Dialogue with the European Commission, audit committee leadership, Russia and Ukraine war, and ESG governance policymaking versus practice

On 31 March and 1 April 2022, members of the European Audit Committee Leadership Network (EACLN) met in Paris to discuss corporate and sustainability reporting with officials from the European Commission (EC). Separately, the network also discussed audit committee leadership practices, Russia’s invasion of Ukraine, and policymaking versus practice in the governance of environmental, social, and governance (ESG) issues. This Summary of Themes provides an overview of the conversations.1 Two forthcoming ViewPoints will provide additional detail on the dialogue with the European Commission and audit committee leadership.

Dialogue with the European Commission

Members discussed corporate reporting and audit with officials from the European Commission’s Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA): Ugo Bassi, director of Financial Markets; Ward Möhlmann, deputy head for corporate reporting and audit; and Delia Mehedintu, policy officer. The officials spoke off the record, but EACLN members offered substantial commentary on the topics discussed. Several key points emerged from the discussion:

- **Review of the internal control environment could be improved.** Members said that internal controls might benefit from measures like those required by the US Sarbanes-Oxley Act (SOX). A member noted that finance functions operating under SOX show greater ownership and accountability for controls than those that do not. Care should be taken to minimize complexity and confusion in implementing SOX-like measures, however, and there are limitations on how much more responsibility and accountability can be imposed on audit committees. “We rely on management information, though we can double-check with the external auditor and the internal auditor,” a member explained.

- **Members oppose splitting financial and sustainability reporting audits.** Reflecting on European Union (EU) efforts to finalize the Corporate Sustainability Reporting Directive, members were skeptical of a European Parliament proposal to require different auditors for financial reporting and sustainability reporting. “A mandatory split doesn’t make sense. A company should make that decision and have that flexibility,” a member said. Other members were of the opinion that there should be a single internal control system for both types of reporting: “It would be inefficient to have two parties working on the same system,”
one said. Members worried that their choice of auditors would be even more constrained by another restriction on the services that auditors can provide, particularly in jurisdictions with joint audit, where companies need two auditors for the financial reports.

- **More analysis is needed to understand the extent of corporate reporting problems.** In a discussion of the EC’s consultation on corporate reporting, members mentioned a report from the European Securities and Markets Authority on enforcement actions by national supervisory bodies. This report asserted that action was taken on 40% of the financial statements reviewed. Members were surprised by this finding. “What is the materiality of those misstatements?” one member asked. Others wanted to know whether the data included problems emerging over time or just at the time of review, and how consistent the data were with the findings of audit regulators. One member observed, “There appears to be a disconnect between national supervisory bodies and audit committees. If we know what the issues are, we may be able to do something about it.”

The EC officials found the dialogue with the audit chairs useful and said they hoped that another session could be organized to discuss the costs of implementing EU audit reforms enacted in 2014.

**Audit committee leadership**

Audit chairs discussed how they tackle expanding responsibilities and shared good practices for running effective audit committee meetings:

- **Members balance a growing committee remit with effective committee management.** As the scope of audit committee responsibilities has expanded, some have moved certain topics to separate risk or sustainability committees. Others have added time to regular audit committee meetings. Many reported scheduling separate sessions on nonroutine items. Members work with management to make prereading materials more focused. Some are in regular communication with the finance team, internal audit, and the external auditor to understand where to focus committee meetings and to identify unexpected issues.

- **Audit chairs develop annual agendas but remain flexible.** Members work with management to put together an annual calendar, with flexibility to address items arising during the year. They then tailor each individual meeting agenda. Ongoing conversations with management, the board chair, the head of internal audit, and the external auditor keep audit chairs informed of developments in the company and offer ideas for topics that should be discussed in future committee meetings.

- **Private sessions take place before or after each meeting and serve different purposes.** Members hold private sessions at each regular committee meeting. Many invite the head of internal audit and the external auditor. Most meet privately with the CFO or with other executives, depending on the matter at hand. When these sessions are held at the end of an audit committee meeting, members use them to calibrate the meeting, to get feedback, and to identify issues for future sessions. More than half of the audit chairs said that they hold private sessions at the beginning of each committee meeting to signal to committee members what they want to focus on, give feedback from their conversations with
management, make members aware of issues they will not have time to discuss, and understand what members want to concentrate on.

- **Investing in the relationship with the external auditor is important.** Members said that they meet with the external auditor prior to committee meetings. One said that she always “triangulates” by meeting with the external auditor prior to meeting with the CFO so that she knows “what questions to ask the CFO in private.” The conversations help this member decide on areas of focus during the committee meetings. Another member emphasized the importance of openness with the external auditor. She encouraged audit chairs “to invest in the relationship, and not only before the meetings,” and to meet with people beyond the lead partners so that the extended team can “get to know you and to know your expectations.” She added that audit committees can particularly learn from the robust process auditors use to build their audit plan, from how they identify and quantify the company’s risks (existing and emerging), and from the audit firm’s quality review or transparency report.

**Russia’s invasion of Ukraine**

Members discussed the Russian invasion of Ukraine with Ivan Krastev, chairman of the Centre for Liberal Strategies in Sofia and a permanent fellow at the Institute for Human Sciences in Vienna. Many insights emerged from the conversation:

- **Vladimir Putin’s words should be taken literally.** Mr. Krastev observed that analysts, the media, and others strive to interpret Putin’s words, and advised, “*Take literally what he says, even if some of the things that he says are quite unbelievable. He believes them.*” Putin initially viewed the invasion of Ukraine as a “special operation” and had expected it would be quick and that Russian forces would be received warmly.

- **History and demographic decline motivate Putin.** Mr. Krastev pointed out that Putin’s motivations are complex. He is not driven by money but by power; his mistrust of those who may succeed him leads him to believe that he must solve all of Russia’s problems in his lifetime.
  - Putin’s view of history and nostalgia for the past underpin his actions. Mr. Krastev noted that Kyiv has a special place in the Russian imagination. It was the center of the first Slavic state and the starting point of Eastern Orthodoxy in the region. A 2021 essay penned by Putin reveals that he views Ukrainians and Russians as the same people. He believes that Russia should be a great power again.
  - Putin wants to solve the problem of demographic decline in Russia. Mr. Krastev noted that Russia, along with other Eastern European countries, is experiencing a rapid population decline. This has been exacerbated by the pandemic, in which Russia is believed to have lost over 1 million people. Putin views annexing parts of Ukraine as an opportunity to add population to Russia.

- **Putin needs a symbolic victory, but this will not end the war.** Mr. Krastev observed that symbolism is very important to Putin: he desires some form of a victory by May 9, a holiday in Russia that commemorates the 1945 surrender of the German Reich. Mr. Krastev does not
believe that Russia has the military capacity to occupy a country as large as Ukraine, but he noted the likelihood of a persisting “two Koreas” scenario, or a return of the Cold War.

- **The war is already changing Russia, but it will also change the West.** Mr. Krastev expects Russia to lose about 10% of its gross domestic product due to the war. The main impact will be on the urban population. Krastev pointed out that the West has also changed due to the pressure of public opinion and that transatlantic cooperation has been rekindled because of solidarity with Ukraine.

- **Businesses should prepare for a period of uncertainty and prolonged economic war.** Mr. Krastev did not foresee sanctions being lifted with the war’s end, noting that sanctions—as well as efforts to evade them—may lead to new regulation.
  - Uncertainty both for Western companies that have exited and that remain in Russia. Mr. Krastev noted that Putin has threatened to sue companies, nationalize assets, close down businesses, or support those that stay.
  - Different impacts of the sanctions depending on sector and country. Some sectors, such as financial services, oil and gas, and technology, are likely to experience stress in the long term, while others, such as pharmaceuticals, fertilizers, and food, will be less impacted. European companies may experience greater losses and disruptions than their US counterparts. The sanctions’ enforcement will also vary by country.
  - New European regulation for cryptocurrency is likely. Mr. Krastev observed that the European Central Bank is already seeing large volumes of cryptocurrency trading, perhaps to assist Russian oligarchs in avoiding sanctions. This, he believes, may be a tipping point for the European Central Bank in moving to regulate cryptocurrency.

**ESG governance: policymaking versus practice**

Members were joined by Andrew Hobbs, a partner and public policy leader for Europe, the Middle East, India, and Africa at EY, for a discussion of recent developments in the European Union’s ESG policymaking and regulation and how boards are implementing ESG governance today. The conversation touched on the following themes:

- **The international ESG standard-setting environment is complex.** Mr. Hobbs observed that developing standards for ESG has historically involved a myriad of standard setters and regulators with varying ESG reporting requirements and different approaches to materiality and assurance. While the situation is being rapidly rationalized, differences will persist.

- **The new sustainability standards boards face challenges.** Mr. Hobbs noted that while the European Sustainability Reporting Board has a good governance structure, current funding arrangements may not be sufficient to execute its mandate. As far as international standards are concerned, the process for national endorsement of standards set by the new International Sustainability Standards Board is also lacking. While the EU and the ISSB are collaborating and view themselves as partners in standard setting, Mr. Hobbs pointed to differences in the way materiality is defined: the ISSB is concentrating on enterprise value for investors, while the European Union’s approach considers the interests of all stakeholders, including investors.

- **Members wondered if regulators have sufficient expertise to create ESG policy.** Audit chairs asked whether regulators fully understand the implications of their actions. One
member asked, “How much practical knowledge is put into developing these standards?” Another said, “They need people with practical background and who know the situation on the ground because it is otherwise counterproductive.”

- **Not everything can fit into “green” or “not-green” boxes.** Members said that many services, products, and materials cannot be easily classified. One member noted that electric cars use clean energy, but they are made of materials that are not green. Another said that in the energy sector you may be eligible to build charging infrastructure but not eligible to produce the energy for that same infrastructure.

- **Members worried that climate issues are receiving an over-weighted emphasis.** One member suggested that “the focus on climate is becoming disproportional” and emphasized, “We can’t forget about the other parts of ESG.” She said that too much focus on climate goals could negatively affect social issues that also need addressing.

- **Mr. Hobbs encouraged members to share their views during the decision-making process.** Mr. Hobbs said that while trade bodies like AmCham and Business Europe speak for businesses and try to positively influence regulation, “there is not enough of the ‘how’ that comes through.” Since proper postimplementation review of EU regulations in this space is rare, he encouraged members to add their voices and engage in a dialogue with standard setters and regulators during the policy/standard setting process.
Appendix: Participants

The following EACLN members participated in all or part of the meeting:

- Horst Baier, Bayer
- Liz Doherty, Novartis and Philips
- Eric Elzvik, Ericsson
- Ana de Pro Gonzalo, STMicroelectronics
- Byron Grote, Akzo Nobel, Anglo American, and Tesco
- Catherine Guillouard, Airbus
- Margarete Haase, ING
- Marion Helmes, Heineken
- Liz Hewitt, National Grid
- Arne Karlsson, Maersk
- Dagmar Kollmann, Deutsche Telekom
- Benoît Maes, Bouygues
- Marie-José Nadeau, ENGIE
- Helman le Pas de Sécheval, Alumnus
- Nathalie Rachou, Veolia
- Mariella Röhm-Kottmann, Zalando
- Guylaine Saucier, Wendel
- Erhard Schipporeit, RWE
- François Thomazeau, Bolloré
- Maria van der Hoeven, Total

EY was represented in all or part of the meeting by the following:

- Marie-Laure Delarue, EY Global Vice Chair, Assurance
- Jean-Yves Jégourel, EY Country Managing Partner, Germany
Endnotes

1 Summary of Themes reflects the network’s use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Quotations in italics are drawn directly from conversations with network members in connection with the meeting.