

Is Your Audit Committee Highly Functional?

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Responsibilities of audit committees have increased significantly over the past 20 years. Although some committees have shifted to accommodate new structures and operations, many have been slow to embrace the increase in roles and responsibilities, leaving them vulnerable to shareholder and stakeholder scrutiny.

The most dramatic changes occurred in 2002 with the passage of the Sarbanes-Oxley Act (SOX), which set the requirements of public company audit committees, including preapproving audit and nonaudit services, overseeing auditor engagement, convening with

auditors to share information on critical accounting policies, and ensuring their audit committee included a “financial expert,” among other things. Because SOX didn’t involve nonpublic companies, several states have enacted legislation of their own.

The interaction between audit committees and their auditors has, for the most part, departed from a traditional year-end “check the box” process to something far more collaborative and consistent. As a firm that has communicated with numerous audit committees, Moss Adams has observed and experienced the spectrum of dysfunctional to highly functional audit committees.

What traits separate the good from the bad? Let’s examine four key ways you can help your audit committee become highly functional.

Understand Your Auditor’s Responsibilities

The auditor’s responsibility to interact with audit committees has evolved over the years. With the issuance of Statement on Auditing Standards (SAS) No. 114, The Auditor’s Communication with Those Charged with Governance, and SAS No. 115, Communicating Internal Control Matters Identified in an Audit, auditors are required to communicate directly with au-

dit committees on certain matters, including the auditor’s responsibilities under generally accepted auditing standards, an overview of the planned scope and timing of the audit, and significant findings from the audit.

As a result, at a minimum, effective audit committees require their auditors to communicate during the planning phase of the audit, to present a concise audit plan and scope of work to be performed, and present the results of the audit and other required communications at the end of the audit. Such communications can be written or verbal, but, when possible, in-person meetings are more desirable for establishing lines of open communication.

Proactively Communicate with Your Audit Partner and Auditor

Effective chairpersons don’t wait for their audit partner to contact them when a problem is identified and needs to be discussed. Those that communicate their expectation for immediate notification are far more effective at handling and responding to issues during the audit, rather than being surprised in a year-end audit committee meeting with unexpected information. We recommend at least semiannual one-on-one meetings between the chair of the audit committee and

the audit partner or auditor.

Don't Underestimate the Importance of an Executive Session

The most highly functional audit committees are those whose standing agendas include an executive session with the auditor. Executive sessions represent time set aside during the audit committee meeting during which management is excused and the audit committee and auditors are free to dialogue about any issues that may be too sensitive to discuss with management present.

Prescheduling executive sessions is always a good idea. While 9 times out of 10 the auditor won't have anything to say to the audit committee that he or she couldn't say with management present, occasionally there are sensitive topics to discuss. Requiring auditors to ask the audit committee chair for an executive session in front of management can create discomfort and may send an inappropriate message to management that the auditors have something negative to report. The auditor's responsibilities, after all, are not to management but to the audit committee.

By prescheduling these sessions, highly functional audit committees allow for open two-way communication to take place and encourage audit committee members to pose questions they perhaps wouldn't be comfortable asking with management in the room.

Follow Up on the Auditor's Recommendations

Auditors are required to communicate significant deficiencies and material weaknesses in internal controls to the audit committee. In addition, the auditor may commu-

nicate other areas for improvement that he or she believes warrant attention and oversight by the audit committee.

To ensure that these matters are addressed in a timely manner, effective audit committees require their management to present their response to the audit findings and any action plans necessary to address them. Follow-up on these matters should occur throughout

the year to ensure they're properly addressed prior to commencement of the next annual audit.

The Bottom Line

A highly functional audit committee is essential to ensuring appropriate oversight over management, financial reporting, internal controls, and assessment of the quality of the audit firm and audit team you've engaged to perform your audit. Want to learn more



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about ways to improve the effectiveness of your audit committee? The American Institute of Certified Public Accountants keeps a wealth of information useful to not-for-profit audit committees on its Web site, www.aicpa.org. From

the home page, search for “not-for-profit audit committee” to find tool kits, case studies, and more.

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