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HOW TO GET FIRST-TIME AUDIT COMMITTEE MEMBERS UP TO SPEED

April 16, 2019 By Paula Loop

Here's a trivia question for you: Which of the following areas does the audit committee typically oversee?

- a.) Fraud
- b.) Financial statements
- c.) Data privacy
- d.) Whistleblower policies
- e.) Third-party risk
- f.) All of the above
- g.) None of the above

The correct answer, all of the above, won't surprise anyone who's served on an audit committee. They know they meet more often than other committees (an average of nine times a year) and their meetings are typically longer than those of other committees. But for those new to the board, realizing the full extent of what the audit committee is responsible for can be an eye opener.

In the past 10 years, the number of first-time directors appointed to S&P 500 boards has risen from 24 percent of the incoming class to 33 percent, according to Spencer Stuart. Fewer of today's newly appointed directors are current or former CEOs, and more are women and minorities with other executive experience, such as line or functional leadership.

Along with this shift to selecting directors with more varied backgrounds, we've noticed another growing trend: More companies are putting new board members without financial expertise on their audit committees.

By itself, this isn't a problem. Considering the close connection between financial reporting and the overall performance of the company, the audit committee can serve as a great training ground—the place where directors without previous board experience are likely to learn the most. Company leaders and board members recognize that many of these new directors aren't financial experts and on the surface, that may seem okay, since the NYSE, for example, only requires a minimum of one financial expert on the audit committee.

However, the problem is that when appointed to the audit committee, first-time directors without financial backgrounds need more intensive onboarding than they typically receive. Most companies do a good job of providing new board members with an overview of the company's strategy, operations, product lines, and revenue streams. But they often underestimate the additional training new audit committee members will need to get up to speed on the complex financial and risk issues they will oversee.

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From the start, new audit committee members need a basic understanding of what the audit committee does, who the key players are, and what their focus should be. Without onboarding sessions that cover these topics, they'll likely be lost when asked to decipher a financial statement, review an internal audit report, or consider disclosures in an earnings release.

This training should cover the seven areas the audit committee typically oversees:

Financial statements
External audit
Internal audit
Compliance and ethics programs
Risk management
Fraud prevention
Financial reporting process and internal controls

Training should also explain the roles and responsibilities of the key people new directors will work with, including:

- External auditors
- Chief audit executive or director of internal audit
- Ethics and compliance officer
- Chief risk officer
- Chief information officer or chief information security officer
- Chief financial officer
- Head of tax

New audit committee members will need to be able to understand the company's financial reporting, including the financial statements and disclosures.

They need to understand certain basics, like the fact that numbers in the company's earnings releases are unaudited and that the tone of the press release announcing those numbers shouldn't be overly positive or negative.

Considering that when stacked together, all of the US accounting standards and regulations are more than a foot thick, just getting a working understanding of the most important rules and regulations—not to mention accounting lingo such as "GAAP" vs. "non-GAAP"—can be a formidable task. Aside from classroom training, other ways to improve the onboarding of new audit committee members include:

- Assigning them an audit committee member buddy to provide extra guidance;
- Helping them establish a strong rapport with the audit committee chair so they feel comfortable asking questions; and
- Arranging meetings with the key members of management and the external auditors to build relationships and understand what they do.

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Although nearly 70 percent of S&P 500 boards have more than one financial expert on their audit committee, choosing committee members with different types of expertise to fill the other seats is a step in the right direction toward broadening the committee's perspective.

In doing so, however, boards need to recognize that these first-time directors will need additional support. The faster new board members can start contributing to committee discussions, the richer those discussions will be.

Ref:
https://blog.nacdonline.org/posts/audit-members-up-to-speed