This bulletin summarizes some of the issues that audit committee chairs of leading European companies are currently discussing with their advisors in EY.
Six main longer-term trends show that industry and geographic borders continue to erode, mandating a broader perspective on the risks and opportunities that may affect your business.

Which of these social and economic shifts should be part of your boardroom discussions this year?

Megatrend 1: global rebalancing
The distinction between “developed” and “emerging” markets will become less important as the balance of economic power becomes multipolar. By 2025–30, some emerging markets per capita incomes will approach parity with those in today’s advanced economies. By 2030, two-thirds of the global middle class will be Asia-Pacific residents, up from just under one-third in 2009. A new tier of emerging markets, including Turkey, Mexico, South Korea and Indonesia, will succeed the BRICs.

Megatrend 2: future of work
The gap between available skills and employers’ needs continues to grow, competition for the right talent accelerates and technological advancement is changing notions of what and where the “workplace” should be. Workforce diversity and resolving the unemployed youth crisis will be critical to long-term growth.

Megatrend 3: digital transformation
The amount of data created every day in 2012 will double every three years, forcing businesses to transform their models to optimize performance in the “big data” era. Cloud computing and mobile technologies have become mainstream and mobile devices increasingly replace PCs. Analytics and social media reach every aspect of an enterprise, constantly posing new cybersecurity and privacy threats.

Megatrend 4: resourceful planet
Commodities and natural resources drive roughly 10% of global GDP and underpin the performance of nearly every industry. Increasing competition for finite resources will drive a new cycle of clean technologies, energy-efficient innovation and unconventional sources of oil and gas. Energy security concerns and pricing, growing food challenges and water scarcity create new risks and opportunities that businesses can no longer ignore.

Megatrend 5: rethinking government
Governments collaborate more with the private sector as they attempt to balance austerity measures with escalating citizen need. Many are undergoing tax reform to improve their revenues and increase competitiveness for investors. As markets become more interconnected, international regulatory cooperation increases along with the number of international standards. Businesses must stay agile to keep up with changes and ensure compliance.

Megatrend 6: reconfiguring the financial system
Implementing many major regulatory reforms simultaneously will see banks continue to struggle with the demands of compliance. The consumer protection agenda will likely stay strong. EU legislative proposals to reform the audit profession, including mandatory rotation and a prescribed list of non-audit services have been provisionally agreed.
In Europe and the emerging markets, changes in bank lending are pushing companies more toward the capital markets to achieve financing.

To learn more about these megatrends and how they may affect your business, speak to your local EY contact.

Questions for audit committees
- Does your boardroom agenda address the non-traditional challenges?
- Is your business actively assessing the risks and opportunities surrounding these trends? What response is planned?
- Are your current risk management and reporting processes equipped to support decision-making in response to these changes in the global economy?
The term “groupthink” is defined as a mode of thinking where pressure for unanimity overwhelms motivation to appraise the alternative courses of action realistically.

Dr. Irving Janis, a professor of psychology at the University of California-Berkley, coined the term after researching a series of leadership failures, from the Bay of Pigs invasion to the Vietnam War.

With the campaign for boardroom diversity enjoying a headwind across the globe, awareness of the danger of groupthink has grown exponentially. Despite this, groupthink still has the power to influence boards and audit committees.

One reason groupthink takes hold is because it’s a largely unconscious dynamic. Without conflict around ideas, participants feel comfortable and can readily agree a solution. All sides feel validated – and remain unaware of the impending danger.

Speaking up

Board and audit committees do have a number of options to minimize the possibility of groupthink. The chair has a critical role in boosting interaction between board members and in setting the tone for board deliberations.

EY Assurance professional Josh K. Jones says: “In the most effective audit committees, we have observed a variety of methods to encourage the mutual sharing of views. That includes the leader taking the time to create that environment, being proactive and asking for different perspectives from people who might not always get their views heard.”

Boardroom effectiveness reviews can also prove useful in understanding the board’s approach and style and can bring an independent outside perspective.

Having a diverse board and committee can be crucial.

“Diversity is a powerful way to avoid groupthink, as people’s minds won’t be programmed to think in the same way,” says Peter Matthews, Chair of Global Learning at EY.

“The idea of having a board that has people of the same educational background, the same career experiences, the same sex, the same ethnic background, means that you won’t get the variety of experiences that enable the best decision to be made.”

Non-executive directors, an increasingly valuable source of diverse talent, can provide senior expertise to review and challenge decisions – a role that is only improved by their informed detachment. However, companies should take care not to negate these potential advantages by only hiring experienced, familiar non-executive directors. Rather than rely solely on their own networks and recommendations to recruit, firms may need to advertise openly to overcome assumptions about where talent can, or should, be found.

Read more about the dangers of groupthink in Reporting magazine issue 6.
A better way to deal with international tax disputes?

With governments struggling to pay off their debts and companies squeezing every last ounce of profit from their operations, disputes over tax are becoming more frequent.

Tax authorities now work together and share information as never before. Following guidance from the OECD, they have increasingly pressed for joint or simultaneous audits of companies and clamped down on loopholes.

As a result, companies need to manage tax risk and its implications, sometimes across many jurisdictions, much more proactively than in the past.

Reputation at stake
The challenge is as much about reputation and governance as it is about managing a company’s tax exposure.

Companies need to tackle “here and now” tax issues, but they also need to consider how past transactions may be viewed against today’s standards of disclosure, and how current decisions may be regarded in the future.

They must remain consistent in what they say about their tax affairs. With governments exchanging information, sometimes on a real-time basis and particularly about international companies, messages can quickly become mixed.

A tax treatment that might result in just a warning in one jurisdiction could result in criminal sanctions or a tough penalty in another.

A new role emerges
To address these challenges, some companies have created a new role — the Global Head of Tax Controversy. Honeywell and Lego have taken this path, and insurer AIG recently appointed Nancy Chassman to this post.

Chassman says she works closely with senior management and the company’s regional tax controversy leaders “to ensure we are proactively and effectively managing our audits and tax litigation.”

She notes that while many tax authorities are aggressively expanding their enforcement activities, they are also seeking ways to improve collaboration with large businesses to resolve tax disputes. She is setting up a framework to implement a global tax controversy function to enhance AIG’s relationships with tax administrators around the world.

“I believe that, through cooperation with tax authorities, we will mitigate tax controversy and resolve tax disputes in a timelier manner,” she says.

Collective responsibility?
This kind of role might not suit every business. Audit committees should consider what value it could add in their organization.

They may see benefit in appointing someone to act as a senior lightening conductor on international tax issues, or to be the “board’s conscience” when tax treatment and reputation intersect.

Then again, is it better for the board as a whole to retain collective responsibility for the issue, with the audit committee overseeing management of the associated risks — as it does with other risk categories?

You can read an interview with AIG’s Head of Global Tax Controversy, Nancy Chassman, in issue 10 of EY’s T Magazine.
Companies seeking business opportunities in Asia-Pacific’s rapid growth markets may be exposing themselves to unnecessary risks of fraud, bribery and corruption.

EY’s Asia-Pacific Fraud Survey suggests that companies in the region fall behind their European and American counterparts in implementing fraud policies.

The risk of unethical practices is greater in rapid growth markets than in Europe, possibly due to a disconnect in the local application of policies. Companies operating in these markets may feel compelled to align with the local business culture over global compliance frameworks, which can create conflicts.

According to the survey, only 40% of the region’s employees said their companies have an anti-bribery and corruption policy or code of conduct in place. This compares to 81% globally and 57% across Europe, the Middle East, India and Africa, putting companies in Asia-Pacific well behind the rest of the world.

Even among companies who do have anti-bribery and corruption policies, employees remain unconvinced of their effectiveness, with fewer than half the respondents saying that the policies work well in practice.

More than a quarter of respondents also said that company management is likely to take shortcuts to meet targets when economic times are tough.

“Given the climate of economic austerity, companies operating in the Asia-Pacific and other volatile markets must take a hard look at how to mitigate the risk of unethical practices,” says Chris Fordham of EY’s Asia-Pacific Fraud Investigation and Dispute Services.

Detecting and preventing fraud – key findings

- 78% of respondents agreed that using technology to examine all transactions across the company would result in better fraud detection and help prevent corruption
- Only 32% of respondents, compared with 53% globally, said that their companies have a whistle-blowing scheme, whereas 81% in Asia-Pacific said that they would be prepared to use this procedure
- Only 26% believe that government efforts against bribery are working. Companies still want governments to do more

Questions for audit committees

- Has the business entered markets where unethical conduct, including bribery and corruption, is widespread?
- Have your anti-bribery and anti-corruption policy practices, such as whistle-blowing schemes, been tailored to address the local regulations and business culture effectively?
- Do your internal reviews make best use of forensic analysis, data analytics and other technology-based solutions to focus resources on the relevant risks?
Boardroom recruitment: time for a change?

How balanced is your board? Does its current composition and representation meet the needs of your organization and help you maintain competitive advantage, or is it time for a change?

While Europe has successfully brought the issue of gender diversity on boards to the forefront of the global debate, the recruitment methods used to fill boardroom positions have hardly changed. Personal networks still form the main method for identifying and recruiting candidates, and often only those who have already served on boards will be considered. These factors work against efforts to broaden the base of experience and skills and maintain a mix of perspectives in the boardroom.

Many business leaders share the view that the current boardroom recruitment process needs to be shaken up.

EY offers four practical considerations for improving your boardroom recruitment, based on insights gained from conversations with clients and board members across Europe:

### 1. Structure
Realign the composition of the board with the evolving needs of the business, taking into account issues such as numbers and profile of non-executive directors, duration of service and sector-specific needs.

Consider rotating non-executive directors regularly and appointing individuals with a wider range of skill to help open up the board’s approach to managing changes and risks.

### 2. Process
Investigate ways to use headhunters more effectively, such as alternating recruitment firms and separating evaluation from search. You could also consider hiring headhunters who represent the candidate rather than the client, advertising for boardroom posts, or using the growing number of databases to identify new candidates.

### 3. Criteria
Create a larger pool of potential candidates by abandoning the requirement that candidates “must have experience of a PLC board.” Instead, widen the search to include those with analytical skills, independence of thinking and a capacity to challenge established ideas.

### 4. Succession
Make a succession plan and keep it transparent. To create a high-quality pipeline of talent, provide training for would-be non-executive directors within your own company by placing them on committees just below board level. You can bring them in occasionally for presentations to the board, or appoint them as observers on a rotational basis.
Raising the standards of ethics and compliance

With regulators getting tougher on business wrongdoing and a minority of employees tempted to cross ethical lines to meet targets in difficult economic circumstances, ethics and compliance programs have become prominent on boardroom agendas across Europe.

How boards and audit committees should share the effort to review and improve standards on ethical behavior and compliance remains open for debate.

Some companies have put ethics and compliance on the main board agenda, which can be an effective way to keep senior executives engaged. Others have created a new committee to deal specifically with the issue. But many delegate the oversight of ethics and compliance to the audit committee.

The audit committee's role

Even when the audit committee is not fully responsible for ethics and compliance oversight, its members need to understand how well the business manages risk in this area.

The European Union's 8th Directive requires the audit committee to monitor the effectiveness of internal control. To do so, it needs a clear view of the ethical and compliance culture in the business.

Managers behaving unethically, or failing to comply with procedures and regulations, typically has a direct effect on the company's underlying financial and accounting information — an issue at the heart of the audit committee's traditional role.

Lifting standards

Companies can use incentives to encourage ethical behavior and reduce compliance risks, such as clear rewards or punishments for specific behavior. However, the company's culture provides a more constant and equally powerful influence.

In fact, how much a company spends on compliance is less important than how well its compliance program nurtures an ethical culture. Successful programs share four key elements:

- **Leadership.** The board and senior executives must set the right tone at the top. The compliance function itself needs a strong leader with authority and independence.

- **A code of conduct, backed by training.** Employees need to understand the rules. Case study and dilemma-based training can help make them real.

- **Zero tolerance.** Employees need to know they will be disciplined or fired if they break the rules. Zero tolerance can apply to markets too, with companies leaving countries where doing business ethically becomes too difficult.

- **Monitoring.** Good information identifies violations and highlights areas where training or guidance is needed. Internal audit can play a critical role here. Big data analysis and whistle-blower hotlines can prove other good sources.
Raising concerns

A whistle-blower hotline, often an integral part of a company’s efforts to stop bad behavior, gives people a confidential way of sharing their concerns – at a high level and outside of line management.

But hotlines are not always effective. European Union laws, and some national laws, can limit a company’s ability to offer a hotline, including who can use it and the kinds of concerns employees can raise anonymously. Laws can also restrict a company from outsourcing its hotline to a specialist provider.

Other challenges arise when companies fail to offer meaningful rewards or incentives to whistle-blowers, or when they don’t have people with the forensic skills or independence needed to follow up concerns properly.

A whistle-blower system can generate such a large volume of alerts that just addressing the issues raised can pose its own difficulties for the audit committee. Should someone filter these alerts before they come to the audit committee? If so, who?

Despite the efforts involved, companies have put ethics and compliance firmly on their boardroom agendas and are experimenting with, and fine-tuning, their approaches.

Whatever model the board uses, the audit committee has a clear role to play in helping identify and manage the associated risks, shaping employees’ behavior and monitoring compliance.

For more information, ask your EY contact for a copy of EACLN ViewPoints issue 35: ethics and compliance.

Questions for audit committees

- Does the board get the information it needs to monitor ethics and compliance? What data would make its oversight more effective?
- How is responsibility for this issue shared among the CEO, board, audit committee and other dedicated executives?
- What is the role of internal audit in building a culture of ethics and compliance?
- What whistle-blowing arrangements exist? How do we know they are effective and what do the issues raised tell us about our company?
Why sustainability should be on your risk management agenda

The confluence of risks and opportunities associated with environmental, social and economic performance has made sustainability a strategic business priority.

Customers expect it, employees seek it and shareholders rely on it. Sustainability has moved from a feel-good initiative to a strategic imperative, driven by demands from more informed stakeholders who increasingly examine whether or not a company succeeds in a manner that supports sustainability.

In boardrooms across Europe, momentum is building for a more integrated approach to sustainability, including how to address the risks that it poses. Embedding sustainability into your organization’s enterprise risk management (ERM) program creates a clear opportunity to increase the effectiveness of risk management practices and improve business performance.

The Committee of Sponsoring Organizations of the Treadway Commission’s (COSO) ERM framework has historically provided a good starting point for organizations as they begin their ERM journey.

COSO identifies the following competitive advantages for including sustainability in an ERM framework:

- Alignment of sustainability risk appetite to the organization’s corporate strategy and the new world view of company value
- Expanded visibility and insights relative to the complexity of today’s business environment
- Stronger linkage of company values and non-financial impacts to the organization’s risk management program
- Better ability to manage strategic and operational performance
- Improved deployment of capital

To learn how to embed sustainability into your ERM framework, read the full COSO and EY report Demystifying sustainability risk on ey.com/ccass.

Questions for audit committees

- Do your sustainability activities and processes align with the corporate strategy?
- Is your sustainability framework agile enough to respond to changes in the risk environment as issues arise?
Despite the struggles of the past five years and the prospect of a weak recovery, joining the Eurozone remains an attractive prospect for Eastern European economies. Latvia became the Eurozone’s 18th member on 1 January, and we expect Lithuania to follow in 2015.

Latvia will be the fastest-growing Eurozone country this year, with GDP forecast to rise by close to 4.5% and accelerate to over 5% in 2015–17. Lithuania may post slightly faster rates of growth. These rates will be well ahead of other Eurozone countries, although both countries experienced very deep recessions during the financial crisis.

The Eurozone economy should gather further momentum in 2014 after returning to growth in mid-2013. But with growth seen at little better than 1.5% a year in 2015-17, the Eurozone will lag well behind both the US and the UK. Another concern is the need for further monetary policy support as inflation is now at a worryingly low level.

Joining the Eurozone to lower risk
- Joining the Eurozone remains an attractive prospect for Eastern European economies, because many already send a large chunk of their exports to the single currency area, so membership removes the exchange rate risk. There is also a perception that they are more likely to attract foreign direct investment as the cost of doing business with other Eurozone countries would fall.
- The loss of control over monetary policy in joining a currency area is a potential risk to small and open economies. However, taking into account earlier substantial internal devaluation and structural reforms, we think that both Latvia and Lithuania are well placed to adapt to Eurozone membership.

The Eurozone continues along the road to recovery ...
- Ahead of Latvia’s accession, the Eurozone is on course for recovery, having achieved a second successive quarter of expansion in Q3 2013.
- After falling by an expected 0.5% in 2013 as a whole, we forecast Eurozone GDP will grow by 0.9% in 2014 and then by about 1.6% a year in 2015-17.
... and now looks less vulnerable to external shocks

- The resilience of financial markets in the face of political turmoil in Italy and fiscal issues in the US has been a pleasant surprise. This reflects faith in the European Central Bank (ECB) as a backstop for Eurozone bond markets and greater confidence in the outlook now that the economy has returned to growth.

- But this resilience cannot be taken for granted. The next big test is the ECB’s asset quality review and the subsequent restructuring of the banking sector. Policy-makers must ensure that – at the very minimum – the relatively modest expectations of the markets are met so as not to threaten the current stability of the region.

- The ECB will also have a key role to play in 2014 in setting policy to counter any tightening in credit conditions imported from the US once the Federal Reserve starts tapering. The surprise rate cut in November is unlikely to be enough to head off concerns about possible deflation.

**Questions for audit committees**

- Are your business forecasts and assumptions consistent with the low growth rate and continued high unemployment anticipated in the Eurozone? What would be the impact of deflation on your business?
- Are the indicators of increasing business confidence revising your assessment of investment projects?
- Do the new Eurozone countries present investment or growth opportunities?

Ask your EY contact about the Eurozone Forecast December 2013 or visit ey.com.
Recent EY publications of interest to audit committees

**Reporting magazine, issue 6**
The latest issue of EY’s international magazine about business challenges explores existing and future risks, cybersecurity and the dangers of groupthink and how to combat it.

**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.

**Cybersecurity: considerations for the audit committee**
Audit committee members increasingly list cybersecurity as a top concern. We explore the issue and provide questions for the audit committee to consider.

**Key considerations for your internal audit plan**
Mergers and acquisitions and divestitures remain some of the most risk-heavy initiatives that any organization can undertake. This report details the key areas where internal audit can play a crucial role in an organization’s strategic transactions life cycle.

**Hidden value of capital allocation**
A higher level of scrutiny around the capital allocation process can help utilities free money trapped by legacy processes – and help the organization grow.