



Information technology governance

Introduction

The Midwest Audit Committee Network is a group of audit committee chairs drawn primarily from public companies headquartered in the Midwest. The eighth meeting of the network was held in Chicago on June 8, 2010, and focused on information technology (IT) governance, including IT risks and projects, and working with the IT organization. Members were joined during the meeting by Will Woods, a principal in Ernst & Young's advisory practice in Chicago, who has significant experience in the planning and overall execution management of large-scale business and technology transformation programs of more than 600 people, having led multiple of these large-scale initiatives across full solution development life cycle. This document synthesizes key issues that emerged from those discussions.¹ For a full list of participants, please see Appendix 1, on page 11.

In addition, Mike Lutze, a partner in Ernst & Young's financial accounting advisory services group, ran a separate session on potential changes to US Generally Accepted Accounting Principles (GAAP) that may result from the joint convergence projects between the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). For a summary of that session, please see Appendix 3, on page 13.

Executive summary

Effective IT systems enable growth and carry substantial risks. Members agreed that the board and audit committee have a valuable role in IT oversight. The key themes of the discussion are summarized below and in more detail on the following pages:

- **Directors' evolving perception of IT** (*Page 2*)

Network members agreed that board directors must understand the growing role of IT in order to ensure an appropriate level of oversight. Identifying, monitoring, and mitigating IT risks are chief amongst directors' concerns. Members are particularly focused on major projects, systems integration, privacy, business continuity, security, access controls, and compliance. Although many companies have IT steering groups within senior management, meeting participants said that in many cases there continues to be a misalignment between the business and the IT function.

- **Working effectively with the IT organization** (*Page 4*)

Members agreed that a strong chief information officer (CIO) with good leadership skills, business understanding, and credibility is essential. Members noted how difficult it can be to assess IT and agreed

¹ *VantagePoint* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments made during the meetings are not attributed to individuals or corporations. Quotes in italics are drawn directly from comments made by members and guests during and after the meeting. Mr. Woods has given permission for selected comments to be attributed; these remarks are not italicized. Other unitalicized, unattributed quotations are drawn from pre-meeting conversations or from conversations of other networks of audit chairs.



that succession planning discussion and board presentations by IT are two effective ways to determine the quality of the IT group. Given the breadth of IT risks and projects, many companies decide to outsource some of the IT function, and several members report success at bringing in external help to assist where niche expertise is needed. Although it is difficult to “*quantify the true value of IT*,” members are more concerned about their companies not spending enough money on IT than running over budget. IT executives typically report to the board at least annually on the organization and budget and quarterly on the status of major IT projects. Members said these reports have the potential to contribute greatly to the board’s knowledge and understanding but wish that the IT organization would refrain from assuming that the board is not capable of understanding substantive IT issues.

▪ **Effectively allocating board oversight responsibilities** (Page 8)

While members agreed that “*a great deal of IT oversight resides with the audit committee*,” some wondered if the full board should be more involved. Several members said that while directors with IT expertise can enhance oversight, they would not “*choose [a new director] solely for their IT experience*.” Members noted that often the board looks to internal and external audit for expertise to supplement its limited knowledge of IT.

Directors’ evolving perception of IT

IT governance is moving up the board’s agenda, propelled by several trends, including the increasing cost and complexity of IT systems, the scale and growth of Internet-enabled businesses, the need for IT-related compliance, and the increasing risk of cyber attacks against the enterprise.

Companies have not always appreciated the importance of having an effective IT function. One member noted, “*When I look at where IT is now compared to where it was five years ago, we’re definitely taking a more proactive approach toward improving the function. The perception of IT has improved a great deal*.” Another shared, “*We now look at IT as not being a cost center, but look at it as a profit center. Once IT starts being viewed that way, the whole outlook changes. That sense of IT being a value creator is huge*.”

Members said that understanding the implications of IT failures plays a large role in the shifting perception: “*If you get it right, it’s wonderful, but if you get it wrong, you’re cooked*.” Added another member, “*I think fear has been a primary reason [for the board’s increased attention to IT] ... If a significant IT event were to happen, it would be very bad*.”

Moreover, directors increasingly recognize the benefit of an effective IT function: “*If you have a robust IT platform, you automatically have a competitive advantage as a company – and you’re at a disadvantage if you don’t. We are now starting to see gaps between some [competitors] because of this*.” Another member remarked prior to the meeting, “*This is one area that can bring the company down. However, it’s also an area where – if done right – companies can leapfrog the competition*.” Still, several members reported that they struggle to integrate IT and strategy: “*My observation is that we’ve made the jump from cost center to business enabler, but haven’t made that jump to the place where IT can be a strategic and competitive advantage. How do we do that?*”



IT risks are top of mind for board directors

Corporations depend on IT to support complex operational and control systems. IT systems have to operate reliably and without disruption, and financial systems must deliver information that is accurate, timely, and secure. A failure in these systems – through a failed implementation, a security or privacy breach, or damage to physical hardware – can cause significant operational disruption. As such, members reported that monitoring risks related to IT is high on the board agenda: *“IT risks are absolutely critical, and [at] every meeting, IT is prominent on the heat map when we’re discussing enterprise risk management.”*

Members highlighted several IT-related risks that greatly concern the board:

- **Major projects.** *“We have embarked on a large, multi-year project [that costs] hundreds of millions of dollars. It covers lots of different processes and supply chains, so obviously the board and audit committee are pressing to make sure all the risks are identified. It’s a big deal, and almost everyone on the board is involved, given the cost, complexity, and reputation issues.”*
- **Systems integration and standardization.** *“We’re trying to move [all the operating units] to standard systems and processes to operate in a global way. The financial systems are in place, but the operational systems are still in the early stage, so the entire board reviews the status of [the integration project].”*
- **Privacy and cyber security.** *“Privacy and security are huge issues at my company. Both the audit and risk committees are focused on monitoring developments. We even have a joint meeting once a year to make sure that we don’t have any gaps.”* Another member said, *“In all cases, privacy risks are among the top risks for us because [they are] loaded with issues.”* A final member commented, *“So much information these days is protected under privacy laws that weren’t protected in the past ... Similarly, [in certain industries] there is very sensitive information related to customers and employees on file that you are now required by law to protect.”*
- **Business continuity.** *“On my board, there has been a significant amount of discussion around business disruption and disaster planning. We discuss the level of risk and how it’s being mitigated.”*
- **Access controls.** *“We still have significant challenges with access controls. We keep fixing and finding and re-fixing and re-finding. Simple things, like making sure terminated employees are no longer on the payroll, are an issue.”* Another member remarked, *“For as long as I’ve been on the board, there has never been a year where access controls has not been on the IT risk report. I always ask why this is so hard to fix.”²*
- **Regulatory reform and compliance.** *“There are a number of risks coming out of health care reform, and changes need to be made immediately to our IT systems to accommodate the new laws ... It’s interesting in terms of prioritization of risks. You think you have one path you’re heading down, and then you get all these [regulatory] bombs thrown in from outside the organization that you need to deal with.”*

² Board members are not alone in their frustration: CIOs described problems relating to access controls as particularly vexing in the February 2005 edition of *InSights*. See Tapestry Networks and Ernst & Young, [“The CIO’s perspective.”](#) *InSights*, February 2005.



Members report that going forward, they will seek to link IT risk management and strategy more clearly: *“We all have enterprise risk management; we call it enterprise risk and opportunities management.”* Added another member, *“I think the construct of strategy and risk management will be a bigger issue for the board going forward. Although we’ve asked for strategic presentations to help us understand the competitive nature of our IT and how we can use it, I think we need to push that more.”*

By managing IT risks, companies can create IT value

Several members report that their companies have senior executive councils to manage IT: *“IT goes a long way to help the board and [audit] committee if you have a group that is interacting with IT on a regular basis but is not directly involved in the IT organization.”* Added another member, *“Usually the senior leadership team goes through and prioritizes which IT projects are the most important and advises the board on which projects are worth the time and commitment.”*

Members agree that a management steering committee can be particularly effective if a company is struggling to prioritize IT investments. Mr. Woods told members, *“One of the best examples I saw was one committee that formed a business technology integration team. The CEO, the business unit heads, and the CIO all sat on it. It was originally formed because there was a continual lack of delivery on the IT plan. This group addressed that problem, and [the IT group] is now part of the business.”*

Despite taking steps to increase management’s involvement in IT, meeting participants agreed that in many cases the business and IT are still not optimally aligned. Mr. Woods said, *“There always seems to be a limited capacity of IT experts, and yet business units pile on and say IT does not deliver. Then, when I talk to CIOs, we’re always hearing they need more resources. Somehow there’s an alignment issue. If you find there is a huge disparity between available resources and requested initiatives by the business, that’s when you know there’s a disconnect that’s not being acknowledged.”* Members agreed that they must follow up on this issue. *“I’m going to go back and gain a better understanding at my companies about how well management is aligned with IT,”* said one.

Working effectively with the IT organization

In discussing effective working relations with the IT organization, members covered the importance of a strong CIO, IT evaluations, IT outsourcing, and IT presentations to the board and audit committee.

The importance of a strong CIO

Members stressed the value a talented CIO brings to a company and pointed out that the desired characteristics for this key executive have shifted: *“The CIO is now seen as a business partner. There has been a change in the landscape from a heavy computing and technology component to a business partner. We now want someone who can sit across the table and be there to move the business down a path and deliver value.”*



Meeting participants noted additional characteristics of an effective CIO:

- **Strong leadership skills.** *“The CIO needs the same characteristics [as] any good leader – good administrator, ability to retain and attract top clients, professional, ability to make the case to management that investment in technology is the wise choice. I don’t think a good CIO is terribly different ... [from] any other great executive. It’s about leadership.”*
- **Understands the business.** *“We have a very effective CIO because he understands our business and our industry so well.”* Added another member, *“We had a problem finding and keeping the right CIO, and we ended up taking someone from within the organization because they really understood the business, and that was incredibly important to us.”*
- **Credible within the organization.** *“We promoted someone from within the company to be CIO, and his strength is that he has previously established relationships which allow him to get more done. He can walk down the hall and sit across the table from anyone in the business and talk about their issues. He’s commanded respect in the business.”*
- **Change agent.** *“I’ve been concerned for quite a while that the individual we currently have in charge of IT likes it the way it is and isn’t so excited about leading change. That’s a critical aspect of IT success, so I would add change management to the characteristics of the ideal CIO.”*

Members considered the CIO’s career path and debated whether the CIO could be considered a candidate for other senior executive roles. One member observed, *“If the CIO is a really strong business leader and expresses an interest, then that’s certainly a dialogue in succession planning that needs to happen. It is highly unlikely we would consider [moving the CIO to another role] unless the individual wanted to do that, though.”* Another member pointed out, *“Generally you don’t see someone going to run a business unit and then com[ing] back to be CIO the way you do with finance and internal audit.”* A third member remarked, *“Our CIO has a lot of respect in the organization and is a member of the senior global management committee, so it’s not as if he hasn’t found success in the CIO position. He already commands a great deal of respect.”*

IT evaluations

Given that many directors lack direct IT experience themselves, it can sometimes be difficult for the board to assess the quality of the IT organization. In our pre-meeting conversations, one member quipped, *“There’s a little bit of mystique about IT ... They only seem to speak English at bonus time,”* and another wondered, *“How would you even know if you have a good IT function?”* One member said the board has two primary means of getting to know the IT organization better: *“First is overall succession planning – most boards look at the CIO and the next two people down. The second would be through presentations. Typically the top person will bring someone else with them, and that’s a good way to get insight into the quality of the IT leadership and staff.”*

Members noted that outside experts can provide the board with an independent, comprehensive review of the IT function. As one member reported prior to the meeting, *“We periodically had others come in from*



outside companies who weren't trying to sell us anything, to both review our IT organization and to educate the board. They [would come] in and give their views on the IT group, what direction they [saw] IT going, and what we should and should not be worrying about. Conversations like that were helpful." At the end of the meeting, one member remarked, *"I appreciate the [concept of] 'trust but verify' – having that third party come in and review IT is a good idea. That's a great suggestion, and I will be taking it to my board."*

Members agreed that one of the most difficult aspects of assessing the IT function is the fact that *"the value is so much more qualitative than quantitative."* One member lamented, *"It's hard to capture the true value of IT. Every time we try to capture the value, the numbers seem so [arbitrary]."* Consequently, members report that oftentimes *"the view of the board is that IT is valuable, but that they should be held accountable for cost."* As one member pointed out, *"You look at other financial areas, and they're easy to benchmark. That is not the case with IT."*

Despite this pressure to quantify the value of IT, members consistently agreed with the member who said, *"We are not concerned about spending too much; more often, we are concerned that we're not spending enough."* Many members believe boards should focus on ensuring IT has adequate resources: *"We should be asking open-ended questions of the CIO such as, 'If you had 10% more resources, what would you do with it? What would you do differently [from] what you're doing now?' Chances are [after you hear the answer], you will respond, 'You're not doing that already?'"*

IT outsourcing

Given the breadth of IT risks and projects, many companies decide to outsource or co-source some of the IT function. As one member remarked prior to the meeting: *"Outsourcing is a whole additional area of IT to consider. I think outsourcing and co-sourcing are increasing – at least at the companies I'm involved with – because of the pace of change and the range of IT projects."*

Many companies seek outside assistance only for specific projects. Speaking prior to the meeting, one member remarked, *"I think we have a very good IT organization, but if there's a new application that's significant to us, we will sometimes get the vendor for the software involved in the implementation."* However, Mr. Woods cautioned members to assess the availability of qualified business subject-matter experts: *"We talk about bringing in outside IT expertise, but program execution management that goes along with IT expertise is important. You have to be careful, because I have seen examples where you get someone who might be an SAP expert, but [that person] cannot manage a project to save their life. As a result, they do not know how to look for proper evidence of execution and making sure everything is being reported properly. Make sure you look for that capability."*

IT presentations to the board and the audit committee

During pre-meeting discussions, members reported that the full board still gets an annual presentation from the CIO or another member of the IT organization: *"The CIO presents to the board once a year, and we discuss the key issues for the coming year: resources, risks, cost structure, staffing levels, and other things along those lines."* Another member pointed out, *"The annual IT presentation to the board does not tend*



to be a deep dive. More, ‘Here’s the issue; here’s the structure; here are the teams that are working on it,’ and so on.”

Members said that the audit committee is more likely than the full board to receive in-depth IT presentations: “I get a report every audit committee meeting from the CIO. Sometimes it’s five minutes; sometimes it’s 45. At least semi-annually we ask for a formal update on the budget and what it’s being spent on. We ask questions like, ‘Are we ahead of the curve? Have there been any security breaches? What’s being done?’”

At the June 8 meeting, members agreed that directors also value periodic reports on the status of major projects: *“We get a full report quarterly on the status of our current major project. The discussion is around progress against milestones, costs against budget, time against project time frame, any particular risks that have been identified that weren’t expected. We also do a red-yellow-green report, and if there’s anything that’s red, you have a detailed discussion.”*

Several members voiced frustration over IT’s occasional reluctance to make reports: *“I can vividly remember having asked an IT person to make a report, and he asked me why. The report he ended up giving was almost condescending.”* One member remarked, *“That’s why the CIO needs to have business experience, so that they understand the importance of communicating with the board.”*

Sample email to audit committee members about an upcoming IT discussion³

As part of our next audit committee meeting, I would like to cover the IT organization and related matters. I believe an update would be helpful, timely, and informative. The following is an outline of what I’m thinking about asking the IT folks to discuss with us in a working session.

1. Background and organization structure of IT, including but not limited to:
 - Organizational structure and governance
 - High-level overview of budget and staffing
 - All organization structures have their challenges. In reference to promoting good tone at the top, driving efficiency across the segments, and improving consistency and quality of internal controls, what challenges does this IT structure present, and how are they dealt with?
2. Major accomplishments and issues being faced, including:
 - Update on IT’s mandate to increase efficiency through standardization of platforms across organizational structure and governance segments – where we’re at, major successes/challenges and opportunities, impact on controls
 - Projects to improve controls and efficiency within segments – where we’re at, major successes/challenges and opportunities, impact on controls

³ Provided by a member of the MWACN, with selected points redacted to protect confidentiality.



- Overview of any recent IT or related functional failures or major problems
- Approach to folding international operations into overall IT operations, hardware, and processes
- 3. Strategic issues in IT that need to be considered for the near-term future, including thoughts on:
 - Investments in major changes in hardware and platforms
 - Dealing with acquisitions or dispositions of business units
 - Offshoring – impact on talent and knowledge retention and future organizational capability
- 4. Other matters that IT would like to bring to the audit committee’s attention

Effectively allocating board oversight responsibilities

“The most important thing is to create the forum for the dialogue around IT to take place [with the board] on a regular basis. There is no one-size-fits-all for IT governance, and different boards approach it different ways. We just need to make sure someone is the owner for creating that dialogue.”

The role of the board and the audit committee

IT governance responsibility often resides with the audit committee, members said, although some believe the full board should take a more active role: *“I think a lot of IT prioritization, decisions, risk management, and whatnot still takes place in the audit committee. I’m not sure if you’ll see it always embodied in the [committee] charters, but [the audit committee] certainly feels like the right place. I don’t think we do as much as we could at the board level, though. I think there ought to be more of an emphasis, and we should spend more time getting the board educated on risks and opportunities in the IT organization.”* Indeed, some audit committee chairs think the central role of IT in many businesses justifies significant discussion at the board level. However, historically others have suggested the board should limit its IT oversight, avoiding a direct role in tactical decisions lest it be accused of meddling.

Some members wondered if boards should consider IT expertise when selecting new directors: *“Do we have the right people around the board table to discuss IT in a meaningful way? When you look at boards, most directors did not grow up in the evolution that’s taken place over the past ten years. From a strategic standpoint, have we challenged ourselves [by asking] if we have the right people?”* Prior to the meeting, one member reported, *“We’re very fortunate to have on the board a former CEO [of a company with significant IT focus], and he brings a whole different level of questions and scrutiny to the process. If you don’t have someone on the board to ask the right questions and make sure the answer makes sense, you can run into a lot of trouble.”*

While members agreed that it is an advantage to have IT experience on the board, they also agreed that *“you wouldn’t choose someone solely for their IT experience. It’s an ‘and;’ it’s not an ‘or.’”* Still, going forward, one member reported, *“I’m on several nominating and governance committees, and I’m going to start paying*



more attention to IT backgrounds in our candidates. It would be helpful to have a director who would have that as a core competency in their background.”

Utilizing sources of expertise

Members observed that most board members lack deep technical expertise and often turn to experts both inside and outside the company. Specifically, many audit committees depend on internal audit to support their IT oversight responsibilities: *“Internal audit does an annual IT review and also does a quarterly IT review of specific projects.”* Another member reported, *“We always make sure that there is a group in internal audit that has significant knowledge of IT, because they report to the audit committee directly, so you can have a greater level of comfort. In many cases, we’ve been able to avoid some issues that could have been problematic had we not had the insight from internal audit in advance.”*

Members discussed the fact that large-scale IT projects carry with them significant program management demands. Several members reported that for those sorts of projects, they have brought in external project management expertise. One, speaking prior to the meeting, said, *“We are undergoing a huge IT project, and we’ve actually hired some outside people who are specialists to come in several times a year to monitor how things are going. They’re not just looking at costs and deadlines, but whether or not [the project] is meeting the needs of the business. Really digging in and assessing how the project is progressing.”*

When boards and audit committees look outside the company for guidance, they often turn to their independent auditor. Meeting participants highlighted several ways the external auditor could add value:

- **Flag noteworthy IT issues with the audit committee.** *“We had a case where our auditor had observed some issues in IT. They brought it to the attention of the audit committee and said, ‘Here are some things you should be looking at.’ We ended up raising it with management, and it was excellent. That was very helpful.”*
- **Monitor IT bench strength.** *“We want [the external auditors] to be our eyes and ears within the company 24/7. They’re there a lot more often than we are, and they know people down in the organization. They should be able to answer questions about the depth of our IT staff.”*
- **Participate in management discussions.** *“[Auditors should get] invited to the management IT team meetings and ask to be included. That way [they’ll] hear more of the intimate details about what is and is not going well.”*
- **Benchmark IT capabilities.** *“External auditors have exposure to a lot of different companies, which gives them more perspective, so we [ask them] open-ended questions about IT in executive session about what they’ve seen in other organizations.”*
- **Ensure the audit partner responsible for IT meets the audit committee.** *“I’m reflecting on how many times, at the audit committee meeting, the partner responsible for analyzing and reviewing IT controls isn’t there. Is it [only] the lead audit partner who’s talking, or is the partner responsible for doing the IT work [also participating]?”*



Conclusion

For many companies, *“IT gets into the guts of the company.”* However, along with enabling new opportunities, IT also brings new risks. Members agreed that effective IT governance requires clear communication and strong relationships. Even though few directors consider themselves IT experts, boards and audit committees have many sources of expertise at their disposal. Moreover, by acknowledging that sometimes they will have more questions than answers, audit committee chairs can become more comfortable discussing IT.

Going forward, members are eager to explore the opportunities IT presents: *“I think it’s important to always be asking ourselves, ‘Are we ahead of the curve?’ We should always be thinking of that next step, and I worry sometimes that we get overconfident because we focus on [individual projects]. We should instead be asking where we need to be in five years to be at a strategic advantage. We should all be thinking about that a lot more.”*



Appendix 1: Participants at the network meeting

The members of the network present, who sit on the boards of approximately 25 large-, mid-, and small-cap companies between them, were:

- Dave Burritt, Audit Committee Chair, Lockheed Martin
- Blake Devitt, Audit Committee Chair, Baxter International
- Brenda Gaines, Audit Committee Chair, Office Depot
- Sandy Helton, Audit Committee Chair, Covance
- Olivia Kirtley, Audit Committee Chair, U.S. Bancorp
- David Landsittel, Audit Committee Chair, Molex
- George Off, Audit Committee Chair, Telephone and Data Systems
- Tom O'Neill, Audit Committee Chair, Archer Daniels Midland
- Rich Roedel, Audit Committee Chair, Brightpoint
- Al Smith, Audit Committee Chair, Simon Property Group
- Dennis van Mieghem, Audit Committee Chair, AEGON USA
- Donna Zarcone, Audit Committee Chair, CIGNA

The following members took part in post-meeting discussions:

- Howard Carver, Audit Committee Chair, Assurant
- Cheryl Francis, Audit Committee Chair, Morningstar
- Laurette Koellner, Audit Committee Chair, Sara Lee
- David Schwartz, Audit Committee Chair, Walgreen

Ernst & Young partners participating in the meeting included:

- Tony Anderson, Midwest Area Managing Partner
- Rich Bonahoom, Midwest Accounts and Business Development Leader
- Will Woods, Principal, Advisory Practices



Appendix 2: Questions audit committee members might ask about IT governance

- ? What factors should determine the board’s level of IT oversight? Is there a minimum level of board responsibility for oversight of IT, regardless of industry or business model, to protect shareholder value?
- ? What measures does the board use to assess the value derived from IT investments? How can the board ensure the level of IT investment is appropriate?
- ? What IT trends are impacting strategic and tactical decision making? What is driving those trends? What are the consequences for the board?
- ? How does the board determine an appropriate level of IT oversight? Are there specific cost or risk thresholds that drive greater oversight?
- ? What IT-related risks are of greatest concern to the board? How have those risks been evolving?
- ? What are the characteristics of an exceptional CIO? How is this role changing? What are the signs that a company has the right CIO, or red flags that suggest it might not?
- ? What are the advantages and disadvantages of centralized and decentralized IT functions? To whom should the CIO report, and why?
- ? How often does the CIO present to the board or audit committee? What information is presented? What additional information would be helpful?
- ? How can the board gain insight into the bench strength and vulnerabilities of the IT organization? How important is it for the board to understand succession planning for key IT professionals?
- ? What role does the audit committee play in IT oversight? How does this differ from the role of the full board? When is it appropriate to form a permanent or temporary board IT committee?
- ? What sources of technical expertise are most helpful to boards (e.g., technology-savvy directors, internal auditors, external auditors, IT consultants, others)?



Appendix 3: Education session on the major FASB/IASB joint convergence projects

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) are currently forging ahead with an unprecedented agenda of standards development in an attempt not only to bring International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (US GAAP) closer together but also to achieve substantial reform of these standards. As an Ernst & Young brief said, “The boards have been working closely together since 2002, when the two standards-setters entered into the Norwalk Agreement that formalized their commitment to convergence. This commitment was renewed in a Memorandum of Understanding (MoU) in 2006, which was updated in 2008 and reaffirmed in November 2009.”⁴

Prior to the MWACN meeting, Mike Lutze, a partner in Ernst & Young’s financial accounting advisory services group, ran an education session on potential changes to US GAAP as a result of the FASB and IASB convergence program. Mr. Lutze said that whether or not the SEC decides to require IFRS reporting in the United States, audit committees and their companies should be preparing for what one observer called a “tsunami of accounting change.”⁵

The FASB and the IASB are on course to bring about major changes to US GAAP

Mr. Lutze said the FASB and the IASB have committed to completing a significant number of convergence projects by June 2011. The projects most likely to be completed include leases, revenue recognition, and financial instruments. Indeed, the FASB released an exposure draft (ED) on financial instruments in May 2010⁶ and is expected to release EDs on the projects around leases and revenue recognition in June 2010.

Mr. Lutze said the FASB will generally provide a four-month comment period for larger projects after releasing the EDs. As an Ernst & Young brief said, “Regardless of any future decision to require IFRS reporting in the US, the projects underway are expected to ultimately result in substantial changes to US GAAP in many areas.”⁷ Mr. Lutze said the timeline for the convergence process is ambitious. Indeed, subsequent to the meeting, the chairmen of the FASB and the IASB sent a letter to the G-20 acknowledging that a few projects will extend into the second half of 2011, preventing the boards from reaching the earlier target date. However, in the letter, the FASB and IASB chairmen said they will keep the June 2011 target date for many projects where converged accounting rules are “urgently required.”⁸ Mr. Lutze said that the convergence projects “will happen eventually” and urged audit committees to speak to their companies’ chief accounting officers and finance organizations to start planning for the potential changes. MWACN members were taken aback by the scale of the proposed changes, and said they intended to address them with their finance organizations and external auditors.

⁴ Ernst & Young, “[FASB/IASB joint projects update.](#)” *Hot Topic*, May 14, 2010, 2.

⁵ Ernst & Young and Tapestry Networks, “[Regulatory change is driving audit committee agendas.](#)” *InSights*, April 2010, 3.

⁶ Reuters, “[FASB proposes financial instrument rule change.](#)” May 26, 2010.

⁷ Ernst & Young, “[FASB/IASB joint projects update.](#)” 2.

⁸ See Financial Accounting Standards Board, “[Joint Statement by the FASB and the IASB on their convergence work.](#)” June, 2010.



Finance executives are urging the FASB and the IASB to slow down

Some finance executives believe the timelines are too aggressive and are asking the accounting standards setters to slow down. In a letter to the FASB and the IASB sent in May, Financial Executives International wrote, “Collectively, we do not believe we have sufficient technical resources in industry to respond effectively to such a large quantity of complex proposals issued over a very short period of time. Even if it were not so, it is not clear to us that the FASB and IASB have the requisite resources to absorb and resolve all of the issues that would be posed by all of these proposed standards in such a compressed time period.”⁹

Members were concerned that the accounting changes might require a massive overhaul of internal controls systems, processes, and procedures and suggested that companies planning to upgrade major information systems take into account the impact the proposed changes will have on those systems. They also recommended that finance organizations consider submitting a letter to the FASB during the comment period, either alone or in cooperation with industry peers.

About this document

The Midwest Audit Committee Network is a group of audit committee chairs drawn from leading companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is convened by Ernst & Young and orchestrated by Tapestry Networks to access emerging best practices and share insights into issues that dominate the new audit committee environment.

VantagePoint is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *VantagePoint* lies in its power to help all constituencies develop their own informed points of view on these important issues. Anyone who receives *VantagePoint* may share it with those in their own network. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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⁹ Financial Executives International, “[FEI Committee Files Letter with FASB, IASB on Impact of MoU Standards.](#)” May 10, 2010.