

Top concerns for audit committees

As boards confront unprecedented levels of uncertainty and an increasingly complex risk landscape, audit committees are faced with ever-growing responsibilities. In a members-only session of the European Audit Committee Leadership Network (EACLN) meeting on 15–16 September 2022 in Berlin, Germany, members discussed issues that are keeping audit committee chairs up at night.

This *ViewPoints* summarizes two overarching concerns that audit committee chairs raised during the meeting and in premeeting conversations:¹

- **Current geopolitical and economic environments require new approaches to risk assessment, oversight, and planning**
- **Audit chairs worry about requirements to disclose nonfinancial information before sufficient processes and controls have been established**

For a list of network members and other meeting participants, see Appendix 1 (page 6), and for a list of reflection questions, see Appendix 2 (page 7).

Current geopolitical and economic environments require new approaches to risk assessment, oversight, and planning

Extraordinary geopolitical uncertainty coupled with volatility in the global economy creates a risk environment that most members cited as their top concern. One said that he had not seen such geopolitical uncertainty in his lifetime: *“At what stage do you start to challenge your business model because of where you think the geopolitical agenda is going to be?”*

This has led many audit chairs to revisit their processes for risk assessment and planning. One noted, *“We have processes that aren’t totally appropriate anymore because they look at risks one by one and how we would mitigate them individually, but we now need to think differently and look at risk in its entirety.”* Another asked, *“How do you plan for the future now? Forget the historic way of doing it—it doesn’t work anymore.”*

As historic risk oversight practices become less fit for purpose, many member companies and boards are looking for new processes and techniques to help them deal with a trifecta of geopolitical, macroeconomic, and cyber risk. Members shared practices that they have found helpful:

- **Developing a risk cartography.** *“We literally created a world map and mark it with relevant risks and figures or data that is relevant country by country,”* one member said. China, she noted, would have been marked for capital investment in prior years, but not any longer. *“Reviewing the map of risk exposures helps us determine if it’s good policy to proceed with our strategy or if it’s time to readjust our plans.”* Another member concurred: in

addition to risk cartography, mitigation and active analysis are critical. His board tasked management to come up with quarterly risk assessments, including explaining why the company is active in certain geographies and reviewing contracts that may have become high risk.

- **Helping management calibrate risk tolerance and manage through new (to them) risks.** A member described *“the risk of getting used to risk,”* particularly for management teams that continue to raise their risk tolerances as the scope and scale of risks increases. She thought that boards should be alert to management becoming *“too comfortable”* with risk. Members also worried about some executives’ ability to manage through record inflation. *“Most management hasn’t lived through this type of inflation,”* one noted, and *“there will be limits on planning for it.”* Another added, *“We’ve been asking, How many consumer price increases can the market withstand?”* She noted that her company has turned to management teams in South America and other traditionally high-inflation regions to help them understand how to manage through inflation.
- **Preparing for the unknown.** While members emphasized the challenges of preparing and planning for unknown risks, boards and audit committees are still trying to do so. At one company, an undefined “black swan” event has been added to the risk map. The audit chair explained, *“It will depend on the kind of situation, but we ask ourselves, How quickly will we be able to get the crisis response organized? Is what is already in place going to work?”* Another member pointed out that *“you can never be sure that you have imagined all possible situations and anticipated everything that could happen.”* An audit chair emphasized that audit committees and boards are responsible for *“giving the shareholders comfort that we have full transparency even with unexpected and never-before-seen risks. So how can we give comfort to the shareholders and other stakeholders that we have a reasonable picture of these risks?”*
- **Incorporating resiliency through scenario planning.** Audit chairs discussed the importance of *“very intentionally”* discussing resiliency. Several members are using scenario planning to incorporate resiliency into planning. The overall message from

Should boards form separate risk committees?

A foundational question for many directors as they face unprecedented risks is, Should we create a risk committee? Apart from financial services companies, where risk committees are typically statutorily mandated, and other industries with highly complex risk profiles, many members did not think that risk committees lead to better risk oversight. *“More and more, their agendas overlap with other committees because the issues don’t fit neatly in a box,”* one member said. Others agreed and added that often the audit committee chair or other audit committee member also serves on the risk committee, so instead of taking work from the audit chair’s plate, a risk committee may add more.

members was consistent, as summed up by one: *“Single-scenario planning is not reliable anymore. You need simulations and multifaceted forecasting processes for the future.”* While specific techniques varied, one member noted that his company uses a *“base plan plus two alternative scenarios,”* while another member’s company *“runs hundreds or thousands of different scenarios through computer models. We then distil it down to four main scenarios that incorporate macroeconomic models. It forces us to think through a lot of different things.”*

- **Revisiting how the board evaluates cyber risk preparedness.** Cybersecurity has long been high on audit committee and board agendas, but current geopolitical turmoil raises the stakes. A member wondered whether her audit committee and board know how to evaluate the company’s cybersecurity team and its work, asking, *“Do you bring in external expertise or do you just rely on management?”* Another audit chair lamented, *“This is what keeps me awake every night. We’ve separated the first and second lines of cyber defence—taken security out of IT—and we have recruited from government with specialized expertise to fill key roles.”* One board decided to test their company’s security, both physical and cyber, by hiring hackers without management’s knowledge. The hackers breached the building’s physical security and had begun to access a server when an employee raised an alarm. The audit chair noted that even though the board had performed this exercise without management’s prior knowledge, executives took it as an *“opportunity to make progress and improve.”*
- **Understanding how near-term reactions to turmoil could lead to longer-term systemic changes.** In a separate session of the meeting, members discussed how energy supply issues are impacting companies’ climate commitments. As part of that conversation, they raised another important risk and planning consideration: that reactions to today’s macropolitical and economic pressures could create longer-term, systemic change. For example, unprecedented instability in global energy markets has created shortages and high prices, leading to behavior changes in consumers, companies, and policymakers. Members noted that even once current energy challenges recede, conduct changes could persist.
- **Being transparent with stakeholders.** While members agreed that scenario planning is essential in today’s environment, *“what we haven’t cracked,”* one said, *“is what you do with what you discover through the scenario planning.”* His advice: *“The only thing you can do is be transparent with investors and stakeholders as you think through all of the risk.”*

Audit chairs worry about requirements to disclose nonfinancial information before sufficient processes and controls have been established

The second key concern many members flagged is related to board and company readiness to provide reliable disclosures as implementation deadlines for some environmental, social, and governance (ESG) reporting requirements near. *“Nonfinancial reporting is going to be as important as financial reporting, and we don’t have the same controls or reporting*

infrastructure around the information,” one member worried. He continued, “Add to that a variety of stakeholders who don’t agree on what they want and who are asking for completely different data sets. I don’t see how this ends well.”

Members agreed that an audit committee’s responsibility for accurate and transparent financial reporting positions it to do the same for ESG disclosures. However, they are less confident in their companies’ abilities to provide well-controlled nonfinancial information. In light of increased scrutiny of ESG disclosures and the advent of new reporting requirements, audit chairs shared practices that have helped them gain some comfort in their ESG disclosure oversight roles:

- **Finding the right balance in deciding what and how much to disclose.** Many audit chairs highlighted the tension between disclosures for *“marketing purposes”* and those that will be part of financial statements and therefore need to be subject to rigorous processes and controls. *“Companies are publishing way too much information coming out of noncontrolled environments,”* one member noted. *“Audit committees need to weigh the risks and rewards of disclosing too much or not enough information. The balance is tricky.”*
- **Clarifying internal organization at the board level.** While members agreed that the audit committee is well positioned to effectively oversee ESG disclosures, many worried about the relatively immature processes and controls that are currently in place for nonfinancial information—and the time it will take to fully develop them. Several audit chairs said that ESG litigation is inevitable; one said, *“With accusations of greenwashing, we all have the feeling that our heads are pretty much on the block.”* All agreed that boards must be very clear on who owns which aspects of ESG policies and decisions.¹
- **Removing dual reporting lines for financial and nonfinancial information.** Several members stressed the importance of *“avoiding two different reporting lines for financial and nonfinancial information.”* Most believed that ESG reporting should fall under the purview of the CFO. One audit chair requested that management move responsibility for ESG reporting from marketing and communications to the CFO. She then asked the CFO to do a deep dive on the processes and controls around ESG key performance indicators and subsequently asked the external auditor to provide limited assurance on the indicators that the CFO deemed as having appropriate controls in place.
- **Promoting consistent standards.** All members expressed concern about the number of standards and frameworks currently in the market. For example, one member noted that different approaches to materiality *“will create different valuations—and European companies will have lower valuations.”* The group worried that standard-setting initiatives from both the European Commission’s European Financial Reporting Advisory Group (EFRAG) and the International Sustainability Standards Board (ISSB) could create conflicting regimes that a single company must comply with. Members felt strongly that Europe needs

¹ For additional information on how boards are structuring ESG oversight responsibility, please see Tapestry Networks’ August 2022 *ViewPoints* titled *Audit Chairs Discuss ESG Oversight* (<https://www.tapestrynetworks.com/publications/audit-chairs-discuss-esg-oversight>)

to coalesce around one set of standards while “*acknowledging the regional and industry differences that exist within the continent.*” Most believed that the ISSB framework is best suited to accomplish this, and some thought that audit chairs should elevate their voices in the discussion around ESG reporting, expressing their preference for ISSB sustainability-related disclosure standards.

About this document

The European Audit Committee Leadership Network is a group of audit committee chairs drawn from leading European companies committed to improving the performance of audit committees and enhancing trust in financial markets. The network is organized and led by Tapestry Networks with the support of EY as part of its continuing commitment to board effectiveness and good governance.

ViewPoints is produced by Tapestry Networks to stimulate timely, substantive board discussions about the choices confronting audit committee members, management, and their advisors as they endeavor to fulfill their respective responsibilities to the investing public. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Those who receive *ViewPoints* are encouraged to share it with others in their own networks. The more board members, management, and advisors who become systematically engaged in this dialogue, the more value will be created for all.

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Appendix 1: Participants

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

- Jeremy Anderson, UBS
- Werner Brandt, Siemens
- Carolyn Dittmeier, Assicurazioni Generali
- Eric Elzvik, Ericsson and Volvo
- Margarete Haase, ING
- Marion Helmes, Heineken
- Liz Hewitt, National Grid
- Benoît Maes, Bouygues
- John Maltby, Nordea
- David Meline, ABB
- Marie-José Nadeau, ENGIE
- Karyn Ovelmen, Arcelor Mittal
- Stephen Pearce, BAE Systems
- Nathalie Rachou, Veolia
- Bernard Ramanantsoa, Orange
- Guylaine Saucier, Wendel
- Erhard Schipporeit, RWE
- Maria van der Hoeven, TotalEnergies

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

- Pam Daley, BlackRock
- Bob Herz, Fannie Mae and Morgan Stanley
- Kimberly Ross, Cigna
- Jim Turley, Citigroup

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
- Julie Linn Teigland, EMEIA Managing Partner, EY

Appendix 2: Reflection questions for audit committees

- ? What is currently the biggest challenge facing your audit committee?
- ? What do you see as the biggest challenge for your audit committee in the next three to five years?
- ? Is your audit committee planning to do anything differently or new next year?
- ? Do you feel that you have enough time to cover all important topics?
- ? Which topics do you spend less time on in audit committee meetings as new items are added to the agenda?



Endnotes

¹ *ViewPoints* 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 members and guests in connection with the meeting but may be edited for clarity.