On being a successful audit committee chair

Five best practices being implemented today.

BY FREDERICK D. LIPMAN

THE SARBANES-OXLEY ACT of 2002 (SOX) transferred powers from the management of a public company to its independent audit committee. The chair of the audit committee has the important role of providing leadership for the audit committee and of exercising powers on behalf of the committee previously reserved to management. Today, successful audit committee chairs are taking a broader view of their responsibilities beyond the technical legal requirements of SOX or SEC or exchange listing rules and are attempting to follow what are developing as best practices. Some of the best practices being implemented today include the following:

Frederick D. Lipman is president, Association of Audit Committee Members Inc. (www.aacmi.org) and partner, Blank Rome LLP, an international law firm (www.blankrome.com).

1. Audit Committee Composition. The successful chair should be concerned about the quality and competencies of the audit committee members. We all know about the requirement for a financial expert imposed by exchange listing rules and SEC disclosure requirements. However, it is not necessary, or even desirable, to require that every member of the committee be an accounting expert. Persons with knowledge of the industry and familiarity with company operations can be valuable members even if they are not financial experts, assuming that they have basic accounting knowledge. Moreover, successful audit committee chair are evaluating the contributions of their committee members at least annually and recommending necessary changes where appropriate.

2. Internal Audit. It is a best practice for the head of the internal audit function to be hired by the audit committee, report directly to the audit committee, and be subject to dismissal by the audit committee. This best practice has, on occasion, created conflicts with management who, under this arrangement, may view the internal auditor as not part of the management team. A successful audit committee chair must anticipate these potential conflicts, devise methods to insure that there is a good rapport between and among the internal auditor, the CFO, and the chief accounting officer, and make certain that all parties understand their respective roles. The audit committee chair should also inquire periodically from the internal auditor as to the adequacy of staffing of the internal audit function. The chair and the internal auditor should exchange cell phone numbers and email addresses.

3. Coordination with Independent Auditor. The chair should have a good working relationship with the partner and manager of the independent auditor so that any problems can be anticipated and any friction with management or the internal auditor quickly resolved. The chair should schedule private meetings with the independent auditors and annually have a robust discussion of any independence issues.

4. Educating the CFO. Many CFOs are uncertain as to what the audit committee expects from them. The successful chair, after consulting with the full committee, must have an open and candid dialogue with the CFO, preferably privately on a one-on-one basis, which would include at least the following topics: (a) the specific types of information the audit committee requires to perform its function, with the understanding that this information needs constant refinement (and too much information is as bad as too little information); (b) what public documents, such as press releases and periodic SEC filings, does the audit committee wish to review prior to publication or SEC filing, and the time frames in which such information is to be supplied to the audit committee; (c) the expectations of the committee for the CFO to immediately communicate material financial developments within the company; and (d) what monitoring of the services of the independent auditor and the costs of such services should be provided by the CFO.

5. Audit Committee Procedure. The successful chair will attempt to develop a consensus among the audit committee members on all important issues and will suggest the need, when appropriate, for special consultants, including independent counsel. The chair will obtain recommendations from the audit committee members as to the number and length of meetings and, with the assistance of the internal auditor, develop an agenda for each meeting. The chair should schedule an annual meeting with the head of both the sales and tax departments and an annual self-evaluation of the audit committee, including a review of the audit committee charter. Finally, the successful chair should insist upon the continuing education of all new and old audit committee members on internal accounting issues and on new accounting pronouncements. ■

The author can be contacted at lipman@blankrome.com. His latest book, *Executive Compensation Best Practices*, co-authored with Steven Hall, was published in April 2008 by John Wiley & Sons Inc.