

Audit Committee Expertise Gets An Upgrade

By Lindsay Frost - February 12, 2018

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Over the past few years, audit committees have been taking charge of internal investigations and other tasks that don't neatly fall under the responsibilities of the nominating and governance committee or the compensation committee. The increasing involvement of the audit committee in high-impact events dealing with cyber security, culture issues, legal investigations and harassment incidents has fueled the need to refresh audit committee member skill sets. As a result, companies are looking beyond directors with purely financial experience to court those with compliance, legal, investor relations and technology expertise to fill audit committee seats.

"It's great to have a Big Four partner or CFO on the audit committee, but having a diversity of experience and viewpoints and expertise, given the breadth and depth of what the audit committee has to handle, suggests [that companies] may want to look at people you haven't considered for the audit committee," says **Eileen Kamerick**, director at **Associated Banc-Corp.** and audit committee chair at **Legg Mason Closed End Mutual Funds** and **Hochschild Mining**. "It's worthwhile to consider broadening and deepening that skills matrix."

Finance Hires Still a Priority

After Sarbanes-Oxley was passed in 2002, the SEC mandated that audit committees must have at least one qualified financial expert. Financial executives are still "at the top of the list" when recruiting for audit committees, says Lee Hanson, vice chairman of Heidrick & Struggles.

Kamerick says that before this mandate, there were a lot of "financially astute" members of audit committees who could read a profit and loss statement, for example, but not many who wanted to focus on areas such as internal controls. Now, the SOX mandate has attracted a "whole cadre" of people from finance and accounting coming onto the audit committee. More recently, this has led to more diverse hires, such as Kamerick herself.

An active or retired CFO or other financial executive has the expertise most commonly sought after by boards looking to fill seats and chair positions on the audit committee, sources say. According to Spencer Stuart's 2017 board index, 32% of audit committee chairs are active or retired financial executives, up from 28% in 2016.

According to EY , 48% of 2017 proxies disclosed that companies had three or more financial experts on the audit committee, 35% reported they had two financial experts and 17% reported they had one.

“With audit committee agendas addressing implementation of several new accounting standards involving significant judgment, an understanding of the application of these new standards and the complexities of doing so, including the effect on controls, is an increasingly important skillset for audit committee members today,” writes Dave Walker, audit committee chair at Chico’s FAS, CoreLogic Inc. and CommVault Systems, in an e-mail.

Legal and Compliance Skills a Plus

Kamerick says additional regulations have increased the need for legal and compliance experts on audit committees. She says the audit committee has become a critical component for the compliance infrastructure, particularly in industries such as financial services.

Additionally, a slew of cultural issues, including those involving sexual harassment, coming to the forefront recently have led to internal investigations in many cases by the audit committee.

“You need a different set of skill sets for how to conduct an internal investigation with outside counsel or a forensic firm,” **Kamerick** says. “Having people [on the audit committee] with a compliance background, a legal background and operational experience in dealing with some of these issues along with the SEC-mandated financial expert — I think this broad-based approach is a good idea.”

For example, in 2017, the audit committee at MiMedx completed an investigation into two employees’ selling products for other companies in violation of non-compete agreements. Additionally, in 2016, TCP International Holdings’ audit committee investigated related-party transactions made by the company’s chairman, Ellis Yan.

Audit committees are more commonly charged with investigating issues related to financial statements and accounting. For example, in January, the audit committee at A10 Networks announced it was investigating revenue recognition practices at the company. In 2016, Comscore’s audit committee investigated issues related to the company’s revenue recognition practices, disclosures and internal controls, and Akorn’s audit committee investigated accounting errors involving transactions related to sales to wholesalers, direct purchasers and other related transactions.

More often these days, claims from the employee whistle-blower hotline are being sent directly to the chair of the audit committee, as well. It's important that the audit committee gets the correct information regarding these complaints, and that nothing is glossed over by management so that the committee can properly "govern, not manage," **Kamerick** says.

Additional Expertise

Audit committees today are facing a multitude of new risks in the areas of cryptocurrencies, cyber security and privacy threats, emerging social media network policies and other compliance challenges, Walker says.

"It has become critically important for board members, and audit committee members in particular, to upgrade their skill sets and remain current in understanding, monitoring and addressing today's risks by attending seminars and conferences with subject matter experts and taking 'deep dives' into risk areas that are new or unfamiliar," Walker writes.

"As boards recruit new members qualified to serve on audit committees, industry-specific and deep technology skills are frequently sought, as are experiences in emerging risk areas," he adds.

For example, when it comes to cyber security, according to a KPMG survey of 800 audit committee members last year, 31% said additional cyber and tech expertise would improve the overall effectiveness of their audit committee.

Kamerick says companies may not necessarily need tech "experts" on the audit committee, but it's helpful to have someone with a deep understanding of cyber issues — deep enough to ask the right questions.

Skills matrices are being used behind the scenes to help boards refresh the backgrounds of the audit committee and full board. For example, Hanson says boards may not want to have only financial experts on the audit committee, so they are using matrices to nail down those with international and cyber experience, for example. She also says committee rotation will help a board member become well-rounded and bring various expertise to various situations over time.

Bob Lamm, co-chair of law firm Gunster's securities and corporate governance practice, points out that it is important for directors to define what makes someone an expert in an area as they fill in the skills matrix. Boards should ask questions like, "How do you define if someone has technological skills? What are the prerequisites for that? What does an international business skill set mean? Does it mean they've

spent significant time in other countries, or that they can sit and oversee international operations?”

This can be critical, as investors consider director skills very important. According to Morrow Sodali, out of 49 institutional investors managing \$31 trillion in assets, 71% say skills is the most important diversity criterion for directors and 66% say board composition is highly important in determining director election voting decisions.

“I think serving on the audit committee is a great way to learn a lot about the company, and you need a complement of audit committee members,” **Kamerick** says. “Using a skills matrix is a helpful tool as boards tackle new challenges and succession planning.”

Lamm says intangible skills such as diplomacy, asking tough questions, balancing different interests, and the ability to deal with a constantly changing set of challenges and jump from one crisis to another are key for audit committees and the full board.

“Despite the fact that other committees have grown in significance, the audit committee still seems to be the one to look to as problems come up, and it doesn’t look like that is changing,” Lamm says.