

boardroom conversations

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# How to become an Audit Committee Chair and then succeed

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## Background

*We are pleased to share with you the results from a joint Egon Zehnder and Audit Committee Chairs' Independent Forum ("ACCIF") project: "How to become an Audit Committee Chair and then succeed".*

*This report is based on a survey of a 140 UK based respondents across Audit Committee Chairs, Board Chairs, CFOs and Audit Partners. The survey was conducted in March and April 2018 and the results show that the role of the Audit Committee Chair has changed significantly over the past decade.*

*The survey was supplemented with 22 interviews with UK Board Chairs, Audit Committee Chairs, CFOs and Audit Partners aimed at determining what characteristics are needed to lead this key Committee, what the job entails now, and crucially how an Audit Committee Chair can succeed.*

*We hope that you find the results helpful and thank all of the respondents and interviewees for their contributions.*

The principal areas that are overseen, monitored or reviewed by Audit Committees – the annual report and other periodic reports, internal control and risk management systems, the internal audit process, and the external audit process – have been the same for many years.

However, the specific obligations placed on Audit Committees have been ratcheted up through successive revisions to the UK Corporate Governance Code in recent years, which in turn have helped to increase the expectations of stakeholders that the Audit Committee will ensure that their interests are properly protected in relation to financial reporting and internal control.

The increasing obligations placed on Audit Committees in recent years have arisen both directly as the Code has defined more closely the specific responsibilities of Audit Committees, and also indirectly as the Code's requirements regarding the content of annual reports have increased. Requirements such as to review the effectiveness of the external audit process and internal audit activities and to advise the Board whether the annual report and accounts, taken as a whole, is "fair, balanced and understandable" have had a direct impact. In addition, new or expanded annual report requirements such as the increased emphasis on the assessment and reporting of risks, including the viability statement, have also in practice expanded the remit of the Audit Committee. In addition, the Committee's report in the annual report is now required to include the significant issues that the Committee considered in relation to the financial statements and an explanation of how it has assessed the effectiveness of the external audit process.

As a consequence, whereas established Audit Committee Chairs have had some opportunity to prepare themselves and their committees to meet the increased obligations and expectations, new Audit Committee Chairs must be ready to meet them on appointment; they must hit the ground running.

This increased scope of activity has meant that appointing the right person as Audit Committee Chair has never been more critical.

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This report summarizes the responses from our survey and supplementary interviews in terms of three key aspects: What it takes to become an Audit Committee Chair; what the role involves and how to succeed.

## What does it take to become an Audit Committee Chair?

### What are the CV requirements?

Over 70% of the survey's respondents said that it is essential to have worked in a finance department and/or have a finance qualification to become an Audit Committee Chair. However, only 1% thought that relevant industry experience was required (although this may well depend on the industry sectors considered as interviewees confirmed that industry sector experience was generally essential in the case of the financial services sector).

Feedback from interviews however was more nuanced, especially from Board Chairs, who emphasized the need for strong Non Executive Director (NED) and Chair skills first and suggested that the career history would indicate whether the candidate has the skills to serve (and Chair) the Audit Committee. If the Audit Committee Chair does not have the financial skills/experience then the Board needs to ensure that these skills are present in the composition of the Committee.

Today the Audit Committee Chair role is much broader than just financial reporting so a breadth of experience and a range of skills are now required to do the role. The requirements highlighted in the interviews include:

- Chair skills and experience, e.g. know how to prepare and manage an agenda and run a successful meeting.
- Ability to create the right balance of skills and experience in composition of the Audit Committee (working with the Board Chair) and to help select/recruit these members.
- Gravitas and transparency with all members of the Audit Committee and create an environment to succeed.
- Ability to drill down into subjects but then summarize and communicate well in plain, non-technical language.
- Ability to form positive and productive relationships with key stakeholders including external auditors, head of internal audit, CFO, CEO, Board Chair and other Board directors.
- Awareness that the level of complexity and responsibility associated with the Audit Committee Chair role is increasing. Therefore, Audit Committee Chairs need the ability to commit sufficient time to the role.
- Independence of thought.
- Robustness of character.

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## **How do companies find Audit Committee Chairs?**

We heard in our interviews that “timing is everything in getting a position” and “most Audit Committee Chair roles are found through executive search firms these days.” We also heard: “it is today rare that a Board chair will find candidates on their own through their own network.” That said, survey respondents suggested that networking continues to play a role in the identification of Audit Committee Chairs.

## **How can aspiring Audit Committee Chairs prepare themselves to attain the role, and what should they think about when it comes to an interview?**

Hints and tips from our interviews include:

- Technical and financial skills are not enough – you need to demonstrate softer skills. For instance, collaboration and influencing skills are key.
- Demonstrate an understanding of and curiosity about the business.
- Ensure you understand the time commitment – this should not be underestimated. Check the dates of the board meetings. You are of no value if you cannot be present.
- Demonstrate that you see the big picture, differentiate big from small, have perspective, and focus on what matters.
- Show you can bring a new perspective. Out-of-the-box thinking is important.
- Ask about plans for your induction.

## **And when you get the role, what are the first steps?**

- Get out and understand the business, the people and the role.
- Pick up the pulse of the company and understand how the decision making process works.
- Get to know your fellow directors.
- Be curious and think laterally.
- Get ready to adapt your style and approach to different relationships.

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### What does the role of the Audit Committee Chair involve?

We asked in the survey and interviews for opinions on what the Audit Committee Chair role entails. The results may be summarized as follows:

#### Key attributes, core skills and experience needed to do the role successfully

- Be clear on the responsibilities your Committee holds and what is expected of you and your committee.
- Open and listening culture is essential. Be collegiate in approach.
- Respect the role of the Executive and “tease” things out – don’t be invasive.
- Be prepared to work outside of formal meetings to get the job done.
- Engender trust by rest of Board that the right questions have been asked and solutions found.
- Stand up for what you believe in. Operate with the highest integrity – this is your responsibility.

#### “Leave no ‘ambiguity’ on who is responsible for each issue”

#### Important activities for a new Audit Committee Chair

- Set the Audit Committee agenda.
- Work outside the Audit Committee meetings as necessary to get the job done.
- Understand and take a strategic view on how to tackle the risks facing the business.
- Lead on actively contributing to the Internal Audit programme of work.
- Make sure the triangle of the Audit Committee Chair, CFO, and the External Audit Partner and the triangle of the Audit Committee Chair, CFO and Head of Internal Audit work openly and effectively.
- Understand that your relationship with the CFO is critical and aim to have an influence on who is hired.

#### “Audit Committee Chair should understand how the ‘CFO ticks’”

- Hold the CFO to account while supporting him/her.

#### “The best Audit Committee Chairs are able to manage this duality effectively”

- Seek out and engage with next level finance and other managers to understand sources and quality of information, in order to get a “feel” for things.

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- Challenge the External Audit Partner to seek opinions and obtain clear explanations.
- Trust but probe the External Auditor.
- Consider meeting with the External Audit Partner before the Audit Committee meetings at which the audit plan or audit results are discussed.
- Maintain contact with the General Counsel and Company Secretary. They are key relationships to establish.
- Keep the Board Chair and CEO informed on significant issues as they arise.

**“If something is bothering you – chase it down. You don’t want to look back and say ‘I could have picked that up’”**

- Remember the Board relies on you and the Audit Committee to assure the quality of the financial reporting.
- Could consider meeting analysts and investors from time to time, though there appears to be little appetite among investors/analysts for such meetings.

## **Relationship with the Board and the wider organisation**

- Remember that you are a board member first and Audit Committee Chair second.
- Remember that you are a true representative of the shareholders.
- Make sure you manage effectively the key external audit-related relationships for the Board.
- Good quality feedback to the wider Board is essential – and the mark of a good Audit Committee Chair. This is a skill set that must be developed and feedback sought.

## **Balance of focus both on process and potential risks to the business**

- Understand key business processes.
- Get out and about in the company to understand the business model and the risks.
- Establish a strategic view on how to tackle the risks facing the business.

## **Support the Audit Committee and run an effective set of agendas**

- Work out the annual cycle and set the annual agenda. Be sure to cover all the points needed.
- Ensure to cover all the Terms of Reference.
- Make sure the agenda is connected with the Board’s cycle and issues.
- Modify the agenda as a result of events such as a report by Internal Audit on a major issue.

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- Make sure that all areas are covered and that clear accountability is maintained in all actions.
- Work closely with the Company Secretary.

## **Audit Committee skills and diversity to align with the challenges facing the business**

- Some 85% of respondents to the survey, backed up by our interviews, thought that along with the Nomination Committee, the Audit Committee Chair needs to lead on ensuring there is the right balance of skills and diversity on the Audit Committee.
- In addition, 91% confirmed that a regulated business would require different skills than an unregulated business (and in most cases a greater time commitment).
- In interviews, respondents confirmed that Audit Committee Chairs and their committees in Financial Services will have a specific skills mix with significant experience in the sector.

## **Keeping up to date**

- Some 71% of survey respondents, again supported by the findings in the interviews, strongly agreed that the Chair must keep up to date on all external governance developments that impact their role.

## **Relationship with the CEO, CFO, Audit Committee members and the Audit Partner**

- As would be expected, a high proportion of the survey's respondents (over 90%) confirmed the need for the Audit Committee Chair to have a strong working relationship with the CFO and other Audit Committee members, in addition to having regular and frequent contact with the external auditors.
- Some 95% of the survey respondents said that they feel free to challenge the CEO and the Executive Committee. And 99% confirmed that as a NED, the Audit Committee Chair is ultimately dependent on the quality of information provided by management and therefore it is important that executive management provide the necessary information/resources to effectively carry out the Audit Committee Chair role.

## **Importance of relationship with Internal Audit**

- The Audit Committee Chair needs to maintain contact with the Head of Internal Audit to discuss Internal Audit findings and to support the objectivity and independence of Internal Audit, making sure that management is not influencing the Internal Audit scope of work or outcomes.
- The risk assessment process needs to lead the Internal Audit plan and the Audit Committee Chair should review and agree the plan and follow up outcomes, holding management to account for delivery of improvements.

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- To obtain assurance regarding the effectiveness of the risk management system, the Audit Committee Chair also needs to understand how managers have assessed risk – and see if their outputs are fit for purpose.
- The Audit Committee Chair needs to have a feel for how the programme of work is going during the year and be consulted by the Head of Internal Audit on any proposed changes in the work plan.

## **CFO succession and talent below CFO**

- Is the Audit Committee Chair's opinion primary when deciding on CFO succession? The survey did not produce a strong answer, with roughly a third of the respondents agreeing, a third of them neutral, and a third of them disagreeing.
- Interview responses found that the recruitment of a CFO is primarily the CEO's responsibility to lead as the key executive working relationship in any business is between the CEO and CFO. However, in many cases the Audit Committee Chair will interview short-listed candidates and should at least have the opportunity to review and approve the CFO appointment.
- Audit Committee Chairs believe that they have a good understanding of the talent below the CFO level and therefore of any potential CFO successors.
- The Audit Committee Chair can support the Board and CEO when there is a need for an emergency replacement for the CFO – this should also be part of the Board/Nomination Committee as part of succession planning.

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## Top 10 tips to be a successful Audit Committee Chair

1. Always remember you are a NED and not an executive.

### “Remember it is not about you. You are there to serve the Board”

2. Build relationships across a wide range of people in the business and drive a wide range of honest discussions.
3. Use full capabilities of the Audit Committee members.

### “Remember it is a team at the end of the day.”

4. Identify and review past tough issues to see how they were resolved.
5. Understand risks and risk management and how they are being managed in the company environment. Don't allow box ticking – this has to be real.
6. Do not be afraid to hold people to account.
7. Stand by your principles and learn from mistakes.

### “You are the custodian of ‘true and fair’ – don't forget that”

8. Use judgment and use your “nose”. Probe and be alert. Read between the lines as well as the lines themselves.
9. Stay relevant. This is the biggest challenge for a NED. Especially in a fast moving world. Find ways to stay relevant.
10. Always finish meetings on time.

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We would like to sincerely thank the following interviewees for their time and insights:

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- Andy Halford
- Hemione Hudson
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- Mary Reilly
- Martin Scicluna
- Alan Stewart
- Alan Thomson
- Julia Wilson
- Guy Wilson

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