

Audit Committee Leadership Network

December 2020

ACLN

VIEWPOINTS

Effective audit committee leadership

Every audit committee fulfils the same central responsibilities for financial reporting oversight, but committee practices vary from company to company. Perhaps because of this diversity, members of the Audit Committee Leadership Network (ACLN) were eager to exchange perspectives and practices on committee leadership. The conversation took place virtually on November 2, 2020. *For a complete list of participants, see Appendix 1, on page 10.*

Executive summary

The discussion focused on three topics:¹

- **Preparation makes meetings both thorough and efficient** (page 2)

Audit chairs prepare, often well in advance of committee meetings, by consulting with management, other directors, and the external auditor. They use these interactions to prioritize topics and structure meetings for efficient use of time. They also coach executives and other attendees on presentation styles and work with them to make materials fit for purpose.

- **Strong leadership enhances audit committee performance** (page 4)

Asserting control over the agenda and meeting mechanics can be important to fulfilling a committee's oversight responsibilities. Audit chairs budget time, use executive sessions and deep dives, and connect with committee members by email or telephone to ensure that key items receive coverage. Dedicated meetings and calls around statutory filings and earnings releases allow audit committees to focus on critical accounting and reporting events apart from their other work.

- **Audit committees' expanded scope calls for collaboration and creative division of responsibility** (page 7)

Today's audit committees have wider oversight responsibilities than before. Managing this in collaboration with other committees can be critical for ensuring that the board works effectively as a whole. Some audit chairs call for additional standing or ad hoc committees, such as cybersecurity or risk, to give emerging topics the requisite degree of rigor.

For a list of discussion questions for audit committees, see Appendix 2 on page 11.

Preparation makes meetings both thorough and efficient

Members emphasized that effective meetings begin with rigorous preparation. Premeeting discussions with a range of internal and external contributors distill the critical issues that need to be addressed and make meeting materials fit for purpose.

Managers and others consulted

Many audit chairs confer with executives and their deputies, the external auditor, and fellow audit committee members and other directors before each committee meeting, sometimes initiating these discussions weeks in advance. Formal requirements and the annual agenda impose structure on each meeting, but detailed preparation with internal and external resources often influences what the audit chair will prioritize. Virtually all members meet with their external auditor. One member said, *“The chief financial officer, the chief accounting officer, and I set the agenda before each meeting. I also have a special relationship with the chief audit executive; we meet for an hour before each meeting and I go through his pitch line by line.”*

ACLN members also reported holding premeeting discussions with the general counsel, outside counsel, controller, company treasurer, head of tax, chief information security officer, chief compliance officer, chief information officer, corporate secretary, and chief risk officer. In some cases, audit chairs also meet with line executives—chief executives, presidents, chief operating officers, and division general managers. These discussions do more than inform audit chairs before a meeting; they also allow committee chairs to coach managers on their presentation styles. A member said, *“My premeeting calls with managers are dry runs devoted to the heavy lifting of committee work. If it takes someone 30 minutes to explain something on those calls, there’s a problem.”*

Given the expanded scope of many audit committees, some members prioritize speaking with the chairs of other committees before each audit committee meeting—for example, the nomination and governance, finance, and risk committees. One member described this collaboration, particularly in the area of risk oversight, as *“cross-pollination”* for the board.

Several members said they hold calls or exchange emails with other audit committee members before each meeting. Those interactions can foster a shared vision heading into the meeting. One member said, *“I email the other committee members saying I’ve met with the executives and ask the members if they want to discuss anything. It’s been helpful. Once you get into a rhythm, those exchanges become natural.”*

Meeting materials

Members discussed ways of obtaining materials from management that work effectively in meetings. Some audit chairs use premeeting discussions with executives to refine their preparation and provide feedback on materials before the rest of the committee receives

them. Many had preferences for the length, format, and content of the meeting books, appendices, and slides, as well as for the use of appendices.

Principal written materials

Members identified preferred practices:

- **Executive summaries and discussion guides can help present key items succinctly.** Several members said that executive summaries are useful for digesting large quantities of data and other details. Discussion guides, which inform participants ahead of time of the items to be discussed in the meeting, can focus the conversation, target high points, and connect related topics.
- **Highlighting, annotations, and hyperlinks make navigating documents easier.** Audit chairs favor materials that guide them to the information and takeaways that they need to focus on while offering the chance to review underlying detail. Highlighted and annotated portions of documents flag key items, while internal hyperlinks make electronically reviewing different sections of materials efficient. One member used highlighted draft forms 10-K and 10-Q to *“focus on the things that are most important.”*
- **Slides, used in moderation, can deliver key points effectively.** PowerPoint slides, including “read-only” slides that are not necessarily intended for meeting discussions, can be effective tools. However, many members said that they do not permit the recitation of slide contents to be the focus of a presentation to the committee. Members tended to agree that a limited number of slides, crafted to fit the committee’s needs, can be useful.

Meeting book appendices

Many members described how they wanted management to use appendices. While some said that they leave it to managers to determine what goes into appendices, others preferred to limit their contents. Several agreed that, for the most part, materials should not be *“buried”* in an appendix; one reason is that it could divert attention away from content that is placed there. *“The board and the company could be at risk if everything shifts to the appendix,”* a member said.

Although most audit chairs had confidence that every committee member was reading all meeting materials, some shared a concern that large appendices discourage close reading. *“Appendices can be a trap,”* one said. Some preferred not to see appendices at all. One member said, *“The rule of thumb is no appendix. Managers have to justify putting content there. If a lot of incremental information needs to be put into an appendix, then we expect an executive summary.”* Another observed that managers often use appendices to provide greater detail than they present in summaries and noted that this is not always helpful: *“We try not to get a lot of appendices. We’ll ask for more data if we need it.”*

Strong leadership enhances audit committee performance

Many factors shape an audit chair's committee leadership style. Prior leadership experience coupled with an awareness of how the committee operated under the predecessor chair can be important influences. Dynamics of the board, including relationships among its committees, can also affect an audit chair's approach.

Asserting control over the committee

Many members agreed on the importance of taking strong control over the committee's agenda and functioning. A new audit chair may need to adjust the predecessor's approaches and establish how premeeting, meeting, and postmeeting work will be handled. Bringing in a fresh approach can enhance good legacy practices while establishing the right posture with management and the full board.

Setting a new tone with management can be a top priority for an incoming audit chair. For example, if executives were accustomed to exerting outsized influence over audit committee meetings, taking control of the agenda may be a priority for a new chair. A member recalled early days in the role: *"I noticed that management determined the topics that were being discussed at committee meetings; the committee didn't have much input. That was the first thing I addressed. It was important to me that we spent time on things that presented the most risk and were the most imperative for us to address in the near term."*

Managing topic coverage and time allocation

Members agreed that most committees have enough time to cover all critical items, but many said that maintaining efficiency and flexibility remains important. The expanding scope of the audit committee, challenges associated with the pandemic, and directors' other oversight responsibilities can put a premium on meeting time. One member observed that *"people have become very sensitive to time."*

Committee size and meeting length and frequency can affect how an audit chair balances topic coverage and time allocation. Members reported that their audit committees had as few as three and as many as seven members. Before the pandemic, in-person meetings ranged in duration from 90 minutes to over four and a half hours, and some committees met in person as many as six times per year. Some committees had no telephonic meetings, while others had 10 per year. Some members said that their audit committees now are holding more, often shorter, meetings in the virtual environment than they held in person before the pandemic.

Committees that have frequent, relatively short meetings can cover as much as committees that hold longer, more infrequent meetings.

Some members said that they were firm about topic time allocations and meeting start and stop times. One member said that the committee had the corporate secretary track the meeting to the committee charter. A member who used a timed agenda said that *"some*

lawyers didn't like that, but the audit committee was able to keep to it." However, the member added, the committee will *"adjust during the meeting and go over time if we have to."*

Although schedules sometimes force meetings to end on time, most members said that scheduling conflicts will not prevent them from covering what they need to cover. *"We'll go as long as we need to go, and management understands that's our prerogative."* A member indicated that more meetings, even shorter ones, can provide opportunities to handle less pressing overflow from previous meetings: *"We meet 13 times a year, so there's no time-allocation problem."* Using written materials to convey information that otherwise would be handled verbally can save time in meetings. One member described balancing efficiency and coverage as an *"art form."* However, the member added, *"One of our goals, in addition to efficiency, should be committee engagement. We don't want to send the message that tight schedules mean people can't speak up and ask questions. The goal isn't to check a box and be able to say we looked at an issue. The goal is to get intellectual engagement from the full committee to address issues of concern."*

Presentation styles can affect topic coverage and meeting efficiency. One member emphasized that presenters should speak to their audience as directly and simply as possible: *"The most important thing management can do in the meeting is point out the things they think the members should know and not lose us in a sea of charts and hand-waving."* Another audit chair insisted on a less rehearsed, more "live" presentation style than some presenting managers have employed: *"Most important: nobody can read from a script. Anyone who does that gets a call saying they can't, or they won't present to the committee again."*

Meetings for earnings releases and forms 10-K and 10-Q

Meetings that cover filings and earnings releases tend to occur telephonically. A member found that having earnings and filings calls in quick succession helps keep the audit committee focused: *"When you look at the management discussion and analysis, it shouldn't be different from what's on the earnings call."* As with other committee meetings, prior preparation with management, the external auditor, and other resources can enhance earnings and filings calls.

One member met with the controller two weeks before the release of each 10-Q to discuss significant accounting matters; the controller later provided the committee with an annotated draft of the 10-Q to guide its focus. The member said that short summaries of complex topics with annotated boxes covering restructurings or derivative accounting that were tied to the summary *"made the whole process easy."* Another said that communicating with management and committee members before the meetings on filings and earnings helps to keep the meeting discussion on track: *"I'll email people questions before the meeting to avoid bogging the meeting down with nuances."*

Members shared other preferred practices around filings and earnings releases:

- **Hold separate technical and strategic calls.** One member reported having two calls for every filing review to allow the committee to focus on technical and strategic items separately, rather than having those elements compete with each other in one discussion.
- **Peruse the representation letter.** Updates sometimes occur without notice to the committee. *“You want to identify in the representation letter what’s different from normal or routine,”* a member said.
- **Review the press release.** The technical aspects of filings and earnings releases receive much of the audit committee’s attention. One member recommended devoting time to the press releases as well. A member said that combining meetings to cover forms 10-K or 10-Q along with their earnings press releases keeps the committee focused on the big picture as well as the details that link each item.

Deep dives

Members said that deep dives, *“special topics,”* or other close examinations of issues that are not standing agenda items arise in a few ways. Some are planned, while others are impromptu extensions of committee meeting discussions. If deep-dive topics cannot be fully covered in a meeting, they may be the subject of a supplemental call or meeting.

Several members said that their committees have regularly scheduled deep dives on topics critical to the audit committee or full board. Some said that they regularly schedule deep-dive meeting segments, using them to cover a range of topics. *“We have three or four special topics a year, like a mergers and acquisitions retrospective, the latest accounting scandal, fraud controls, profit and loss controls, or an internal bad actor,”* one said.

Members reported that they had covered the following topics during the past 12 months:

- Cybersecurity and information technology
- Tax and accounting considerations
- Legal, compliance, ethics, and whistleblower issues
- Key geographic areas and business units
- Mergers and acquisitions and other strategic actions
- Internal audit and internal controls
- COVID-19 pandemic
- Regulatory developments
- Treasury items, budgetary issues, financial systems, and pricing issues
- Third-party relationships
- Critical audit matters

One audit chair emphasized that deep dives on quality of earnings are important. *“Those are a big deal,”* the member said. *“Often the audit committee talks about everything else and not enough about the accounting positions that drive the company’s results. Those are critical.”*

Executive sessions

Executive sessions can streamline a meeting and amplify its takeaways. Private discussions with the external auditor, the legal team, and key accounting and financial executives can focus issues, identify key risks, and help the audit chair set the course of a meeting. One member used executive sessions to open each meeting and *“cover and clear the agenda and let everyone know what I think the important pieces of the meeting will be.”* At the end of the formal meeting, executive sessions can help a committee identify action items and develop topics for further inquiry.

An EY leader said that executive sessions with the external auditor could be particularly valuable: *“Specifically ask external auditors what they are seeing elsewhere that may improve your company’s operations and controls.”* One member mentioned that the external audit team should focus on the content of the meeting but not the client relationship itself: *“We made clear to the auditor that committee meetings are not a chance to introduce new members of the audit team to us. There are other settings and opportunities to make those introductions.”*

Attendance by directors not on the audit committee

Most audit committees allow directors who do not sit on the committee to attend their meetings. Few members reported regular attendance from such noncommittee directors, but there were exceptions. At one company, the lead director and board chair sometimes elect to attend all audit committee meetings. At another, most board members join part of every audit committee meeting to participate in discussions on topics that are relevant to the full board: *“Cybersecurity and data privacy is a standing audit committee agenda item. I schedule it for the first hour and invite the full board to join. There’s general interest and high participation from the other directors.”* Another member said that major news affecting the company has led the full board to attend all of every audit committee meeting because *“nobody wants to miss anything.”*

Audit committees’ expanded scope calls for collaboration and creative division of responsibility

Many audit committees are now overseeing risks including cybersecurity; environmental, social, and governance (ESG); and major technology implementation. While audit chairs acknowledge that these added responsibilities make sense from a governance perspective, they regularly report that an expanded agenda can test the capacity of a committee.

Sharing oversight responsibility with other existing committees can alleviate some of the pressure. One member said that the board’s nomination and governance committee *“controls”* cybersecurity oversight, but that the audit committee inevitably addresses the topic and that it *“would be natural to have cybersecurity on the audit committee because it pertains to controls.”* Another member said that their board’s risk committee splits risk oversight with the Effective audit committee leadership

audit committee: *“The risk committee handles operational risk, while the audit committee handles overall risk, including compliance, legal, internal audit, and financial risk.”* Another expanded on the division of responsibility: *“The risk committee chair proposed eliminating duplication between the risk and audit committees. In so doing, the risk chair returned to the audit committee sole responsibility for liquidity, tax, and internal audit risks. The risk committee gets a copy of the audit committee’s meeting materials, so it knows what we’re covering. We get an annual or semiannual report from the risk committee so we can understand the key enterprise risks they’re handling.”* Risk and audit committees often have overlapping members.

Audit chairs welcome additional oversight responsibilities that naturally fall under their committees’ purview, although they are wary of undertaking too much for the full board. One member was concerned that a broader audit committee scope could undermine the committee’s core mission of overseeing financial reporting: *“We can’t take everything on for the board. We need to make sure that accounting issues are adequately covered.”* Forming new committees, such as for cybersecurity or sustainability, may be a practical solution. One member thought that risk committees—even outside of financial institutions, where they exist as a regulatory requirement—could help achieve better board coverage of nonfinancial risks.

As ESG gains attention in the investment community, many audit committees are becoming involved in ESG reporting. An EY leader noted that *“the proliferation of ESG is making some audit committees double down to discuss related metrics and filings.”* A member who was seeing the same trend said, *“ESG is not one of the audit committee’s core competencies, but investors are looking at this now and we need rigor and quality in those reporting processes.”* However, the member was wary of *“squeezing all of ESG into the audit committee’s scope, given the focus it now needs.”*

Conclusion

While no two audit committees have identical oversight responsibilities, all share the same core mandate. As emerging risks and reporting obligations mount, so do the expectations for audit committees. Time management and good meeting practices help audit chairs manage their committees’ oversight responsibilities. For some audit chairs, effective audit committee leadership begins with an assertive, personalized approach to meeting preparation and mechanics. Communication with management and other directors telephonically, by email, and in executive sessions can help make meetings efficient and ensure that the board and its other committees function well independently and in collaboration with each other.

About this document

The Audit Committee Leadership Network is a group of audit committee chairs drawn from leading North American companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

ViewPoints 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 *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. 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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Appendix 1: Participants

The following ACLN members participated in all or part of the meeting:

- Barbara Byrne, ViacomCBS
- Pam Craig, Merck
- Pam Daley, BlackRock
- Dan Dickinson, Caterpillar
- Sam Di Piazza, AT&T
- Dave Dillon, 3M and Union Pacific
- Lynn Elsenhans, Saudi Aramco
- Fritz Henderson, Marriott
- Bob Herz, Morgan Stanley
- David Herzog, MetLife and DXC Technology
- Charles Holley, Amgen and Carrier Global
- Hugh Johnston, Microsoft
- John Lowe, Phillips 66
- Brad Martin, FedEx
- Wick Moorman, Chevron
- Suzanne Nora Johnson, Pfizer
- Chuck Noski, Wells Fargo
- Louise Parent, FIS
- Paula Price, Accenture
- Tom Schoewe, General Motors
- Leslie Seidman, GE
- Gerald Smith, Eaton
- Tracey Travis, Facebook
- Jim Turley, Citigroup and Emerson Electric
- David Weinberg, The Coca-Cola Company
- Maggie Wilderotter, Hewlett Packard Enterprise
- John Veihmeyer, Ford
- Robin Washington, Salesforce.com

EY was represented in all or part of the meeting by the following:

- Kelly Grier, EY US Chair and Americas Managing Partner
- John King, EY Americas Vice Chair of Assurance Services
- Steve Klemash, EY Americas Leader, Center for Board Matters

Appendix 2: Discussion questions for audit committees

- ? Do you find that your audit committee meets at the right cadence and for the right length of time? What, if anything, would you change?
- ? What feedback do you give to managers about their attendance and presentation style at audit committee meetings?
- ? How would you change the meeting materials that management prepares for your audit committee meetings?
- ? Which topics would you like to spend more time on in the audit committee? Which topics would you like to spend less time on?
- ? If your board does not have a risk, finance, or cybersecurity committee, should it? Why or why not?
- ? Are your external auditor and audit partner playing the desired role on your audit committee and in preparation for its meetings? What would you change?
- ? What surprising or particularly valuable contributions has your external auditor made at, or in preparation for, your recent committee meetings?

Endnotes

¹ *ViewPoints* 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 are not attributed to individuals or corporations. Quotations in italics are drawn directly from conversations with network members in connection with the meeting.