



THE FUTURE
OF THE AMERICAN
BOARD

AUDIT
COMMITTEE
BLUEPRINT

In Partnership With





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ABOUT THE KPMG BOARD LEADERSHIP CENTER

The KPMG Board Leadership Center (BLC) champions outstanding corporate governance to drive long-term value and enhance stakeholder confidence. Through an array of insights, perspectives, and programs, the BLC—which includes the KPMG Audit Committee Institute and close collaboration with other leading director organizations—promotes continuous education and improvement of public and private company governance. BLC engages with directors and business leaders on the critical issues driving board agendas—from strategy, risk, talent, and ESG to data governance, audit quality, proxy trends, and more. Learn more at kpmg.com/us/blc.

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About the Future of the American Board

What is the Future of the American Board Initiative? NACD convened the Future of the American Board Commission—a diverse, influential group of seasoned board leaders from top private and public companies and notable governance practitioners from across the investor, regulatory, and academic communities—to help guide boards through an increasingly turbulent and unpredictable future.

The Commission's perspectives and experiences shaped a [comprehensive framework](#) for board governance centered on 10 Key Principles that boards can use and adapt to ensure they are fit for the future. This framework, released in the fall of 2022, is accompanied by a set of practical blueprints, focused on the shifting roles of the key board committees, issued in the spring of 2023. Partners leading these working groups include KPMG (audit committee), Marsh McLennan (risk committee), Pearl Meyer (compensation committee) and Korn Ferry (nominating and governance committee).

What are the main takeaways? The report's 10 Key Principles provide guidance for boards that is rooted in progress American boards have made since NACD issued the first set of Key Agreed Principles in the wake of the global financial crisis of 2008. These updated principles are reflective of intensifying pressures and expectations that will affect companies and their governance in the coming years. Most important, in a world that seems less governable, the quality of board governance will be increasingly vital to the sustainability of our enterprises and trust in our market economy.

How to use the report and the committee blueprints: What is different about the report is that the Commission developed high-level principles with key questions that are meant to spur board discussion on critical improvements. The Commission understood that prescriptive, one-size-fits-all advice wouldn't be effective for individual boards and companies. The Commission expects that as boards confront these questions, they will come to different conclusions based on their level of maturity, the strategies they are pursuing, and the pressures they are facing. The four blueprints help translate the Commission's principles into practical guidance at the board-committee level.

About This Report

As part of NACD's Future of the American Board initiative, the KPMG Audit Committee Institute/ Board Leadership Center and NACD convened the Audit Committee Working Group. Its purpose was twofold. First, to identify what has changed, and will change, for audit committees—internal and/or external forces and factors having the greatest impact on the audit committee's work, responsibilities, agenda, and time. And second, to identify key areas of focus and emerging practices for audit committees to consider as they reassess their oversight processes and refine how the committee operates in an ever-more turbulent business and risk environment.

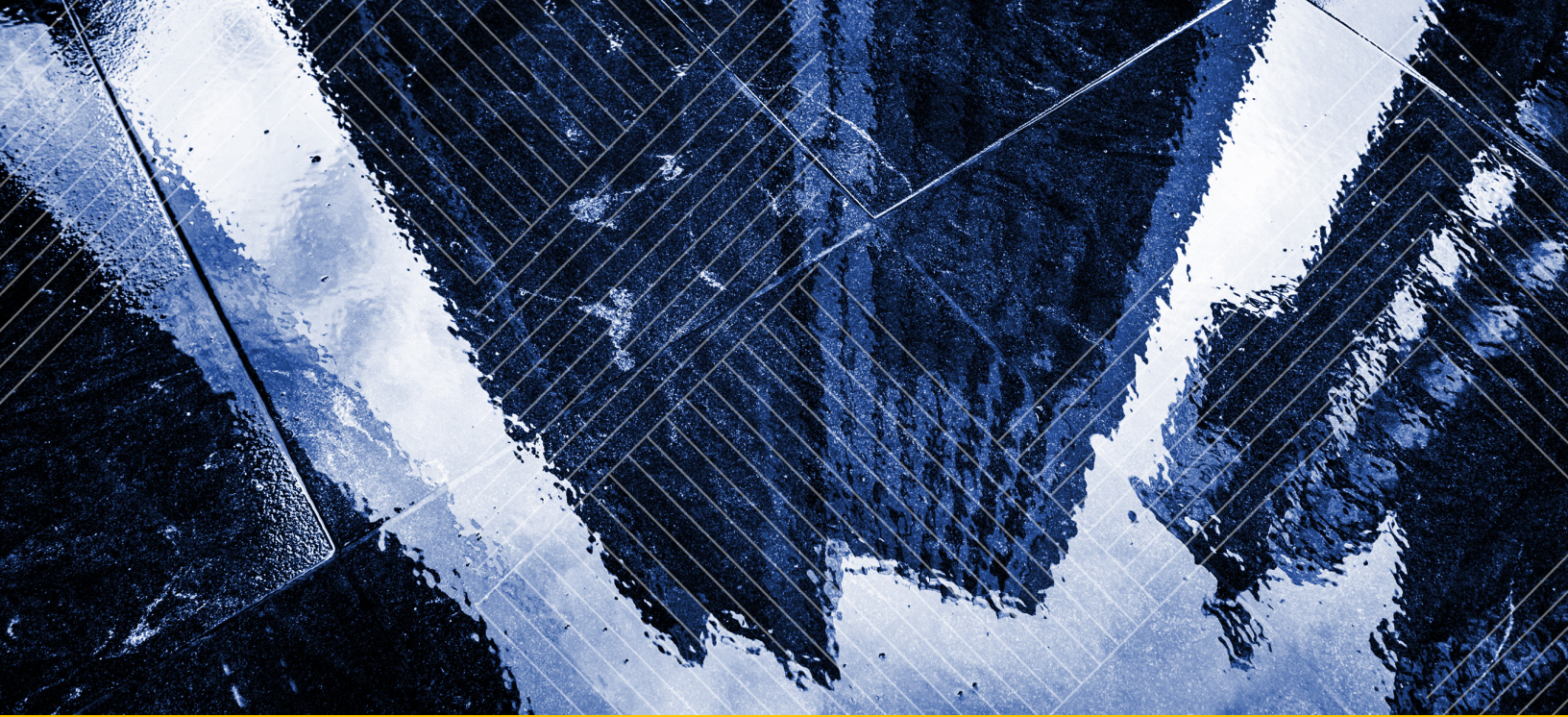
This report builds on some of the recommendations from the report of the NACD *Blue Ribbon Commission on the Audit Committee*,¹ which was issued in the wake of the global financial crisis to provide practical suggestions and highlight leading practices regarding audit committee effectiveness. Recognizing that audit committees and boards are at another inflection point, the insights from this report's diverse Working Group are designed to put audit committee effectiveness into fresh context. It also recognizes that each audit committee faces challenges unique to that committee, board, company, and industry.

The insights and suggested actions highlighted in this report can help every audit committee reassess its effectiveness at this pivotal moment for audit committees, boards, and Corporate America, and position itself for the future.

KPMG Audit Committee Institute / Board Leadership Center

National Association of Corporate Directors

¹ [Report of the Blue Ribbon Commission on the Audit Committee](#), National Association of Corporate Directors, 2010.



AUDIT COMMITTEE BLUEPRINT

Executive Summary

THE BIG PICTURE: WHAT'S CHANGED?

Our discussions with members of the Audit Committee Working Group focused on several fundamental questions about audit committee oversight that are acute today, starting with the big picture: what macro trends affecting audit committee practices, priorities, skill sets, and committee composition will be key going forward?

It's clear that the audit committee's core role—oversight of financial reporting, related controls, disclosures, and oversight of auditors—has not fundamentally changed. And principles from the 2010 *Report of the NACD Blue Ribbon Commission on the Audit Committee* still hold true. However, aspects of reporting itself are changing, and audit committees must stay current on developments in areas including environmental, social, and governance (ESG) issues, cybersecurity,² artificial intelligence, and geopolitics. At the same time, the increased complexity and uncertainty of the business and risk landscape have raised the stakes and increased the workload of audit committees. COVID-19, the Russia-Ukraine war, high-profile cyberbreaches, digital disruption, mounting climate risks, inflation, and economic dislocations are among the issues that continue to test audit committee and board practices and skill sets.

² There are differing views on whether "ESG" includes cybersecurity and related issues.

Several overarching themes emerged from the Working Group’s discussions:

- ▶ **Expanding risk oversight responsibilities.** The increasing complexity and unexpected interconnectedness of risks has put a premium on more holistic risk management and oversight. Many (if not most) audit committees today are shouldering heavy risk agendas and oversight responsibilities beyond their core responsibilities—for cybersecurity, data privacy, supply chain, geopolitical, and regulatory compliance risks, as well as oversight responsibility for all or aspects of management’s enterprise risk management (ERM) system and processes.
- ▶ **Expanding responsibilities for ESG oversight.** Demands from regulators, investors, employees, customers, and other stakeholders for action as well as increased disclosure and transparency—particularly around climate, cybersecurity, and ESG—continue to intensify. Many audit committees are evaluating what their role should be vis-à-vis their companies’ corporate sustainability reports and other ESG disclosures, as well as the selection of disclosure frameworks (to the extent not mandated by law or regulation). The US Securities and Exchange Commission (SEC) has been aggressive in identifying deficiencies in disclosure controls and procedures and in calling out “greenwashing.”
- ▶ **The game changer for audit committees: regulation of climate and other ESG disclosures by the SEC and foreign regulators.** The SEC’s disclosure proposals, particularly its climate proposal, as well as recent foreign sustainability reporting requirements—such as the European Union’s Corporate Sustainability Reporting Directive, which has an extraterritorial reach that may touch many US multinationals—are likely a game changer for audit committees. They greatly expand the committee’s workload and oversight responsibilities (including overseeing the company’s compliance with differing global ESG reporting regimes, and the external auditor’s attestation of green house gas emissions and other information required by global regulators) and require greater coordination with other standing committees than has historically occurred.
- ▶ **Increasing complexity of the audit committee’s core oversight responsibilities.** While the scope of audit committee oversight responsibilities has increased significantly, the committee’s core oversight responsibilities—for financial reporting, related controls, disclosures, and oversight of auditors—have also become more complex and demanding, particularly given the uncertain business and risk environment.
- ▶ **Impact of changing audit committee member skill sets—including reliance on one or two members as financial experts.** As the audit committee’s role and responsibilities continue to expand and evolve beyond its core oversight responsibilities, the skill sets of many audit committees have changed, or are in the process of changing. As audit committees add members with experience in IT, cybersecurity, climate, or other areas critical to the business, many audit committees may be relying on one or two members, such as the chair, to do the “heavy lifting” in the oversight of financial reporting and controls.

Members of the Working Group offered different viewpoints on the implications of these challenges to audit committee oversight and effectiveness. Based on their insights—as well as on recent KPMG Board Leadership Center/Audit Committee Institute research and ongoing dialogue with audit committees³—this report spotlights 10 critical areas of focus going forward (see the chart below).



³ See *On the 2023 Audit Committee Agenda* and other audit committee insights from the [KPMG Board Leadership Center/Audit Committee Institute](#).

As emphasized by the Working Group members, the 10 areas of focus are not fundamentally new. But our discussions put them into a new light and fresh context (some, including “critical alignments,” with a note of urgency). Taken together, they can provide the audit committee with a good overarching view—a framework—for reassessing and fine-tuning its oversight practices, skill sets, and leadership.

More broadly, the considerations and recommendations offered here can also help the audit committee support the full board’s consideration of risk oversight roles and responsibilities. Indeed, audit committees have long been an important voice and catalyst in sparking healthy discussions by the full board about risk oversight, corporate compliance, culture, and transparency.

Used in tandem with NACD’s *The Future of the American Board report*, the following recommendations can enrich those full-board, multi-committee discussions as the audit committee rethinks and fine-tunes its own effectiveness.



KEEPING PACE AND POSITIONING FOR THE FUTURE: 10 ESSENTIAL AREAS OF AUDIT COMMITTEE FOCUS

Financial Reporting and Related Expertise



Stay focused on financial reporting and related internal control risks—job number one—and ensure that audit committee members have and maintain a level of financial literacy and expertise essential to the task, as that task continues to evolve.

While the scope of audit committee oversight responsibilities has increased significantly, the committee's core oversight responsibilities—for financial reporting, related controls, disclosures, and oversight of auditors—have also become more complex and demanding. Indeed, the uncertain global business and risk environment has amplified a number of critical questions for today's audit committees, including these:

- ▶ Which financial reporting, accounting, and disclosure issues have been (or are becoming) the most challenging and the subject of substantial discussion by the audit committee?

- ▶ Do audit committee members have the level of financial literacy and expertise essential to ask intelligent, probing questions about financial information and the related risks and controls underlying such information? Are they able to assess the quality, not just the acceptability, of critical accounting policies, judgments, and estimates?
- ▶ Is the committee staying up to date with proposed or potential changes in accounting standards in areas such as ESG and taxes, as well as foreign regulatory changes that may affect the company and its disclosures?
- ▶ As the audit committee may seek members with experience in IT, cybersecurity, climate, or other areas critical to the business—who also have the skills and background to be good directors generally—is the committee relying on just one or two committee members, such as the chair, to do the “heavy lifting” in the oversight of financial reporting and controls?
- ▶ Is the committee maintaining a sharp focus on the company’s control environment, and is management regularly taking a fresh look at the control environment? Are controls, including disclosure controls and procedures, keeping pace with the company’s operations, business model, and changing risk profile, including cybersecurity risks and regulatory changes?

Working Group Observations

“We’re probably past the days of audit committees being comprised only of former CFOs and those with financial backgrounds. You might still see that in the chair role, but for audit committees to oversee all the other issues on the committee’s plate, you need a different mix of skill sets.”

“On my audit committee, the chair is the only real financial expert. I don’t think that is unique. I’m not saying it’s a bad thing, but it’s an interesting evolution to be aware of.”

“There needs to be more than one expert in financial reporting and controls on the committee so that there can be a dialogue among people who understand the issues. Otherwise, the reason for collective oversight is lost.”



FORWARD-LOOKING: CONSIDERATIONS AND ACTIONS

- ▶ **Level of financial literacy and expertise.** Periodically assess whether audit committee members have a level of financial literacy and expertise essential to the task—recognizing that those levels may change over time. In making the assessment, look beyond the stock exchange requirements and the SEC definition of an “audit committee financial expert,” and consider how many audit committee members are true financial experts—i.e., have substantial, firsthand career experience either in preparing or auditing financial statements of public companies. How many financial experts does the committee require, given the unique situation of the company and industry? What do audit committees of peer companies look like? Is the committee over-relying on one financial expert? Audit committee chairs should consider how they and other members of the committee are staying current on financial reporting developments. It can be helpful for audit committee chairs to share best practices with other audit committee chairs.
- ▶ **Company-specific factors.** Recognize that there is no one-size-fits-all solution and that the level and nature of financial reporting expertise will depend in part on the nature and complexity of the company’s business and transactions. For example, audit committees of companies in the insurance, energy, or banking industries may want (and need) financial experts with industry-specific experience dealing with complex technical accounting and auditing issues.
- ▶ **Assessing financial expertise.** In assessing whether the committee has the necessary financial expertise for today and tomorrow, other considerations might include these:
 - The financial reporting challenges posed by the complex economic and risk environment, e.g., asset impairments, credit impairments, fair value measurements, forecasting, revenue recognition, income taxes, and other accounting areas requiring significant judgment.
 - Internal control challenges posed by the geopolitical, macroeconomic, and risk environment, as well as changes in the business, such as remote work, acquisitions, new lines of business, digital transformations, etc.
 - Heightened fraud risk posed by remote work, economic uncertainty, the risk of recession, and the pressures on management. How robust are management’s processes to prevent and detect fraud?
 - Increased demands for transparency through disclosure, including SEC comment letter trends.
 - SEC rulemaking on climate, cybersecurity, and human capital management (HCM)—as well as new global ESG reporting requirements—are greatly expanding the responsibilities and workload of audit committees and the potential need for expertise (both financial reporting and non-financial reporting). Audit committees need to understand and assess the soundness of the methodologies and policies that management is using to develop its metrics and disclosures. Are the company’s internal controls and disclosure controls sufficient for ensuring the accuracy, reliability, and consistency of data, whether or not the disclosures are included in documents that are formally filed with the SEC or another regulator?

Risk Oversight



Continue to assess whether

- ▶ the risk oversight responsibilities assigned to the audit committee, beyond the committee's core oversight responsibilities, are reasonable in scope;
- ▶ the committee is the right standing committee to oversee each of those risk categories; and
- ▶ the potential interconnectedness of critical risks is being evaluated.

There are different views as to what risks should remain with the audit committee. Periodically reassessing the allocation of risk oversight responsibilities among the board and each of its standing committees is a healthy governance exercise.

Consider whether the audit committee is overloaded with other risk oversight responsibilities—such as cybersecurity, data privacy, supply chain, geopolitical, and ESG-related risks, as well as oversight responsibility for all or some aspects of ERM. The oversight of “mission-critical” risks, such as safety, may require more attention at the full-board level or perhaps the focus of a separate board committee.

If the audit committee has oversight responsibility for one or more of these risks, consider whether the committee has the requisite expertise among its members, or needs to engage experts as consultants or advisors to assist in discharging its oversight duties.

While risk and crisis readiness are clearly a matter for the full board, the audit committee should also probe with management into whether the company's crisis management plans reflect the company's changing risk profile (including emerging risks) and are robust, actively tested or war-gamed, and updated as needed.

Working Group Observations

“In most cases, audit committees have the board members who are most attuned to oversight, compliance, and controls, even if they are not deep accounting and financial reporting experts. We’ve talked about whether we should allocate some AC responsibilities for risk oversight to other committees, but what other committee is more competent than the AC to oversee management of cybersecurity and other risks that have their foundation in processes, controls, and related skills?”

“It’s important to make sure the audit committee has a ‘reasonable scope’ and that it’s the right committee of the board to oversee a risk—and whether the full board should be looking more closely at particular risks such as cybersecurity and IT that are so essential to a company’s strategy.”

“ERM has evolved a lot—not only how you do it, but how you prioritize given all the risks out there (inflation, people, cyber, geopolitical, etcetera), identifying the risks and assigning them to committees of the board. ERM once seemed to be disconnected from the business, but I’m now seeing it more as an umbrella—assessments, oversight, conversations, readiness.”

“As to cyber risk, data governance, ransomware, customer data, and payment data—crisis readiness is critical. Make sure the company is staying on top of its risk assessments, and tabletop exercises must have a place.”

“In industries where food safety and other health and safety issues are critical risks, I’m seeing a standing committee, such as a health and safety committee or a sustainability committee, as well as the full board providing close oversight of these risks.”

“Most boards have evolved their oversight of risk so that each major risk is assigned to a standing committee, and that standing committee runs point on the risk, and then it’s discussed at the full-board level.”

“There is a very strong alignment between our risks and our strategy. We regularly ask for the ‘disaster case’ for each of the company’s mission-critical risks. Essentially, we built a bespoke ERM system, so management is getting what it needs to run the business, with a better view of how mission-critical risks and opportunities connect.”



FORWARD-LOOKING CONSIDERATIONS AND ACTIONS

- ▶ **Take a holistic approach.** The increasing complexity and fusion of risks—such as geopolitical, economic, cybersecurity, data privacy, supply chain, compliance, climate, and others that are ESG-related, as well as risks posed by advances in digital technologies such as cloud computing, robotic process automation, machine learning, artificial intelligence (AI), generative AI, blockchain, quantum computing, and cryptocurrencies—require a more holistic approach to risk management and oversight. At the same time, investors, regulators, ESG rating firms, and other stakeholders are demanding higher-quality disclosures on cybersecurity, climate, and other ESG risks—and *more* disclosure concerning how boards and their committees oversee the management of risk.
- ▶ **Reassess the audit committee’s risk agenda.** Given this challenging risk environment, boards must periodically reassess the risks assigned to each standing committee. As part of this effort, it is essential that the audit committee periodically reassess whether the risk oversight responsibilities of the audit committee, beyond its core oversight responsibilities, are reasonable in scope and whether the committee is the right standing committee to oversee each category of risk oversight it has been assigned.
- ▶ **Help ensure that the audit committee’s and the full board’s oversight of cybersecurity risk is keeping pace.** Cybersecurity risk continues to intensify. The acceleration of AI and digital strategies, the increasing sophistication of hacking and ransomware attacks, the war in Ukraine, remote work, and ill-defined lines of responsibility—among users, companies, and vendors—have elevated cybersecurity risk. Boards have made strides in monitoring management’s cybersecurity effectiveness—for example, through adding board expertise, company-specific dashboard reporting, assessing cybersecurity talent, weighing vulnerabilities and emerging threats, war-gaming breach and response scenarios, and ongoing third-party risk assessments. Yet, the growing sophistication of cyberattacks underscores the challenge.

Audit committees and boards should continue to assess periodically whether their oversight is keeping pace, including their readiness—and management’s—for changes to SEC rules on cybersecurity disclosures.

- ▶ **Assess the committee’s skill sets beyond the core.** Does the committee include members with the experience and skill sets necessary to oversee areas of assigned risk beyond its core responsibilities—such as cybersecurity and data security, supply chain issues and geopolitical risk, and climate and other ESG risks and disclosures? Investors and regulators are focusing on the audit committee’s composition and skill sets.
- ▶ **Don’t just focus on the last crisis.** In thinking about risk oversight and crisis readiness, the committee and board should make certain that management is thinking about how new and emerging risks may play out, either individually or in combination—and that management is not just focused on the last crisis.
- ▶ **Periodically review the audit committee charter.** At least annually, the audit committee should review and reassess the adequacy of its charter and whether the charter clearly identifies the risks that have been assigned to the audit committee beyond its core oversight responsibilities.

ESG Risks and Disclosures



Clarify the role of the audit committee in overseeing the company's climate and other ESG risks—particularly the scope and quality of ESG/sustainability reports and disclosures—taking into account changing regulatory mandates.

What is the audit committee's role in overseeing ESG risks, including management's development of processes and controls to help ensure the quality of climate, human capital management (HCM), and other ESG disclosures—whether in SEC or other regulatory filings, voluntary sustainability reports, or on company websites? What is the audit committee's role in overseeing management's preparations for the SEC's final climate disclosure rules? What are the responsibilities of other standing committees for oversight of climate and other ESG risks? When the audit committee and another standing committee(s) have overlapping oversight responsibilities for an ESG risk, how do they coordinate oversight?

WORKING GROUP OBSERVATIONS

"At one company I'm involved with, management's disclosure committee formed a subcommittee, cochaired by the head of investor relations and a senior executive in financial reporting, charged with reviewing the ESG-related information contained in sustainability reports, the process for accumulating it, and the adequacy of controls around it. This subcommittee has changed the dynamics. We have a framework and organizational processes, and everyone understands that it's important. With issues like cyber and data privacy, I worry that no matter how much time we spend, it's never enough. From a regulatory and compliance standpoint, these issues are getting much more complex, particularly in light of differing global requirements."

"Audit committees are struggling with putting metrics out around ESG and what those metrics would be. Is the audit committee responsible for overseeing the integrity of ESG metrics?"

"Audit committees today need to focus on the quality of the information that their companies are including in their sustainability reports and elsewhere. But the SEC's climate rules will be a game changer, as audit committees will have to oversee these climate disclosures, including the role of management's disclosure committee in the preparation of those disclosures, as well as related disclosure controls and procedures."

"When multiple committees have oversight responsibilities, it's important to assign the overarching responsibility to one committee and have the chair of that committee actively collaborate with the other committee chairs to bring a full report out to the board. That process in and of itself encourages active engagement and collaboration across committees."



FORWARD-LOOKING CONSIDERATIONS AND ACTIONS

- ▶ **Recognize the increasing *stakeholder* demand for high-quality ESG disclosures.** The pressure from stockholders and other stakeholders on companies to make high-quality ESG disclosures continues to increase—and in many respects, institutional investors function as de facto regulators. And the plaintiffs’ bar is focusing, among other things, on disconnects between a company’s statements on ESG and the underlying facts as the basis for lawsuits.

The SEC continues to focus on the adequacy of ESG disclosures through comment letters (some of which question why disclosures in sustainability reports are not also included in SEC filings) and enforcement actions, and the European Union and certain countries are further down the rulemaking path than the United States.

Although there are efforts at ESG reporting convergence, global disclosure frameworks and requirements currently vary. ESG regulations may differ substantially among jurisdictions, including the ESG topics to be addressed and the level of disclosure required. Many companies, particularly multinationals, may be subject to more than one set of regulations in addition to demands from stockholders and other stakeholders. Such companies will have to navigate conflicting demands.

Some non-US jurisdictions and ESG frameworks utilize a definition of materiality that requires considering the impact of the company on the environment and society in addition to financial materiality—creating a much broader range of issues to address.

- ▶ **Plan now for implementation of the SEC’s climate disclosure rules.** The SEC rules will be a game changer and mark a shift from materiality and principles-based disclosures to specific disclosure of detailed information and data, and will require third-party assurance on certain matters. Management’s preparations for implementing the SEC’s climate disclosure rules—e.g., identifying and recruiting climate and ESG talent and expertise, developing internal controls, and putting in place technology and systems—will be a significant undertaking (likely taking months) and will require significant time and attention from the audit committee, board, and perhaps other standing committees. Audit committees and boards should plan now for how the SEC’s new climate disclosure rules—as well as global sustainability and other regulatory reporting requirements—will impact board and committee risk oversight responsibilities.
- ▶ **Periodically reassess how the board, through its committee structure, oversees the company’s material ESG issues.** Boards are taking a variety of approaches to oversight of climate and other ESG risks. For many, much of the heavy lifting is done at the committee level, which reports out to the full board. The compensation, nominating and governance, and audit committees all may have some responsibility. For example, the compensation committee may oversee human capital and executive compensation issues (including ESG metrics), and the nominating and governance committee (or in some cases, a sustainability committee) may have general oversight responsibility for ESG. Audit committees may have responsibility for oversight of impacts on the financial statements, controls governing the capture of this information, and ESG disclosures.

- ▶ **Coordinate oversight.** With standing committees playing a vital role in helping boards carry out their ESG oversight responsibilities, information sharing, communication, and coordination among committees and the full board are essential. Given the financial reporting and internal control implications associated with ESG risks, the issue is particularly acute for audit committees. Audit committees need to recognize the input that other committees require, and those committees must appreciate the information needs of the audit committee. Key areas in which information sharing is critical include these:
- Considering where ESG information is disclosed—e.g., sustainability reports, SEC filings, and company websites, and whether the information that is disclosed is consistent, regardless of where disclosed
 - Helping to ensure that voluntarily disclosed ESG information is subject to a high level of rigor—and that management’s disclosure (or similar) committee includes individuals, such as the head of sustainability and chief human resources officer, who have the line of sight and skills to vet the company’s ESG disclosures
 - Selection of the company’s ESG reporting framework(s)—the SEC climate proposal is based in part on the Task Force on Climate-related Financial Disclosures framework
 - The role and composition of management’s disclosure committee (versus management’s ESG team or committee) in connection with ESG disclosures (whether voluntary or mandatory), as well as coordination between those committees

Talent in the Finance Organization



Focus on leadership and talent in the finance organization, and whether finance has the talent and skill sets to meet the evolving corporate reporting landscape as well as the organization's information technology needs.

Finance organizations face a challenging environment today, including addressing talent shortages while managing digital strategies and transformations and developing robust systems and procedures to collect and maintain high-quality ESG data and comply with evolving domestic and foreign data privacy and data protection regulations. Quality corporate data is needed to meet investor and other stakeholder demands and to comply with existing and anticipated laws and regulations. At the same time, many are contending with the fundamental difficulty of forecasting and planning in an uncertain environment.

Given the evolving challenges and role of the chief financial officer (CFO), it is critical for the audit committee to stay attuned to the needs of the CFO and the finance organization. Does finance have the necessary leadership, talent, skill sets, and other resources?

WORKING GROUP OBSERVATIONS

"The role of the CFO has expanded in recent years. The CFO is now leaning in on operations, is the face to the Street, the right hand of the CEO, driving business transformations and strategy, managing the finance organization and the internal control environment. It is critical that the CFO find the right balance."

"The audit committee must set clear expectations for the CFO and foster robust, two-way communications with the CFO."

"Succession planning for the CFO is a priority. Once a year, we focus on the senior financial leadership that the board typically does not see so that we can understand the strength of the talent pipeline and identify would-be successors to the CFO."

"If the board has to tell the CFO it's 'okay to hire,' that's a problem; it's too late. The CFO needs to be ahead of the audit committee, doing what needs to be done."

"Audit committee support of the CFO and finance team has really become more critical today—helping them to maintain focus on the long-term financial performance, insisting on objectivity in financial disclosures, and helping ensure that the organization's strategic financial reporting initiatives have the right level of prioritization and resources."



FORWARD-LOOKING CONSIDERATIONS AND ACTIONS

As audit committees monitor and help guide finance's progress in these areas, we suggest three areas of focus:

- ▶ **ESG teams and skill sets.** Many finance organizations have been assembling or expanding management teams or committees charged with managing a range of ESG activities, including enhancing controls over voluntary ESG disclosures and preparing for the SEC's climate disclosure rules. These teams and committees often include members from outside the finance organization who have skills/expertise in climate or other ESG areas. How far along is the finance organization in its preparations for new/enhanced ESG disclosures? And does finance need an ESG controller?
- ▶ **Digital strategy and data-driven insights.** The acceleration of digital strategies and transformations continues to affect finance organizations, presenting important opportunities for finance to add value to the business. As the finance function seeks to combine strong analytics and strategic capabilities with traditional financial reporting, accounting, and auditing skills, its talent and skill-set requirements must change accordingly. Is finance attracting, developing, and retaining the talent and skills necessary to match its evolving needs, recognizing that inadequate staffing may pose a potential risk of an internal control deficiency?⁴ Are the data and analytics that the finance function generates being fully leveraged—by management, the board, and the audit committee—to add insight and support forward-looking discussions about the company's critical risks and strategy?
- ▶ **CFO role and pipeline.** Understand the scope of the CFO's responsibilities, set clear expectations, agree on priorities, insist on transparency, and support the CFO. Make succession planning for the CFO, as well as bench strength in the finance organization more generally, a priority.

⁴ Amanda Iacone, "Accountant shortage, resignations fuel financial reporting risk," Bloomberg Tax, February 14, 2022.

Audit Quality



Reinforce the importance of audit quality and set clear expectations for frequent, candid, and open communications with the external auditor.

The audit committee should set clear expectations for frequent, candid, and open communications between the external auditor and the audit committee—beyond what’s required—particularly regarding the company’s culture, tone at the top, and the quality of talent in the finance organization. Consider the quality of the auditor’s insights regarding how the company’s financial reporting and related internal control risks have changed in light of the geopolitical, macroeconomic, and risk landscape.

WORKING GROUP OBSERVATIONS

“Setting expectations is key. Make it clear that the audit committee wants and needs frequent, informal communications with the audit engagement partner. And auditor independence is essential.”

“As chair, I meet with the engagement partner prior to each committee meeting—or often more frequently—to consider the issues that should be on the committee’s agenda and to stay abreast of developments.”

“Aside from audit results, ask the external auditors if they’re seeing anything interesting in the data and information they’re generating from their audit work.”

“What are the increased risks posed by more audit work—both external auditor work and internal auditor work—being conducted remotely? Are auditors missing some red flags that might have been picked up if working on-site?”



FORWARD-LOOKING CONSIDERATIONS AND ACTIONS

Continually reinforcing audit quality and transparency requires a sustained focus on these issues:

- ▶ **Tone and expectations.** Audit quality is enhanced by a fully engaged audit committee that sets the tone and clear expectations for the external auditor and monitors auditor performance rigorously through frequent, quality communications and a robust performance assessment.⁵
- ▶ **Internal controls.** In setting expectations, audit committees should discuss with the auditor how the audit of the company's financial reporting and related internal control risks has changed in light of the geopolitical, macroeconomic, and risk landscape—including supply chain disruptions, cybersecurity, inflation, interest rates, market volatility, climate change and other ESG issues, as well as remote work and changes in the business. Relatedly, how has the auditor updated its risk assessment approach?
- ▶ **Open communications.** The list of required communications is extensive, and includes matters about the auditor's independence, as well as matters related to the planning and results of the audit. But taking the conversation beyond what's required, particularly regarding the company's culture, tone at the top, and the quality of talent in the finance organization, can enhance the audit committee's oversight. It can also create space for a discussion around dynamic or emerging issues arising from the audit. Topics for discussion with the external auditor include changes in the audit plan, the audit budget, staff turnover, engagement team workload (including excessive overtime), how the engagement team is using AI to improve the efficiency of the audit, milestones throughout the year, engagement partner selection (if applicable), and audit engagement fee negotiations.
- ▶ **Audit firm's quality controls.** Audit committees should also probe the audit firm on its quality control system, which is intended to drive sustainable, improved audit quality—including the firm's implementation and use of new technologies. What are the risks posed by more of the audit process being conducted remotely? In discussions with the external auditor regarding the firm's internal quality control system, consider the results of Public Company Accounting Oversight Board (PCAOB) inspections, Part I and Part II, and internal inspections and efforts to address deficiencies.⁶ Remember that audit quality is a team effort, requiring the commitment and engagement of everyone involved in the process—the auditor, audit committee, internal audit, and management.

⁵ See the Center for Audit Quality [External Auditor Assessment Tool](#).

⁶ PCAOB inspection reports have a public portion (Part I), and most include a nonpublic portion discussing the audit firm's quality controls (Part II). See [Guide to PCAOB Inspections](#), Center for Audit Quality.

Internal Audit's Value



Make sure internal audit is focused on the company's key risks, including emerging risks—beyond financial reporting and compliance—and is a valued resource to the audit committee.

At a time when audit committees are wrestling with heavy agendas—and issues like ESG, supply chain disruptions, cybersecurity, data governance, and global compliance are putting risk management and compliance to the test—does internal audit serve as a valuable resource for the audit committee and a crucial voice on risk and control matters? Does internal audit focus not just on financial reporting and compliance risks, but on critical operational and technology risks and related controls, as well as culture, ESG, and emerging risks? Are disclosure controls and procedures and internal controls a key area of internal audit focus? Help ensure that internal audit has the resources, skills, and expertise to succeed.

WORKING GROUP OBSERVATIONS

"Internal audit should be viewed by management as the team they can't do without, instead of as the team management wants to avoid. There is often a perception that IAs are 'gotcha' people."

"I think that internal audit is much more valuable when they are more holistic and strategic. They can be a sensor of trouble signals in the larger organization early on. This requires mature leadership and partnership with the C-suite."

"Internal auditors are highly skilled at mapping risks—looking at the universe of risk, how it's mapped, analyzed, mitigated, and prioritized."

"Among the top five risks that internal auditors are focusing on today, I see talent, cybersecurity, supply chain, fraud, and ESG. Does internal audit need new talent? Yes. There is a need to upskill."

"Internal audit is looking at a broader portfolio of risk today, so they need people with new skill sets. They don't need to be a jack-of-all-trades, but they do need to have a deep enough understanding of the issue to assess the risk."



FORWARD-LOOKING CONSIDERATIONS AND ACTIONS

- ▶ **Align priorities.** If internal audit is to be a valuable resource to the audit committee and a crucial voice on risk and control matters, it is essential that there is clear alignment between the audit committee and the chief audit executive (CAE) as to internal audit's priorities. This means focusing not just on financial reporting and compliance risks, but on critical operational and technology risks and related controls, as well as on culture, ESG, and emerging risks.
- ▶ **Make ESG risks and controls a priority.** As ESG risks are rapidly evolving, disclosure controls and procedures and internal controls should be a key area of internal audit focus. Clarify internal audit's role in connection with ESG risks and ERM more generally—which is not to manage risk, but to provide added assurance regarding the adequacy of risk management processes.
- ▶ **Assess internal audit's skill sets and talent pipeline.** With the tight labor market, does internal audit have the talent it needs? Recognize that internal audit is not immune to talent pressures.
- ▶ **Audit plan flexibility is key.** Reassess whether the internal audit plan is risk-based and flexible enough to adjust to changing business and risk conditions. The audit committee should work with the CAE and chief risk officer to help identify the risks that pose the greatest threat to the company's reputation, strategy, and operations, and to help ensure that internal audit is focused on these key risks and related controls. What's changed in the operating environment? What risks are posed by the company's digital transformation, remote work, and the company's extended organization: sourcing, outsourcing, sales, and distribution channels? Is the company sensitive to early warning signs regarding safety, product quality, and compliance?
- ▶ **Set expectations.** Set clear expectations for internal audit and help the CAE think through the impact of digital technologies on the internal audit function.

Transparency



Insist on transparency—both internal and external—among the board/audit committee, management, and the internal and external auditors.

Good external transparency hinges on achieving internal transparency (including information quality and flow) and communications among the board/audit committee, management, auditors, and other key players in the organization. Is there a culture of candor? The information the committee receives should be high quality, balanced, from a variety of sources, and presented in a fashion that offers insight and highlights issues and trends for consideration. Ultimately, the audit committee needs to receive the information that is essential to providing effective oversight of the company's financial reporting, internal controls, ERM processes (or assigned aspects of ERM), finance team, and the internal and external auditors.

Recognize the inherent information asymmetry challenge—of management being the primary source of the board's information—and consider whether the board should be hearing more third-party perspectives on issues such as emerging risks. Management should brief the board on what it learns from engagement with the company's largest shareholders and other key stakeholders.

More than ever, investors and other stakeholders want to understand how the audit committee carries out its oversight. Consider how the audit committee's proxy disclosures could provide investors and stakeholders with a fuller picture of the audit committee's oversight responsibilities and how the committee executes those responsibilities—beyond what is technically required.

WORKING GROUP OBSERVATIONS

"There is a natural reluctance by management to provide too much information to the audit committee. The materials have to be high quality and robust, but not excessive in quantity, so that the audit committee can understand the issues and do its job."

"I'm seeing many audit committees expanding their proxy disclosures and increasing their transparency regarding the committee's composition and oversight responsibilities."

"Make sure the committee is getting information, not just data, from business and functional leaders as well as internal and external auditors. With real information, the committee will be in a position to discuss and provide insight regarding the critical issues facing the business and probe whether everyone at the table understands the risks, how the risks are being mitigated, what controls are in place, and whether the controls are working."



FORWARD-LOOKING CONSIDERATIONS AND ACTIONS

In setting expectations for candid communication and quality information, the audit committee should keep the following considerations front and center:

- ▶ **Trust and reputation.** Given the unprecedented events of the past few years—a fast-changing regulatory environment, economic and supply chain challenges, increased ransomware attacks and other cybersecurity risks, along with demands for greater action on climate and other ESG issues—trust and transparency are more important than ever, not only to investors and the capital markets, but also to customer relationships, brand reputation, and the health and well-being of employees.
- ▶ **Pressures on financial reporting.** For investors and other stakeholders, much of that trust and transparency is grounded in the quality of a company’s financial reporting and disclosures, and the story they tell. The turbulence and disruptions of the past few years have added significant stress and strain to financial reporting processes and the risk and control environment, and that pressure is likely to continue.
- ▶ **Assessing transparency.** We recommend two key areas of focus for the audit committee in assessing transparency:
 - Is the audit committee satisfied with the level of internal transparency, including information quality and flow and communications among the board/audit committee and management, auditors, and other key players in the organization?
 - Does the company’s proxy tell the audit committee’s story—or is it mostly boilerplate? Given the audit committee’s critical oversight role, it is important for investors and stakeholders to understand and have confidence in the committee’s work. Consider ways to enhance the audit committee’s reporting and communication with investors and stakeholders.⁷

⁷ See the Center for Audit Quality *2022 Audit Committee Transparency Barometer*.

Compliance and Culture



Closely monitor the tone at the top and organizational culture—particularly across the finance / financial reporting function—with a sharp focus on yellow flags and behaviors (not just results).

In times of disruption, economic slowdown, remote work, pressure for results, and employee turnover, a culture of compliance throughout the organization is essential, and it starts with the tone at the top. At a practical level, are the company's regulatory compliance and monitoring programs up to date? How does the company mitigate third-party/vendor compliance risk? How effective is the company's whistleblower reporting process?

WORKING GROUP OBSERVATIONS

"You have to create an environment in which people feel that they can speak up and say, 'We don't have the resources we need to do what you are asking.'"

"Watch for 'repeat offenders.' They are often a symptom of a poor culture, and they raise questions about integrity and openness. Are the finance, compliance, and internal audit functions 'empowered,' or is there a culture that discourages leaning in too far?"

"The audit committee needs to develop a close relationship with the chief compliance officer—and open, candid communications are key."

"Excessive turnover on the board or in management is a bad symptom. Management knows more than we do, and excessive or fast departures are usually an indicator of a problem."



FORWARD-LOOKING CONSIDERATIONS AND ACTIONS

Effectively overseeing the company's compliance activities—and understanding the underlying culture—requires a sharp focus on the following:

- ▶ **Tone at the top.** The reputational costs of an ethics or compliance failure are higher than ever, particularly given increased fraud risk, pressures on management to meet financial targets, and increased vulnerability to cyberattacks. The right tone at the top and culture throughout the organization (including commitment to its stated values, ethics, and legal/regulatory compliance) is fundamental to an effective compliance program. This is particularly true in a complex business environment, as companies move quickly to innovate and capitalize on opportunities in new markets, leverage new technologies and data, and engage with more vendors and third parties across complex supply chains.
- ▶ **Yellow flags and behaviors.** Closely monitor the tone at the top and culture throughout the organization with a sharp focus on behaviors (not just results) and yellow flags. Is senior management sensitive to ongoing pressures on employees, employee health and safety, productivity, and employee engagement and morale? As we have learned, leadership and communications are key, and understanding and compassion are more important than ever. Does the company's culture make it safe for people to do the right thing? It is helpful for directors to get out in the field and meet employees to get a better feel for the culture. Help ensure that the company's regulatory compliance and monitoring programs are up to date, cover all vendors in the global supply chain, and communicate the company's expectations for high ethical standards.
- ▶ **Whistleblower reporting.** Focus on the effectiveness of the company's whistleblower reporting channels (including whether complaints are being reported), investigation processes, how complaints are resolved, and any related trends. 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? With the radical transparency enabled by social media, the company's culture and values, commitment to integrity and legal compliance, and its brand reputation are on full display.
- ▶ **Department of Justice's Sentencing Guidelines.** Discuss with counsel the efficacy of the company's compliance program in the context of the Federal Sentencing Guidelines.⁸

⁸ See the Department of Justice's updated policies on criminal enforcement for corporate misconduct, as announced in its "[Monaco Memo](#)" in September 2022, and the [United States Attorney's Offices' Voluntary Self-Disclosure Policy](#), announced in February 2023, which sets a national standard for circumstances under which companies may receive credit for voluntarily self-disclosing criminal conduct.

Critical Alignments



Help maintain critical alignments throughout the organization—culture, purpose, strategy, goals, risks, compliance, controls, incentives, performance metrics, and people.

During times of dramatic change, the risk of misalignment—of culture, purpose, strategy, goals, risks, compliance, controls, incentives, performance metrics, and people—goes up exponentially. Management needs processes to link changes in the company’s risk profile, including those posed by changes to the business, to the company’s strategy and risk management efforts, its internal control processes, and its compliance program. Going forward, it will be more important than ever for internal audit to help identify and communicate key areas of concern about these linkages.

Given the speed of change—and the velocity of risk—management may need to assess the company’s critical alignments on a more frequent basis than in the past.

While it is the responsibility of management to maintain these alignments, audit committees are in a unique position to oversee management’s efforts.

WORKING GROUP OBSERVATIONS

“Over the past few years, maintaining critical alignments has been a major challenge for management teams—and a huge area of risk in itself. I’m not sure that the topic gets the focus that it should.”

“This has to be a key area of oversight for the full board and each standing committee, as they all have a different line of sight into the issue.”

“Internal audit clearly needs to take a close look at critical alignments, but the issue needs to be a priority for every business unit and function throughout the business. And there needs to be a robust management process so management and the board communicate about these alignments.”



FORWARD-LOOKING CONSIDERATIONS AND ACTIONS

To help ensure that management has in place the necessary processes for proper linkage between the array of activities that must be aligned (and realigned) as significant changes occur and risks develop—as well as effective oversight of those processes—we suggest the following areas for audit committees to probe:

- ▶ **Risk inventory.** Does management have a full current inventory of the company's critical risks, and how/how often is the inventory updated? How has the company's risk profile changed? What emerging/evolving risks have been added to the risk radar? What's missing?
- ▶ **Changes in the business.** Has management identified the risks posed by changes in the business—whether a change in people, business processes, technology, products, or business models? Change creates risk, and an important part of any discussion about change and risk is “complexity”: the greater the complexity, the greater the risk. Every company should, at a minimum, consider the need for a formal process to identify the significant changes—planned and unplanned—taking place in the business and the risks these changes pose.
- ▶ **Communicating changes.** Is there a formal process to update and link changes in the company's risk profile, including risks posed by changes taking place in the business, to the company's risk management efforts, its internal control processes, and its compliance program? Changes in the company's risk profile pose internal control and compliance issues. It is essential that any changes be communicated throughout the organization so that appropriate risk mitigation activities, internal controls, and compliance initiatives can be implemented. A formal process to ensure that this communication takes place—and that proper linkages are established—is key.
- ▶ **Internal audit's role.** Does internal audit proactively identify new and emerging risks and help articulate how these risks are managed across the organization? This requires that internal audit have a “seat at the table,” is capable of anticipating emerging risks, and that it takes the initiative to adjust audit plans and activities as changes in the business, the company's risk profile, the control environment, and the compliance environment occur.
- ▶ **Coordinated oversight of critical alignments.** Do the audit committee and other standing committees effectively coordinate their oversight of management's critical alignments, including management's processes to maintain these alignments? The audit committee and the full board play a key role in helping to ensure that—from top to bottom—management's goals, objectives, and incentives are properly aligned, that performance is rigorously monitored and assessed, and that the culture throughout the organization is “right.” Information sharing and communication/coordination among the board's standing committees regarding these critical alignments is vital.

Audit Committee Focus and Effectiveness



Make the most of the audit committee's time together; effectiveness requires efficiency and advance preparation.

The first two areas of focus discussed above emphasize the importance of audit committee composition and skill sets—including financial reporting expertise as well as members with the experience and skill sets necessary to oversee areas of risk beyond the committee's core responsibilities. While audit committee composition and skill sets are essential to the committee's effectiveness—and should be reassessed at least annually—meeting the workload challenge requires efficiency and advance preparation as well.

WORKING GROUP OBSERVATIONS

"The frequency of audit committee meetings has increased to handle the workload. On one of my audit committees, each year we have four in-person meetings, plus four telephonic meetings. In addition, we have at least four other meetings each year—not considered formal audit committee meetings—to take deep dives on critical audit matters, legal matters, and various other developments important to our oversight."

"Our audit committee has expanded the number and length of audit committee meetings and we're doing more work in between. The chair goes deep with the CFO and CAE between meetings so we can cover issues more efficiently during committee meetings."

"The chair makes sure that there is a comprehensive pre-read, and we don't talk about pre-reads during committee meetings. We use that time to talk about the latest concerns."

"Based on the skills of other members of the audit committee, the chair asks them to take the lead on something within their skill set—to ask probing questions. It's not delegating to one member. It's engaging the rest of the committee and leveraging any unique skills and experiences they bring to the table."

"Rotation of the audit committee chair is a challenge. I think the issue is that boards get comfortable. I keep volunteering to resign, but each year they ask me to remain as chair for one or two more years."

"It makes sense to have the heir apparent on the audit committee for a few years before taking on the role of chair, but you have to balance that with using the audit committee as a stepping stone for new board members. We have new members serve on the audit committee for two years as a learning experience."



FORWARD-LOOKING CONSIDERATIONS AND ACTIONS

- ▶ **Improving effectiveness and efficiency.** In assessing opportunities to improve the committee's efficiency and effectiveness, consider:
 - Streamlining committee meetings by insisting on quality pre-meeting materials (expecting pre-read materials to have been read) and making use of consent agendas
 - Whether financial reporting and compliance activities can be addressed more efficiently with management and auditors, freeing up time for discussion of more substantive issues facing the business
 - Leveraging the array of resources and perspectives necessary to support the committee's work, including seeking out a variety of third-party views and information sources
 - Spreading the workload, rather than relying on the audit committee chair to shoulder most of the work
 - Spending time with management and the auditors outside of the boardroom to get a fuller picture of the issues and develop strong relationships
 - Taking a hard, honest look at the committee's composition, independence, and leadership. Is there a need for a fresh set of eyes? Is it time for a rotation of the chair and/or committee members?
 - Assess the culture of the audit committee. Is the committee being too passive in simply receiving management presentations at meetings? Is most meeting time devoted to discussion and questions versus management presentations?
 - Conducting robust self-assessments of the audit committee's effectiveness

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