

For the Audit Committee Leadership Network

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Audit Committee Agendas

About this document

InSights is produced by Tapestry Networks to provide assessments of key issues of interest to audit committees. Anyone who receives *InSights* may share it with those in their own network. The ultimate value of *InSights* lies in its power to help all constituencies develop their own informed points of view.

Formed in 2003, the Audit Committee Leadership Network (ACLN) is a group of audit committee chairs from leading companies committed to improving the performance of audit committees and enhancing trust in financial markets. More recently, regional networks have been formed, comprising audit chairs from companies based in the North Central and Mid-Atlantic regions. These networks are all convened by Ernst & Young and coordinated by Tapestry Networks to access emerging best practices and share insights into issues that dominate the new audit environment.

Why the focus on audit committee agendas?

At a recent ACLN meeting, members said it would be helpful to understand how audit committees have adjusted their priorities following the passage of the Sarbanes-Oxley Act in 2002. Since committee priorities are generally reflected in their meeting agendas, Tapestry Networks contacted members of the ACLN, the Mid-Atlantic Audit Committee Network, and North Central Audit Committee Network. The following audit committee chairs shared committee agendas, responded to a survey, or participated in a telephone interview:

- Jim Adams, Texas Instruments
- Dan Akerson, American Express
- Jim Boland, The Goodyear Tire & Rubber Company
- Jim Brady, Constellation Energy Group
- Jim Broadhurst, National City Corporation
- Bob Burt, Pfizer
- Scott Cowen, Newell Rubbermaid
- Gene Fife, Caterpillar
- Michael Gellert, Humana
- Roland Hernandez, Wal-Mart
- Charlie Hopkins, Charming Shoppes
- Bill Jews, MBNA
- Vic Lund, Borders Group
- Mike Ressner, Magellan Health Services
- Mary Schiavo, Worthington Industries
- John Schwieters, Smithfield Foods
- George Smart, FirstEnergy Corporation
- Sandy Warner, General Electric Company

Several themes emerged from their responses. With audit committees working harder than ever before, this issue of *InSights* has been developed to help committee chairs understand:

- The need to balance routine and discretionary agenda items in the face of longer and more frequent meetings
- How to use committee meetings to assess the quality of the finance organization
- The role of the chair in driving the audit committee's priorities

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Executive Summary

1. **Audit committees: more meetings, longer hours, and added detail** *(pages 3-4)*

Since the passage of Sarbanes-Oxley, audit committee meetings have grown longer and more frequent, with members reporting an average of 18 hours in audit committee meetings over the course of a typical year. Increasing time is being dedicated to compliance, but some members worry that a check-the-box, regulatory focus is inconsistent with the need to review broader risk questions. Members describe an increased emphasis on detail, driven by a renewed appreciation of the committee's responsibilities.

Several members described techniques that help their committees make the best use of time in their face-to-face meetings. These include issuing interim reports and white papers, and holding informal dinners with management.

2. **Presentations: more interactive and more from middle management** *(pages 4-5)*

Management presentations are an important part of the audit committee's agenda, yet chairs feel they need to be less structured and more interactive. In addition to hearing from the chief financial officer (CFO), many committees also want to hear directly from mid-level finance managers in order to evaluate the capabilities of the entire finance team and assess the tone at the top.

3. **The audit committee chair: acting as a clearinghouse between meetings** *(pages 5-6)*

Despite the fact that there is a structured framework for planning audit committee agendas, the chair plays a key role in ensuring that the committee stays focused on the most important issues. As the primary contact with the external auditor and management, the chair also determines which issues and information require the attention of the full committee between regularly scheduled meetings. The increase in e-mail communications between meetings may raise important process and liability questions.

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1. Audit committees: more meetings, longer hours, and added detail

Sarbanes-Oxley has contributed to increased regulatory responsibilities for audit committees, but several committee chairs describe the benefits of recent changes. One audit chair said, *“We are moving toward better-quality discussions and less formal presentations from management and auditors.”* Another noted, *“There is a higher sense of responsibility for [carrying out] the duties of a board member. We do not tolerate passivity on [the] board. Being an active player is encouraged.”*

Many extra hours

One evident change is that audit committees are meeting more often. On average, they meet 10 times a year; half these meetings are held in person and half on the telephone. Members say that committee meetings held in person average about two-and-a-half hours in length, while telephone meetings tend to have a more focused agenda, with an average length of one hour.

As a result of the increase in the length and frequency of meetings, some audit committees now meet for more than double the number of hours they met in the past. A recent survey of Fortune 500 organizations reported that their audit committees meet an average of 19.7 hours per year, up from 12.9 hours pre-Sarbanes-Oxley.¹ Network members reported similar increases, and average nearly 18 hours in audit committee meetings over the course of the year. One ACLN member said, *“the pressures of Sarbanes-Oxley and the PCAOB [Public Company Accounting Oversight Board] have caused us to change. The length and complexity of the meetings have definitely been altered.”*

Agendas follow a predictable pattern

Most companies create an annual calendar (also described as a matrix or roadmap) that is driven by the audit committee charter and any accompanying risk management framework. One ACLN member described the roadmap as *“the full board’s direction to the audit committee. Audit committee membership and direction is the board’s concern.”*

The basic framework for many audit committee agendas is routine and predictable. For example, one North Central member said that in January or February they review year-end audit reports, in the spring they review the management letter and the external and internal audit plans, in late summer or early fall they look at trends and issues, and at year-end they handle other reporting.

Balance between routine and discretionary activity

While most members reported an even balance between routine and discretionary items, some said that up to two-thirds of the agenda was focused on routine items, while a few described a primary emphasis on discretionary items. Members did not come to agreement on whether Sarbanes-Oxley has caused a shift in the time spent on routine activity relative to discretionary activity. One North Central member observed that *“Sarbanes-Oxley has influenced our agenda greatly.”* However, others said that while Sarbanes-Oxley has increased the number and length of meetings, it has not altered how time is divided between routine and discretionary work.

¹ Institute of Internal Auditors Research Foundation, *“The Sarbanes-Oxley Act of 2002: Effect on Audit Committee Meetings at Publicly Traded Companies,”* March 18, 2004, 2.

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One member provided the following examples of discretionary items recently discussed by one of his audit committees:

- business risks (e.g., hedging strategies using derivatives, etc.)
- transactions (equity investments, related-party transactions, etc.)
- reviews of finance and accounting team and organizational structure
- review of liquidity and financial analysis

One North Central member said Section 404 internal control requirements have led to *“an inordinate amount of time being spent on [this issue], and not as much as there should be on [other issues].”* This member was concerned that a check-the-box, regulatory focus has reduced the amount of time the committee can devote to dealing with important questions regarding other risk issues.

Increased attention to detail

ACLN members reported that the committee is increasingly looking for inconsistencies and is approaching its role with a greater attention to detail. One member said, *“On one level it’s refreshing, but it’s a ... lot of work.”* Another member supported this detail orientation, saying that *“instead of going through required things routinely, everyone takes a real interest in anything that looks other than 100%.”*

Making the most of meeting time

During our conversations with network members, we identified several practices that help the audit committee make the most of the time it spends together in person.

- Issuing interim reports between meetings

One audit chair increased the amount of discussion time available in meetings by asking management to distribute two-to-eight-page interim reports covering non-controversial, routine financial items. Six or seven such reports are generally issued between audit committee meetings.

Another network member described “White Papers,” commissioned three to four times a year by the audit committee, in which business units are asked to describe how they generate earnings. The committee is able to understand key business and accounting issues better with the context these reports provide.

- Interacting informally with management

Another audit committee has an informal dinner meeting with two or three members of management each year. The audit chair said that, *“there is so much material to get through, we [can’t] cover it in our audit committee, and everybody wants to cover it.”* Dinner provides an opportunity to meet in an informal setting, leading to a more collaborative relationship with management.

2. Presentations: more interactive and more from middle management

Members said that management regularly presents to the audit committee. In some cases, these presentations are formal updates about well-understood operations or results. In other cases, they enable a deeper look into an operation or risk area that the committee would like to understand better. While nearly every audit committee obtains regular input from the external auditor and senior executives (including the CFO, CEO, controller, general counsel, and internal chief audit executive), some network members see ways to improve the quality of the input they receive.

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Presentations need to be interactive

Members said that most presentations are 20-30 minutes long, split evenly between presentation and discussion. Although most members allow the use of PowerPoint slides, several observed that presentations often feel overly programmed or rehearsed. To minimize presenters' reliance on a formal presentation, one committee sets a limit of 10 slides and encourages presenters not to read directly from the slides.

Presentations should provide insight into finance department bench strength

Management presentations are an important way for audit committees to gain key insights into the company's operations; their secondary agenda is often to help committees understand the depth and quality of the CFO's organization and to evaluate the tone that is being set at the top. In addition to hearing from the CFO, several members said they also like to invite mid-level staff, since it gives the committee the opportunity to gauge the bench strength of the finance department. One Mid-Atlantic member said, *"I feel strongly that we need to get below the top management level to understand the quality of people [in the organization]."*

Another Mid-Atlantic member said that presentations are usually very interactive and include a lot of questions. The committee assesses not only the content but also the confidence and competence of the presenter. In asking management to take the committee through the 10 most important financial processes, one member will *"demand of the CFO to see key people in action presenting to us."*

3. The audit committee chair: acting as a clearinghouse between meetings

Most members said they spend between 100 and 200 hours per year serving as audit committee chairs, with one member noting that he now spends two full days a year with the external auditor, something he never did before Sarbanes-Oxley. Members generally agreed that the chair's time commitment was at least twice that of other audit committee members. Furthermore, one North Central member said the number of hours *"would be higher than that expected for other [board] committee chairs, and the retainer is also higher to reflect this."*

Audit committee chairs face a difficult set of challenges. They must ensure that the committee agendas cover all regulatory requirements, as well as any other mandates set out in their charter. They are also responsible for guiding the committee's oversight of the broader risk management effort. Members described some important elements of the chair's role.

Setting priorities

While the basic meeting agenda contains certain required items, members still feel that, as chairs, they are responsible for ensuring that the agenda does not become too mechanized. In preparing the agenda, one member said he will add or reprioritize issues that come up between meetings, noting that his committee uses a *"rolling framework that can be modified as necessary."*

In some cases, the committee holds an annual brainstorming session with management, board members, staff, and external auditors to set the agenda for the coming year. However, the chair is ultimately accountable for setting the committee's priorities. One ACLN member said, *"I get a recommendation [from] internal audit, but [the agenda] is a reflection of what I want to review."*

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Acting as a clearinghouse

Aside from their role in the meetings, audit committee chairs described themselves as the primary committee contact with management and external auditors between meetings. Audit committee chairs receive several phone calls and e-mails over the course of a month, and they need to judge when an issue should be brought to the attention of the whole committee. In this capacity, one member described himself as *“a clearinghouse for whether an issue goes more broadly.”*

Audit committee chairs are often granted the authority to act on behalf of the committee on specific matters. One North Central member wrote, *“I handle routine matters such as minor fee arrangements [and] communication with outside auditors and management. Our charter allows me to do this, and then the entire committee ratifies my actions. I use my judgment to see if I am comfortable making the decisions alone or if I want to bring the entire board into the issues.”*

One Mid-Atlantic member said that *“there are rarely issues handled outside the formal meeting framework, as we attempt to [deal with] any issues [in] real time with the whole committee involvement via e-mail.”* An ACLN member also observed that *“interestingly, more is happening by e-mail.”* The use of electronic communications raises interesting questions about process and board liability. E-mail use has advantages, but it may also present unanticipated risks.

Conclusion

With the scope of their role ever increasing, audit committee chairs must ensure that the committee focuses on the right issues, at the right time, with input from, and deliberation by, the right people.

Sarbanes-Oxley provides a valuable framework for helping to plan the routine items included in audit committee agendas. However, many committee chairs recognize that in order to be effective, they must balance the need for compliance with legislative and regulatory requirements against the strategic imperative of their risk management responsibilities.

The views expressed in this document represent those of the Audit Committee Leadership Network, the North Central Audit Committee Network, and the Mid-Atlantic Audit Committee Network, select groups of audit committee chairs committed to improving the performance of audit committees and enhancing trust in financial markets. They do not reflect the views nor constitute the advice of network members, their companies, Ernst & Young, or Tapestry Networks. Please consult your counselors for specific advice. Ernst & Young refers to all members of the global Ernst & Young organization, including the U.S. member firm of Ernst & Young LLP.

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