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,

I am pleased to provide you with the latest edition of our Audit Committee Bulletin – a briefing designed to summarize the topics EY discusses with the audit committees we work with.

For boards tasked with oversight of our clients, change is a constant. Economic, regulatory and political forces continue to affect the risk management, financial reporting and governance of businesses throughout Europe.

In this issue:

- Companies are facing unprecedented reputational risk in relation to tax. Audit committee members can expect to see tax risk and controversy management move further up on the board’s agenda. On page 3, you will find highlights from our recent global tax survey, including a look at how companies are addressing their own policies, using technology in new ways and communicating with tax authorities.

- The results of EY’s latest global fraud survey show that executives believe fraud is widespread but there’s a suggestion that compliance fatigue may have set in. We explore the role of the board and audit committee in ensuring a comprehensive and effective anti-fraud approach.

- The Dutch Audit Profession Act has imposed an eight-year audit firm rotation period and sharply restricted non-audit services. Highlights from a recent discussion of audit committee chairs on page 5 explore the law’s impact and the potential lessons for other European countries.

- Many organizations are looking to move to a centralized operating model for their risk, control and compliance function to align processes better with the rest of the business, and drive down costs. We explore how the audit committee might work with businesses to support the design and transition to a new model. Integrated reporting is gaining ground, but audit committee members don’t always agree on the role the audit committee should take in providing oversight. We summarize some of the issues.

The articles in this issue are summaries of more detailed material. If you would like to explore any of the topics further, please get in touch with your EY contact.
Rising tax risks mean audit committees must increase oversight

When it comes to tax, companies believe that they now face unprecedented levels of reputational risk. That is one of the key findings of the recent EY global report *Bridging the Divide*, which reveals the most important sources of current and anticipated tax risk for companies today.

More than four out of five of the tax and financial executives surveyed (81%) expect these already heightened tax risks to become more important for their companies in the next two years. Their views indicate that audit committee members can expect to see tax risk and controversy management move further up the business agenda.

Survey findings of particular interest to audit committees include:

- Eighty-four percent of the largest companies agree that entering into, or operating in, an emerging market significantly increases levels of tax risk and controversy risk, up from 67% in 2011.

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Increasing the tax function’s level of involvement and communication with the rest of the business often proves critical to successful risk management.

“Today’s global business environment presents a complex assortment of tax risks for multinationals, particularly when they are operating in less familiar markets. Audit committees should be actively engaged on this issue. They must ensure that they have open lines of communication within their own enterprises,” says Dave Holtze, EY’s Global Tax Vice Chair.

For companies to bridge the divide between their current and future tax risk management models, they will need to follow a well-thought-out, well-resourced strategy while remaining flexible enough to deal with changing legislative and business requirements.

Short-term oversight actions for audit committees might include:

- Ensuring your business is prepared to address the implications of new transparency demands and the Organisation for Economic Co-operation and Development’s Base Erosion and Profit Shifting project.

- Encouraging better visibility and control of any active disputes or uncertain tax positions around the world.

- Making sure your company has the right resources in place – in terms of people, technology and systems – to deal with all required tasks.

**Questions for audit committees**

- How recently have you reviewed your tax risk or tax controversy policy?
- Does the audit committee regularly engage with the tax function in your organization?

To learn more about the most important tax risks facing today’s businesses and to download the full survey, visit [www.ey.com/taxriskseries](http://www.ey.com/taxriskseries).

**Tax risk isn’t just about what’s outside**

When we asked tax and finance executives what were the biggest potential sources of operational tax risk:

- 75% cited insufficient resources to cover tax function activities.

- 64% cited insufficient internal communication.

- 57% cited a lack of processes or technology.
Corruption leaves boards struggling to cope

EY’s latest Global Fraud Survey has found concerning levels of perceived fraud, bribery and corruption across the world. Nearly 40% of all respondents believe that bribery and corruption are widespread in their country.

Overcoming compliance fatigue: reinforcing commitment to ethical growth draws on in-depth interviews with more than 2,700 executives across 59 countries. The findings suggest that, at a time when compliance fatigue appears to have set in, management and boards may be struggling to respond to both long-standing threats and emerging risks.

Despite international cooperation between regulators becoming more frequent, respondents described a largely static internal compliance environment:

- One in five businesses still does not have an anti-bribery and anti-corruption (ABAC) policy.
- Forty-five percent of organizations have not introduced a whistle-blowing hotline.
- Less than 50% of respondents have attended ABAC training.
- Less than a third of businesses conduct anti-corruption due diligence as part of their M&A processes.

In terms of new fraud risks, cyber crime does not appear to be as high on the agenda as might be expected given the severity of the threat. Of those surveyed, 48% considered cyber crime to represent a very or fairly low risk to their business; however, 60% said that cyber crime should be discussed regularly by the board.

The board’s role

The survey also revealed that those companies with the most engaged and demanding leadership were the ones making the most robust compliance efforts across the business. In these organizations, the board sets a challenging plan and continues to ask tough questions, actively holding senior management accountable for results.

Questions for audit committees

- Is management focusing its resources on the right risks?
- Do senior managers attend compliance training, and what oversight does the board have?
- How can management encourage ethical conduct?
- Does the board have any reason to believe that compliance efforts are losing momentum?
- Does the business operate in markets where unethical conduct, including bribery and corruption, is widely accepted?
- What are the board’s and the audit committee’s level of engagement relating to cybersecurity?
- Does the company align cybersecurity objectives with corporate strategic or functional objectives, and with its overall risk appetite and risk tolerance?
- Does the company have a cyber-breach incident response plan that is in compliance with the regulatory guidance on the disclosure of cybersecurity issues?

What does good look like?

Our survey points to a structural level of unethical and illegal conduct whose impact businesses must seek to minimize. This means being able to detect, investigate and remedy the actions of individuals within their organization that are prepared to act unethically.

Reflecting on our research and our experience of serving clients around the world across a wide variety of industry sectors, below are some of the key elements of leading practices:

- Board engagement – boards need to challenge management appropriately and request regular updates regarding fraud, bribery and corruption risk, particularly around new risks, such as cyber fraud and cyber crime.
- Big data – mining big data using forensic data analytics tools can improve compliance and investigation outcomes and help provide useful summary information to the board.
- Anti-corruption due diligence – such specialized due diligence should be the norm, not the exception. If pre-close work is not possible, then undertaking post-close work is essential, given the company may own the liability for illegal acts.
- Escalation procedures – companies should have clearly defined escalation procedures, whether to respond to a whistle-blower or a cyber threat, to minimize the damage being done.
- ABAC training – companies should have clear ABAC training programs tailored to general job functions and levels of seniority. C-suite executives need to lead from the front on training and cannot be exempt from it.
- Budget support for internal audit and compliance functions – both play essential roles in improving standards of business conduct and in keeping the company out of trouble.
The Dutch Audit Profession Act imposes an eight-year period for audit firm rotation and sharply restricts non-audit services. Although the effective date for mandatory rotation is 1 January 2016, the new law, which is more restrictive than recently passed EU audit legislation, has already begun to have a substantial effect on the Dutch audit market.

The European and North American Audit Committee Leadership Networks recently met with several audit committee members of Dutch companies and with a number of EY Netherlands partners to reflect on the law’s impact and its lessons for the rest of Europe.

The participants expressed concerns about the act’s rapid implementation and the additional workload created for audit committees. But they also noted that many large companies are responding to the legislation by carefully planning their procurement of audit firm services.

Some businesses have reaped unexpected benefits from the tendering process. These benefits have included the valuable internal discussions they have held on how to streamline and restructure financial reporting processes, and the fresh approach to their audit they have gained by engaging a new firm.

The group discussed how the law will affect the audit profession and market, and several themes emerged:

» Fee pressures must not undermine quality. All stakeholders, including regulators, remain concerned about protecting audit quality. In the event of downward pressure on fees (and unrealistically low bids in some cases), audit committees will have to be vigilant in defending quality. And audit firms may have to improve how they assess the risks and difficulties involved in prospective audit engagements, if they are to avoid underpricing them.

» Market pressures may force audit firms to favor generalists over specialists. Frequent redeployment of staff to new accounts requires greater flexibility from staff and could represent a threat to audit quality. Recruiting young people into the audit profession could also become more difficult.

» Mid-tier audit firms have not received the anticipated boost. So far, the law has not reduced concentration in the market. This is probably because smaller firms lack the capacity to compete for larger accounts.

The law will undoubtedly shake up the Dutch audit market by creating a large number of transitions. But both incoming and outgoing audit firms have an incentive to cooperate to ensure a smooth handover. If the process is planned well in advance, and if the new firm is invited to shadow the old firm on the last audit, it can help the new firm to learn about the company and its accounts.

As the law starts to take effect, companies will need to explore ways of easing the transition from one firm to another. They will have to balance the need to minimize disruptions against the benefits of bringing new perspectives to the audit.

Read more about the discussion on mandatory audit firm rotation and the Dutch experience in ViewPoints.

The new Dutch law and its European context

The aim of the Dutch Audit Profession Act, as stated by Dutch policy-makers, is to increase the independence of external auditors and so to improve the quality of audits. Another objective is to increase competition in the audit market by providing more opportunities for mid-tier audit firms.

The restrictions apply to all Dutch public interest entities (PIEs). Dutch PIEs include:

» Companies incorporated in the Netherlands under Dutch law that are listed on a regulated market in the EU

» Banks, central credit institutions and insurers with registered offices in the Netherlands

» Entities falling into specific categories designated by the Ministry of Finance

The restrictions on non-audit services took effect on 1 January 2013, with a two-year transition period for pre-existing contractual obligations. The effective date for mandatory firm rotation is 1 January 2016. A company will need to change its audit firm before then if not doing so would mean that it would have had the same auditor for eight consecutive years or more on that date. When an audit firm rotates out of an engagement, it cannot be rehired for a period of two years.

Read more about the discussion on mandatory audit firm rotation and the Dutch experience in ViewPoints.
Risk, control and compliance: creating functions for the future

Centralized operating models can help your organization manage risk more effectively and drive down costs. Have the risk and compliance functions kept pace with the rest of your business?

Businesses often put pressure on functions such as HR, finance and IT to deliver maximum value at minimum cost. In larger companies, this challenge is often met through centralized operating models, which make use of shared services centers, offshoring (for example to India, eastern Europe or South America) and outsourcing to third-party providers.

Risk, control and compliance functions have historically been less willing to embrace such operating models. But some organizations have started challenging these functions to reconsider their reluctance.

Many organizations believe that a centralized approach represents an important opportunity to align these functions with the rest of the business, to manage risk more effectively, to drive down costs and to make the best use of technology.

Increasingly, organizations are not asking “if” but “when and how” they should make the move to a centralized risk, control and compliance operating model. Audit committees of businesses moving to a centralized operating model should be aware of the practical challenges and risks involved with this transition.

In the design phase, the business must:

- Plan to make full use of work shifts to maximize productivity and ensure global coverage
- Set clear service level agreements and responsibilities
- Manage exchange rate and inflation risk
- Control telecommunications costs

And, in the transition phase, the business must:

- Carefully manage expectations on how long recruitment can take
- Prepare for potential reporting delays and technical interruptions
- Ensure effective knowledge transfer to those on the operating center team

Organizations that fail to carry out these key tasks risk financial loss, reporting errors and fraud.

Questions for audit committees

- Does your risk, control and compliance operating model meet current business needs, and is it aligned to the longer term business strategy?
- If you are considering a centralized operating model for risk management, are you aware of the issues to address in the design and transition phases?

To learn more, read the full report: Centralized operations: the future of operating models for risk, control and compliance functions.
Audit committees: finding their role in integrated reporting

Integrated reporting is gaining ground. This is in part because of increased pressure from investors and regulators. However, many companies and their boards wonder what the best approach is and what role their audit committees should play in integrated reporting.

To discuss these issues, members of the European and the North American Audit Committee Leadership Networks met with Paul Druckman, CEO of the International Integrated Reporting Council (IIRC), and Keith Nichols, CFO of Amsterdam-headquartered paints and coatings company AkzoNobel, a participant in the IIRC’s pilot program for integrated reporting.

The IIRC leads a coalition of regulators, investors, companies, standard setters, accounting professionals and non-governmental organizations. Its stated mission is to embed integrated reporting into mainstream business practice in both the public and private sectors.

Druckman and Nichols told the network members that integrated reporting is not simply another layer of reporting. They said it, rather, a more coordinated and concise means for companies to show how they create current and future value, and to describe the assets and resources they use to do so. They also emphasized that, although the mechanics of integrated reporting may not be easy, integrated reporting is not as difficult as it may first appear.

The role of the audit committee remains unclear

During the session, the audit committee’s role in integrated reporting was debated. Participants’ opinions differed on whether non-financial information should be subjected to auditing and on how the audit committee should oversee such processes.

Some network members suggested that audit committees should limit their role to managing more traditional areas. Others thought that audit committees should take a larger role, but with the requirement that the full board sign off on the final report.

Nearly all of those currently conducting integrated reporting said that some level of assurance was necessary and that their audit committee played a role in this.

Participants also debated whether audit committees had the expertise necessary to deal with the non-financial information. Some doubted that non-financial information would ever fall under the same regulatory oversight and scrutiny as financial reporting.

When it comes to oversight, there were different views about what role the audit committee should play:

- **The audit committee’s role is vital to integrated reporting.** Several members suggested that the integrated nature of reporting makes the audit committee responsible. Others felt that the audit committee’s most important role is to ensure sound processes in the gathering of non-financial information.

- **The audit committee is not responsible for integrated reporting.** Some members argued that audit committees lack knowledge of the critical risk factors in non-financial aspects of the business. Others thought that the responsibility for integrated reporting should be split among several committees, each overseeing its own area. Some participants expressed the view that the strategic nature of integrated reporting puts it beyond the scope of the audit committee.

Questions for audit committees

- Have you assessed the benefits and risks of integrating non-financial information with the financial information in your reporting?
- Within your organization, who has responsibility for controls around non-financial information? What role does internal audit play in integrated reporting?
- Should non-financial data be audited in a similar way to financial data? What is the role of the external auditor in assessing inconsistencies between the company’s financial statements and other information?
- How will your audit committee’s role change when integrated reporting is introduced?
Integrated reporting (as proposed by the IIRC) sets out that, in future, corporate reporting will need to provide a broader and longer-term view of the performance of organizations.

To achieve the greatest level of value creation from your move to integrated reporting, it is important to carry out the following steps:

- **Describe the strategy:** the aim of integrated reporting is to help companies better demonstrate sustainable value creation, by enabling them to explain how they use both tangible and intangible assets. To show sustainable value creation, it is essential to describe the strategy and business model.

- **Build the right team:** bring together talent from across the organization to create both a steering committee and an operational team. The steering committee should include senior representatives from finance, compliance, sustainability, human resources (HR), operations, legal and internal audit. The operational team should include people from the same groups, and it should be made responsible for gathering core information and reporting that information back to the steering committee.

- **Assess the gaps:** you will need to build a business case for integrated reporting. This should focus on how integrated reporting will help create value for shareholders and on how the planning and measurement improvements it will bring will help build long-term sustainable value. A practical first step toward achieving this is to benchmark the reporting data the organization has against the IIRC framework to reveal what additional information is needed.

- **Determine material matters:** start with a broad list of matters relating to the various capitals your organization depends on. This list can be organized around internal factors (such as the value-creation strategy and emerging risks) and external factors (the needs, interests and expectations of stakeholders). This list will help you determine which matters are material to investors and which matters influence value over time – these will need to be disclosed in the integrated report.

- **Establish KPIs that are aligned to the business strategy:** to implement integrated reporting successfully, you must identify the issues and capitals that have a material impact on performance. KPIs allow for value to be quantified. They also provide a means for tangible and intangible assets to be measured. Once senior management has determined the appropriate indicators, management can focus on monitoring strategic and material matters, and investors can assess value creation.

- **Secure consensus:** it is important to realize the difference between having a strategy and being able to communicate and execute it. The project team should strike the right balance between protecting the organization’s competitive standing and giving stakeholders clear indicators of its long-term prospects for sustainable value creation.
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 diversity: accelerating performance in corporate boardrooms**
We offer a perspective on how boards can capitalize on diversity to improve their own performance in the context of a possible introduction of quotas for female non-executive directors on the boards of large companies across the EU.

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

**Board Matters Quarterly (US): doing business in China**
The Chinese economy is flourishing, making China a focus for many companies. Board Matters Quarterly examines some of the business challenges and opportunities in China and offers questions for the board to consider on issues related to bribery, corruption, cybersecurity and IP theft.

**Staying on course: a guide for audit committees**
Our guide for audit committees provides an overview of the role, questions to consider and tools such as an example charter, a self-evaluation, a meeting planner and more.

**Let’s talk: governance - 2014 proxy season review**
Our 2014 proxy season review sees company-investor dynamics evolving as engagement becomes mainstream in the US.
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