

AUDIT SEASON

A DAUNTING WORKLOAD AND SPIRALING RESPONSIBILITY MAKE THE AUDIT COMMITTEE A TOUGH SELL. WHAT TO HUNT FOR WHEN YOU'RE HUNTING FOR HELP. BY C.J. PRINCE

Blythe McGarvie had him in her sights. As chair of the audit committee for auto parts giant LKQ, she'd drawn a bead on her potential replacement—a newly retired CFO who recently joined LKQ's board. She hoped to convince him to join the board as a member of the audit committee and, perhaps in a year or so, take over her role as chair. She broached the idea and explained the time commitment—four regular board meetings per year, plus an additional four audit committee meetings and, as chair, reaching out before each audit committee meeting to talk with the external audit partner and with the corporate internal audit executive to make sure every base is covered. "I think I scared him," she says. "He withdrew from the process and did not want to go forward."

The audit committee has always had a lot on its plate. Thanks to technology, globalization and the sheer pace of change, multiplying risks have filled that plate to brimming. In addition to the traditional tasks of providing oversight of the financial reporting process, the audit process, internal controls and compliance with regulations, a host of other risks have made their way onto the audit committee's agenda, including cybersecurity, data privacy, ESG, supply chain, general culture and executive misbehavior.

The growing time commitment, workload and level of responsibility and risk are making sourcing candidates, especially those who can head up audit, more challenging. "It is definitely getting

more and more difficult to get people who want to be an audit committee chair," says McGarvie, who also chairs nom/gov for Apple Hospitality REIT and is on the audit committee at Sonoco.

Alice Schroeder, who chairs the audit committee for Quorum Health and sits on audit for both Natus Medical and Prudential Plc. agrees and says she understands why. "The audit committee has been handed some new hats," she says. As one recent example, she points to "overseeing how effectively enterprise risk management is being conducted by management—that's a big job," she says. "And then other aspects just keep getting added on, like [ornaments on] a Christmas tree."

The list does indeed seem to be growing by the day. On December 30, the SEC's chairman, chief accountant and director of

the division of corporation finance issued a joint public statement on the role of audit committees in financial reporting, including key reminders regarding oversight responsibilities, such as "tone at the top."

"They just kind of slipped that in there," says McGarvie. "So now tone at the top is on the audit committee's list. Really? Because I always thought that was the board's role."

The SEC has made things more difficult by barring anyone from serving on more than three public company audit committees at a time—a rule with which Schroeder takes issue. "Serving on three audit committees is not a full-time job—period, full stop," she says.

McGarvie is even more blunt. "The idea you can't be on more [than three] is ridiculous," she says, noting that a director who is able to serve on multiple audit committees



STOCK.ADOBE.COM

gets a much better sense of trends among auditors, how they operate and how they compare with one another. “You really benefit from looking at different information across the board.”

She adds that another thing making it hard to find good candidates is that non-U.S. candidates who would otherwise accept and add value often don’t qualify as financial experts because they don’t have a good enough understanding of GAAP. “So that’s very limiting,” she says.

Gregory Weaver, who chairs the audit committee on Verizon’s board, says he sees no shortage of talented, qualified candidates with strong financial backgrounds. “But some people, frankly, don’t want to serve on the audit committee because it’s a lot of work. And not just work, but more risk. So, some people would rather work on nom/gov, finance, comp, and they have skillsets that make them valuable there,” he says. “Some just opt out.”

There are plenty of qualified audit committee candidates, adds Julie Hembrock Daum, who has conducted more than 1,500 director assignments as head of the North American board practice of Spencer Stuart. But if you’re looking to check two boxes with one candidate—audit experience and diversity—as many boards are doing, that’s harder to find. “Those candidates are in huge demand right now, and they can pick and choose,” she says. “So there is a candidate pool, but it’s not robust because it’s almost picked over.”

For all the hard work one faces as a member of the audit committee, McGarvie, who has served on eight boards and chaired audit committees for decades, tells those she is wooing that serving on audit is actually fun. “I say that, and people laugh a little, but it is, because it’s the most pivotal committee on the board,” she says. “I tell everyone, if you get on a board, go to the audit committee first—you’ll see how things are done, you’ll understand what drives our margins, you’ll see where our strengths and weaknesses are. It really gives you a thorough peek into the tent.”

Unlikely Suspects

Given that most boards don’t have vacancies all that often, seats must be maximized, with members checking off a host of boxes. Financial acumen may be just one of many sought-after skills on the matrix, along with a tech background, knowledge of ESG, diversity. Depending on the needs of a particular board, industry experience, CFO expertise, audit committee experience may or may not be critical—and no one candidate is likely to have everything covered. Here are some of the skills you’re likely hunting for—and how to bag them for audit.

Financial Acumen, Fascinated by Process

Usual Suspects: CFOs, COOs

Unconventional Targets: Curious Engineer Types

Maybe Say: “This is the best way to dig into how the whole business works and make sure that it’s running right.”

It may sound obvious, but given the stakes, it’s worth repeating that a proven track record of financial acumen is critical. “A good audit committee member understands financials and accounting, not in the same depth as an accountant, but understands numbers to the extent that they know what makes sense—not just with an S, but with a C—so they can see patterns in the financials,” says Darrell S. Freeman, Sr., who serves on the audit committees for Cross Country Healthcare and Reliant Bank. “These days there are a lot of ways to represent numbers and to represent EBITDA, but just being able to understand how all those things are interconnected is important.”

That person also needs to enjoy digging into process, says McGarvie. “Some people say, ‘Well, I’m not an engineer,’ but you don’t have to be an engineer. You just have to say, ‘This is how we’re going to go through the process and not just act ad hoc.’” That is something

to be aware of when bringing former CEOs on board, she adds. “A lot of former CEOs are used to having a whole cadre of support who create the process. So I find sometimes former CEOs provide great insight, but not so much on process.”

Seasoned Skeptic with Loud Voice

Usual Suspects: Audit Committee Members

Unconventional Targets: Older Board Members

Maybe Say: “We really could use someone with your experience to help us ask the right questions.”

Financial wizardry won’t be that valuable if the director isn’t willing to speak up—and persist when necessary. “This person needs to be an independent thinker, willing to ask the right questions, the tough questions, even if the questions push the audit partner or the finance folks back on their heels,” says Freeman. “I’ve seen organizations that have gotten into trouble, and they wouldn’t have if just the right questions had been asked.”

McGarvie points to Boeing as an example where a lack of skepticism on the board made a bad situation worse. For months after the 737 Max was grounded, following two deadly crashes in 2019, then-CEO Dennis Muilenburg promised stakeholders and the board that the plane would get FAA approval to fly by the end of the year. “He was making that up. He had no reason to put out that kind of hope. So why did the board believe him?” Ultimately, he was fired—but not before angering shareholders, airlines, regulators and victims’ families.

A good audit committee member will not stop querying until he or she is comfortable with the answer, says Freeman. “I keep asking questions until it becomes clear to me,” he says. “And if I can’t get clarity there, I’ll ask our audit partner—without anyone else in the room, if necessary.”

This is where experience plays a big role, both in confidence and persistence. “More than ever, members of the audit committee really should come from a background where they have become seasoned in this whole area, because they’ve been on audit committees and have seen pretty much A-to-Z types of activities, or they come from a business background that has exposed them to these kinds of issues,” says George Muñoz, who chairs the audit committee for Altria Group and serves on audit for Marriott International.

Service-Minded, Commitment to Excellence



Usual Suspects: CFOs, CEOs

Unconventional Targets: Former Military, Law Enforcement, Government

Maybe Say: “This is the most difficult committee, and there’s a ton of work. But it’s also the most important committee—and we need someone who gets that and is ok with that.”

McGarvie likes to use the old adage about the difference between the chicken and the pig to communicate the level of commitment she believes audit committee members need to have. “The chicken is involved when she presents an egg—the pig is committed when the bacon is on the plate,” she says. When it comes to audit, “you can’t just say you’re involved, you have to be committed—with your relationship with the CFO, with your audit partner, with your corporate audit executive.” And that means whoever you choose to serve on audit, he or she should really have a passion for the role.

“I don’t serve on boards for the money or for the prestige—I serve because I think I am relevant to keeping our financial system healthy,” says McGarvie. “If you’re doing it for the right reasons, then you’ll do the things that are required to be on an audit committee and to chair an audit committee.”

Weaver echoes the importance of enthusiasm on the part of your audit committee prospects. “You need to have both the combination of talent and really a desire and a passion [to do the work],” he says. “Make sure you have somebody

who wants to be there, enjoys being there and has the right talent.”

Shroeder takes it one step further: Look for someone who wouldn’t be comfortable joining the board if they were not on the audit committee. “Because if you’re the right person with the right skills, it’s going to be very important to you to have that information and participate in those discussions to feel comfortable with the risk of being on that board,” she says. “So that’s one good test of the right person for the audit committee.”

Separates Signal from Noise



Usual Suspects: Former CFOs and CEOs

Unconventional Targets: Entrepreneurs

Maybe Say: “We need someone who is very strategic and can operate at a very high level—someone who can focus on what’s really important and see what’s not.”

“The biggest thing,” says Daum, “is that they know the difference between management and government. That’s huge.” Former CFOs who have been on the receiving end of board query often know what it’s like when boards get too far into management, she adds. “You need someone who is very strategic and can operate at a very high level.”

As an entrepreneur who ran a company for 25 years before selling it two-plus years ago, Freeman fits the bill. “I’ve always been deep into the numbers because I was a hundred percent shareholder,” he says. “I’ve also had to stand up accounting departments in my own organization, so I understand the intricacies of what goes on in accounting.”

That ability to stay both high level and focused is critical at a time when headlines detailing the latest #MeToo crisis or cyber breach can easily distract members of the audit committee from the board’s real priorities, which already have a limited amount of time to be addressed. “All of that requires discernment,” says Muñoz, as does prioritization. “To prioritize requires an assessment of what is materially an evolving risk, and what is materially an existing risk and how does one weigh

them and monitor to make sure that management is looking at all of them. I’m not saying that prioritizing means only pay attention to the top ones—it just means making sure that the top ones get the adequate attention.”

He adds to that the importance of being careful with one’s words and not “just thinking out loud or making gratuitous comments” because “what the board member asks about or tries to get into more deeply matters greatly because it uses up important time, and it sends a signal about priorities.”

Diligent, Self-Motivated Student



Usual Suspects: CFOs

Unconventional Targets: Inquisitive Executives from Big Tech Companies

Maybe Say: “The committee is responsible for so much more than just the numbers these days. We could really use someone who is game for tackling whatever comes next.”

Audit committee members, in addition to devoting time to committee meetings and prep, must also stay current on all areas of risk—some of which are changing by the day. Cybersecurity, for example, is shifting so quickly, that “even if you were an expert five years ago, you’re likely not one today,” says Weaver. “You have to attend as many outside seminars as you can, listen to what others are doing and what the experts are doing. Also, spend a good bit of time with the internal experts and make sure [the board is] bringing in third-party service providers. We like to rotate those through so that you get to hear a number of different perspectives around that.”

Muñoz adds that audit committee members must stay abreast of “all of the major geopolitical and global economic and demographic changes and technology changes that are taking place globally—all of which have the potential to impact risk. “So, as one transforms a company because of digitizing or technology challenges or the like, are the internal controls being sacrificed in any way because of that shifting?” he asks. And while committees should not simply chase headline news,

TO SPLIT—OR NOT TO SPLIT— THE AUDIT COMMITTEE

they need a finger on the pulse of what's trending. "For example, when sexual harassment became a big issue, one had to determine whether our hotline, our code of conduct, our tracking and our HR systems for tracking those kinds of issues and resolving them, how are they working and what kind of litigation exposures are out there?" said Muñoz. "There has to be some knowledge of what's going on globally to make sure that we don't get tripped up."

Weaver notes that while he doesn't think there is "a blueprint for a great audit committee member," it's key to avoid having too much similarity—of background, skillsets, points of view. As an auditor for many years and former CEO of audit firm Deloitte & Touche, Weaver had the opportunity to sit in on 60 to 70 audit committee meetings a year. "I got to observe a lot of things that worked right and things that didn't work right," he says, "and having that diversity is really, really important. Sometimes people ask questions that lead to other questions that you might not have thought of from your background."

Schroeder agrees, noting that while one of her boards has a diverse board from a gender standpoint, "we also want it to be diverse in the way we think and not make mistakes as a board by being too similar in the way we make decisions." That board is currently using biometrics and psychometrics to evaluate how directors use their energy and brains in problem solving and decision making—analysis and research vs. creating new ways of working—and whether they could benefit from diversifying psychologically, in addition to skills variation. "We've learned a lot from that," she says. "I think that's a best practice that will become a standard practice because groupthink is one of the biggest risks that boards face." **CBM**

Given the audit committee's expanding agenda, more boards are considering the step of siphoning off areas of considerable risk to new, separate committees—e.g., finance, cybersecurity or, more generally, risk. We asked four experienced audit chairs to weigh in.

>> Blythe McGarvie (LKQ, Sunoco, Apple Hospitality REIT): Yes, I think it's a good idea. And when I was chairing the Accenture audit committee, I said, 'This is too much,' and we split off some of our responsibilities to a finance committee. A lot of non-financial services companies are now creating a risk management committee because there's only so much the audit committee can do. And having a [separate] risk management committee, as financial services [firms] are required to do, is a very good idea. But then you have to have committee members who can serve on the risk management committee or the finance committee—so you still need financial experts.

>> Alice Schroeder (Quorum Health, Natus Medical, Prudential): I have never heard anyone suggest that, and I think it's probably because you can't divide the responsibility for the financial reporting and the controls that underlie it and have somebody only understand and be accountable for half of it. What I have heard—and I hear this a lot—is that the pay for audit committees and their chairs is lagging the responsibility and that, although it often is the highest-paid person other than the chair of the board, it is still generally an underpaid role and that contributes to the difficulty in recruiting.

>> George Muñoz (Altria Group, Marriott): There are pros and cons, and I come out on the side of saying it's better to have one audit committee that is already understood by the rest of the board as having a responsibility to actually use their experience and their exposure to the company's issues in a way that prioritizes, from the board members' perspective, what is being addressed in the proper way and what needs to be delved into further. So, I don't think just dividing it up [makes sense] because any committee spun off from the audit committee may have a special intention or purpose but without the benefit of knowing the ramifications or the domino effect that go beyond that one area, whereas it's the audit committee's responsibility to look into that.

>> Greg Weaver (Verizon, Goldman Sachs Trust): We do have a heavy agenda, but I don't believe we need a separate risk committee at Verizon. While not exclusively, separate risk committees are, in my view, more often needed when there is heavy federal or state regulatory oversight, so, for instance, financial companies, including those in the banking and insurance sectors.

