By Kenneth Daly and Robert P. Garrett

Why Committees Must Coordinate

The publicity surrounding stock option backdating highlights the need for audit committees and compensation committees, as well as other board committees, to better coordinate their activities.

Sarbanes-Oxley and the exchanges prescribe specific responsibilities for the board's audit, compensation and nominating/governance committees. However, given the increasing complexity of business, boards are delegating more oversight responsibilities to board committees that can undertake a more intensive review of the activity or issue. For example, a number of boards have delegated responsibility for M&A, risk management, technology, privacy, compliance, public policy and various finance functions.

Despite the clear benefits of these arrangements, there is a risk that they may cause the board to become balkanized. This is more likely to occur if committee members lack sensitivity to important issues—such as failing to recognize that certain features of an incentive compensation plan may create undue pressure on internal control systems, or that marketing initiatives may affect revenue recognition.

From the audit committee's perspective, given the financial implications of virtually every business activity, the coordination issue is particularly acute. So audit committees need to recognize the types of input that other committees require, and these other committees must appreciate the information needs of the audit committee.

For example, an audit committee would be aware that the company did not make certain proposed year-end post-audit adjustments that were determined to be "not material"; however, the audit committee needs to be sensitive to the fact that this information may be important to the compensation committee—which may determine that the adjustments were important for compensation purposes. If the adjustments had been made, bonuses might not have been paid.

Similarly, other board committees that have responsibility for components of risk oversight must communicate so that the audit committee understands the company's nonfinancial reporting risks that may have financial reporting implications.

Compounding the challenge is that committee meetings are often held simultaneously, with little opportunity for members of one committee to "sit in on" and learn about the activities of other committees.

In light of these challenges, at a number of boards, committee chairs are attempting to identify areas where their oversight responsibilities may overlap, and develop a regular, frequent communications process to share and discuss their oversight activities. In addition to executive compensation, areas in which the audit committee and other board committees may have overlapping responsibilities include M&A activity and the impact of proposed M&A activity on the company's Section 302 and 404 processes; issues affecting the company's compliance with debt covenants; legal and regulatory compliance; risks associated with new marketing and sales plans and other business practices, which may have implications for internal controls and audits of internal controls; and management of the company's most significant business risks, many of which may be overseen by multiple board committees.

Finally, many committee chairs are focusing on the adequacy of their reports to the full board. In addition to ensuring that their reports are comprehensive and understandable, committee chairs are focusing on their timing. At a minimum, committee chairs provide copies of the minutes of their meetings at each board meeting. However, on issues where oversight responsibilities may overlap, committee chairs increasingly recognize that communications—both formal and informal—need to be more frequent and timelier.

Hold the Powerpoints

A productive audit committee meeting depends in large measure on the dynamics between committee members and other participants. Most audit committee members say they need to improve these dynamics by devoting more time to discussing issues and asking questions of management.

According to a recent survey conducted by KPMG's Audit Committee Institute, more than 65 percent of audit committee members say that they devote too much of their meeting time—more than half the meeting—to listening to presentations; that same percentage of audit committee members say that at least half of their meeting time should instead be spent actively discussing issues. PowerPoint presentations appear to be a major culprit.

To address this issue, many audit committee chairs now insist that PowerPoint presentations and other materials to be reviewed during the committee meeting be distributed well in advance. These audit committee chairs also instruct management to assume that committee members have read the materials prior to the meeting, and to limit their presentation to an overview of the most significant issues. Audit committees can ill afford to listen to a recitation of facts contained in materials they have already reviewed.

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