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Audit committee leading practices and trends

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The following is a summary of certain leading practices and trends for audit committees. The list is not all-inclusive, and certain activities may be the responsibility of the full board or another committee.

Committee composition and dynamics

- Focus on committee composition, including members' independence and financial expertise, as well as their industry, risk management, business, and leadership experience.
- Limit the number of audit committee members to four or five to optimize effectiveness.
- Consider periodically rotating audit committee members, including the chairman.
- Meet at least quarterly, or more frequently as circumstances dictate.
- Engage independent advisers when needed.
- Maintain appropriate coordination between the audit committee and other board committees.

Oversight of internal controls and financial reporting

- Understand key controls and reporting risk areas as assessed by financial management, the internal auditors, and the independent auditor.
- Emphasize oversight of corporate taxes, an area where high-risk and high-dollar decisions are often made.
- Leverage the value of internal controls beyond compliance.
- Consider levels of authority and responsibility in key areas, including pricing and contracts, acceptance of risk, commitments, and expenditures.
- Understand complex accounting and reporting areas and how management addresses them.
- Understand significant judgments and management estimates and their impact on the financial statements.
- Stay abreast of pending financial reporting and regulatory developments and understand how they may affect the company.
- Consider the nature of SEC comment letters being issued to companies in similar industries.
- Understand the issues raised in SEC comment letters received by the company, as well as management's planned response.

Risk oversight

- Focus on financial risk oversight and assessment and understand financial risk management policies and processes.
- Avoid becoming overly dependent on checklists for monitoring financial risk.
- Periodically reassess the list of top risks, including which member of management and which board committee is responsible for each.
- Evaluate information technology (IT) projects and related risks, particularly those with financial statement impact.
- Consider post-acquisition reviews to evaluate the reliability of initial acquisition assumptions and make adjustments to future acquisitions if necessary.
- Have appropriate business leaders periodically provide an overview of their business, focusing on financial risks and other factors influencing the financial statements.
- Communicate the company's financial risk story to stakeholders.
- Understand the issues raised in SEC comment letters received by the company, as well as management's planned response.

Ethics and integrity

- Focus on the tone at the top, culture, ethics, and hotline monitoring.
- Provide oversight of compliance with the company's code of ethics/conduct.
- Initiate internal/independent investigations on matters within the committee's scope of responsibility.
- Understand the risk and mitigation mechanisms with regard to management override of controls.

Interaction with the CFO and finance organization

- Conduct annual evaluations of the CFO.
- Understand management's process for early identification and resolution of accounting and other issues.
- Understand plans to address new accounting and reporting requirements and related risks.
- Provide input into management's goal-setting process.
- Discuss succession planning for the CFO and staff, including bench strength.

Interaction with the internal auditors

- Ensure that the internal auditors have direct access to the audit committee.
- Consider having internal audit report directly to the audit committee and administratively to senior management.
- Play an active role in determining the highest and best use of internal audit, as well as the appropriate structure of the group (e.g., in-house versus outsourced resources).
- Be involved with the internal audit risk assessment and audit plans, including activities and objectives regarding internal control over financial reporting.
- Conduct annual evaluations of the chief audit executive.
- Understand internal audit staffing, funding, and succession planning, particularly the adequacy of resources; consider performing peer benchmarking to compare relevant metrics.

Interaction with the independent auditor

- Exercise ownership of the relationship with the independent auditor.
- Focus on the independent auditor's qualifications, performance, independence, and compensation, including a preapproval process for audit and nonaudit services.
- Get to know the lead audit partners and meet periodically with specialists (e.g., tax, IT, actuarial, SEC).
- Establish expectations regarding the nature and method of communication, as well as the exchange of insights.
- Set an annual agenda with the independent auditor and engage in regular dialogue outside of audit committee meetings.
- Provide formal evaluations and regular feedback.

Executive (private) sessions

- Audit committee meetings should be preceded or followed by private sessions with the CFO, the internal auditors, and the independent auditor.
- Use an executive session for committee members to discuss how the meeting went and to identify agenda topics for future meetings.
- Discuss succession plans for the finance organization with the CEO and CFO annually during a private session.
- Establish expectations as to what sort of topics and discussions are expected of the independent auditor in private sessions.

Committee effectiveness and self-assessment

- Review and approve the audit committee charter and align activities with a calendar that incorporates required activities and allows flexibility for additional topics.
- Develop meeting agendas in consultation with management; resist the urge to repurpose existing agendas without discussion.
- Align audit committee meeting materials and agendas with priority areas.
- Distribute briefings and other materials well in advance of meetings.
- Reports should include executive summaries that highlight issues and critical discussion points to allow for discussion versus presentation during meetings.
- Manage meeting attendees to allow open and candid discussions.
- Perform a robust self-assessment annually.
- Discuss the results of the self-assessment with the audit committee in an executive session and develop tactical actions to address findings.

Member orientation and education

- Provide orientation of new members that focuses on audit committee responsibilities and involves committee members, the CEO, the CFO and finance management, internal audit, and the independent auditor.
- Address board education in the company's corporate governance guidelines to be consistent with NYSE or NASDAQ listing standards.
- Include educational topics on the agendas 1-2 times per year; topics may include: a deep dive on a specific area of the business and related risks, or a refresher on a significant accounting estimate.
- Consider offering annual continuing education opportunities in financial reporting and other areas relevant to the audit committee (e.g., specialized or regulated industry matters, new regulations, operations, and emerging topics such as cybersecurity).

Executive compensation

- Coordinate with the compensation committee on incentive compensation goals.
- Work with the compensation committee to understand the implications of the incentive structure, including its impact on employee retention and potential increases in fraud risk.
- Increase focus on the compensation of officers and directors, including the appropriate use of corporate assets.

For more information:

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