Audit Committee Roundup

Got a Pen? Five Critical Benchmarking Questions

By Mary Pat McCarthy

The best boardroom and audit committee discussions tend to be sparked by incisive questions (a director's stock in trade). To get a read on directors' concerns and priorities in the emerging business and regulatory environments, we asked a series of pointed survey questions at our Spring Audit Committee Roundtable series, held in 29 cities in May and June. These questions—about information quality, boardroom culture, risk oversight, and more—generated a healthy dialogue among the 1,300 directors and senior executives attending the sessions—and they're likely to trigger an enlightening discussion in your boardroom as well.

We've reprinted these questions for you in a survey format—to use as an informal benchmarking exercise—along with insights from the Roundtable discussions. (You'll find the national results on page 54.) At a time when expectations for effective oversight are extraordinarily high, and the business and regulatory landscapes are fundamentally changing, audit committee and board introspection is time well-spent.

How concerned are you that your board's ability to provide effective oversight is hampered by the quality, timeliness, and credibility of the information it receives?

Very concerned ___

Concerned ___

Somewhat concerned ___

Not concerned ___

If you're concerned, you're in good company. Most directors want to raise the bar on information quality: They want pre-meeting materials that are clearer, more focused, and better prioritized, with more industry benchmarking and less extraneous material.

We see leading boards working closely with management to determine the critical information the board requires, including the company's key performance indicators (KPIs) and risk information; and they're requesting information in a format that is clear and meaningful—e.g., graphs, heat maps, or other visualizations that show how various assumptions affect forecasts (what-if scenarios), concentrations of high/low performance, and industry/competitor comparisons. They're also seeking information from third parties (e.g., auditors, outside counsel, consultants) to test and complement the information that management provides.

> At a time when expectations for effective oversight are extraordinarily high, and the business and regulatory landscapes are changing, time invested in audit committee issues and board introspection is well spent.

To what extent does the culture of your organization encourage directors to question, challenge, and test management?

To a great extent ___

To a limited extent ___

Not at all ___

Normally, one size doesn't fit all—but in this case, there is a best answer: "To a great extent." To this end, leading boards and audit committees are more rigorously questioning, testing, and challenging management about the company's key risks and management's risk assumptions; and they're probing management on the implications of KPIs and risk information for the company's strategy, risks, operations, financials, and performance. As one Roundtable panelist noted, "This is not about embarrassing anyone; it's about getting to the heart of an issue." It's also about fully leveraging board members as a sounding board for management: a good question could turn the direction of a discussion—or a strategy—dramatically.

Does management have a discrete, formal process that identifies the key changes affecting the business, and links that information to its risk management efforts?

Yes ___

No ___

Change poses risk. Boards are recognizing the importance of having a formal process to link significant changes with the company's risk management efforts. The audit committee—which tends to have a good line of sight on these issues—can help by considering the adequacy of the company's process for identifying significant change and linking those changes to its risk management efforts, internal control processes, and compliance program. Internal audit can help connect the dots and communicate key areas of concern about these linkages. The board and audit committee should consider whether sufficient time is devoted to looking forward—toward the risks and opportunities posed by the company's strategy and the changing business landscape.

In which areas is your audit committee involved in helping to address the risks associated with the company's compensation plans? (Select all that apply.)

Reviewing compensation disclosures, including CD&A ____
Defining appropriate and accurate metrics to measure performance ____
Determining quality of data used to assess actual performance ____
Ensuring compensation arrangement does not encourage "excessive" risk ____
All of the above ____

Every audit committee should, at a minimum, review compensation disclosures, including Compensation Discussion and Analysis. But the audit committee also may be able to assist the compensation committee with determining appropriate metrics to measure performance, and to assess the quality of the data used to assess actual performance. Ensuring that incentives do not encourage "excessive" risk-taking goes to the broader task of risk oversight—and here some audit committees are indeed weighing in. The bottom line: Audit committee involvement is less a question of "if," and more a matter of "to what extent."

Generally, in which areas are today's boards "falling short"? (Select two.)

Leadership ____
Commitment/engagement of individual directors ____
Ability/willingness to challenge management ____
Board composition and skill sets ____
Willingness to address board performance ____
None/other ____

The highest vote-getters here were the third and fifth responses—which speaks to the increased focus by directors on board effectiveness. The changing regulatory landscape and the demands of investors, regulators, and legislators for governance reform have heightened the expectations for effective oversight. Boards are sharpening their focus on their own performance, including their ability and willingness to challenge management. For many boards, this will require shaking things up; for others, it will mean applying greater focus and intensity.

Next question: How would your fellow board members answer these questions?

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National Survey Results Audit Committee Roundtable Series

How concerned are you that your board's ability to provide effective oversight is hampered by the quality, timeliness, and credibility of the information it receives?

Very concerned – 9%
Concerned – 24%
Somewhat concerned – 42%
Not concerned – 25%

To what extent does the culture of your organization encourage directors to question, challenge, and test management?

To a great extent – 56%
To a limited extent – 37%
Not at all – 6%

Does management have a discrete, formal process that identifies the key changes affecting the business, and links that information to its risk management efforts?

Yes – 41%
No – 59%

In which areas is your audit committee involved in helping to address the risks associated with the company's compensation plans? (Select all that apply.)

Reviewing compensation disclosures, including CD&A – 28%
Defining appropriate and accurate metrics to measure performance – 17%
Determining quality of data used to assess actual performance – 23%
Ensuring compensation arrangement does not encourage "excessive" risk – 16%
All of the above – 16%

Generally, in what areas are today's boards "falling short"? (Select two.)

Leadership – 8%
Commitment / engagement of individual directors –16%
Ability/willingness to challenge management – 27%
Board composition and skill sets–19%
Willingness to address board performance – 26%
None/other – 4%

These survey results reflect responses from some 1,300 directors and senior executives attending Audit Committee Roundtable sessions in 29 cities during May/June 2009. Other key survey findings are provided in ACI's 2009 Spring Roundtable Report, available at www.auditcommitteeinstitute.com.