

# West Audit Committee Network - South Chapter

June 2018

WACN  
South

SUMMARY of THEMES

## Managing emerging technologies, the relationship with the external auditor, and oversight of workplace misconduct

Audit committees have long sought to improve their relationship with the external auditor, but many have only recently begun devoting board time to oversight of workplace conduct and emerging technologies like robotic process automation (RPA). Members of the South Chapter of the West Audit Committee Network (WACN) discussed all three of these topics on May 23.

### Managing emerging technologies

EY's Chris Surdak joined members for a discussion about new technologies. In a wide-ranging discussion, he emphasized three key points for board members:

- **Automation is about more than cost savings.** Mr. Surdak discussed how companies are starting to utilize new software, such as robotic process automation (RPA), to automate repetitive tasks that were once performed by humans. He explained that these projects provide value in different ways: *"People want to talk about return on investment, and that's great. But there is also return on time with projects that once took five days taking five minutes, and return on quality as robots get through a process without any errors."*
- **Boards should ask difficult questions about new technologies.** WACN members expressed that it can be difficult to separate hype from reality when assessing investments in technology. Mr. Surdak said it is important for boards to insist that their companies are thoughtful about implementation: *"When things get scaled it gets complicated quickly. Caution is especially important with RPA because once a software robot is trained, it either completes the process correctly 100% of the time or never."* To ensure new technology is applied safely and effectively, one member noted the value of having someone from internal audit participate in innovation projects: *"It is good to have someone looking for governance issues and gaps in controls."*
- **Include HR as you consider or adopt these technologies.** RPA and other emerging technologies will change the nature of a company's workforce. Mr. Surdak advised: *"It's not just about the new technology; it's a new, digital labor force. Many of the questions about adoption are HR questions, not technology questions."*

## The relationship with the external auditor

Members discussed their perspectives on what makes for a high-quality audit, and shared their experiences evaluating audit quality. Members made three suggestions for how audit firms can provide excellent client service:

- **Demonstrate industry knowledge and experience.** Members highlighted industry expertise as a key attribute of a good auditor. One member said, *“I think there are so many judgements and estimates made based on the industry you are in. Having a lead partner that understands the industry and where those judgements and estimations sit competitively—that’s vital.”* While members emphasized the importance of industry expertise, they also noted that industry boundaries are changing as companies digitize their businesses. EY’s Mike Verbeck explained, *“We have so many clients switching business models or industries. It’s good having someone who understands your current industry, but our clients also want someone who understands what they may be in five years. It’s about providing the best team based on the situation.”*
- **Build trust.** Members said that a prerequisite to an effective audit is a relationship of trust among the auditor, audit committee, and management. One member summed it up: *“You don’t want to meet your audit partner when you’re in the ditch and important decisions are being made. You want to have a good feel before that.”* Several members mentioned the importance of knowing how the auditor will handle difficult situations. One member said, *“What’s really important to me is exception processing. When something goes wrong, how will you handle it? Is there some fundamental trust? Do we know how the issue will be raised and dealt with?”* Members added that when there is a new partner or a new audit chair, it is important to have a conversation about how each prefers to communicate with each other, and to agree upon a cadence of communication before any issues arise.
- **Show that excellence is more than competence.** Members said that a technically flawless audit is table stakes; they find value when the auditor does something unexpected. One said, *“One great partner always tells me something I didn’t know, whether it’s a tax issue or something in the future we haven’t thought of yet.”* One area where audit firms can helpfully go beyond what is required is helping committees get ahead of critical audit matters (CAMs) disclosures required in 2019. One member said, *“My concern is it will take two or three years for the CAM process to shake out. I’ve been asking our auditor what the CAMs would be if we were required to disclose them this year.”* Several members said that they hope to see a dry run of their CAMs this year. EY’s Mike Verbeck said, *“We plan to do just that for all of our clients, provided they are comfortable with us undertaking the work.”*

## Oversight of workplace misconduct

Recent high-profile allegations of inappropriate workplace conduct have dominated the news. WACN members were joined by Paul Hastings Partner Jennifer Baldocchi to discuss what companies should consider in the #metoo era.

- **Be prepared for more claims and greater settlement demands.** The current spotlight on workplace misconduct has led to a substantial increase in new allegations by employees, typically paired with settlement demands that are exponentially higher than in years past. Ms. Baldocchi said, *“Everything is different now than it was 20 years ago, 10 years ago, or even six months ago. Settlements can be very high, and these cases can be incredibly difficult to litigate in court.”* She also warned that the current media environment creates added challenges for companies and boards, including providing due process to employees facing misconduct allegations.
- **Review workplace policies and procedures.** Ms. Baldocchi highlighted the importance of practical policies that prohibit inappropriate conduct but are also enforceable: *“I worry about companies setting the bar so high on the policy that they don’t follow through on it when the time comes. Companies need policies that they will enforce.”* She added that the current wave of attention provides a good opportunity to revisit workplace training practices, ideally with a focus on in-person, interactive sessions rather than online videos. Board members should also work with management to establish a protocol for what level of employee complaints are reported to the board (for example, any allegations against senior management). Ms. Baldocchi advised: *“Boards can’t look at every single complaint, but you should be receiving more than you did in the past.”*
- **Investigate thoroughly.** Members were interested in what boards should do to address an allegation of misconduct by senior management. Ms. Baldocchi advised about the importance of a thorough investigation, conducted by a trained investigator: *“If the allegation involves the CEO or one of the CEO’s direct reports, the board will likely take control and oversee the investigation. It might not be a lawyer; you need to consider that the investigator will likely become a witness, and lawyers aren’t always the best witnesses.”* She added that even if the investigation is conducted entirely outside the company, *“having a strong HR department is so crucial. It can be tough to defend a case if the HR department isn’t good.”* A member added, *“When I join a board, part of my assessment of the CEO is based on the strength of the HR function and the CHRO.”*
- **Guard against backlash.** The current climate has many executives on edge, and members, in turn, were concerned about the unintended consequences. One member said, *“I’m worried that there could be a backlash against mentoring women, especially at the higher levels. I’m not sure women today would have the same opportunities to be mentored and supported that I did. That concerns me.”*

## About this document

*The South Chapter of the West Audit Committee Network is a select group of audit committee chairs from leading 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.*

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### Meeting participants

- Ralph Boyd, Sandy Spring Bancorp
- Traci Dolan, Steel Dynamics
- Rich Dozer, Knight-Swift Transportation
- David Engelman, PrivateBancorp
- Leslie Heisz, Edwards Lifesciences
- Diana Laing, Macerich
- Sara Lewis, PS Business Parks, Sun Life Financial, and Weyerhaeuser Company
- Roger Molvar, PacWest Bancorp (*North member*)
- Steve Page, AeroVironment
- Dick Poladian, Occidental Petroleum and Public Storage
- Clarence Schmitz, AECOM
- Mike Stein, Aimco
- Joe Tesoriero, Smart & Final Store

EY was represented by the following:

- Kay Matthews, Vice Chair and West Region Managing Partner
- Mike Verbeck, West Region Assurance Managing Partner