Financial transaction and accounting issues have reached an unprecedented level of complexity. Subjective accounting standards and challenging economic and regulatory environments, together with ongoing pressure on management to “make its numbers”, have put a premium on “getting the numbers right”.

Audit committee oversight essentials ...

As guardians of shareholder interests and financial reporting integrity, audit committees play a pivotal role in helping to ensure that the critical accounting policies, judgements and estimates applied by management present a fair and accurate picture of the company’s financial position and performance.

Effective audit committee oversight in this respect requires understanding of key financial reporting processes, getting the right information on a timely basis, setting clear expectations for transparency and quality and, most importantly, being diligent in probing management about the accounting issues that management and external auditors dedicated the most time to resolve.

Also, audit committees should maintain a sharp focus on the finance organisation, making sure it has the resources to succeed, and seek to ensure it is focused on the company’s long-term performance.

Each judgement or estimate can significantly impact a company’s financial statements and each estimate has a range of possible and supportable results. Challenging management’s judgements of key assumptions underlying critical accounting estimates, and understanding management’s framework for making accounting judgements and estimates should be at the core of the audit committee’s discussions with management and the external auditor.

In particular, the audit committee should:

- Understand and evaluate the facts, economics and financial reporting requirements surrounding each critical accounting judgements and estimate.
- Consider the appropriateness of management’s selection of accounting principles and critical accounting policies.
- Assess the method and the assumptions used in making critical accounting judgement and estimates.
- Question the degree of aggressiveness or conservatism surrounding judgements and estimates and assess the risk for management bias.
- Ensure external audit is sufficiently satisfied that management’s accounting policies, judgements and estimates are fit for purpose.

### Audit Committee Questions

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Key questions for audit committees to consider:

**Accounting policies and practices**
- Has management considered all transactions, conditions or events that could give rise to new or revised accounting policies?
- Are critical accounting policies and estimates used in accordance with IFRS and consistent with the intent of IFRS?
- Where accounting policies have been changed: Why was the accounting policy changed? What were the alternatives considered? Are the changes consistent with external events and circumstances? What is the impact of these changes on current and future financial statements?
- How do the company’s accounting policies and practices compare to those of peers?
- Is the external auditor and the audit committee satisfied that the selection of accounting policies and practices is appropriate in light of the nature of the company’s operations and significant transactions?
- If the external auditor were solely responsible for preparation of the company’s financial statements, would they have been prepared any differently than the manner selected by management?

**Judgements and estimates: process and assumptions**
- What were the processes used to arrive at critical accounting judgements or estimates?
- What were the alternatives considered by management? Does the process properly factor in low probability but high impact events that might impact the estimate?
- Are the methods and the nature of key assumptions commonly used to make a particular type of accounting estimate in the company’s particular business?
- Are all key assumptions subject to appropriate internal controls and reasonableness checks and have those internal controls been tested by internal and/or external audit?
- Are the key assumptions internally consistent with budgets and forecasts and with the disclosures in the narrative sections of the annual report?
- What was management’s approach related to accounting estimates where its analysis indicated a number of outcome scenarios?

**Dealing with estimation uncertainty**
- How were the effects and risks of estimation uncertainty assessed and mitigated?
- Has appropriate sensitivity analysis been conducted to flex assumptions to identify how robust the model outputs are in practice and that the assumptions are unbiased?
- Has management performed retrospective reviews on the outcome of accounting estimates? If significant discrepancies were noted, were they appropriately remediated in the current year’s estimates?
- Are the models, the key assumptions and the key sensitivities disclosed appropriately related to critical accounting judgements and estimates, commensurate on the related risk of potential management bias and estimation uncertainty? How do these disclosures compare to the company’s peers?
- Is the audit committee satisfied that appropriate disclosure is included in the financial statements related to critical accounting judgements and estimates?

**Earnings management and potential bias**
- What is the risk of management bias for each judgement and estimate? What safeguards are in place to mitigate the risk of management bias, if any?
- What is the external auditor’s view on the degree of aggressiveness or conservatism surrounding management’s judgements and estimates?
- Do any accounting principles and estimates subvert the intent of IFRS (e.g. by using techniques such as: “Big bath” restructuring charges to conceal unrelated costs, creative acquisition accounting to influence valuations, “cookie jar reserves” to support future earnings, misuse of the materiality concept or accelerated revenue recognition)?
- Are any unusual analytical relationships noted in the financials that may indicate that earnings are being mangled (e.g. increased revenues versus decreased receivables, increased profitability versus decreased cash flows or unusual performance compared to competitors)?

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