

# Audit Committee Leadership Network

November 2022

ACLN

SUMMARY of THEMES

## Top challenges for audit committees, SEC enforcement, Washington outlook, special investigations, and investor dialogue

On November 10-11, 2022, the Audit Committee Leadership Network (ACLN) met in Washington, DC to discuss:

- **Top challenges for audit committees**, a members-only discussion
- **SEC update and enforcement discussion** with Elad Roisman, partner at Cravath, Swaine & Moore LLP and former commissioner and acting chair, US Securities and Exchange Commission (SEC or “Commission”); and Jennifer Leete, partner at Cravath, Swaine & Moore LLP and former associate director, division of enforcement, SEC
- **Washington outlook:**
  - **PCAOB update** with Steven Jacobs, EY Americas director of SEC regulatory matters and capital markets leader
  - **Midterm election implications** with Ray Beeman, EY principal and leader, Washington Council
- **The audit committee’s role in special investigations** with Sally Yates, partner at King & Spalding and former deputy attorney general and acting attorney general at the US Department of Justice (DOJ)
- **Investor and audit chair dialogue** with Wellington Management’s Yolanda Courtines, senior managing director, portfolio manager, and chair of the Investment Stewardship Committee, and Carolina San Martin, managing director and director, ESG Research

Below is a summary of each discussion.<sup>1</sup> Forthcoming *ViewPoints* will provide additional detail on the sessions discussing top challenges for audit committees and special investigations.

### Top challenges for audit committees

Audit chairs face a complex risk landscape, unprecedented levels of uncertainty, and ever-expanding responsibilities. Members discussed their most pressing challenges, which included: 1) ESG preparedness; 2) unprecedented levels of uncertainty and compounding risks; 3) cybersecurity; and 4) the growing audit committee agenda, each summarized below.

- **ESG preparedness.** Members are worried about their companies' overall ESG preparedness. *"We are standing up new organizations and creating whole new control environments. It is a big lift."* Members are also concerned about the cultural challenge of moving ESG reporting into the financial reporting system. *"There is a big difference between marketing speak and reporting speaking,"* one explained. Another emphasized: *"One of most important things you can do is stress to the CFO and CAO that they may need to sign a 10-K with this information."* Members cited Scope 3 as a top concern. While it remains to be seen what the SEC will ultimately decide on Scope 3 disclosures, most ACLN companies will have to comply with European regulations, which include Scope 3.
- **Unprecedented levels of uncertainty and compounding risks.** What makes today's risk environment unique is the scope, scale, and interconnectedness of risks once viewed as largely independent. As one member framed it, *"From a risk management standpoint, all of these risks are stacking together ... We have a lot of volatility in the markets, geopolitical issues, and energy issues."* Compounding risks that members highlighted include:
  - **China.** *"China is number one on my list of things that keep me up at night,"* one said. He added that his board has spent six hours on China in the last two meetings—more than they have during his entire four-year board tenure.
  - **Energy.** No ACLN members expect the US to have an energy emergency, but the energy crisis in Europe has them thinking about the implications for their companies. A member commented that *"the energy challenge will be here for a decade"* and that the world is on track for shortages in areas that will be hard to predict. He advised members to prepare for global energy challenges for the foreseeable future.
  - **Supply chains.** Energy and geopolitical disruptions translate into supply chain concerns. *"De-risking"* supply chains, including decreasing dependence on China, as well as reexamining European supply chains in light of potential energy shortages this winter and beyond, were top of mind for members.
  - **Unknown risks.** Following the COVID-19 pandemic, audit chairs are worried about "black swan" events, which are especially challenging to plan for. One recounted how prior to COVID-19 a pandemic had been on their risk map, *"but we never thought it would shut down global supply chains."* Another added: *"You can identify the risks, but you may not have any concept of the actual impact they would have ... it can be a much bigger scale than you ever could have imagined."*

To address the interconnected nature of today's risk landscape, ACLN members' companies are using scenario planning to ensure that they can respond quickly to unexpected events. They are refreshing and strengthening their enterprise risk management (ERM) processes. One member noted that ERM practices can fall short if they take a siloed view of risks and fail to consider how one risk may impact or intensify others. *"But companies and boards can get better at asking where the non-obviously*

*interconnected risks are going to occur.*” Another explained that his company created a risk council with cross functional leaders to gain a broader view of risks and their implications.

- **Cybersecurity.** Cybersecurity is a “*never-ending struggle*” for many audit committees, one chair said. The continuous evolution of cyber risks and the heightened threat environment, especially as geopolitical tensions remain high, keep many audit chairs questioning whether they are doing enough, have allocated sufficient resources, and are putting the right questions to executives. Members discussed how they oversee cybersecurity, including the cadence of updates from management and outside experts, as well as the use of cyber rating agencies. On ransomware, an audit chair suggested that “*companies have gotten better at quickly responding and recovering. The threat actors are getting better, but companies are too.*”
- **A growing audit committee agenda.** As new risks and issues continue to pile onto the audit committee agenda, members must balance oversight of an expanding scope of responsibilities with limited time. One asked the group: “*With all of these new risks and topics—cybersecurity, ESG, geopolitical, trade issues, and others—getting allocated to the audit committee agenda, are accounting and finance getting the short end of the stick?*” Members shared practices for running meetings effectively and efficiently, including strategic use of executive sessions to ensure committees focus on the highest priorities and move those items to the beginning of the agenda so they do not get squeezed for time. One audit chair segregates the agenda by items needing approval, items for discussion, and those accepted as-read.

## SEC update and enforcement discussion

Elad Roisman, former commissioner and acting chair of the SEC and now a partner at Cravath, Swaine & Moore LLP, and Jennifer Leete, partner at Cravath, Swaine & Moore LLP and former associate director, division of enforcement at the SEC, joined ACLN members to discuss the SEC’s current rulemaking priorities as well as the current enforcement environment. Several key themes emerged:

- **Boards need to pay attention to the unprecedented speed, scope, and volume of SEC rulemaking.** According to an October 13, 2022, SEC Inspector General report, the SEC issued 26 new rule proposals in the first eight months of 2022—twice as many as in the first eight months of the previous year.<sup>2</sup> “*This Commission’s regulatory agenda is incredible,*” Mr. Roisman noted, describing not just the volume of rulemaking, but also the breadth. “*The rules cover every facet of the marketplace,*” he said, “*Every public company has to pay attention to what the SEC is doing, because they all will be impacted by some of these rules.*”
- **The climate-related disclosure proposal will fundamentally change disclosures required for public companies.** ACLN members are extremely concerned<sup>3</sup> with the Scope 3

reporting requirements in the SEC's March 2022 proposed rule, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*.<sup>4</sup> Most believe that substantial work and time is needed before Scope 3 disclosures can be consistent, comparable, reliable, and useful to investors. Mr. Roisman also noted that aspects of the way the proposal is written turns the traditional view of materiality on its head: *"Is the disclosure rule aimed to reflect climate change's impact on your company or your company's impact on climate change?"* he posited. While most observers believe the SEC's final rule will be challenged in court, Mr. Roisman highlighted that, *"Boards should assume that some version of the proposed rule will go into effect. Directors need to understand from management what systems and controls are in place or need to be built to ensure the company is prepared."*

- **SEC enforcement is in an aggressive phase, but still tethered to the courts.** Ms. Leete, who recently departed the SEC after more than 20 years in the enforcement division, summarized the current environment as aggressive, *"but ultimately, it is tethered to the courts and what they can win in a litigation."* She highlighted SEC Chair Gary Gensler and Enforcement Director Gurbir Grewal's focus on deterrence and their publicly articulated view that past penalties have not been high enough to effectively deter big companies. *"That is animating big penalty numbers now,"* said Ms. Leete.
- **Self-reporting is a complex decision.** ACLN members were particularly interested in how the SEC views self-reporting. *"What are the requirements for self-reporting, especially when it is a gray area? How should a company think about the risk versus reward?"* one asked. Another noted that *"It feels like you never get enough credit when you self-report."* Both Ms. Leete and Mr. Roisman emphasized that every situation is different, and that significant analysis and judgment should go into the decision. Boards should think carefully about the long game and what a settlement could mean for the company down the road.
- **Cooperation must be proactive and fulsome for companies to receive credit.** *"When you think about self-reporting, there is also cooperation,"* Ms. Leete pointed out. The SEC can give credit to companies who cooperate, however *"they mean full cooperation. Complying with subpoenas can feel like cooperating, but the enforcement division views that as just complying under law. Cooperation is more than that."* Members discussed how companies may sometimes decide to hold off on self-reporting until they have fully investigated the issue. In those instances, Ms. Leete advised companies to *"pivot and cooperate. It's not a binary choice,"* she said, *"You can still get substantial credit if you hold off on self-reporting and cooperate extensively."*
- **ESG enforcement activities are early stage, but companies should be cautious about impending climate-related disclosures.** The announcement of the ESG task force's first enforcement actions earlier this year, along with the SEC's proposed rules on climate-related disclosures have many audit chairs' wondering how the SEC is approaching ESG

enforcement. ESG enforcement is still in its early stages. Ms. Leete expects that initially much of the enforcement activity will be in the “*greenwashing*” arena, with asset managers drawing a lot of the scrutiny. But she warned that companies should be careful about making statements like “*We are net zero*,” if they do not have data to back up these claims. Public statements—whether in SEC filings or not—should be measurable and documented. She noted that once the climate-related disclosure rule becomes effective, the enforcement division will likely begin by looking at filings to identify outliers or very aggressive statements but will “*proceed carefully in the early stages, then start building up to harder cases.*”

## Washington outlook

Members met with Steven Jacobs, EY Americas director of SEC regulatory matters and capital markets leader, to discuss the PCAOB and its current priorities. In the last year, the PCAOB issued a new draft strategic plan, announced an ambitious standard-setting agenda, and signed a Statement of Protocol Agreement with China, among other changes. Mr. Jacobs highlighted several factors important for audit committees to be aware of as they work with their external auditors:

- **Standard-setting agenda.** There is “*an aggressive standard setting agenda and significant effort to update standards*,” Mr. Jacobs said. Focus areas include audit quality, noncompliance with laws and regulations, and attestation standards, which members were particularly interested in given the likely impact on ESG reporting.
- **Inspections.** “*Inspections continue to be really rigorous*,” Mr. Jacobs said. “*We’re seeing that with individual inspections but also with target inspections.*” The PCAOB uses target inspections to review areas of current and emerging risk topics across multiple firms; this allows them to compare different practices of the firms and provide feedback to auditors on a timely basis.<sup>5</sup> The PCAOB is focused on looking at how current macroeconomic issues are impacting broad risk and inflation. There also continues to be inspection focus on audit quality, internal controls reporting and testing, and IT auditing.
- **Enforcement.** The PCAOB is taking a more aggressive stance on enforcement, Mr. Jacobs reported. He noted that “*a lot of the new tools we’re seeing the PCAOB use are ones that the SEC has been using for some time—such as data analytics or enforcement sweeps to focus on one particular issue.*” The number of enforcement cases is increasing, he added, as is the imposition of higher penalties.
- **Independence.** “*Is there an increased focus on independence or anything we should do differently with our auditors?*” a member asked. Mr. King advised members to monitor independence rigorously. “*The responsibility sits with both the external auditors and audit committee. We all need to be extremely vigilant*,” he said.



Members then met with Ray Beeman, principal and leader of EY's Washington Council practice to discuss the US midterm election and implications for large, global companies. While the full outcome of the election was unknown at the time of the meeting, Mr. Beeman discussed several key points for audit chairs:

- **Tax policy risk is likely to decrease under a Republican-controlled House.** Though Mr. Beeman said he *"wouldn't dismiss the possibility of tax policy changes in the next Congress, because any kind of external event could trigger tax changes,"* he also noted that *"looking farther out to the Congress after the next one, regardless of which party controls it, the Tax Cuts and Jobs Act will expire, which will drag other tax issues in at that time. It is never a steady state in the tax policy world."*
- **Increased IRS funding is likely to move forward, and companies will feel the impact over time.** Mr. Beeman discussed the \$80 billion in new IRS funding, which will be distributed over a number of years and lead to the IRS hiring more specialists and the agency auditing companies in areas where they have been lagging. While not immediate, *"companies will gradually feel the impact of more robust audits."*
- **Some bipartisan efforts may be possible.** *"What could be some surprise areas of compromise?"* a member asked. Mr. Beeman pointed out that both parties have opportunities to align on China and Big Tech. *"Both sides have different complaints about Big Tech, so you're probably feeling whiplash if you're in that sector, but there may be some broad areas where they will work together."*

## The audit committee's role in special investigations

Members discussed the board's role in special investigations with Sally Yates, who had a long and distinguished career in the US Department of Justice before returning to private practice as a partner at King & Spalding.

Ms. Yates outlined the environment for board-led investigations. *"There are not a lot of hard and fast, black and white rules,"* she said, *"It is more of a totality of the facts and circumstances."* Today's special investigations have multiple audiences: *"Not just the obvious ones like regulators or enforcement, but also shareholders, employees and the public."* She advised boards to *"zoom out,"* balancing the firm's long-term brand and reputation against short-term risks. *"We lawyers will want to give you the safest advice to minimize risk,"* she said, but noted that this may not be in the company's best long-term interest.

Members discussed a range of practical issues including:

- **When the board should take ownership of an investigation.** Boards are more likely to lead an investigation today: *"Even if legal liability doesn't necessarily attach to the conduct at issue, if it affects reputation, brand, or even the reputation or brand of executives who may be involved,"* the board may be pressured to step in. A threat to customer confidence,

for example, could raise an investigation to the level of the board. And management may be reluctant to involve the board. A member said: *“There was a circumstance where the first time we heard about something was reading it in the press. That led to a very candid conversation with the CEO and the general counsel.”*

- **Whether to self-report.** *“This is one of the most difficult decisions for a company to make,”* said Ms. Yates; even though she spent some 30 years at the DOJ, *“I will not say that you should self-report every time.”* Nonetheless, regulators and law enforcement are increasing pressure to self-report. The DOJ is seeking to clarify the benefits of voluntary reporting, and they now look at a company’s long-term record and ethos. *“There are increased incentives to voluntarily disclose, but some asterisks,”* she added.
- **When and where to self-report.** Timing of self-reporting can also be murky. Although the DOJ encourages early disclosure, *“before you even know anything,”* Ms. Yates suggests taking the process in stages: inform the authorities what you have found, what you don’t yet know, and let them know that you will report findings. In many cases, reports will need to be made to multiple agencies: the DOJ, the SEC, and a security or intelligence agency like the FBI. Members asked how to prioritize. *“The agency that has criminal authority is the one you want to make sure you talk to,”* Ms. Yates replied, *“You don’t want to alienate any of the agencies, but make sure that these are satisfied first. You may also need to disclose to the SEC. In that case, make sure you are not inconsistent.”*
- **How to work with outside counsel.** Where the general counsel cannot be involved, perhaps because his or her conduct is at issue, boards need frequent interaction with outside firms involved in an investigation, and an agreed upon investigation plan. *“When you send them off on their own and don’t hear back from them for a year and a half, you can see millions of dollars of fees spent and a broad investigation that you were not planning,”* she warned.
- **How to keep others informed.** Members cited reasons for tight lines of confidentiality, but ultimately noted that it is important to provide some level of disclosure, especially to the board. A member advised asking, *“Who will be upset with the process that we followed?”* Ms. Yates suggested asking outside counsel to describe the process of the investigation to the rest of the board: *“This is how it will work. Then, it’s not as mysterious.”* External auditors also need to be kept informed. *“As an audit chair, make sure you are getting the information you need to make the right disclosures to outside auditors,”* advised Ms. Yates. EY’s John King said that auditors expect *“to be brought along appropriately.”* Keeping auditors in the dark can raise trust issues, and, said Ms. Yates, *“You don’t need to add to your problems by having the outside auditor say we’re not signing.”*
- **When to end an investigation.** Ms. Yates advised against artificial deadlines but warned that an indefinite timeline could lead outside lawyers and the investigation *“down every rabbit trail”* in an effort to avoid risk, *“and to feel good that we have done everything.”*

Regular, open communication with outside counsel is essential. *“Pick and choose what really matters and what doesn’t,”* she said. But ending an investigation can be complicated. An audit chair described such a situation: *“We had all the regulators signed off, there was no issue, but there were the people internally who had raised the issue to begin with. They weren’t satisfied. Notwithstanding regulators and a lot of money, it came down to employees who just didn’t agree with regulatory standards. It gets very complicated.”*

- **What to do after an investigation ends.** Audit chairs spoke of building learnings from an investigation into compliance training and moving insights across the world. A member said: *“If you unearth control weaknesses as you’re going, don’t wait until the end of the investigation, implement them immediately while it is going on.”* Ms. Yates left members with a final take away: *“Just complying with the law is the absolute low bar. You should be doing things to be proud of how you’re doing business. That requires you being more intentional than just reacting.”*

## Investor and audit chair dialogue

In 2022, Wellington Management amended its [Global Proxy Voting Guidelines](#) related to overboarding to count the audit chair role as two board seats. Specifically, it says (emphasis added):<sup>6</sup>

*“We expect directors to have the time and energy to fully commit to their board-related responsibilities and not be overstretched with multiple external directorships. Our internal voting guidelines define directors as over-boarded when serving on five or more public company boards; and executives when serving on three or more public company boards, including their own. **We also consider the roles of chair of the audit committee and chair of the remuneration committee as equivalent to an additional board seat when evaluating the over-boarding matrix.**”*

Audit chairs in the network and elsewhere believe that this bright-line policy does not account for the many nuances of directorships and committee chairmanships. Yolanda Courtines, senior managing director, portfolio manager, and chair of the Investment Stewardship Committee, and Carolina San Martin, managing director and director, ESG Research joined the meeting to discuss this policy and how Wellington approaches ESG. Key takeaways from the discussion include:

- **Investors are noticing the growing responsibilities of audit and compensation committees.** The new language in Wellington’s overboarding guidelines stems from recent observations that audit and compensation committee agendas *“continue to grow and are getting weightier with time,”* according to Ms. Courtines. *“Audit chairs are sitting in the hot seat. The breadth of what you’re doing is enormous, so we’ve looked to capture that level of additional responsibility.”* She cited cyber risk, climate-related reporting, and special investigations as examples. Responsibility for investigations often falls to the audit



committee, she said; they want to “capture that spike factor” that could land on audit committees at critical moments or times of stress for the company.

- **Wellington gives portfolio managers flexibility in implementing its proxy voting guidelines.** Ms. Courtines and Ms. San Martin underscored that their overboarding policy is not a hard and fast rule, but rather raises a potential issue for analysts to probe deeper. *“We’re not a rules-based firm. We’re open for engagement, debate, and understanding your view if you disagree. Ultimately, it comes to the portfolio team to make decisions,”* Ms. Courtines said. Members encouraged Wellington to share the data on their engagement with companies on this issue and make the information available in their annual stewardship report. Members also acknowledged that audit committees could disclose more about the processes they use to balance workloads.
- **ACLN members do not believe that chairing the audit committee creates double the work.** Audit chairs shared feedback with Wellington on why they disagreed with the double counting of audit chair seats:
  - **Audit chairs have more time to prepare.** Several members noted that being audit chair is easier than being a committee member because the chair gets materials in advance and can ask questions of the management team before the meeting.
  - **Serving on multiple boards can help an audit chair perform the role better.** Members recognize patterns, apply learnings and good practices across multiple companies, and see how different external auditors work. Further, director education benefits all of their board and committee roles. A member explained: *“I get educated on ESG, cyber, the SEC, or whatever the topic is once. The education I get is applied to all my boards. I don’t need to do it multiple times.”*
  - **The policy does not reflect what the marketplace is observing.** Members observed that the Wellington policy implies that the audit chair does double the work of other committee members. One member disagreed, *“That is not the case for the committees where I am just a member. In reality, the difference is small ... The marketplace, through board compensation, has said how much they value it—maybe 10% more, but you are saying it is 100% more.”*
  - **Board evaluations should be used to address underperformance.** Members acknowledged that there are cases of low performing board members but believe investors should look at the overall board assessment process instead of singling out certain committees or roles. *“If someone truly doesn’t have the time and energy to devote to their boards, then investors should look to the board chair to refresh membership,”* one said.
- **It is not unusual for investors to have limited engagement with audit chairs, but not all companies provide access to board members.** While it is unusual for investors to engage

with audit committees, members were surprised to hear that Wellington sometimes encountered difficulties meeting with board members generally. Ms. Courtines said, *“We still sometimes find it difficult to get access to board members ... As a portfolio manager, insight into the board is critical. Boards often outlast CEOs, and they think long-term. If I could put out an ask, it would be that you ask management to provide us with that access.”*

- **Wellington favors materiality-based, standardized ESG disclosures ...** *“Standards are good,”* noted Ms. San Martin, *“because we think the lack of standardization has created challenges for both companies and investors. We advocate for standard-setters to take a materiality-based approach.”* Members asked if they give equal weight to the “E”, “S”, and “G” factors. Ms. San Martin noted that Wellington does not weight the factors identically but instead aims *“to figure out which E, S, and G issues will matter most to investment performance in future.”*
- **... but does not expect “perfection” in Scope 3.** Members outlined the challenges their companies face with Scope 3 reporting. Ms. San Martin responded, *“We understand. This isn’t a ‘gotcha’ moment and we don’t expect perfection.”* Ms. Courtines added, *“We want to use [Scope 3] to see if a company understands conceptually where their big carbon footprint is coming from. Once we understand which categories of Scope 3 you have the most exposure in, then we can engage with you to ask questions ... For Scope 1 and 2, we can hold companies accountable. For Scope 3, it’s awareness.”* Members broadly agreed with this approach but highlighted that perfection—or at least calculability and accuracy—are necessary for information that is included in financial statements, as the SEC is proposing.

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## Appendix: Participants

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

- Judy Bruner, Applied Materials and Seagate Technology
- Jeff Campbell, Aon
- Janet Clark, Texas Instruments
- Bill Easter, Delta Air Lines
- Gretchen Haggerty, Johnson Controls
- Bob Herz, Fannie Mae and Morgan Stanley
- David Herzog, MetLife
- Akhil Johri, Boeing and Cardinal Health
- Arjun Murti, ConocoPhillips
- Leslie Seidman, GE
- Greg Smith, Intel
- Cindy Taylor, AT&T
- John Veihmeyer, Ford
- David Weinberg, The Coca-Cola Company

The following ACLN members participated virtually in part of the meeting:

- Pam Craig, Merck
- Dave Dillon, 3M and Union Pacific
- Bella Goren, Marriott
- Charles Holley, Amgen and Carrier Global
- Suzanne Nora Johnson, Pfizer
- Fred Terrell, Bank of New York Mellon
- Tracey Travis, Meta
- Jim Turley, Citigroup

The following European Audit Committee Leadership Network (EACLN) members participated virtually in part of the meeting:

- Aldo Cardoso, Imerys
- Carolyn Dittmeier, Assicurazioni Generali
- Liz Hewitt, National Grid
- David Meline, ABB
- Karyn Ovelmen, ArcelorMittal
- Maria van der Hoeven, TotalEnergies

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

- Julie Boland, EY US Chair and Managing Partner, and Americas Managing Partner
- John King, EY Americas Vice Chair—Assurance
- Patrick Niemann, EY Americas Leader, EY Audit Committee Forum

## Endnotes

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<sup>1</sup> *Summary of Themes* 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 members and guests in connection with the meeting but may be edited for clarity.

<sup>2</sup> Office of the Inspector General, *The Inspector General's Statement on the SEC's Management and Performance Challenges*, (Washington, DC: Office of the Inspector General: 2022), 7.

<sup>3</sup> Audit Committee Leadership Network, *SEC Comment File Number S7-10-22: Meeting with members of the Audit Committee Leadership Network*, memorandum (Waltham, MA: Tapestry Networks, 2022).

<sup>4</sup> U.S. Securities and Exchange Commission, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, proposed rule, March 21, 2022.

<sup>5</sup> Center for Audit Quality, *Guide to PCAOB Inspections*, (Washington, DC: Center for Audit Quality, 2021), 6-7.

<sup>6</sup> Wellington Management, *Global Proxy Voting Guidelines 2022*, (Marlborough: Wellington Management, 2022).