

Audit Committee Leadership Network

December 2022

ACLN

VIEWPOINTS

Top concerns for audit committees

As boards navigate increasingly complex risks, evolving regulatory developments, and ongoing economic and geopolitical uncertainty, audit committees are grappling with new oversight responsibilities and wide-ranging agendas. On November 10–11, 2022, members of the Audit Committee Leadership Network (ACLN) held a members-only session in Washington, DC, where they shared the top concerns keeping audit chairs up at night. This *ViewPoints* summarizes key themes that ACLN members highlighted during the discussion:¹

- **Impending environmental, social, and governance (ESG) reporting requirements present a major concern.** (page 1)
- **Compounding risks and unprecedented uncertainty create new oversight challenges.** (page 2)
- **Audit committee agendas, already crowded, are under even greater stress.** (page 4)

For a list of meeting participants, see Appendix 1 (page 8), and for a list of reflection questions for audit committees, see Appendix 2 (page 9).

Impending ESG reporting requirements present a major concern

Members conveyed their worries about overseeing ESG disclosures, particularly in light of the US Securities and Exchange Commission's (SEC) climate-related disclosure proposal issued earlier this year. Members are also monitoring sustainability standards in jurisdictions such as the European Union, which has proposals for a broad list of required ESG disclosures. They highlighted several key concerns:

- **Scope 3 emissions reporting.** Members questioned the practicality and usefulness of Scope 3 reporting requirements in the SEC's proposal. One said, *"Even if Scope 3 reporting could be implemented in a way where you could make an assessment, it is multiple counting. I worry that Scope 3 gets in the way of having good guidelines for Scope 1 and 2 that are enforced and consistent."* Nevertheless, preparing for Scope 3 reporting seems inevitable. In a separate session, Elad Roisman, former SEC commissioner and acting chairman of the SEC and current partner at law firm Cravath, Swaine & Moore, advised that even though the SEC's final rule will likely be challenged in court, *"boards should be prepared 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.” One member pointed out that *“even if Scope 3 is removed from the US disclosure rules, it is still in Europe, so you still have an issue.”*

- **ESG reporting processes and controls.** *“We are creating an ESG reporting regime out of nothing and standing up new organizations. That is a big lift; it is a whole new control environment,”* a member said. Most members believe that their companies need substantial work and time to develop processes and internal controls for strong audit committee oversight and nonfinancial reporting that is consistent, comparable, reliable, and useful to investors. One compared it to the early days of the Sarbanes-Oxley Act, a US federal act passed in 2002 that led to stronger disclosure and auditing requirements for public companies: *“We all have experience with how long it took to get the right SOX processes in place, and this seems bigger than SOX.”*
- **Cultural change.** Standing up ESG reporting processes also involves cultural change, which can be challenging to implement and oversee. Sustainability reporting has typically been the responsibility of *“marketing or sustainability teams, who are very well intentioned,”* a member said, *“but there is a big difference between marketing speak and reporting speak. That is an ongoing challenge.”*

ACLN members discussed how their companies are improving ESG oversight; all agreed that there is still much to be done before ESG disclosures can be as rigorous as financial ones. To promote more consistency and accuracy of data, one member formed a cross-functional management disclosure committee. *“We look at the sustainability report just as we do a 10-Q,”* the member explained. Another asked for an internal audit of the sustainability report and *“found room for improvement.”*

Members discussed good practices for ESG oversight at the Audit Committee Leadership Summit in June 2022, summarized here: “[ViewPoints: Audit chairs discuss ESG oversight.](#)”

Compounding risks and unprecedented uncertainty create new oversight challenges






Global companies face complex macroeconomic and geopolitical forces—including high inflation, geopolitical tensions, and economic volatility. Because these tensions are heightening business risks and directly affecting financial statements, they have become a focus for audit committees. Members cited unprecedented levels of uncertainty and the increasing scope, scale, and interconnectedness of risks as a top concern. In a recent op-ed, former US Treasury Secretary Larry Summers said, “The United States right now faces as complex a set of macroeconomic challenges as at any time in 75 years.”²

Today’s adverse events are more intense in severity and frequency and more interrelated than ever. As one member framed it, *“From a risk-management standpoint, all these risks are stacking together. We have a lot of volatility in the markets, geopolitical issues, and energy issues.”* Another agreed: *“The challenge of the current risk environment is that it is impacted*



from so many different angles—inflation, interest rates, lockdowns in China, supply-chain issues, and export regulations.”

Which risks are most concerning for ACLN members?

 Geopolitical	 Supply chains	 Cyber	 Unknowns	 Energy
<p>Geopolitical tensions are a top concern, especially around China. A member said, <i>“China is number one on the list of things that keep me up at night.”</i> His board spent six hours on China in the last two meetings—more than in his four years on the board. <i>“It is shocking how quickly things have changed. What was once a huge opportunity is now a big risk.”</i></p>	<p>Energy supply and geopolitical turmoil create supply chain concerns. <i>“De-risking”</i> 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.</p>	<p>Cybersecurity is a <i>“never-ending struggle”</i> for many audit committees. Continuously evolving cyber risks and a heightened threat environment have many audit chairs questioning whether they are doing enough, have allocated sufficient resources, and are putting the right questions to executives.</p>	<p>Audit chairs worry about <i>“black swan”</i> events, which are especially challenging to plan for. A pandemic had been on one risk map, <i>“but we never thought it would shut down global supply chains.”</i> Another added, <i>“You can identify risks but may not have any concept of the actual impact. It can be a much bigger scale than you could have imagined.”</i></p>	<p>Members do not expect the US to have a near-term energy shortage, but the European energy crisis has them thinking about the implications for their companies. One felt that companies should prepare for long-term issues: <i>“The energy challenge will be here for a decade”</i> and the world is on track for new shortages.</p>

ACLN members recognize that historic risk-oversight practices may no longer be fit for purpose. Members shared helpful new practices:

- Break down silos and integrate enterprise risk management (ERM) processes.**

Decentralized ERM models can fall short if they take a siloed view of risks and fail to consider how one may impact or intensify another. Audit committees can play an important role in driving an integrated approach to risk. *“The big thing we all missed with ERM was viewing it in silos. We identified risks but didn’t connect them to others—supply chains and the pandemic are a good example,”* one member said, adding that *“audit committees and boards can get better at asking where the non-obviously interconnected risks are going to occur.”* Another company created a risk council with cross-functional senior leaders from throughout the company to gain a broader view of risks and their implications. *“Now, we’re looking at an integrated risk assessment and prioritizing a discussion about ‘blue sky’ scenarios at the top of the agenda, because that type of thinking often gets squeezed for*

time if left for the end. Putting it at the top of the agenda has saved us on some things,” the member explained.

- **Increase scenario planning and be prepared to act.** A member said, *“We had put a lot of thought into potential scenarios. No one had imagined COVID specifically, but having that framework helped us react faster.”* Another added, *“The key is being ready to take action. In some ways, it doesn’t matter the specific event; if you’ve thought through a variety of crises, you can be prepared even for things you didn’t imagine.”*
- **Seek ways to incorporate diverse perspectives and specialized expertise.** *“A diverse board with a range of perspectives”* can provide valuable insight for risk oversight, members said. For example, several reported that their boards have members who live in China, which *“is really valuable.”* One member’s board formed a government affairs advisory committee—led by the audit chair—to focus on global governmental and political risks. The committee includes a portion of the board as well as external advisors with backgrounds ranging from national security to journalism. Recruiting members with non-US perspectives was a key consideration. It has been a *“great forum to have a dedicated focus on these risks and has enabled the company to make proactive moves to minimize risk,”* the member said.
- **Be transparent with stakeholders.** Members stressed the importance of informing investors and other stakeholders about current levels of risk and uncertainty. Referencing a change in the company’s strategy with China, a member explained, *“We’ve gone a step beyond scenario planning and communicated to investors about our decision to take China out of our projections for the next three years.”*
- **Stay vigilant to cyber risks.** Members underscored the need to stay up to date on cybersecurity. *“It’s a moving target, and you always have to be improving,”* one said. A regular cadence of updates from management and outside experts is vital. Members are also using cyber-rating agencies. *“It is very important to get a cybersecurity assessment of your company and to monitor it as part of the audit committee, including a security scorecard based on what regulators and investors look for,”* one advised. Learning from cyber situations at other companies can help identify less common weaknesses. *“I try to get a learning from major incidents that happen,”* a member explained, referencing a publicly reported cyber incident that involved merger and acquisition (M&A) activity: *“Part of the M&A risk assessment now has to be cybersecurity and the time needed to get a target company onto a secure platform.”*

Committee agendas, already crowded, are under even greater stress

New risks and oversight responsibilities are further crowding audit committee agendas, and members are struggling to balance increased scope against 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?”* The member wondered whether reduced attention to *“the fundamentals”* could exacerbate control risks.

Members discussed good practices to focus on both essential and emerging topics:

- **Manage agendas rigorously.** *“Time management of our agenda is a challenge. We can’t get too bogged down on regulatory and compliance, and we need to prioritize talking about the business and risks,”* a member said. Several shared guidance:
 - **Prioritize agenda items.** Audit chairs should play a proactive role in structuring and prioritizing the agenda—both annually with the master calendar and on a meeting-by-meeting basis. *“My company has a master agenda for the year. I review that each year, and it is an opportunity to decide what needs more emphasis,”* one member said. To manage each meeting’s agenda, another said her committee *“segregates the agenda by items for approval, items for discussion, and items accepted as read.”*
 - **Work with external auditors and management ahead of the meeting.** Adjusting agendas prior to each meeting is an important part of the process. Members reported seeking input from the external auditor and management—including the CFO, general counsel, chief accounting officer, internal audit, chief compliance officer, and other executives.
 - **Use executive sessions strategically.** Audit chairs use private sessions at either the beginning or the end of each audit committee meeting as a means of obtaining committee members’ thoughts in a more open, candid manner. When used at the beginning of a meeting, audit chairs can ask for committee members’ views on the highest-priority items and move those items to the top of the agenda. *“Executive sessions are also super important to identify future topics,”* a member added.
 - **Schedule deep dives as needed.** When time is limited and an important topic may benefit from a more focused and longer discussion, or if committee members need education on a new subject, members reported using off-cycle, deep-dive meetings and often hold them virtually. Example deep dives included education on new accounting standards, discussions on issues under investigation, and reports on IT and cyber risks.
- **Keep materials and presentations focused and relevant.** Members shared methods they use to manage meeting materials and provide more time for discussion:
 - **Preread materials taken as read.** Audit chairs increasingly rely on preread materials to make more effective use of time when the committee is together. One explained, *“Before I was chair, the meetings were all presentations. I changed it so that everything is now taken as read. The folks presenting will highlight three or four items in a few minutes, then we’ll spend 20 minutes on actual discussion.”*

- **Routine dashboards.** Dashboards are effective tools for monitoring major risks (e.g., cybersecurity) and enable audit committees to assess changes from meeting to meeting in a simple and clear format, members said.
- **Video briefings.** A few members reported that short videos are being used by management to brief directors before meetings and suggested the technique could also be used for audit committees. *“The CEO sends a 30-minute video briefing to the full board before meetings, and it is very effective. That could be used for the audit committee as well,”* one said.
- **Coordinate with other committees.** As ESG, cyber, and other emerging risks continue to grow in complexity, members’ boards are looking carefully *“at what each committee is covering.”* Overall coordination among committees is important *“as the whole agenda for the board expands,”* a member pointed out. In addition to regular committee updates at board meetings, some committees also ensure there is overlap in members on certain committees—audit and risk, for example. One member noted that she meets with the chairs of other committees to ensure nothing is missed and that there *“are no audit or accounting implications that no one is thinking about.”*

A European perspective on top challenges

Members of the European Audit Committee Leadership Network (EACLN) also discussed their views on top challenges for audit committees in a September 2022 meeting. While there were many similarities, the specific focus areas and urgency around concerns varied from those of ACLN members.

As a top priority, EACLN members worry about the uncertain geopolitical and economic environments—likely due in part to their more immediate proximity to the Russia-Ukraine war and the European energy crisis. As a second concern, they mentioned ESG, the principal worry for ACLN members. In addition to readiness for rigorous ESG reporting, European audit chairs expressed significant concerns about potential reporting challenges if the requirements of various disclosure standard setters (e.g., the International Sustainability Standards Board, European Financial Reporting Advisory Group, and SEC) are different.

For a summary of EACLN members’ top concerns, please see [“ViewPoints: Top concerns for audit committees.”](#)

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 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

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

Appendix 2: Reflection questions for audit committees

- ? What is currently the biggest challenge facing your audit committee?
- ? What do you see as the biggest challenge for your audit committee in the next three to five years?
- ? Is your audit committee planning to do anything differently or new next year?
- ? Do you feel that you have enough time to cover all important topics?
- ? Which topics do you spend less time on in audit committee meetings as new items are added to the agenda?

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 members and guests in connection with the meeting but may be edited for clarity.

² Lawrence H. Summers, "Curbing Inflation Comes First, but We Can't Stop There," *Washington Post*, October 31, 2022.