



Governance Insights Center

ACES (Audit Committee Excellence Series)



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Audit committee effectiveness: practical tips for the chair

Regulatory mandates, investor expectations and workloads are growing. How will your audit committee meet the demands?

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Having the right skills and experience on your audit committee is key to meeting today's challenges. But to really set the committee up for success, your chair needs the right approach to take advantage of the committee's strengths. Having an effective chair is essential.

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Today’s boards are increasingly being asked to up their game—by regulators, investors and proxy advisors. Audit committees are being tasked with overseeing increasingly complex areas, such as cybersecurity risks, and workloads are growing. The entire board relies on the hard work of the audit committee to meet its overall objectives. But many audit committees are asking whether they have the right approach to meet these demands.

Audit committees need to find ways to meet the heavy burden of regulatory mandates, keep up with increasing stakeholder expectations and find time for unforeseen issues. Here are some ideas for the audit committee chair to build the right audit committee and keep members performing at a high level.

“ I have a growing concern about the amount of work required by some audit committees. ”

– Mary Jo White, Former Chair, US Securities and Exchange Commission (SEC)¹

¹ Keynote address at the AICPA National Conference on Current SEC and PCAOB Developments, December 9, 2015.

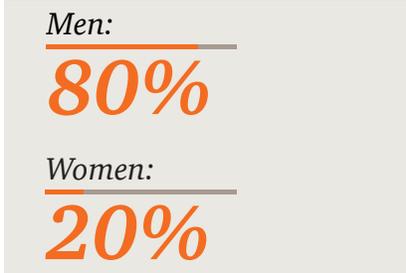




The audit committee chair: the cornerstone of the committee

A high-performing audit committee starts with a good chair. Good leadership and effectiveness go hand-in-hand. Effective chairs can bring out the best in other committee members, management and external auditors.

S&P 500 audit committee chairs: who are they?



Source: Spencer Stuart, 2017 Spencer Stuart U.S. Board Index, December 2017.

Audit committee chairs need to have experience, healthy skepticism, integrity and strong communication skills. And to be a truly effective, he or she has to take the time to really work on the committee agenda and make sure meetings run well. They also need to be able to effectively coordinate with other board committees. For instance, the audit committee needs to coordinate with the compensation committee to provide input on whether adjustments to GAAP profit measures used to determine CEO incentive compensation are appropriate and accurately calculated.

What attributes make a strong audit committee chair?

Highly experienced	Professionally skeptical	Confident, with strong integrity	Organized and proactive	Strong communication and interpersonal skills	Willing to devote the time and energy necessary
Understands the business, its risks and controls	Willing to provide an independent point of view	Promotes a strong "tone at the top"	Prioritizes the most important agenda items	Provides clear updates of issues to the full board	Takes the time to develop the agenda and effectively execute meetings
Knows when to elevate topics to a full board discussion	Intellectually curious	Demonstrates to others that all elements of the charter are being addressed	Good facilitator; cuts off low-value discussions	Willing to ask tough questions and have uncomfortable conversations	Available as a "sounding board" for management and other committee members



What should the audit committee's composition look like?

A key responsibility of the audit committee chair is to work with board governance leadership to focus on its overall composition. This means having the right people in place and keeping the committee informed and members periodically refreshed.

NYSE and NASDAQ requirements for audit committee composition*

- Must have at least three members
- All must be:
 - independent
 - financially literate
- At least one member must have accounting or financial expertise or sophistication (audit committee financial expert)

* Companies need to work with company counsel to ensure compliance.

An effective audit committee goes beyond just meeting the stock exchange requirements. While nearly all directors tell us that financial expertise is a very important attribute on their board, nearly two-thirds also say the same about risk management expertise.² These skills are especially important for audit committee members, as boards typically delegate much of risk oversight responsibilities to the audit committee. Also, audit committees are charged with oversight of cybersecurity risk about half of the time,³ making digital and cyber skills important as well.

Diversity can bring real benefits to a board—and to an audit committee. For example, 57% of directors believe that gender and racial diversity improve their board's approach to strategy and risk oversight.⁴ Diversity comes from having a variety of viewpoints. When it comes to business experience, having a mix of both active and retired financial executives, CEOs, risk professionals and public accounting executives can provide diverse views and perspectives.

Sometimes, an audit committee has only one member who is a “financial expert,” and many times that person is the chair. When this is the case, the chair needs to take care to use that expertise as a resource but also ensure that he or she doesn't dominate discussions. Audit committee members who have other skills and expertise but not the same level of deep financial expertise can provide valuable perspectives that enhance the dialogue and improve the committee's oversight.

When assessing what's needed on the audit committee, it's important not to overlook “soft” skills. Skills like negotiation, teamwork, problem solving and communication can complement the critical “hard” financial and technical skills that audit committees need.

² PwC, 2016 Annual Corporate Directors Survey, October 2016.

³ PwC, 2017 Annual Corporate Directors Survey, October 2017.

⁴ PwC, 2017 Annual Corporate Directors Survey, October 2017.



“ Investors look to audit committees with high expectations to establish and maintain the appropriate tone, capacity, and competence to oversee the quality of the financial reporting system. ”

– Wesley R. Bricker, Chief Accountant, US SEC⁵

A good audit committee will also have members who maintain the respect and trust of their peers and management and understand their role in deterring fraud. If there are allegations of wrongdoing by company personnel, audit committees may be tasked with performing an investigation and forming conclusions on behalf of the board. Committee members should have the integrity and objectivity necessary to deal with any bad actors.



⁵ Remarks before the University of Tennessee's C. Warren Neel Corporate Governance Center, March 24, 2017.



Too big, too small or just right?

Most audit committees are made up of three to six members, with four being the most common. We believe that having four members is a “sweet spot” for audit committees. For starters, keeping the audit committee smaller promotes efficient discussions and makes it easier to schedule meetings. Also, it makes succession planning easier. In the event of unforeseen member turnover, having four members instead of the minimum of three may avoid a crisis. For the same reason, audit committees should have at least two audit committee financial experts. Most companies seem to agree, since almost 70% of companies in both the S&P 500 and S&P 1500 have audit committees with more than one financial expert.⁶

Financial experts: what to disclose?

SEC rules require companies to disclose in their proxy statement whether the audit committee has at least one financial expert. If so, the person’s name and independence must be provided. Some companies choose not to disclose other audit committee members who are also financial experts—because it isn’t required. But we encourage companies to disclose the names of all members who meet the definition of a financial expert. This enhances transparency for investors.

Some institutional investors and proxy advisory firms have expressed concerns about the “over-boarding” of directors. And there are specific rules that apply to audit committee members. The NYSE requires directors who serve on more than three public company audit committees to get approval from each of their respective boards. Given the time commitment involved with most audit committees, the audit committee chair should regularly assess possible “over-boarding” of audit committee service by its members.

41% of S&P 500 boards limit the number of other audit committees on which a director can serve



Of those, **99%** allow members to serve on up to two other audit committees

Source: Spencer Stuart, *2017 Spencer Stuart U.S. Board Index*, December 2017.

⁶ [Center for Audit Quality and Audit Analytics, analysis of 2017 proxy statements](#)

Having four members is a “sweet spot” for audit committees



Refreshment through rotation

Director tenure is a topic of debate for boards and investors alike. Longer-tenured members have deep experience, understand the business and know how the company works. But long tenure can sometimes breed complacency and a perceived lack of independence from management. For example, institutional investor State Street Global Advisors may vote against long-tenured directors that serve on the audit committee when the overall board has a high average director tenure.⁷

To promote refreshment on the audit committee, many boards rotate membership. Rather than using formal rotation policies, most boards have a process to regularly review committee assignments. Committee needs and director expertise, experience and availability often drive changes, rather than simply the number of years a member has served. We believe a board rotation policy can provide effective refreshment. A term of five to seven years, with some flexibility for special situations, is a reasonable term to balance institutional knowledge with fresh ideas from new members.



Onboarding—using the audit committee

For onboarding purposes, consider having new board members attend audit committee meetings as observers. Hearing about core audit committee agenda items (e.g., risk oversight, financial reporting, significant judgments and estimates) can be highly valuable and an efficient way to educate new board members on the company—even if they are not going to be a member of the audit committee.

⁷ Rakhi Kumar, “Addressing the Need for Board Refreshment and Director Succession in Investee Companies,” State Street Global Advisors, February 2015, <https://www.ssga.com/investment-topics/general-investing/2015/Addressing-the-Need-for-Board%20Refreshment-in-Investee-Companies.pdf>.



Getting (and staying) up to speed

It’s one thing to have a good audit committee in place. But the audit committee chair needs to take a lead role in helping get new members up to speed and ready to add value. A structured process is critical to successful onboarding. This can help new members learn the specific responsibilities of sitting on the committee. It should start with a robust meeting with the audit committee chair. It should also involve meetings with the CEO, members of the financial leadership team, internal audit and external audit.

Audit committee onboarding 101

Area	Key orientation topics
Financial reporting	<ul style="list-style-type: none"> • Critical accounting policies • Key estimates • Internal controls over financial reporting • Business segments • Financing and liquidity • Regulatory environment (e.g., SEC, PCAOB) • Earnings guidance practices • Timing and process for SEC filings
Risk and compliance	<ul style="list-style-type: none"> • Risk management process • Whistleblower program • Code of conduct
Audit committee processes	<ul style="list-style-type: none"> • Audit committee charter • Meeting agendas
Support and resources	<ul style="list-style-type: none"> • Committee self-assessments • Role of the chair • Continuing education

Continuing education is important for all board members, considering today’s pace of change. Education is particularly important to the audit committee given changing accounting and regulatory standards. Finding the time for continuing education can be a challenge for audit committee members. But it is important for audit committee chairs to monitor the educational needs of the committee and keep the committee sharp. Some best practices include:

- In-boardroom meetings – reserve agenda time for internal and external speakers on topics such as industry developments, regulatory and accounting updates and governance hot topics
- External training – attend events, or have committee members who have attended events debrief the committee on takeaways



Making the meeting effective and efficient: practical approaches

Audit committees know they need to work hard to meet the mandate of their charter and to tackle other critical issues that may arise. How do they balance those duties with practical time constraints?

Some audit committee chairs use innovative approaches to meet mounting demands. We describe a few of those approaches below.

Agenda planning: setting the course

As the saying goes, “If you don’t know where you are going, any road will get you there.” Without a carefully planned agenda integrated with the charter requirements, it’s hard to set an efficient course for the year. The committee may even fail to fulfill its basic duties. Some best practices include:



Designate a management liaison—The audit committee chair will need help managing the agenda-setting process, including inevitable changes throughout the year. It’s important to designate a specific person (e.g., corporate secretary, chief audit executive) to liaise with other members of management and coordinate changes to the agenda.



Comply with the charter—The audit committee charter is the starting point to plan the agenda for the year’s topics. The charter is the audit committee’s commitment to shareholders and reflects its required actions. Agenda planning needs to account for each item in the charter.



Plan the topics annually—Map out the agenda topics and time allotments, by meeting, for all scheduled meetings at the start of each year. Most topics are recurring. Make time for “deep-dives” of selected topics such as IT and income taxes. And leave room for unexpected issues that may come up during the year.



Confirm agenda topics before each meeting—A critical step is for the audit committee chair to touch base with other committee members, management and the external auditors before the agenda is distributed. The chair can then make adjustments to topics or change the allocation of time.

Agenda planning tools

Often, audit committees use agenda planning tools to help chart and monitor meeting topics for the year. They also help ensure that the committee is meeting all of its charter requirements. (See a sample agenda planning tool in Appendix A).



Pre-meeting materials: getting to the point

Many directors tell us that there is room to improve board materials. They want more management insights, better-highlighted risks and shorter and more summarized materials.⁸ For audit committees, effective pre-meeting materials are critical given the volume of materials required for oversight. Some best practices are:



Agree on timing – Committee members need to have time to review and digest the materials. Usually, management strives to have materials available at least a week in advance of the meeting. A shorter lead time may be appropriate for telephonic meetings with limited agendas, such as those covering quarterly earnings releases. With the common use of board portals, a best practice is to post materials to the portal as they are available but make sure deadlines are clear for the most critical topics.



Use executive summaries – Audit committee members often experience information overload. A good executive summary for each section of the pre-read materials can help. Astute committees establish a protocol with management so written materials get to the point up front and the appropriate level of supporting content follows. Common points for impactful executive summaries are:

- Why the topic is on the agenda
- Management’s insights and conclusion
- Key takeaways
- Action steps (e.g., committee vote) and timeline



Highlight changes – Reviewing a high volume of recurring SEC filings, various reports from management and communications from the external auditors can be challenging. Many of the recurring reports use nearly identical verbiage; this makes it difficult to know what is new or what has changed from the prior meeting. Request that management highlight substantive changes from the prior quarter in these reports (e.g., SEC filings, management representation letters from external auditors). This allows the audit committee member to focus on the underlying reason for the changes, particularly when the change was unexpected.



Use appendices – Different committee members may want different levels of detail in the materials. Focusing on the core content and including the “nice to have” detail in an appendix can make the materials more concise and focused, while not short-changing those who want to read more. It is important for all committee members to agree on the level of detail to be included in appendices. Also, committee members may want to consult the company’s legal team to understand their obligation, if any, to review supplemental information provided in appendices.

⁸ PwC, 2015 Annual Corporate Directors Survey, October 2015.



Examples of pre-meeting materials best practices

Example pre-meeting materials

Best practices

<p>Management financial analysis</p>		<ul style="list-style-type: none"> • Executive summary of primary takeaways • Use of graphics to highlight trends
<p>Form 10-K</p>		<ul style="list-style-type: none"> • Executive summary of points of emphasis • Highlight major changes from prior filings
<p>Chief audit executive points</p>		<ul style="list-style-type: none"> • Executive summary of audits completed compared to plan, significant unresolved findings, audit plan changes and other sensitive items • Dashboard of key information such as audit reports issued, unresolved issues, past due findings, trend analysis of findings by risk/theme/business unit and internal audit function resource needs
<p>Chief Compliance Officer</p>		<ul style="list-style-type: none"> • Executive summary of significant new claims, status of unresolved claims, risk assessment changes and other sensitive items • Dashboard of tailored information such as new and unresolved claims and trend analysis of claims by risk/theme/geography/business unit and compliance group resource needs
<p>External audit correspondence (e.g., engagement letters, management representation letters, legal letters)</p>		<ul style="list-style-type: none"> • Highlight changes and updates from the prior year or quarter • Provide explanation of reasons for significant changes

Final preparations: the meetings before the meeting

As audit committee chair, final preparation before the meeting is critical in order to lead an effective and efficient meeting. After reading the pre-meeting materials, a series of touch points with those integrally involved in the upcoming audit committee meeting (most likely the CFO, controller, chief audit executive and external auditor) is key to being prepared.

What are the objectives of these meetings?

- Build relationships
- Get clarification of the pre-meeting materials and provide feedback
- Provide guidance on points to emphasize during the presentation at the upcoming meeting and thoughts on how to stay within the allotted time
- Alert individuals to potential questions and challenges from committee members

Overall, these meetings are intended to ensure all participants are well prepared without making the meeting overly scripted.



Executive and private sessions: enhancing communication

Used properly, executive sessions and private sessions are tools that are critical to the effective functioning of the committee. Many committees do not take full advantage of these sessions. Here are some best practices for each:

Executive and private session best practices

Executive sessions



Attendees – Only audit committee members



Purpose:

- Give committee members unstructured time to interact
- Before the meeting – react to pre-meeting materials and provide final input on the agenda
- After the meeting – debrief to agree on priorities and provide input on next meeting’s agenda



Frequency – At the beginning and end of most, if not all, meetings

Private sessions



Attendees – At a minimum, the CFO, chief audit executive and external audit; each of which should have the opportunity to meet alone in private session with the committee. The chief compliance officer and chief risk officer might also have sessions, as well those who attend meetings occasionally, such as the chief information security officer, chief information officer and tax leader.



Purpose:

- Promote candid and confidential conversations in an unstructured setting
- Build relationships
- Clarify matters discussed during the full meeting
- Inquire about sensitive topics, such as the risk of fraud and corporate culture
- Mentor and coach members of management; the collective knowledge and experience of the audit committee is highly valuable and should be used to help develop members of management



Frequency – At the end of all face-to-face meetings

One last point on executive and private sessions: Resist the temptation to make a “game-time” decision to skip them when meetings are running long. They are critical to audit committee oversight (and they don’t need to take up a lot of time).



Assessments: making the audit committee better

An annual assessment process should go beyond the minimum stock exchange requirements and be a mechanism to help a good audit committee become great. Individual members can give and receive specific feedback and development points. Assessments can help ensure that the committee is functioning well and finding ways to improve. Committees

that participate in frank discussions about their performance and their composition and then commit to acting on results of their self-assessments will naturally stay sharp.

For more on the importance of assessments, read [*Beyond “check the box” – Getting real value from board assessments*](#)





Enhanced proxy disclosures: taking credit for what you do

Audit committees often take pride in their diligent and thorough oversight. But investors and other stakeholders don't always see those efforts. Increasingly, investors are calling for audit committees to voluntarily enhance their proxy disclosures. By describing in more detail what the committee does, investors can evaluate the committee's performance and make informed voting and investment decisions.

Audit committees are required to make certain disclosures in a company's annual proxy statement. The majority of these requirements have not been updated since 1999 and many disclosures use boilerplate language. In 2015, the SEC considered possible rulemaking to avoid boilerplate language but did not proceed to any rulemaking. The SEC staff continues to encourage expanded disclosures.

Even absent any rulemaking by the SEC, many are pushing for enhanced proxy disclosure on audit committee oversight. A variety of stakeholders, including investors, proxy advisory firms and policy organizations, are pushing for change.

Audit committee review of the draft proxy statement should focus on the following:

- Audit committee report
- External auditor fee disclosure
- External auditor appointment ratification
- Oversight of risk

When reviewing the proxy, we encourage audit committees to evaluate the usefulness and transparency of disclosures and consider enhancing them to respond to what investors are asking for. To get started:

- Ask those who prepare the proxy statement to draft sample enhanced disclosures,
- Benchmark proxy disclosures of peers and competitors, and
- Review proxy disclosures of companies that have already embraced enhanced disclosures.

Armed with this information, the audit committee can take a critical look at its past disclosures and decide whether to enhance them.

Having a strong audit committee chair in place is the cornerstone of an audit committee. Coupled with the right composition of members and sound approaches to tackling a demanding workload, the audit committee is destined to be high performing, effective and efficient.



How PwC can help

To have a deeper discussion about how this topic might impact your business, please contact your engagement partner or a member of PwC's Governance Insights Center.

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Other “Audit Committee Excellence Series” topics include:

- Overseeing taxes in a new era
- Financial reporting oversight
- Getting the most out of internal audit
- To GAAP or non-GAAP? The SEC is watching
- Forward-looking guidance

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Appendix A

Sample audit committee meeting agenda planner⁽¹⁾

Topic	Charter reference ⁽²⁾	February	May	July	October	December
Management – Accounting and reporting						
Accounting policies	FS.1					X
Significant estimates and judgments	FS.1	X				
New accounting standards – impact and implementation plan	FS.5			X		
Review Form 10-K	FS.2	X				
Legal issues review	FS.4	X	X	X	X	X
Related party transactions	FS.3	X		X		
Global staffing update, succession plan, competence assessment and continuous improvement plan	---			X		
Management – Risk and compliance						
Compliance and business conduct report (including hotline complaints and code of conduct violations)	C.3	X	X	X	X	X
ERM – risk assessment and updates	C.2		X			X
ERM – cyber risk	C.2		X			X
ERM – review of Form 10-K risk factors	FS.2					X
Insurance coverage update	---			X		
Internal audit						
Internal audit global annual plan	IA.2		X			
Internal audit activity report and annual plan update	IA.2				X	
Internal control over financial reporting assessment and deficiencies status update	FS.6	X	X	X	X	X
Internal audit charter review	IA.3		X			
Fraud risk assessment	C.4		X			X
Global staffing update, succession plan, competence assessment, co-sourcing arrangements and continuous improvement plan	IA.3				X	
Annual assessment of internal audit	IA.4					X



Topic	Charter reference ⁽²⁾	February	May	July	October	December
External audit						
Global audit plan and fees	E.2		X			
Pre-approve external auditor fees (as needed)	E.2	X	X	X	X	X
Year-end audit results and required communications	E.4	X				
Annual assessment of audit firm, engagement team and lead audit partner	E.5	X				
Independence review	E.5	X				
Appointment of external auditor	E.5	X				
General						
Executive session	G.2	X	X	X	X	X
Approval of minutes	---	X	X	X	X	X
Review annual agenda plan	---	X				
Committee annual assessment	G.5	X				
Audit committee charter review	G.4					X
Proxy statement review	G.3	X				
<ul style="list-style-type: none"> • Oversight of risk • Related-party transactions • Audit committee report • External auditor fee disclosure • External auditor ratification 						
Private sessions	G.2	X	X	X	X	X
<ul style="list-style-type: none"> • Each meeting (CFO, CCO, internal audit, external audit) • At the discretion of audit committee (CISO, CIO, tax leader) 						
Special topics and deep dives (on an “as needed” basis)⁽³⁾						
IT implementation projects and initiatives	---		X			
IT security update	---				X	
Income taxes	---			X		
Treasury	---					X
Regulatory environment	---				X	
Shared service center performance and initiatives	---					
Review policy on hiring employees of external auditor						
Review policy on hiring employees of external auditor	E.6					X

⁽¹⁾ Excludes quarterly meetings related to earnings releases and Form 10-Q SEC filings. These meetings are often telephonic with limited agenda topics. Some committees have expanded these telephonic meetings to add an agenda item or two to help relieve time pressure from other meetings with full agendas.

⁽²⁾ It is helpful to refer to specific sections of the Audit Committee Charter. A separate analysis should be done to ensure all charter actions are addressed in the meeting planner.

⁽³⁾ Special topics and deep-dive areas are at the discretion of the audit committee based upon current events and risks. Typically, these are not required to be addressed each year.