the public.

## Your checklist

To comply with ASX recommendations on diversity, listed companies must:

- establish a diversity policy with measurable objectives
- disclose the measurable objectives and the company's progress in achieving them in their annual report
- make their diversity policy available to the public
- report on the proportion of women employed throughout the whole organisation, in senior executive positions and serving on the board
- or if not, explain why you have departed from these recommendations.

## Are you making the most of your talent pool?

Rather than a new compliance burden, we see the ASX recommendations as an opportunity for Australian companies to enjoy the proven benefits that diversity offers.

By focusing on diversity, your organisation can:

- benefit from a skilled talent pool that may have otherwise been left untapped
- help staff feel valued, promoting loyalty and increasing retention
- create a workplace that better reflects the marketplace and our communities
- generate more innovative ideas by avoiding cultural conformity and encouraging openness to alternative points of view
- enhance your company's reputation and brand.

As a result, greater diversity can even boost profitability. Recent research reveals that global organisations with the highest share of women on executive committees have an average ROE 41% higher than their peers.\*



\* Women Matter 2010: Women at the top of corporations: Making it happen, McKinsey & Company 2010.

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### *Are you building cultural change?*

*Here are five key elements to consider when building your diversity strategy:*

1. **Embed diversity into your organisation's strategic agenda.**  
It takes time and consistent effort to create a culture that values the richness of diverse skills, thoughts and experience. You need to articulate that diversity is now a strategic priority, while painting a clear picture of what success will look like.
  2. **Have your strategy publicly endorsed by the leadership team.**  
A visible commitment to diversity by the CEO, Board and senior management is critical to successfully driving cultural change.
  3. **Build women leaders.**  
Every diversity strategy should include targeted development, coaching and sponsorship programs for women. The aim is to support women to achieve their career aspirations while simultaneously recognising and supporting other aspects of their life, including family.
  4. **Raise awareness of unconscious bias.**  
In most organisations, unconscious bias is the major barrier to creating an inclusive culture. By raising awareness of bias and its effects, you can achieve more equitable results in decisions concerning promotions, remuneration, development and recruitment.
  5. **Adopt a multifaceted approach.**  
To achieve far-reaching cultural change, you need to work on a number of fronts simultaneously. In particular, you need to:
    - identify the specific challenges and barriers preventing diversity in your organisation
    - create quantitative measures and targets
    - adopt HR policies to address the issues you have identified and create a work environment that supports staff as they progress through their careers.
- True transformational change requires leadership, sponsorship and understanding, consistent communication and alignment with a firm strategy over a significant period of time.

# Does your risk appetite support sustainable growth?

**Business growth inevitably involves risk. One of the things you need to achieve sustainable growth is to create a rigorous approach to assessing, monitoring and managing risks within every level of your organisation.**

## *How much risk do you want to take and why?*

Every business faces risks to achieve its strategic objectives. Yet in some organisations, decision making on risks is informal, intuitive and transaction-based. An intuitive approach can lead to organisations taking on more risk than they realise and not being well prepared to manage these risks and optimise returns.

In the wake of the global financial crisis many organisations have recognised that the uncertain business environment and potential for variability in performance outcomes requires serious consideration. Organisations should rigorously consider the nature and level of risk that is acceptable to their business and what resilience and capability exists to manage these risks.

By doing so, you may be able to tackle the future with greater confidence.

## *Why focus on risk appetite?*

A clearly understood risk appetite may help to unlock value within your business by facilitating:

- better alignment of decision making with risk management strategies and return expectations
- decision makers to test and minimise subjective biases in decision making
- appropriate consideration of the capability and resilience to manage risks
- confidence in your business's ability to maintain targeted levels of financial strength
- challenging whether your business strategy has considered a range of future scenarios – from optimistic to pessimistic.

## *How do you unlock value by focusing on risk?*

To manage risk for sustainable business growth, consider your:

1. **Risk appetite** – By discussing your risk appetite, you can evaluate the nature and amount of risk your organisation is willing to accept to achieve its objectives. Consider:
  - your risk appetite for the short-term (12 months) and long term (e.g. 3-5 years)
  - the perspectives and expectations of key stakeholders and shareholders

- your capacity to bear risk, including your financial capacity
- acceptable and unacceptable risks, and measures for identifying, monitoring and managing such risks. For example, your organisation may be comfortable taking the risk of overseas expansion but may not accept the risk of expanding into certain countries.

2. **Resilience to risk** – Organisations can fall into the trap of spending too much time quantifying and modelling risk. It is important that you also spend time considering how well your organisation would be able to respond to a range of risks and deciding which risks are acceptable.
3. **Decision-making processes** – Decision-making processes may involve rigorous analysis and discussion of risks, options and strategies to optimise the return.
4. **Alignment of performance management, authorities and decision rights** – Your organisation should outline clear boundaries, responsibilities and escalation criteria. Decision rights, limit structures and delegated authorities should be identified and aligned with your risk appetite. You should also consider whether your performance management and recognition systems are aligned. For example, if you want to avoid short term decisions having long term adverse outcomes consider whether your incentive program has the right balance between the short and long term performance goals.

## *Your risk appetite checklist*

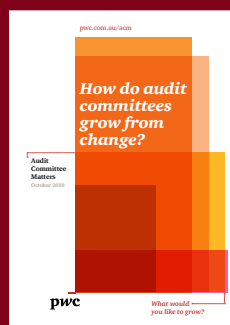
*Have you:*

- *identified which risks are critical to achieving your strategic objectives?*
- *aligned the Board, management and decision-makers across the business on the nature and level of acceptable risk to the business in pursuing growth objectives?*
- *discussed and communicated what risk profile your business would like to pursue and what risks are unacceptable?*
- *ensured investment decisions are made with full knowledge and analysis of risks?*
- *considered whether your performance management approach drives the right kind of behaviour around risk management?*
- *measured and managed risks in a consistent and rigorous way?*
- *considered how resilient your organisation might be to “unexpected” events?*

*If you are not certain of the answers to any of these questions, it may be time to take action.*

# Additional thought leadership

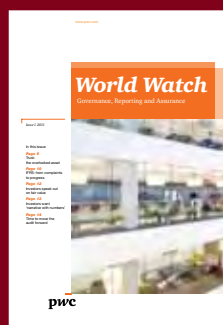
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The series of booklets which make up the PwC Audit Committee Handbook are designed to help audit committee members work through their maze of responsibilities in a practical manner. We welcome your thoughts on how this handbook can become even more relevant to your role, as we review the current content.

Please email your thoughts to Tim Nesbitt at: [tim.nesbitt@au.pwc.com](mailto:tim.nesbitt@au.pwc.com)

[pwc.com.au/audithandbook](http://pwc.com.au/audithandbook)

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## **Contact details**

If you have questions about any of these topics, contact your usual PwC representative. We value your feedback and input, if you have any suggestions or comments, please contact:



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