This bulletin summarizes some of the issues that audit committee chairs of leading European companies are currently discussing with their advisors in EY.

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Dear readers,

The purpose of this bulletin is to share some of the conversations that EY has with the audit committees we serve. We address the risk and governance topics that are top of mind in committee meetings and network discussions across Europe and beyond. On page 10, a survey we conducted shows that economic conditions, internal controls and fraud dominated our clients’ agendas last year. You’ll find the article on page 5 looks at how data mining technology can be highly effective for fraud risk assessment and compliance.

With the year-end financial reporting complete for many, we find boards use this time to reflect on the past year and consider some of the broader issues that will affect their individual and collective performance as they provide governance and oversight.

Stakeholder engagement and reputation is a continued theme. In our opening article we present two investors’ perspectives on the interaction they would like with audit committees. The following article considers the opportunities and risks of social media in corporate communication.

You will be aware of the latest rulings from Brussels on mandatory audit rotation. Auditor change has already accelerated. We are seeing many more tenders across Europe, the Middle East and Africa, especially for Public Interest Entities. In our experience, this can be a challenging process for management and audit committees if the auditor relationship is a long-standing one. On page 7, we outline key points on auditor selection and page 8 shares highlights from a discussion with audit committee chairs on planning a rotation once a new audit firm is selected. Your EY account team would be pleased to discuss the specific implications for your organization in more detail with you.

If you would like to explore any of the topics in the Audit Committee Bulletin further, please get in touch with your EY contact. These short articles summarize more detailed material that is available – and we would be delighted to set up a discussion.

Pascal Macioce
EY’s Assurance Leader for Europe, Middle East, India and Africa
Investors have started taking a greater interest in audit policy and practices, and many actively seek direct engagement with audit committees.

Members of the European Audit Committee Leadership Network (EACLN) met with Jeannette Andrews, Senior Analyst at Universities Superannuation Scheme (USS) Investment Management, and Deborah Gilshan, Corporate Governance Counsel at RPMI Railpen Investments, to explore the audit committee-investor relationship. USS and Railpen, two of the largest pension funds in the United Kingdom, have been at the forefront of investor initiatives on audit policy in the European Union.

Both said that investors would like to improve their understanding of audit committee activities and would welcome more frequent communication with committee members.

“There’s limited information available to investors about what you do as a committee,” said Andrews.

“Audit-related issues are often addressed by finance directors and other management instead of audit committees.”

She said that companies fail to respond when investors reach out to them on audit issues.

“Investors do read the audit report. We’re not voting mechanically. Whenever we vote against or abstain, we write to the company to explain our position, why we are not supporting the resolution and, if the issue is in relation to an audit, we send our position paper. But the response rate from companies has been less than 5%.”

Both investors would like to see more informative audit committee reports. Andrews suggested that “reporting should be specific and owned by the audit committee – not written by the external auditor or management.”

Gilshan said she’d like to know: “Is there a healthy tension and debate? Are people held accountable? How does the relationship work among the auditor, management and audit committee?”

She noted that a lot has changed since the financial crisis: “Shareholders have much greater interest in understanding audit.”

Investor activism

Investors also take an active interest in audit market reforms throughout Europe. In 2012, a number of institutional investors drafted a position paper. Among other reforms, it proposes a maximum tenure of 15 years for audit firms, a cap on fees for non-audit services of 50% of the value of the audit, and more disclosure in the audit report. More than 30 people representing institutions that collectively manage more than €2 trillion have signed up to the reforms.

Audit chairs’ reaction

Although EACLN members welcomed the growing investor interest in audit, they expressed concern about excessive disclosures and skepticism about mandatory reforms, arguing for flexibility and judgment exercised by the audit committee and board. They were surprised by investors’ perceptions about the audit committee’s work, and disappointed by management’s lack of response to investors’ desire for dialogue. They also recognized the need for more engagement.

“Investors did not have a clear view. They thought audit committees subcontract out their responsibilities,” said one audit chair.

“There is a lot we can do to demystify what the audit committee does.”

Questions for audit committees

› Has the board developed a strategy for engaging with investors on corporate governance topics? What role does the audit committee have in this dialogue?
› Has the board identified audit committee members who could speak with investors, and trained them appropriately?
› Who currently handles audit-related information requests from investors?

To read more from the discussion, ask your EY contact for a copy of ViewPoints 39: Dialogue with institutional investors about audit policy.
Reputational threats drive audit committee concerns about social media

Social media networks add and link customers, employees, investors and other stakeholders to your business every second of every day.

Most directors are concerned primarily with the growing reputational risks that such a ubiquitous channel can generate — for example, when an event or headline “goes viral” on social media and propagates, creating a disproportionate impact.

The best way to mitigate this type of reputational risk is by monitoring social media chatter and ensuring the company is well placed to respond rapidly. This can pose a challenge when companies have time-consuming approval processes.


As one former digital activist said: “Whether you like it or not, people out there on social media are talking about you, reading about you and making up their minds about you ... If you are not part of these conversations, guess who is in charge of public perception and brand reputation? The consumers you have angered, your competitors and the activists who hate you.”

Tracking social media conversation allows a company to understand which topics are provoking discussion and intervene when needed to sway the discourse in their favor. Organizations should listen, engage and persuade — in that order, and quickly.

Opportunities often remain underexploited

Companies active in social media conversations often lead the way with customers and employees. They don’t only turn to social media when things go wrong. They engage regularly and build loyalty. They may generate revenue growth through better targeting and reduce costs by eliminating less effective advertising.

Although many audit committee chairs remain skeptical of the benefits of employees’ use of social media, research indicates that employees trained about the proper use of social media channels actually become highly effective ambassadors for their companies.

In addition, with investors and analysts increasingly drawn to social media for both communication and research purposes, investor relations departments have found social media an effective communications channel. A 2012 survey by the Bank of New York Mellon Corporation revealed that 32% of Western European companies use at least one form of social media to communicate with investment professionals.

Boards should take an active oversight role

Forward-thinking audit committee chairs and advisors suggest that, given the gravity of the reputational risks involved, social media should be a full board issue, rather than one limited to an audit or risk committee.

Some board directors receive updates about policies regarding social media use by employees and management. However, they often remain unaware of how different areas of the business actually use it. As part of increasing awareness, boards may wish to consider adding a director with digital expertise, though they may be tough to come by.

Directors who use social media as a personal source of news and market intelligence are often better equipped to ask management more pertinent questions.

Questions for audit committees

- What are the most significant risks our organization faces from social media?
- What is our strategy for mitigating reputational risk?
- How are we monitoring our organization’s reputation in social media and how quickly can we respond to issues?
- Does the board receive the appropriate briefings on social media policies and issues as they arise?
- Does the board have “digital” members or executives with the necessary skills and experience to coordinate social media programs?
Mining big data to mitigate corruption risk

What is FDA?
FDA refers to the ability to collect and use data, both structured (such as general ledger or transaction data) and unstructured (including email communications or free-text fields in databases) to identify potentially improper payments, patterns of behavior and trends.

72% of respondents say emerging big data technologies can play a key role in fraud prevention and detection.

90% believe forensic data analytics will enhance the risk assessment process.

Yet only 2% are leveraging big data technologies.

and only 11% are using statistical analysis and data-mining tools.

Companies are missing opportunities to mine big data to reduce fraud risk and improve anti-bribery compliance, according to a recent EY survey.

EY's Global Forensic Data Analytics Survey, Big risks require big data thinking polled more than 450 executives, including heads of internal audit, compliance and legal teams.

Sixty-three percent of respondents agree that they need to do more to improve their anti-fraud or anti-bribery procedures, including using forensic data analytics (FDA). Two-thirds indicate that they need to raise management's awareness of the benefits of FDA in general, and of proactive transaction monitoring in particular.

Regulatory requirements, anti-corruption laws and recent enforcement trends emerged as the clear driving forces behind the design and use of FDA. The vast majority of respondents (90%) felt that FDA “enhances our risk assessment process” and helps “detect potential misconduct that we couldn't detect before.” Risk areas such as bribery and corruption, asset misappropriation and financial misstatement are priorities for FDA attention.

“Regulators and law enforcement agencies are intensifying their cross-border cooperation. Significant corporate fines and jail sentences for executives have become more common. In this climate, boards should encourage management to utilize forensic data analytics in their ongoing compliance efforts,” says David Stulb, EY’s Global Leader of Fraud Investigation & Disputes Services.

“Given that their companies are likely generating substantial data volumes, it would be prudent for board members and other stakeholders to encourage management to accelerate their efforts to glean as much insight as possible from their big data. Better risk assessments and more effective compliance, among other benefits, are likely to follow,” he said.
Audit committees struggle to find balance of skills

Audit committees have seen their roles evolve in response to the overarching challenge of risk and its management. The committee now regularly looks beyond the financial data reports to focus on an organization’s ethics and quality of procedures. New areas of responsibility may include oversight of international operations, litigation and investigations, cybersecurity and the impact of political shocks.

A high level of recent and relevant financial experience will always remain a core requirement for the audit committee. However, these expanded responsibilities have put new emphasis on the importance of including non-financial expertise and soft skills within the group.

The ability to draw on a mix of competencies can prove critical when trying to understand the full spectrum of risks. For example, someone with deep sector knowledge can bring operational insights and a background on industry-related compliance issues. Broad business experience, proficiency in specific areas such as technology or public policy, legal training, and people skills (such as the ability to challenge management in a constructive manner) have all become sought-after capabilities to create a well-rounded audit committee.

**A tough recruiting environment**

Boards face a difficult balancing act assembling the portfolio of desired skills within the size limits of the committee.

Recruitment challenges pose further complications. The time commitment for financial directors has gone up in the wake of the financial crisis, so they only sit on one board at a time. European boards face remuneration issues when trying to recruit directors from the United States, where compensation packages have a different structure. Remuneration also varies widely across Europe, with Switzerland and Spain at the top, the UK in the middle, and France and the Netherlands at the bottom (a 2012 Hay Group survey found that median basic board fees were €197,500 in Switzerland and €20,000 in France).

Several countries have implemented quotas to ensure that women constitute a certain percentage of the board. This trend is growing.

Today’s boards find that, to achieve the right balance of skills in such a difficult recruiting environment, they must cast the net wider and look beyond their traditional sources for candidates. They are approaching recruitment in a more systematic manner, often putting succession plans in place among current board members. Some boards are tapping into the pool of younger, less experienced candidates and then offering the training and support needed for them to grow into the role. Others consider candidates from outside their industry or geography.
Questions for audit committees

- How do you ensure an effective level of financial expertise?
- How important is specific sector experience compared with broader senior-level business experience? How do you balance the requirements?
- How can the audit committee support new members?

To read more about audit committee composition, ask your EY contact for a copy of ViewPoints 38: Audit committee composition.

For more insights on board diversity and meeting recruitment challenges, see the EY report Time for change: recruiting for Europe’s boardrooms.

Examples of regulation and guidance regarding audit committee composition

Regulations and corporate governance codes in the European Union and the United States typically specify that at least one member of the audit committee should have accounting, auditing or financial expertise. Some codes and proposed legislation go even further.

How does your audit committee measure up?

- **EU Directive on statutory audit**: at least one member shall have competence in accounting and/or audit.
- **European Commission proposal on audit policy**: one member shall have expertise in audit and another shall have expertise in accounting and/or audit. The committee members as a whole shall have competence relevant to the sector in which the audited entity is operating.
- **UK Financial Reporting Council**: at least one member shall have recent and relevant financial experience.
- **Spanish Corporate Governance Code**: all members, particularly the chairman, shall be chosen with reference to their knowledge and background in accounting, auditing and risk management matters.
- **German Corporate Governance Code**: the chair shall have specialist knowledge of accounting and internal control.
- **New York Stock Exchange listing requirements**: all members shall be financially literate, and at least one must have recent and relevant financial experience.
Choosing an auditor

In many companies, the audit committee takes the lead in choosing a new auditor. The selection process can be complicated and time-consuming, but also presents an opportunity to challenge the status quo and improve the quality of the audit. Members of the European Audit Committee Leadership Network recently discussed their most important auditor selection criteria and points to consider. Here’s a short summary of their conclusions.

The audit plan
Understand the approach the auditor will take when conducting the audit.

Sector expertise
Given that different industries pose different audit challenges, how recent and relevant is the bidding firm’s experience in your sector?

Staffing of the engagement
Be clear who will be on the team and for how long. If expertise in a specific area such as tax, corruption and bribery, exposure to the US or emerging markets risk is important to your business, make sure you have access to that talent and that the right people are assigned to your engagement.

Global reach and integration
Large global companies should have an audit firm capable of auditing remote offices effectively. Look for evidence about how well the firm works with its overseas network, and the depth of knowledge and seniority of local staff in your key countries.

Efficacy of the consultation process
Evaluate how well the firm resolves difficult accounting issues and consults between its functions and offices. For example, how is the IFRS desk organized? Can technical disputes be resolved quickly and efficiently?

Character and authority of the senior partner
The senior partner should have the courage to point out mistakes and challenge management in a way that supports a good relationship. References can help you assess the candidate’s emotional intelligence and character. You could also ask the bidding partners about the largest crisis they’ve experienced and how they handled it.

Audit fees
Evaluate cost alongside audit quality and depth and breadth of the firm’s offerings.

Independence as determined by non-audit services
Regulatory requirements often determine the nature and percentage of non-audit service that an audit firm can provide. When evaluating a potential new auditor, ensure that you understand the implications for non-audit services to avoid potentially costly mistakes.

Read more from the EACLN discussion on audit tendering in ViewPoints 37: Audit firm retendering and rotation.
Since the financial crisis, regulators, policy-makers and some investors have put the independent audit process under the microscope. Increasingly, these groups are questioning the audit firm-client relationship and calling for greater transparency.

Bowing to this pressure, last month the European Parliament adopted final legislation requiring audit firm rotation. Some countries were further ahead: Italy has required rotation every nine years since the 1970s. The Netherlands recently imposed an 8-year rotation period effective from January 2016, and in the United Kingdom, FTSE 350 companies must retender every 10 years.

The clamor for greater transparency around the audit-client relationship has led to a new approach in corporate reporting and raised the levels of auditor rotation. More audit chairs are finding themselves managing an audit firm transition – often for the first time.

Companies with a new auditor face the challenge of managing the incumbent while installing the replacement. How well a company does this can make a big difference to the transition’s outcome.

Changing auditors is complex and potentially disruptive, but it also presents a genuine opportunity to improve the quality of audits. Audit chairs can help foster a smooth transition by putting several processes in place:

1. **Plan the transition well in advance**

   Planning for the transition is so important that the UK’s Financial Reporting Council (FRC) – often considered a leader in corporate governance – suggests that the company incorporates transition planning into the tender process by asking the competing firms how they would manage it. The company could also request that the incoming firm names a specific partner responsible for the process. Creating a project management office and structures for feedback will help keep the rotation on track and highlight issues as they arise.

2. **Allow sufficient overlap between the two firms**

   Rather than assuming adequate collaboration between the outgoing auditor and the incoming one, audit committees need to factor in sufficient overlap to allow for knowledge transfer, effective dialogue and a review of working papers. This period will usually be 6 to 12 months. The FRC suggests that the new auditor be involved in key stages of the outgoing firm’s last audit. The audit committee can also request that staff of the incumbent firm share knowledge about the business and its systems and processes.

3. **Provide management support**

   Management plays an important role in assisting the new auditor. Transparency and openness are the keys to building a successful relationship. Business leaders should make themselves available to answer questions.

4. **Provide audit committee support**

   The audit committee must build a strong relationship with the new external auditor and clearly define the committee’s responsibilities. Members can help guide the incoming auditors by sharing their company knowledge and identifying risks that the new auditors may have overlooked because they aren’t familiar with the details of the business.

Other factors besides regulation may prompt a company to change auditors. Some institutional investors support and advocate periodic rotation. An organization may decide to change if it is dissatisfied with the performance of its current audit firm. Or, if two merged companies have different auditors, the combined entity will typically reflect on the merits of both and select one of them to be the new auditor.

Whatever the reason, changing auditors can be a long and costly process, but proper planning will help ensure a successful transition.

This article summarizes key points raised at the November 2013 European Audit Committee Leadership Network meeting. To read more from the discussion on auditor retendering and rotation, including views on potential impacts on the audit profession, ask your EY contact for a copy of ViewPoints 37: Audit firm retendering and rotation.
On the audit committee agenda

Audit committees in our region are most worried about the economy, internal controls and fraud. They also spend more time addressing risk and cash flow issues than they did three years ago.

A November 2013 survey asked EY partners across Europe, the Middle East, India and Africa which issues were on the minds of the audit committees they serve, and how audit committees were spending their time. The online survey generated 690 responses about EY clients. Five hundred were publically listed companies and 397 have turnover over US$1 billion.

The results can help you benchmark your audit committee’s issues and activities. To discuss the findings in more detail, speak to your EY contact.

Survey reveals top audit committee issues
How today’s audit committees spend their time, ranked by importance

**Significantly increased activities for the AC in the past three years? (>10% mentions) – ranked by importance**

- Power and utilities
- Oil and gas
- Diversified industrial products
- Consumer products
- Retail and wholesale
- Real estate
- Banking and capital markets
- Insurance
- Telecommunications
- Technology

### Activities

- Time spent on risk-related issues
- Overseeing liquidity and cash flow of the company
- Reviewing forecast data
- Time spent on the detail of accounting judgments and policy
- Understanding the rationale behind accounting positions
- Overseeing reputational risk
- Time spent in audit committee meetings
- Seeking external advice on key risk issues
- Understanding impact of audit policy reforms

### Importance Levels

- Most important
- Important
- Moderate importance
- Low importance
- Least important

*The survey asked: “How have the following activities changed for the audit committee in the past three years?”*
Recent EY publications of interest to audit committees

Insights 19: Ensuring social media is on the board’s agenda
How much oversight do you have with social media? We explore its risks, opportunities and benefits from a board’s perspective.

Big risks require big data thinking: EY’s 2014 Global Forensic Data Analytics Survey
Fraud and corruption risk is rising, but many companies are missing opportunities to manage it. Here’s how companies can use ‘big data’ to combat fraud and improve compliance.

Tomorrow’s investment rules
Learn why institutional investors are placing increasing importance on environmental, social and governance information and how they assess its value.

Board Matters Quarterly (India)
The inaugural issue from India looks at regulatory changes, tax risks and essentials to evaluating board effectiveness. It also shares a board member’s perspective on the critical challenges facing audit committees and boards.

Time for change: recruiting for Europe’s boardrooms
We examine the need for a new approach to recruiting in Europe’s boardrooms to drive competitive advantage, and interview non-executive directors and audit committee chairs.

Reporting magazine (May 2014)
This issue touches on the themes of new risks, stakeholder communications and technology.

Board Matters Quarterly (US)
We discuss the challenges and opportunities of current digital technologies, and provide questions for boards and audit committees to consider.

Point of view
EY shares perspectives and context on the new European Union audit legislation.