Definition for alert: condition of heightened watchfulness or preparation for action

Last August, the results of the AICPA-UNC Business and Industry Economic Outlook Survey showed that, for the third consecutive quarter, CPAs serving in business and industry continued to foresee slowing economic growth. “Our members are still seeing increased pressure on profits from rising costs without the ability to raise prices,” Chris McKittrick, the AICPA’s director of members in business, industry and government, said. “Expectations for revenue and hiring are trending downward.”

As we enter autumn, we see headlines every day about the subprime meltdown, upheaval on Wall Street, the credit crisis and corporate bailouts. Companies of all sizes face possible impacts from this financial crisis – now and in the future.

The AICPA in May 2008 issued a Financial Reporting Alert (“Alert”), Strengthening Financial Management and Reporting, intended to help members of an entity’s financial management and audit committee assess risks. The Alert includes questions for the audit committee and executive management to consider, plus topics they can use to assess an organization and its operating environment including its customers and suppliers (see box, right).

It is important to remember business risks result from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity’s ability to achieve its objectives and execute its strategies – and from the setting of inappropriate objectives and strategies.

Audit committees must continue to address all types of risks with their senior management team in addition to focusing on risks in the financial statements. In March 2008, the AICPA issued The AICPA Audit Committee Toolkit - Public Companies, 2nd Edition, which contains tools (e.g., the audit committee charter; conducting executive sessions; COSO Internal Control – Integrated Framework; COSO Enterprise Risk Management – Integrated Framework) that can assist audit committees in their oversight responsibilities regardless of wild swings in current events. Other audit committee toolkits are available for private companies, not-for-profits and governments.
Steps audit committees should still be taking include:

- Overseeing the adequacy of disclosures in the footnotes to the financial statements including:
  - Issues with FASB Statement No. 157, Fair Value Measurement
  - Issues with investment or credit losses and reliance on credit rating agencies’ ratings of investments
  - Understanding balance sheet exposures (e.g., cash, accounts receivable, accounts payable, debt agreements, investments, etc.); off-balance sheet exposures and other exposures (e.g., ability to access credit and capital, the cost of capital and oil, interest rates, etc.)
  - Understanding the issues associated with a pension plan (e.g., valuation of assets, interest rates, discount rates, and other assumptions used, etc.)
  - Understanding the effects of the credit crisis and/or consolidation on the entity’s customers and suppliers
- Evaluating the entity’s controls over risk and liquidity and discussing them with the entire board (for best practices, see “Observations on Risk Management during the Recent Market Turbulence” at sec.gov/news/press/2008/report030608.pdf)
- Assessing the impact of economic slowdown, market turmoil and financial institutions’ bankruptcy and consolidation on their entity
- Has the entity any issue with access to credit, financing, capital and/or covering insurable risks?
- Has the entity any issue with an IPO or divesting of assets or debt offerings, etc.?
- Has the entity any issue with M&A activity? In any M&A activity, review the resources needed for integration and the risk of not being successful
- Does the MD&A discuss the impact of current financial and economic crisis on the business? Does it reflect a current view of opportunities and risks based upon today’s market?
- Assessing the structure of the audit committee, the board and the entire committee structure to ensure the oversight of risk management is adequately covered and determine whether other committees are required or additional expertise is required to fully understand the risks
- Assessing the entity’s “tone at the top” (e.g., culture, risk appetite and strategy, incentive compensation)
- Asking questions not only about traditional risks but also non-traditional risks and assumptions used to build future-looking models
- Asking questions on what hasn’t changed, what has changed and may change that has an impact on the business
- Assessing the need for increased communication with both Internal Audit and External Auditors
- Monitoring companies conversion to XBRL
- Aware of the issue and have an understanding of the level of preparedness of the entity on International Financial Reporting Standards (IFRS)

These times warrant increased watchfulness to ensure your organization is not critically impacted by the credit markets’ continuing turmoil.
For further information:

- **AICPA Audit Committee Effectiveness Center:**
  http://www.aicpa.org/audcommctr/homepage.htm

- **AICPA Business and Industry Economic Outlook Survey:**

- **AICPA Current Accounting Issues and Risks 2008 – Strengthening Financial Management and Reporting:**
  https://www.cpa2biz.com/AST/Main/CPA2BIZ_Primary/Accounting/PRDOVR~PC-029203/PC-029203.jsp

- **COSO Enterprise Risk Management – Integrated Framework:**
  https://www.cpa2biz.com/AST/Main/CPA2BIZ_Primary/InternalControls/COSO/PRDOVR~PC-990015/PC-990015.jsp

- **COSO Internal Control – Integrated Framework:**
  http://www.cpa2biz.com/AST/Main/CPA2BIZ_Primary/InternalControls/COSO/PRD~PC-990009/PC-990009.jsp?cm_sp=RHN-_XSELL-_CWTPAB

- **IFRS:**
  http://www.ifrs.com

- **XBRL**
  http://www.xbrl.com

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