

■ The growing load of audit committees

Audit committees are under more pressure than ever before and their work loads are growing, a new survey by Deloitte has found.

The study, *Audit Committee Effectiveness*, involved interviews with 100 audit committee chairmen of ASX 200 companies between April and August this year.

It reveals that many boards have delegated their growing compliance burdens to committees, often to the audit committee. In addition, while audit committees had routinely monitored issues like financier management, lending agreements, refinancing debt and bank covenants, these issues have become more complex in the wake of the global financial crisis (GFC) and are now demanding much more attention and scrutiny.

Audit committees are also increasingly monitoring high-level business and operating risks, as well as non-financial metrics – such as customer satisfaction and employee engagement – because of the potential for these leading indicators to flag future financial issues, says Deloitte partner Greg Coultas.

“As a result, audit committees are under more pressure. They have more items on their agenda and a much heavier work load. In the past, they may have had about four meetings a year, each lasting one to two hours. Now they can have six meetings a year of three to four hours duration and a significant amount of extra meetings in between.”

Indeed, the survey indicates that the GFC has brought more prominence to the activities of audit committees and that these committees have moved to centre stage of board activities. “We are also seeing many more board members coming along to audit committee meetings, especially before the half and full-year results. They were invited before, but now they are actually turning up. This shows how important these meetings have become,” says Rod Smith, national leader of Deloitte’s assurance and advisory services.

But despite the extra workload, 23 per cent of respondents didn’t believe there was an appropriate balance between risk and reward for audit committee members. Many felt that they would be held more accountable if anything went wrong.

“Many audit committee chairs said that they believed their financial literacy and accounting expertise made them more vulnerable to censure,” says Smith. “Despite the ultimate responsibility resting with the board, when it comes to the

accuracy of financial statements, there was a widespread belief amongst our respondents that audit committee members carry more responsibility than other members of the board.”

The survey also discovered that audit committees have been developing far closer ties with management, especially the CFO, as well as with both the internal and external auditors in recent years. Closed sessions which exclude management and feature open and frank discussions with the external auditors are becoming much more important and are used to add value by evaluating financial management and to pick up emerging areas of concern.

Contribute feedback



■ Keeping it in the family

Family businesses are particularly concerned about balancing family concerns with business imperatives, retaining family control and ownership and fairly compensating those family members with active business involvement.

Resolving conflicts among family members and preparing and training a successor are also big worries.

These are the findings of the KPMG and Family Business Australia *Survey of Family Businesses 2009*.

According to Bill Noye, a partner in KPMG's Middle Market Advisory practice, the survey highlights that managing the family component of a business becomes more difficult as the business moves from one generation to the next.

"As each generation comes into the business, it generally means there are more family members in there, so governance structures become more important.

"Learning how to manage the family component early on in the evolution of the family business, through the use of family councils, family constitutions, boards and the like, will pay dividends down the road."

The survey found that only 28 per cent of respondents have established formal family councils. A third possess a board or other formal governing body. A further 43 per cent say they rely on less formal structures.

On succession planning, Noye says an obvious change from previous surveys was a large decline in owners planning to sell their business or transfer equity in the next five years. Reasons for this may include the recent slump in business values and incumbents being concerned about their successors' capacity to take over the reins in uncertain times.

Little more than 40 per cent of current business owners surveyed plan to pass on the business to their children or other family members, while 20 per cent intend to eventually sell the business to other owners or employees outside of family.

Noye says the survey showed some improvement in succession planning and in the level of formal board structures (although the latter still had a long way to go). Board evaluation processes also needed some work.

However, he notes that family businesses generally performed better than non-family businesses during the global financial crisis. "This is because they tend to be more patient with their profit expectations and more conservative from a balance sheet perspective and with their investment decisions."

Indeed, 36 per cent of respondents claimed the availability and increased cost of finance has had no effect on their businesses over the past year. A further 35 per cent reported only a small impact. Despite this favourable result, 28 per cent of businesses say they have cancelled investment projects and 46 per cent have deferred them. More than half of the respondents had made no change in their employee numbers over the previous 12 months – 13 per cent actually added to their workforce. Most expect to at least maintain current workforce numbers in the year ahead.

■ The value of a correct record

Directors who adopt appropriate record-keeping practices give themselves a fighting chance if ever called to account, suggests Dudley Kneller, a partner at Middletons.

He says cases like the recent James Hardie judgment highlight the importance of correct minute-taking and managing information properly.

In this case, Justice Gzell, in the NSW Supreme Court, found that the company had failed to comply with the law requiring that the minutes of the meeting be recorded in a minute book within one month of the meeting. Only documents recorded in a minute book within one month of a meeting are accorded evidentiary value.

Kneller says: "From a document retention perspective, directors should insist upon being provided all relevant information in advance of making decisions. Don't approve press releases or other important company documents unless you have seen them, reviewed them properly and are happy that you have exercised proper due diligence in that regard. Is the board pack complete? Are all relevant exhibits attached? If not, can you make an informed decision? Do you want to take that risk?"

He says directors should also ensure that minutes are prepared while fresh in the mind of directors and that they are sufficiently detailed and appropriately recorded. Be mindful of the one-month time limit requirements.

"Carefully review the minutes of meetings for accuracy and retain a copy of all minutes approved during your appointment to the board of directors. You may wish to consider destroying all notes of board meetings after your review of the minutes unless such notes are reasonably relevant to pending or potential litigation," he says.

Kneller says directors also need to monitor email use. "What is the company policy in relation to emails? Do you need to hold on to them and if so for how long? It goes without saying that you need to be especially careful about what you say in emails. Four of the top 10 verdicts in the US in 2005 were directly attributable to 'smoking gun' emails.

"Do you have a copy of the company's most recent document retention policy and are you following it? One need only look at the US bank Morgan Stanley whose failed document retention policy and subsequent inability to produce documents required by the judge led to an order of \$604 million in damages being made against the company.

"Any decision to destroy or delete emails should be consistent with the company's document retention policy. In Victoria, under the *Crimes Act*, both companies and associates of companies can be prosecuted for destruction of documents that are, or are reasonably likely to be, required in legal proceedings. Both are punishable by large fines. Case law in this area too has shifted in recent years and there is arguably now a higher standard of 'anticipation' of litigation which requires directors and companies alike to ensure that documents are only destroyed in appropriate circumstances."

■ Turning a troubled business around

Company turnaround plans can often fail because they are still being implemented by the internal management team or because they do not focus enough on stakeholder management, says Michael Fingland, a director of the Turnaround Management Association of Australia and managing director of Vantage Performance.

He says the US long-term average success rate for business turnarounds is only 30 per cent. The majority of turnarounds in the US fail because companies try to struggle on and do it themselves, rather than get experts in early enough to assist.

“In our experience, seeking expert assistance six to 12 weeks earlier than usually is the case can improve the chances of a successful restructure from 30 per cent up to as high as 60-70 per cent,” says Fingland.

“About 50 per cent of time during the first three to six months should be spent on managing stakeholders, the rest of the time on financial and operational restructuring.”

He says one of the board’s most critical decisions when embarking upon a corporate turnaround is whether the company has sufficient resources and experience within the senior management team to execute the plan.

“It is rare for the CEO or CFO to have experience in executing turnarounds. As a result, a common feature in the US and an emerging trend in Australia is the recruitment of a Chief Restructuring Officer or CRO. They are usually ex CEOs or CFOs who have experience in this area and take charge of developing and/or project managing the major initiatives over a one to two-year period. They either report to the CEO or directly to the board. This allows the senior management team to stay focused on the core business, which greatly increases the chances of success.”

Fingland says most successful turnarounds only require management to steer the business five to 10 degrees from its current course, but they also usually have one common feature.

“They are built around two to three major initiatives. This enables management to effectively demonstrate ‘what will be different’ going forward and provides greater focus and, therefore, greater momentum. Where management teams go wrong is that they try to progress 10 to 15 initiatives at once. This approach just doesn’t work, as the many stakeholders need to see traction quickly.

“So a critical decision to be made by the board is what those three big decisions should be, and in what order will they roll out the remaining initiatives. Focus on stabilising the business first, sometimes at the expense of profit, and then implement revenue and margin generative initiatives.”

Fingland says there are six essential elements required to turn around a business that is in trouble or senses trouble ahead. They are:

- Ability to prove business viability.
- Ability to manage key stakeholders.
- Establishing or rebuilding management credibility.
- Maintaining or improving business reputation.
- Maintaining supplier credit.
- Securing/extracting internal and external funding.

■ Unexpected tax consequences

The *Tax Laws Amendment (2009 Budget Measures No. 2) Bill* 2009, announced in October by the Federal Government to amend the employee share plan rules, contains an unexpected provision that will affect some existing employee share plans, warns Sally Morton, a tax partner at Deloitte.

Plans that currently offer either a cash or share alternative at the discretion of the employer or where the number of shares to be acquired under the plan cannot be determined until a future event, have not, until now, been subject to tax under the employee share scheme (ESS) rules until a definite share or right to a share is acquired. Such employment benefits will now be taxed under the ESS rules as though they have always been ESS interests.

According to Morton, many companies will find that existing plans are affected by these changes and where the award under the plan has not yet vested in either cash or shares, the company may discover unexpected tax consequences for participating employees.

“If the plan is not a qualifying plan and is ultimately delivered in shares, the tax liability will now arise at the original grant date of the award, not the date that the award vests and is delivered in shares,” says Morton.

“Employees who participate in these plans may find that they have an undeclared tax liability for the year of grant and will need to amend their tax returns to report the gain and pay the tax due, and potentially incur an interest charge on the overdue tax.

“In some cases, depending on the share price movement since grant, this may be a benefit and in other cases it may be a costly exercise for the employee.

“Companies may need to consider delivering affected employment benefits in cash to avoid potentially punitive consequences for employees.”