Audit committee agendas and charters

Members of the European Audit Committee Leadership Network (EACLN) convened in Paris on 18–19 November 2014 where, in a members-only session, they discussed the expanding agendas and evolving charters of audit committees, focusing on how audit committees are managing and prioritizing agenda items in the face of mounting demands from stakeholders.1

The ViewPoints provides a summary of the key issues raised during the discussion along with background information and insights that members shared before and during the meeting.2 For further information on the networks, see “About this document,” on page 8. For a full list of participants, see Appendix 1, on page 9.

Executive summary

Since the 2006 passage of the European Union’s (EU’s) 8th Company Law Directive, which defined the role of the independent audit committee in publicly traded companies, audit committee responsibilities have continued to grow, and as a result, audit committee agendas have expanded. When the financial crisis hit, companies came under further scrutiny, and audit committees took on even more responsibilities, in the form of new agenda items and more in-depth focus on items that had previously not commanded as much attention. With this higher-profile role came more regulator and stakeholder scrutiny. One observer concluded that “the global audit committee community is now facing the same ‘expectation gap’ that historically has presented a challenge for the auditing profession.”3

At the EACLN meeting in Paris and in conversations with members before the meeting, discussion focused on several themes related to audit committees’ growing agendas and their management:

- **The compliance burden (page 2)**
  
  Members agreed that as regulators at the EU and national levels prescribe more rules for companies to follow, it places additional burdens on audit committees who are tasked with overseeing company adherence to these rules. As a result, compliance comes to dominate audit committee agendas. Some voiced concern that compliance may obstruct the view of the bigger picture and feared audit committees risk losing focus on the business and business strategy.

- **The audit committee role in risk oversight (page 4)**
  
  How audit committees should respond to risk oversight was also discussed. Members noted that the audit committee often becomes the default home of risk oversight and questioned whether it was too much for one committee to handle. Members discussed how committee and full-board roles should be defined and where responsibilities should lie, such as strictly defining audit committee roles as overseeing the processes regarding risk management and having management be more responsible for raising specific risk issues.

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1 In another session, EACLN members had a dialogue with members of the IAASB. See European Audit Committee Leadership Network, Dialogue with the IAASB, ViewPoints (Waltham, MA: Tapestry Networks, 2014).
2 ViewPoints reflects the network’s use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.
3 Center for Audit Quality, Global Observations on the Role of the Audit Committee (Washington, DC: Center for Audit Quality, 2013), page 3.
• Innovative measures for managing agendas (page 5)

Members shared techniques and strategies for managing agendas, including having frequent conversations with management outside the committee meeting, using technology to prompt attention to agenda items ahead of time, coordinating with other committees to minimize agenda overlap, and managing the flow of information to the audit committee.

For some questions for the audit committee to consider, see Appendix 2, on page 10.

The compliance burden

For more than a decade and increasingly since the financial crisis, compliance issues have proliferated, and more often than not, oversight responsibility has landed on the audit committee. But audit committee chairs are asking what price this focus on compliance exacts from other parts of the business. “Our work is now 75% to 80% compliance. This is a danger on a long-term basis,” warned one member.

Regulations defining audit committee roles have spread across Europe

In response to the financial crisis, regulators and legislators have codified much of audit committees’ responsibilities, and regulators are starting to scrutinize audit committee work with as much intensity as they examine management and external auditors. “Regulators lost confidence in management, and they increased the level of responsibility for directors,” one member commented. “The agenda is too much, but it is what I have to deal with.”

To understand the growing burden on audit committees, consider current regulations put in place at the EU and national levels:

• European Union. EU legislation that came into effect in June 2014 and is being implemented in the next two years mandates a strengthened audit committee role.4 In addition to appointing the auditor and monitoring company financial reporting processes, the audit committee must now monitor the effectiveness of the company’s internal quality control and risk management systems, including internal audit functions.5 The auditor will also provide more detailed report to the audit committee regarding the performance of the audit. These changes come on top of existing audit committee responsibilities maintained in the legislation, such as monitoring the statutory audit, ensuring auditor independence, ensuring that provision of non-audit services is in line with EU restrictions and overseeing reappointment and retendering, duties that will require even more time with the introduction of mandatory rotation.

• France. In 2010, the working group of the French financial market regulatory authority, the Autorité des marchés financiers (AMF), issued a paper that called for audit committees to monitor the effectiveness

4 See EY, European Union Audit Legislation, Point of View (London: Ernst & Young Global Limited, 2014), page 5, for the portion of the new EU legislation that deals with the audit committee’s responsibilities.

5 In most jurisdictions, if a company has established an independent risk committee, supervision of risk management systems can fall to that committee, especially in financial services firms. However, members reported that they still work closely with risk committees to manage reporting, as many issues cross responsibility boundaries and need to be closely coordinated.
of internal control and risk management systems, which stated, “As a general rule, internal control and risk management systems are not restricted solely to financial matters and [encompass] all aspects of the company.” The AMF defined risk as including “operational risk, credit risk, liquidity risk, market risk and legal risk, along with strategic, industrial and environmental risks.” Moreover, French law requires companies to retain two auditors, a practice known as joint audit, which results in audit committees having two statutory auditors to oversee and two relationships to manage. They must also rationalize any discrepancies between the two additional auditor reports that the new EU directive requires the audit committee receive.

- **Germany.** Germany’s corporate governance code lacks many of the specifics about audit committee responsibilities found in the codes of other jurisdictions. The current code says that the audit committee is responsible for “the monitoring of the accounting process, the effectiveness of the internal control system, risk management system and internal audit system, the audit of the Annual Financial Statements, here in particular the independence of the auditor, the services rendered additionally by the auditor, the issuing of the audit mandate to the auditor, the determination of auditing focal points and the fee agreement, and – unless another committee is entrusted therewith – compliance.”

- **The Netherlands.** The Dutch corporate governance code was last revised in 2008, but further revisions are expected that will see more responsibility and accountability put on the audit committee. In 2010 and in 2012–2013, the Dutch Authority for Financial Markets conducted two rounds of review of statutory audits performed by the Big Four audit firms, calling out deficiencies relating to “the tests of controls, the substantive procedures and the external auditor’s critical assessment of obtained audit evidence.” A Dutch EY partner said that for such issues, regulators are asking the audit committee to show how it oversaw the audit and company controls and to explain why the auditor was chosen. This partner further reported that in spring 2014, Dutch regulators engaged with supervisory boards across the country, letting them know that supervisory boards in general and audit committees in particular are “becoming more and more important and will get more responsibility.” Among the responsibilities currently detailed in the Dutch governance code is a recommendation that audit committees be responsible for company tax planning policy and “the applications of information and communication technology,” the latter of which encompasses the growing issue of cybersecurity.

- **United Kingdom.** The United Kingdom’s recently updated corporate governance code enjoins audit committees to take a more prominent role on a broader spectrum of governance issues. Of specific note, the September 2014 revisions of the UK Financial Reporting Council (FRC) guidelines asks audit committees, on behalf of the board, to provide “the information necessary for shareholders to assess the

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7 Ibid, page 9.
8 Ibid.
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company’s position and performance, business model and strategy.” Audit committees should also expect regulators to start scrutinizing the audit committee report as rigorously as the auditor’s report, a UK EY partner said. The duties of the audit committee detailed in the updated corporate governance code include review of whistleblower rules (to ensure employees have confidential means of raising concerns and appropriate investigatory mechanisms are in place), assessment of internal audit’s activities and primary responsibility for appointing, reappointing or removing the external auditor.

Focus on compliance may put other areas at risk

Members said that regulatory demands are changing the committee’s focus. Some voiced concern that important issues may get overlooked as audit committees try to balance all their responsibilities, including such complex new responsibilities as oversight of cybersecurity risk. “We know we need to do compliance, but it can’t be at the expense of the business. We have to step back and set a balance between compliance and the business,” one member said. Another said, “I don’t think checking boxes on [required] items is the right way. I’m concerned I’m missing important things. I’m missing them because I do not have enough time to address all the issues I should be addressing.” One member described how compliance came to dominate their audit committee agenda: “We asked, ‘Where in the organization do you put compliance? Is it a line management issue? Do you have the balance right?’ It ended up with the audit committee partly because of the proliferation that comes up through the internal audit function, which reports to the audit committee. We had to stand back and say, ‘compliance’ is dominating our agenda.”

“We can’t let others appropriate our agenda. We need to be in the driver’s seat.”
– Audit committee chair

“All once you have a perimeter so vast, how can you design the activity to address it? How can you manage your activity?” asked one member. Another member suggested that audit committee chairs establish this boundary themselves: “Regulators keep adding to the agenda. It’s our responsibility not to let them dictate what we focus upon. It’s our responsibility to define the focus of the audit committee. We can’t let others appropriate our agenda. We need to be in the driver’s seat.”

Some members saw enhanced regulatory attention to audit committee activity as an opportunity to better define the audit committee agenda. “This is pushing everyone in the right direction,” said one member. “It requires more structure around application of risk. It requires additional structure around how to raise issues.” Another member commented that regulations are “changing the professional profile of the director. It makes for a more professional director.”

The audit committee role in risk oversight

Risk oversight has come to take up more and more of the audit committee’s time – and a larger place on the agenda – particularly if a board does not have a risk committee. “The question arises: does the audit committee have its arms fully around all (the audit and risk demands)? Is it part of your role to understand how risk management functions in your company?” asked one member. Part of the problem is that the audit committee has become the default assignment of all risk management oversight, a practice that

members said needs to be kept in check. One member explained the audit committee’s risk responsibilities thus: “The audit committee should make sure there are processes for risk oversight and that management is addressing it. The audit committee should make sure oversight of risk is allocated to the proper committee. The audit committee is the guardian of processes.” Another member added, “The danger for the audit committee is that it is trying to do more of the job that management should be doing and less overseeing of internal structure to make sure management is doing its job.”

Some members urged audit committees to make management more accountable for risk. “I tell management, your responsibility is to have a comprehensive report on systemic issues. If there is specific risk, call me, and we will address it, but I don’t want 400 reports on risks. Management is responsible for checking risks, and if they don’t report something to us, it is their responsibility, not ours,” said one member. Another suggested that the full board, rather than the audit committee, should have the final word in risk oversight: “Risk is management’s responsibility to address and then send it to the audit committee for review before taking it to the full board, where it should lie. Audit committees review, boards decide.”

Another member suggested an escalation process to help keep the audit committee agenda manageable: “The compliance manager needs to decide if [a risk issue] is a real issue or a non-issue … Minor issues should be dealt with at management level and serious issues reported to the audit committee so the audit committee can act.”

Innovative measures for managing agendas

While items on the audit committee agenda vary by industry, region and company culture, members agreed that all audit committee chairs need to develop creative ways for managing those agendas. Members shared some of the practices that they are employing to meet their obligations.

Use discussions outside of formal meetings to streamline agendas

Nearly all members reported that the audit committee’s expanded agenda means they spend much more time outside of formal meetings, having one-on-one conversations with key members of management, including CFOs, internal auditors and division heads in important markets. “By spending quite a lot of time with the head of compliance and other heads of the business, you can streamline the agenda and make sure important matters rise to the top,” said one member. Another member said discussions with management can help hone the agenda: “I find that every two years I need to ask, ‘What should our focus be on?’ I ask the CFO and internal audit to do the same.”

In the United Kingdom, the FRC recommends audit committees take this approach: “Formal meetings of the audit committee are the heart of its work. However, they will rarely be sufficient. It is expected that the audit committee chairman, and to a lesser extent the other members, will wish to keep in touch on a continuing basis with the key people involved in the company’s governance, including the board chairman, the chief executive, the finance director, the external audit lead partner and the head of internal audit.”

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Members noted that these interactions also help the committee keep business strategy on its radar as compliance grows on the agenda. “It’s a real opportunity to be involved more deeply in the business of the company,” said one member. Another member asks management what keeps them awake at night, which provides insights into what is driving the business and a course for action. “Risk awareness is still growing,” the member said about management’s responses. “I participate in risk discussions; it elevates the responsibility. Knowing that the audit committee chair is there increases the response to risks.” Another member recommended getting multiple perspectives for a more complete picture: “I meet with CFO, auditors, etc. I say to them, ‘Here’s what I am hearing.’ Then I ask if this is right and what are you seeing. Sometimes there may be disagreement. I make sure those points are raised in meetings to make sure they are properly addressed.”

**Coordinate efforts with other committees**

The issue of coverage gaps, noted above, concerned members, particularly for boards with risk committees. Several members on boards with audit and risk committees said it helps to have board directors who serve on both committees. “We make sure there are no gaps by sitting on each other’s committees to make sure we dovetail but not overlap,” said one member. To take it a step further, one member’s board is testing having internal audit report to both the audit and risk committees, with compliance issues going to the risk committee and non-compliance issues coming to the audit committee. “It makes for a nice division of labor,” the member said, adding that the board also reexamined its committee charters as part of the process.

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**Use technology to help ensure members come to meetings prepared**

One member’s company has deployed technology to alert directors prior to meetings about upcoming agenda items so they can prepare and make sure the issues are addressed. The technology, which is similar to systems in use in internal audit, is also used to track open issues and ensure closure. Another option discussed is electronic distribution of board documents. When documents are available in electronic format, board members can quickly click through topic headings and drill down for more in-depth information. Electronic document sharing also makes information sharing easier between committees, aiding in coordination and lowering the risk of gaps in the board’s coverage of issues.

**Take control of the information flow from management**

A number of members said audit chairs need to be more assertive with management about what issues should be coming to the committee. “It’s no longer management providing information to the audit committee; it’s the audit committee clearly defining the information needed from management,” said one member. Another member said too much information from management is as detrimental as too little. “This is always an issue, the ineffectiveness of reporting,” the member stated.
Interim reports

One suggestion that came up both at this meeting and at a recent network meeting of North American audit chairs\(^\text{16}\) was to have management provide interim reports, between meetings, to reduce the barrage of information at the meeting itself and give committee members more time to absorb issues and formulate questions for management.

Summaries with recommendations

Another suggestion was to have management summarize issues and provide recommended actions. For example, one North American audit chair’s company provides the audit committee with “a one-page memo from the chief audit executive describing the objectives for the meeting and the actions needed by the audit committee; in each tab, a one-page memo with the actions required and comments, [plus] two sections, one for essential content and one for content that would be nice to read.”\(^\text{17}\) But some members questioned whether audit committees can meet their legal obligations if they are too selective about the information they choose to see. “The legal opinion I got said the executive summary [from management] does not meet [the audit committee’s] responsibility. If we ask management to prioritize items, then we are responsible for those priority items. If I tell [management to limit reports to a certain numbers of pages], then I can be held responsible [for what’s missed],” said one member.

Supplemental viewpoints

To balance the information received from management, the audit committee can also invite the external auditor to meetings. The external auditor can provide “checks and balances against what you are hearing from management,” a member said. “It’s essential for the audit partners to get a full view,” added another member. An EY partner said the meetings benefit the external auditor too and recommended closely coordinating with internal audit to maximize the benefits. All of these interactions, the EY partner said, also allow the audit partner to help the audit committee prepare for the full board meeting.

Additional support

One member’s audit committee created an internship for high-potential finance staff that involved working as staff for the audit committee for 18 months to two years. The intern reads all the information the audit committee receives, joins in one-on-one meetings with management and gets involved with all aspects of the audit committee’s work. “It’s an excellent training opportunity. We get support, and they get training and exposure to senior management,” the member said.


\(^\text{17}\) Ibid.
Conclusion
As regulatory oversight continues to evolve, audit committee agendas are likely to continue growing. For some members, fulfilling the obligations entailed in being audit committee chair has become nearly a full-time job. Members agreed that taking control of the audit committee agenda is a productive first step toward meeting their commitments in a reasonable amount of time and with a reasonable application of resources. As risk and compliance take over more of the agenda, boards are reassessing their current committee structures to see if they meet today’s needs. Whether adding a risk committee or evaluating the alignment of board, management and committee responsibilities, directors are addressing their evolving roles. One thing was clear: “There are different ways to do things; there is no one way. That is important to understand.”

About this document
The European Audit Committee Leadership Network is a group of audit committee chairs drawn from leading European companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management and their advisers as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of ViewPoints lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive ViewPoints are encouraged to share it with others in their own networks. The more board members, members of management and advisers who become systematically engaged in this dialogue, the more value will be created for all.

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Appendix 1: Participants

Members participating in all or parts of the meeting sit on the boards of 35 large-, mid- and small-capitalization public companies:

- Ms Patricia Barbizet, Audit Committee Chair, Peugeot and Total
- Dr Werner Brandt, Audit Committee Chair, Lufthansa and RWE
- Mr Aldo Cardoso, Audit Committee Chair, GDF SUEZ
- Mr Ángel Durández, Audit Committee Chair, Mediaset España
- Mr Lou Hughes, Audit Committee Chair, ABB
- Ms Shonaid Jemmett-Page, Audit Committee Chair, GKN
- Ms Olivia Kirtley, Audit Committee Chair, U.S. Bancorp*
- Dr Maurizio Lauri, Chair of the Board of Statutory Auditors, Unicredit
- Mr Pierre Rodocanachi, Vice Chair and Audit Committee Member, Vivendi
- Ms Guylaine Saucier, Audit Committee Chair, AREVA
- Ms Martine Verluyten, Audit Committee Chair, STMicroelectronics and Thomas Cook

EY was represented in all or parts of the meeting by:

- Mr Jean-Yves Jégourel, EMEIA Assurance Leader
- Mr Christian Mouillon, Global Risk Management Leader

*Member of the North American Audit Committee Leadership Network
Appendix 2: Questions for audit committees

? What regulatory, industry, company or other issues are driving your agenda?

? Are regulators scrutinizing your audit committee work more, and if so, how?

? What should the limits of audit committee responsibility be?

? What consequences are you seeing from growing audit committee responsibilities?

? How are you working with management, the rest of the board and the external auditor to address these impacts?

? How do your boards divide duties? Which issues should belong to the audit committee and which should belong to the full board or other committees?

? How do you ensure important issues are singled out and brought to the audit committee?

? How do you manage the flow of information to the audit committee to make sure important items are not missed?

? What practices do you employ for managing the audit committee agenda?