Life in the hot seat:  
Filling the role of audit-committee chair

Outstanding audit chairs exhibit three leadership attributes that together help them thrive in an environment of heightened risk and increasing responsibility for oversight.
The role of audit-committee chair today may fairly be called “the hot seat.” The role has always been demanding, typically requiring more time than any other committee assignment and encompassing a broader range of responsibilities. Audit committees meet more frequently than do other board committees, spend additional time with external auditors, and work closely with the CFO and key financial leaders. But over the past five years, the responsibilities have continued to multiply and the pressures on the audit committee and its chair have greatly intensified.

More responsibility, more risk

Consider risk oversight. The New York Stock Exchange, for example, has long required that the audit committee of listed companies “discuss guidelines and policies to govern the process by which risk assessment and management is undertaken.” Although the NYSE doesn’t require the audit committee to be solely responsible for risk oversight, many boards of companies that are not in heavily regulated industries lack board-level risk committees. And even where there is a separate risk committee, the audit committee must still coordinate with it to make sure that risk is being fully addressed.

Meanwhile, the risks—especially operational risks—have proliferated and grown in seriousness. Since the massive computer breaches at a number of major companies in 2014 and thereafter, cybersecurity has loomed larger than ever on audit-committee agendas. Third-party risks related to such issues as the environment, corporate reputation, labor practices, bribery, and more have also come to take up more of the time of many audit committees.

At the same time, audit committees and their chairs face increasing responsibilities for oversight of reporting, compliance, and controls. And the greater public focus on those responsibilities heightens the risk of lawsuits, SEC fines, and other penalties as well as the risk to the reputations of directors. Audit committees also face increasing pressure from regulators, institutional investors, and proxy advisory firms to improve transparency in their disclosures about how they exercise those oversight responsibilities. In December 2015, for example, the Public Company Accounting Oversight Board (PCAOB) issued new rules and amendments to its auditing standards intended to provide investors with more information about engagement partners and accounting firms that participate in a company’s audit. In May 2016, these rules were approved by the SEC; they will go into effect in 2017.

In the face of these developments, today’s audit chair must be equally at home with financial and compliance issues and with operational and strategic issues. In addition, the role comes with a host of formal and procedural duties: audit-committee chairs must schedule committee meetings and establish the agenda for each in consultation with the chairman of the board, committee members, management, and the external auditor. They must see that properly prepared financial statements, management discussion and analysis, and other appropriate documents to be reviewed by the audit committee are circulated prior to the meetings. They must oversee the hiring and independence of the external audit firm and maintain a direct communication between the committee and the external auditor, while also overseeing the performance of the internal audit function. And they must see that the committee complies with its obligations to the full board.

Given the burdens of the role, most boards offer their audit chairs an additional retainer beyond their base compensation for board service. Among Fortune 100 companies, that additional retainer averages about $23,000 annually, with a median of $25,000. (For comparison, the additional retainer for compensation-committee chairs averages $13,000 and for nominating-committee chairs about $8,000.)

Further, 75% of audit-committee chairs among the Fortune 100 are retired, another indicator of the demands of the role in terms of both time and responsibility. And their average age of 65 suggests that those who are not already in retirement may be nearing it.

Not surprisingly, then, it can be the most difficult committee role to fill.
Financial expertise and today’s audit chair

On the face of it, boards would seem to have great leeway in filling the audit-chair role. SEC rules specify only that the committee consist of three independent members, all of whom are “financially literate,” as determined by the company itself. For example, prior service as a CEO or CFO can satisfy the requirement. Companies must also disclose whether the committee includes at least one member who is an “audit committee financial expert,” defined by the SEC as someone who understands generally accepted accounting principles (GAAP) in relation to estimates, accruals, and reserves and who has experience evaluating financial statements, experience with internal controls, and an understanding of the committee’s functions.

Nevertheless, many worthy candidates are reluctant to take on the job, though they qualify as financial experts. For example, many director candidates with experience as chief executive but less than intensive finance experience are uncomfortable with the technical demands of the job. Accounting rules change rapidly and can be abused by bad actors in the company—abuses that can be hard to detect by the chair. Strikingly, of the 39% of Fortune 100 audit chairs who are or have been CEOs, 71% began their careers in finance.

The “financial literacy” requirement is well covered among other current Fortune 100 audit chairs as well. Thirty percent are active or retired CFOs, 22% have been partners in a Big Four accounting firm, and a handful are or have been investment bankers. In addition, a small number are or have been divisional presidents or academics or have served in government—some of whom also have financial or compliance expertise. The high combined percentage of CEOs and CFOs in the audit-chair role (69%) is in fact consistent with the numbers for all board placements generally—according to the Heidrick & Struggles Board Monitor, a yearly tracking of board trends, CEOs and CFOs together claimed roughly two-thirds of new appointments to boards of Fortune 500 companies in six of the seven years from 2009 through 2015. ¹

Indispensable leadership attributes

Along with financial literacy, outstanding audit chairs possess a deep understanding of strategy. Like all independent directors, they should know the company’s industry, business model, and strategy as thoroughly as possible. But the audit chair must also understand how issues in accounting, auditing, and compliance affect those things. In addition, the chair should be fully attuned to the company’s risk appetite—and not only in matters of finance but also in all areas of risk within the purview of the committee. And the chair must have vision—the ability to understand trends that will affect the risk profile of the company and the foresight to ensure that appropriate actions are put in place to mitigate the impact of those risks and safeguard the company’s assets.

In addition to financial expertise and strategic vision, outstanding audit chairs exhibit the following three leadership attributes that are desirable in any director but have highly specific relevance to the sensitive and potentially contentious issues their committees address:

• **They lead teams adroitly.** Audit chairs have no real direct authority. They must therefore lead with subtlety, tact, and diplomacy. They must also exercise considerable management skill, orchestrating and apportioning the committee’s work and responsibilities among the appropriate members. Expanding their notion of “team,” they must effectively use the company’s outside auditor, consult closely with the CFO and the financial-leadership team, and keep the full board informed about their work. And when the audit chair lacks competency or knowledge about a particular issue, he or she must be willing to depend on other committee members who do have the requisite knowledge.

• **They are independent and collegial.** A director who is both genuinely independent and collegial is unthreatened by disagreement and acknowledges the contributions of others while working collaboratively for the good of the company and its stakeholders. In the atmosphere of candor and collegiality that effective audit committees live and breathe, the chair must act not only out of conviction but also with the grace that encourages others to speak up, that persuades rather than confronts, and that gets results.

• **They are courageous.** If, in the course of the audit committee’s work, unwise or questionable practices on the part of management come to light, the audit chair must have the courage to speak up. It is easy, of course, to object to obvious mistakes or misfeasance. But there are many situations that don’t rise to that level but should be confronted, even in the face of resistance from management. Conversely, audit chairs must have the courage to back the CEO or management when they think management is right, despite criticism from the press, the public, or shareholders.

Boards certainly know how difficult the audit-chair role is. Even when they find someone who combines these leadership attributes and the right mix of financial knowledge and strategic vision, they rarely recruit that new board member straight into the role of audit-committee chair. In fact, our analysis indicates that three years, on average, elapse between joining the board and assuming the role of audit chair, giving the new board member time to get acclimated to the board and the company. Only if the individual has previously served as audit chair for a publicly traded company is this transition shorter. Once in place, audit-committee chairs serve for an average of about five years or more. This relatively lengthy tenure suggests that once boards find a qualified, high-performing chair, they prefer to keep that person in place as long as possible. Given the demands of the role today, it’s easy to see why. With public-accounting partners required to rotate clients every five years, and with continuing pressures on independence for audit chairs, it would not be unusual for companies to mirror a similar rotation for its audit-committee chairs—which will only increase demand for qualified candidates for this role in the future.

**About the authors**

Alyse Bodine (abodine@heidrick.com) is partner-in-charge of Heidrick & Struggles’ Philadelphia office and a member of the Financial Officers Practice.

Michele Heid (mheid@heidrick.com) is a partner in the Philadelphia office and a member of the CEO & Board and Financial Officers practices.

A version of this article was originally published in *Directors & Boards* magazine.
Heidrick & Struggles’ CEO & Board Practice has been built on our ability to execute top-level assignments and counsel CEOs and board members on the complex issues directly affecting their businesses.

We pride ourselves on being our clients’ most trusted advisor and offer an integrated suite of services to help manage these challenges and their leadership assets. This ranges from the acquisition of talent through executive search to providing counsel in areas that include succession planning, executive and board assessment, and board effectiveness reviews.

Our CEO & Board Practice leverages our most accomplished search and leadership consulting professionals globally who understand the ever-transforming nature of leadership. This expertise, combined with in-depth industry, sector, and regional knowledge; differentiated research capabilities; and intellectual capital enables us to provide sound global coverage for our clients.

Leaders of Heidrick & Struggles’ CEO & Board Practice

Global
Bonnie Gwin
New York
bgwin@heidrick.com
Jeff Sanders
New York
jsanders@heidrick.com

Asia Pacific
Fergus Kiel
Sydney
fkiel@heidrick.com
Graham Poston
Singapore
gposton@heidrick.com

Europe and Africa
Sylvain Dhenin
Zurich
sdhenin@heidrick.com
Will Moynahan
London
wmoynahan@heidrick.com
Heidrick & Struggles is a premier provider of senior-level executive search, culture shaping, and leadership consulting services. For more than 60 years we have focused on quality service and built strong relationships with clients and individuals worldwide. Today, Heidrick & Struggles' leadership experts operate from principal business centers globally.

www.heidrick.com

WE HELP OUR CLIENTS CHANGE THE WORLD, ONE LEADERSHIP TEAM AT A TIME®

Copyright © 2016 Heidrick & Struggles International, Inc. All rights reserved. Reproduction without permission is prohibited. Trademarks and logos are copyrights of their respective owners.