

Northeast Audit Committee Network

December 2017

NEACN

SUMMARY of THEMES

Audit chairs discuss the state of the economy, disruptive innovation, and the future of audit

On December 11, 2017, members of the Northeast Audit Committee Network (NEACN) met in New York to discuss the current and future macroeconomic outlook, digitalization and disruptive technology, and innovative approaches to the external audit.¹ For a full list of meeting participants, please see page 6.

A benign economic environment could turn as cycle comes to an end

Members debated the current and future state of the global economy with Ebrahim Rahbari, Managing Director and Head of Global Macroeconomics at Citigroup. Mr. Rahbari noted that global growth is close to 4% (at purchasing power-parity-adjusted rates)— a rate which includes developing economies – and continues to expand, with no major economies considered to be “in trouble.” European economic growth had been stronger for most of the past two years than that of the United States, which is an unusual dynamic, according to Mr. Rahbari. He also emphasized that growth today is more evenly distributed across sectors and population segments, highlighting the highest rate of wage growth in recent history. Under these conditions, he said, businesses are globally beginning to increase investing, a trend we have not seen for quite some time.

NEACN members and Mr. Rahbari discussed several known factors with the potential to affect the economic climate:

- **Tax legislation.** With policymakers getting closer to a decision on tax legislation, members were eager to understand the anticipated economic impact of the proposed bill.² Mr. Rahbari shared his expectation that the tax bill would likely add 0.5% to the gross domestic product over the next two years, with some regional differences. Companies may accelerate capital spending as a result of some specific incentives in 2018, although he noted that companies typically don’t react strongly to tax incentives. Mr. Rahbari also said this bill will have little impact on household spending. In summary, although Mr. Rahbari did not expect a dramatic impact from the tax legislation, he did raise the concern that this bill provides tax relief rather than more comprehensive tax reform.
- **Inflation.** Members raised a collective concern that inflation may be building up in the US economy given the prolonged growth cycle. Mr. Rahbari said he expects inflation will be “well behaved,” meaning inflationary forces from robust economic growth and tight labor markets will likely be offset by deflationary pressures resulting from increasing automation and oversupply in the energy markets. He noted that businesses and consumers remain

cautious, particularly in their investment and savings, which is a *“legacy of the financial crisis.”* Members agreed with Mr. Rahbari that it is getting harder for companies to find qualified employees. Workers are far less likely to quit their jobs, trade unions are not asking for much more, but there has still been a pickup in median wage growth of late.

- **New Fed Chair Jerome Powell.** Mr. Rahbari does not expect to see much policy change from Chair Powell initially, but there is broad turnover coming at the Federal Reserve and those changes could prove to have economic consequences. He noted that given the remaining candidates for the board, new Fed leaders are likely to be less inclined to deploy quantitative easing measures in the next downturn.
- **Trade policy.** Several members raised their concern that trade agreements, such as the North American Free Trade Agreement and Trans-Pacific Partnership, are at risk of being disrupted. This change in policy could have a significant effect on companies whose sales and supply chains would be impacted. Mr. Rahbari and members also noted that a change in the US stance on trade could allow other players in the market, notably China, to take a larger role on the global economic stage.

Mr. Rahbari observed that the economy is in the late stages of the business cycle. Some of the positive signs, such as a pickup in investment and the potentiality of wage growth, signal a turning point on the horizon, though not an imminent one. Mr. Rahbari commented that when we run out of economic momentum, underlying problems will be exposed. He warned members that China, Europe, and the housing markets all pose potential risks. Members asked Mr. Rahbari what they should be watching for in the future. He responded, *“Consider how to plan for future capacity carefully. There will be increased difficulty of finding staff, and rising wages will cause challenges for some companies. On the policy side, 2018 is a year when monetary policy rates will come to a 40- to 50-basis- point increase and central banks will move away from printing money. This has the potential to cause long-term interest rate shocks.”*

Boards starting at the top when assessing innovation mindset and capabilities of companies

Members discussed how boards oversee management efforts to transform companies in an era of technological innovation. Woody Driggs, EY’s Americas Advisory digital leader, joined the discussion and began with the reasons why the current wave of technological advances, including digitalization, is quite different in kind and in impact from previous technology changes: *“This transformation is less about the impact of any one technology but more about the speed at which the technology is being made available and how quickly business decisions need to be made as a result.”* He provided an example of this accelerated pace: *“Within 20 days of launching, the Pokémon GO app had 45 million users in the U.S. alone. With 20 minutes of the average social media user’s time now devoted to Pokémon GO and not other social platforms, this meant that within 18 days of introduction, other social media*

companies faced the decision of whether or not to buy this technology. Decision time is being pushed and it's the speed of technology that is scary to businesses. To be ready for it, companies need to shift their mindset from 'doing digital' to 'being digital'."

Mr. Driggs described the importance of the cumulative effects of layering technologies, giving an example: *"[Navigation] apps provide basic mapping data. Then you add a layer of user data, the social data, which is people adding information about what is happening on the roads at that moment. Another layer of data from highway systems combines with the most up-to-date mapping data, which [the app] relies on its best users to provide real time. Those four layers give you tremendous insight on how to get from point A to B."*

Members discussed how best to nurture innovation in a company: should the company create a separate "skunkworks" organization or infuse innovation in throughout the existing business units, perhaps under the direction of a chief digital officer?³ Mr. Driggs suggested a different approach altogether: *"It's more about how you work through innovation. Digital companies create lots of small teams of two to three innovators that all compete for a limited amount of money to invest. These teams rapidly develop the minimum viable product that gets quickly into the market. If the new product succeeds, build on it. Companies need a "fail fast" mentality and no punishment for risk taking."* Members were struck by the difference between decision-making in traditional incumbent companies and this experimental approach.

Mr. Driggs also stressed the importance of a customer-centric focus, for both B2C and B2B business models. He said, *"Instead of trying to automate every business process you have, it's fundamental to look at this from the outside in. Which of these technologies are best applied to your business? And become obsessed with the customer experience – constantly look at ways to improve it."* One member shared an approach to a better understanding of customers: *"We recently brought in two customers to talk to the board about how our new product would add value and improve their organization. It was a good exercise."*

Members shared the approaches their boards are taking to ensure their companies have the right skill set at the top. One member said, *"The board needs to perform a robust evaluation of the CEO every year and consider the skill sets needed in the future. If the company is inadequate in innovation, it might be time for a new CEO."* Other members suggested focusing on board level education, adding digitally savvy directors who bring in new questions for management, and creating a technology committee to oversee specific risks. When asked about hiring outside advisers, one member said, *"I think it's a matter of looking inside and going deeper within the ranks of the company to find the younger cohort with digital expertise."* Mr. Driggs concluded with some advice for members: *"It's a question of when you will be disrupted, not if. So be sure your companies are agile and that the business is set up to execute. Focus on customer experience and be sure to look from [their perspective] when deciding in which technologies to invest."*

EY demonstrates the power of a digitally transformed audit

Members visited the EY Union Square wavespace site for a demonstration of how technology is transforming many aspects of a public company audit. Members saw a demonstration of Canvas, EY's digital audit hub, which connects audit teams and their clients to create a single global audit platform, now used on every audit the firm undertakes. Canvas enables both clients and EY management to see the status of milestones throughout the audit cycle. It helps to keep project plans moving forward more efficiently than ever before.

Additionally, EY demonstrated Helix, its suite of data analytics tools for use in its audits. These tools use advanced methods, including artificial intelligence, to analyze data from the transaction level up to the consolidated trial balance. Many of the Helix tools address sector-specific audit issues, such as automotive warranties, insurance premium collection, and trade spending. The analytics tools can speed up identification of outliers in data—for example, spotting payroll entries where the tax paid is unusually high or low. Members also viewed a third demonstration that showed how EY is using automation to reduce time spent on administrative tasks related to confirmations, which allows staff to focus their energies on analyzing results and making decisions.

The overall goal, according to Scott Zimmerman, EY's Americas Assurance Innovation and Digital leader, is to digitally transform the audit experience so our teams can stay connected through one global platform, continuously perform procedures, reduce burden, and examine virtually all data in a company to provide valuable insights and target the things that matter.

About this document

The Northeast Audit Committee Network is a select group of audit committee chairs from leading 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.

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

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Meeting participants

The following Northeast Audit Committee Network members attended all or part of the meeting:

- Virginia Addicott, CDW
- Bill Creekmuir, Party City
- Steve Elliott, AllianceBernstein and PPL Corporation
- Patrick Gross, Waste Management
- Paul Joubert, Ares
- Doug Maine, Orbital ATK, BroadSoft, and Rockwood Holdings
- Craig Owens, The J.C. Penney Company and Dean Foods Company
- Marianne Parrs, Stanley Black & Decker
- Mike Ranger, Covanta
- Leslie Seidman, Moody's
- Brad Warner, Capital One
- Ron Waters, Fortune Brands Home & Security

EY was represented by the following:

- Mark Besca, New York City Office Managing Partner
- Rich Jeanneret, Vice Chair and Northeast Regional Managing Partner
- Tim Tracy, Northeast Region Assurance Managing Partner

Endnotes

¹ *Summary of Themes* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and guests and their company affiliations are a matter of public record, but comments made before and during meetings are not attributed to individuals or corporations. However, the guests have given permission for their remarks to be attributed. Comments by the guests and network members are shown in italics.

² Please note that subsequent to our meeting, the tax legislation has been passed by the House and Senate.

³ Tuck Rickards, Kate Smaje, and Vic Sohoni, "[Transformer in Chief: The New Chief Digital Officer](#)," McKinsey and Company, September 2015.