



# The role of the audit committee chair

KPMG's Audit Committee Institute

The importance of the audit committee (AC) chair's leadership—in setting the committee's tone, work style, and agenda—is vital to the committee's effectiveness and accountability, and cannot be over-emphasized. In our experience, the most effective AC chairs are fully engaged—recognizing that the position may require their attention at any time, and often beyond regularly scheduled meetings; they understand the culture of the organization; they set clear expectations for committee members, management, and auditors; and they ensure that the right resources are being employed to support quality financial reporting.

To provide effective leadership, the AC chair must have a clear understanding of the committee's duties and responsibilities; be able to commit the necessary time (which will vary, depending on the size and complexity of the business); be readily available on urgent matters and in times of crisis; and have the requisite business, financial, communication, and leadership skills.

## Setting the agenda

The AC chair plays a critical role in focusing the agenda on what is important: quality financial accounting and reporting and effective internal controls. The AC's rolling 12–24 month agenda should align with the responsibilities set forth in its charter while also allowing flexibility to address emerging issues.

- The initial draft of the agenda for each meeting is often prepared by the chief audit executive (CAE) and/or chief financial officer (CFO) for the AC chair, who works with them to finalize it and ensure that agenda items are ready for discussion.

In preparing the agenda, many AC chairs:

- Start with priority topics, then add the required checklist items (not vice versa)

- Solicit input on the agenda from the CFO, CAE, and general counsel, and confer with the lead director to obtain his or her input
- Encourage members of the audit committee to provide input on the agenda.
- AC chairs often set aside “white space” time at the beginning of each AC meeting for the AC members to have one last look at the agenda (including time allocated to each item on the agenda) after members have had an opportunity to review premeeting materials.
- Many AC chairs set aside time at each meeting for the AC to take a “deep dive” into an important accounting policy, judgment, or estimate, a significant accounting development facing the company, or the company's use of non-GAAP.
- Many AC chairs also request a summary of the company's key accounting judgments and estimates at least annually.

- “Mission creep” is an important issue for ACs. A key role for the AC chair is to ensure that the AC does not take on too much responsibility beyond its core responsibilities and that committee members’ skills align with the responsibilities. Risk management may be one such responsibility.
- The AC chair may need to discuss with the lead director and nominating committee chair the possibility of shifting certain oversight responsibilities to another committee or to a new committee.

## Making the most of AC meetings

The AC chair plays an important role in ensuring both the quality and timeliness of premeeting materials. For the committee to make the most effective use of its time together, all committee members should receive and review materials prior to the meeting—and make requests for additional information in advance—so that members can devote more time during the meeting to discussion.

- Copies of all presentations to be made at the AC meeting should be included in pre-meeting materials. The AC chair should limit presentation time and the use of PowerPoint.
- Most AC chairs specifically instruct management to assume that AC members have read all premeeting materials.
- An important role for the AC chair is to work with management to enhance the reliability of information flow to the audit committee—including premeeting materials, materials presented at the AC meeting, and other materials made available to the AC on a less formal basis.

Many AC chairs conclude each AC meeting with an executive session so that AC members have an opportunity to discuss important matters privately without management present. The AC may also choose to hold private sessions with the CAE, CFO, external auditor, and other senior executives who can provide valuable insight to the committee about the challenges facing the company.

- “Management risk”—i.e. the risk associated with management performance or failure to perform—is an important topic of discussion.

## Aligning and coordinating AC oversight activities with the board and other committees

In recent years, we have seen a number of changes in how boards—through their committee structure—oversee risk. One major change is a general recognition that risk oversight is a responsibility of the full board—not the responsibility of any single committee, such as the AC. A second change we see is the emphasis on ensuring that risk oversight responsibilities and activities are appropriately allocated and well-coordinated among the board’s committees—and reducing some of the burden on the AC. That might call for an additional board committee(s), such as a technology, finance, compliance, or (for banks) risk committee. To balance the workload, we see boards assigning specific risks to these committees (e.g., cyber risk to the technology committee), and we also see boards reassigning risks among their three mandatory committees.

As a result, AC chairs are playing an increasingly important role in ensuring that the risk oversight activities of the board and other board committees are properly coordinated with the AC, and that the AC has the necessary skill sets.

AC chairs work with lead directors and nominating/governance committee chairs to ensure that:

- The risk oversight responsibilities of the full board and its committees are clear.
- There are proper communications about risk among board and standing committees.
- Risk oversight processes are keeping pace with the increasingly volatile and disruptive business and risk environment.

Possible approaches to improve coordination and reduce the risk of a balkanized board/committee structure include:

- Overlapping committee memberships: many AC chairs recommend that at least one member of the AC serve on the compensation committee and other key committees (e.g., finance, risk, and compliance)
- More robust committee reports to the full board

- Education for all board members regarding the financially sensitive risks that the various committees may oversee

### Understanding the business and its inherent risks

A key role for the AC chair is to ensure that all committee members understand the critical risks to the business—risks to its strategy, its business model, or its survival.

To that end, many AC chairs:

- Emphasize the importance of spending informal time with key people in finance, risk management, internal audit, and external audit
- Encourage their committees to get out and “kick the tires”—visiting company locations, meeting local management and employees, as well as members of the local external audit team. The goal is to obtain a better understanding of the issues facing the business, including the problems and concerns of various managers throughout the business, as well as the tone and culture of the organization
- Meet with leaders of the various lines of business in an effort to understand their strategies and the risks to these strategies

- Insist that their committees be kept apprised of regulatory/compliance issues that are ongoing.

In light of the #MeToo movement, many AC chairs are taking deeper dives into culture and behavioral risks. To that end, ACs are probing HR for cultural and behavioral data (employee surveys, turnover rates, and exits exit interviews, etc.) beyond what has historically been provided regarding ethics, compliance, and whistleblower hotline complaints.

### Supporting the CFO

Understand that the role of the CFO has become much more complicated, challenging, and demanding in recent years. A critical role for the AC chair is to support the CFO and develop trust before there is a crisis.

AC chairs can support CFOs by:

- Developing a strong, healthy relationship with the CFO; spend time (informal) with the CFO
- Focusing on between-meeting developments
- Helping maintain focus on the long-term financial performance rather than short-term earnings targets
- Helping inject objectivity into the company’s financial disclosures
- Helping facilitate effective shareholder communications:



## What would most improve your committee’s overall effectiveness? (only top 5 responses are shown; multiple responses allowed)



Source: KPMG’s 2017 Global Audit Committee Pulse Survey

- Major institutional investors (such as BlackRock, State Street, and Vanguard) continue to emphasize the importance of environmental, social, and governance (ESG) issues (ranging from climate change to diversity) to corporate performance—and as key to long-term value creation and preservation
- Help shape the company’s key ESG messages to investors and other stakeholders in the context of strategy and long-term value creation
- Helping ensure that CFO has adequate resources and staff support:
  - A high-performance finance organization is key to success
  - Budget and headcount should increase as CFO responsibilities have increased
  - Focus on hiring, training, and developing talent, including developing succession plans for all key finance staff positions.

## Setting clear expectations for internal and external auditors

Because external and internal auditors play a vital role in the financial reporting process, effective oversight of auditors is a core responsibility of the audit committee.

Under the Sarbanes-Oxley Act (SOX), the AC of all U.S. public companies is “directly responsible for the appointment, compensation, and oversight” of the external auditor, including the resolution of any disagreements between management and the auditor regarding financial reporting matters. In fact, many ACs are emphasizing their ownership of hiring and firing decisions regarding the external auditor. A good working relationship between the audit committee chair and the lead audit engagement partner is essential—both to the AC’s effectiveness and to the effectiveness of the engagement team.

An important responsibility of the AC chair is to ensure that the AC devotes sufficient time to:

- Evaluations of the audit firm and internal audit (IA)—both formal and informal
  - Annual evaluation of the external auditor (EA) has become more robust (See the Center for Audit Quality “[External Auditor Assessment Tool](#).”)
- Succession planning for (i) lead partner and key members of the engagement team, and (ii) the CAE and key members of IA and financial staff. AC chairs need to establish a process for AC members to get to know key members of the engagement team and IA team.

- Reviewing PCAOB inspection findings (See the Center for Audit Quality [Guide to PCAOB Inspections](#).)
- Discussing with the external auditor and management the auditor’s plans for implementing the PCAOB’s new auditing standard, which will expand the audit opinion to include a discussion of critical audit matters (CAMs). The CAMs requirements will take effect for audits of fiscal years ending on or after June 30, 2019 for large accelerated filers.

AC chairs often help to clarify the role of IA:

- Do the AC, the CFO, and others have a crisp, shared vision as to what the role of IA is at the company? (There is often a wide difference of opinions.)
- The responsibilities of IA are now broader than financial audits and SOX 404, often including operational audits as well as involvement in risk management and legal/regulatory compliance.
- Increasingly, IA is being asked to monitor the impact of the business and regulatory environment, as well as tone at the top and corporate culture, on the company’s compliance program.
- There is a need to review IA’s mission and charter and ensure understanding of IA’s role in each of these areas.
- AC chairs help ensure that IA’s resources and skill sets are properly aligned with its mission and responsibilities.
  - Is there a need for IT or foreign language skills?
- Informal relationships between AC chair and audit engagement partner and CAE are critical.
  - AC chairs have frequent (often weekly) informal contacts.

AC chairs need to be consulted on CAE performance, compensation, and hiring and firing decisions.

## Assessing the tone at the top and throughout the organization

As boards increase their focus on the company’s culture and values, commitment to integrity, legal compliance, and brand reputation, AC chairs are encouraging their committees to take a harder look at the company’s “capital R risks”—tone at the top, culture, and incentives—all of which are critical to the integrity of the financial reporting process.

Areas of focus include:

- Observe how management gets things done and interacts with one another. Is information flow open and encouraged or overly controlled?
- Take a close look at incentive plans and the risk-taking behavior they may encourage.
- Help ensure that the company's regulatory compliance and monitoring programs are up-to-date, cover all vendors in the global supply chain, and clearly communicate the company's expectations for high ethical standards.
- Take a fresh look at the effectiveness of the company's whistleblower program. Does the audit committee see all whistleblower complaints? If not, what is the process to filter complaints that are ultimately reported to the audit committee?
- Ask for internal audit's thoughts on ways to audit/ assess the culture of the organization.

## Emphasizing continuous improvement for the AC

AC chairs recognize that AC effectiveness is an evolving process that requires staying abreast of fast-changing business developments so that the AC has the knowledge needed to evaluate the information it receives and on which it is basing its decisions.

- The AC chair should consider the need for focused education and development programs on company-specific issues to help keep the committee's skills sharp, whether through external training or events or presentations by subject matter experts during committee meetings.
- The AC chair needs to monitor whether the AC is improving. How do you know the committee is "moving the ball forward"?
- In addition to education, the AC's self-assessment process is critical to its continuous improvement. As noted in the 2017 KPMG Board Leadership

Center publication, *Enhancing evaluations for boards, committees, and directors*, a strong evaluation of the committee and individual members begins with a process designed to facilitate an "honest, constructive, and insightful assessment of strengths, weaknesses, and gaps that leads to meaningful follow-up. Evaluations may be performed in a variety of ways, and there is no one 'right' way to do them." The 2016 *Report of the NACD Blue Ribbon Commission on Building the Strategic-Asset Board* recommends that committee evaluations be conducted at least every other year, and companies listed on the New York Stock Exchange are required to perform an annual evaluation of the AC.

- The lead director can help address performance issues at the committee and individual director level.
- The AC chair plays a key role in conducting the self-assessment and must assume ownership for the process.

Possible approaches include:

- Decide on the purpose and scope of the evaluation—what do we want to accomplish?
- Bring appropriate rigor to the process
- What areas do we need to focus on, such as key audit committee oversight processes?
- How can we receive valid feedback?
- How can we act on the feedback to make a difference?
- Involve the necessary resources up front.
  - Where can we find necessary expertise, internally and externally?
  - Who should handle, analyze, and provide feedback to the AC?

“*Aside from the results of the self-evaluation, I would say that at the end of the day, our effectiveness as a committee is best measured by controllership and compliance within the company. Is controllership well-managed? We're always going to have compliance problems, but are we informed of them? Do we understand them? Do we investigate them promptly and fully? Do we take action when we find something we don't like?*”

— **Audit Committee Chair**

- Integrate/coordinate AC self-assessment with those of board and other committees.

## Ensuring that the AC has the “right” composition and dynamics

The chair should consider the dynamics of the AC. An important question for the AC chair is, “how do AC members interact with each other, with the chair, and with the board, management, and auditors?”

The chair should also consider the overall AC composition (ensuring the committee includes the “right” mix of people with the appropriate mix of hard and soft skills).

- Qualities to look for in AC members include integrity, collegiality, trustworthiness, and professional skepticism, including a willingness to probe and ask tough questions.
- Do we have an appropriate mix of current experience and relevant skill sets: financial reporting expertise, industry knowledge, and global perspective? Depending on the role of the committee (e.g., IT, risk, etc.), are there other skills we need to add?
- The AC chair needs to work closely with the chair of the nominating/governance committee in the AC member selection process to assess:
  - The committee’s effectiveness in working together
  - The working and communication styles of individual members
- The AC chair should also work closely with the nominating/governance committee chair on plans for both committee and chair succession
- AC chairs often seek AC member agreement on a process for ongoing, regular review of the committee’s dynamics, as well as an ongoing development program focused on the committee’s dynamics.

## Providing leadership

To be effective, the AC chair should be a strong leader by:

- Setting the tone: dedicated, informed, probing, and independent—willing to challenge management, when appropriate.
- Keeping the committee focused on what is important
- Making sure the AC has the resources and support to do its job
- Pushing back when too much has been added to the AC’s plate (and periodically reviewing and refining the AC’s charter)
- Ensuring that all AC members are engaged
- Promoting communications—both formal and informal—among AC members
- Spending time between meetings working with management and auditors to ensure that all relevant issues are identified and addressed by the committee.

# Additional resources and reading

**KPMG Board Leadership Center**

**KPMG's Audit Committee Institute (ACI)**

**On the 2018 audit committee agenda**

**KPMG audit committee guide**

**Navigating uncertainty: The long view**

# KPMG's Audit Committee Institute

As part of the KPMG Board Leadership Center, the Audit Committee Institute (ACI) provides audit committee and board members with practical insights, resources, and peer-exchange opportunities focused on strengthening oversight of financial reporting and audit quality, and the array of challenges facing boards and businesses today—from risk management and emerging technologies to strategy, talent, and global compliance. Learn more about ACI at [kpmg.com/aci](https://kpmg.com/aci).

# KPMG Board Leadership Center

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