

Southeast Audit Committee Network

October 2018

SEACN

SUMMARY of THEMES

Discussions on internal audit transformation, regulatory policy, and social media

Members of the Southeast Audit Committee Network (SEACN) met in Atlanta, Georgia, on October 8, 2018, to discuss internal audit's shifting scope and role in today's digital world, new developments at the Public Company Accounting Oversight Board (PCAOB) and Securities and Exchange Commission (SEC), and the current political environment in Washington.

Internal audit transformation

SEACN members were joined by Joanne Sebby, chief internal auditor, First Data Corporation, and Lisa Hartkopf, EY's Americas internal audit leader, for a discussion on how technological advancements, shifts in the risk environment, and regulatory pressure are changing the scope of work and talent needed for successful internal audit functions. *"The pace of change today is unprecedented,"* Ms. Hartkopf noted. *"Internal audit also needs to change, to adapt and respond to the business and emerging risks in an agile way. Yet few chief audit executives are challenging the status quo."* Members and guests also discussed ways for chief audit executives (CAEs) to deliver enhanced value to the company. Key themes from the discussion included the following:

- **Add value to the business without losing sight of assurance.** Many companies have identified ways to streamline Sarbanes-Oxley compliance and controls testing, but it remains a significant time commitment for many audit functions. Increasingly, however, internal audit functions are also expected to add more value to the businesses by getting involved earlier in major technology transformation projects, for example, and conducting more real-times audits. Ms. Sebby said, *"At many companies, internal audit is going through significant transformation, and at the core, it's about technology and turning the focus from a historical review to one involving foresight ... The question is, how do you get to the point where you are not looking and saying, 'Accounts payable had an issue 11 months ago, to saying 'There may be a problem in accounts payable, I am going in now.'"*
- **Prioritize technology risks and talent.** Ms. Hartkopf noted that new tools such as data analytics that can advance the function and understanding the risks in adoption of advanced technologies in the business require greater technology proficiency in the audit function. Equally, she stated, *"Internal audit is not spending enough time on IT. Large IT transformation projects are often outside of scope."* Many traditional auditors do not have this training. *"In addition to core accounting knowledge, it's essential for internal auditors to*

gain experience with technology. I've encouraged my teams to become fluent in the language of technology. Internal audit hours spent on these risks are not going to be reduced, so we all have to learn it," Ms. Seby said. Members and guests agreed that the shortage of qualified technology experts presents challenges for internal audit teams. One participant suggested internal audit may not be used to making the business case for additional resources. It may be difficult for internal audit functions to keep up with the pace of technology advancement. Ms. Hartkopf noted, *"Other functions have these advanced tools. There is a real disconnect between leading practice and technology and what most internal audit functions have. There is an increasing gap between the external auditors, finance teams, businesses, as compared to internal audit."*

- **Use internal and external resources to supplement existing capabilities.** At many member companies, cosourcing enables internal audit teams both to stay on top of emerging issues and also to cover their core audit responsibilities sufficiently. For some members' companies, outsourcing the entire function is a cost-effective solution. Other members reported that cosourcing certain tasks, such as Sarbanes-Oxley testing, IT-related audits, or coverage for international operations freed up internal audit's time to focus on more valuable projects for the business. Members and guests also highlighted the value of rotating talent from the business into internal audit to build knowledge. Ms. Seby noted, *"We've had good luck bringing in skilled staff from other part of the business to help think about risk in a new way."* One said they asked internal audit to coordinate with the IT function to make sure they have the right expertise looking at key technology risks. Ms. Seby noted that they often rotate technology experts from the IT function through internal audit to address this challenge.

Guests and members highlighted the following ways audit committees can support the internal audit function:

- **Ensuring the function has sufficient resources.** Ms. Hartkopf and Ms. Seby suggested that audit committees might ask the following questions of their internal audit teams: What are you spending to drive innovation? Do you have the right resources and talent to accomplish your core work and drive innovation? How is the audit plan changing from year to year? Does your budget reflect those changes?
- **Providing CAEs with a seat at the executive table.** Members acknowledged the importance of the audit committee—specifically the chairman—in helping to elevate the role of today's CAE with management and other business leaders. A member said, *"Internal audit remains engaged in key initiatives by having a seat at the table with management. At one company, a senior leader from the function is present in every strategic meeting that occurs."* Ms. Seby highlighted how participation in strategic discussions ensures a more forward-looking, insightful audit: *"No matter what it is, internal audit is engaged in governance and strategy setting. Audit is engaged in a company-wide, strategic list of*

projects, and often, these are incorporated into the audit plan.” Ms. Hartkopf added, “Internal audit needs to be focused on the risks that are being talked about in the boardroom.”

- **Evaluating internal audit leadership.** Members commented on ways they evaluate the CAE and internal audit function. One member reported looking at *“benchmarking, peer reviews, management surveys, regular evaluations, and our own empirical impression on whether [the CAE is] doing well or not.”* One member described playing a lead role in initiating and drafting the CAE’s formal performance review: *“As the audit chair, I draft the evaluation and give it to management for review. I also make recommendations on the executive’s salary and bonus. Doing the evaluation myself reinforces who internal audit really reports to—the audit committee.”* In other members’ companies, the audit committee provides input, but the CFO or CEO completes the formal evaluation. Many agreed that this process was beneficial, given that these executives often have insights into dynamics at the company that the board lacks.

A Washington policy update

Bridget Neill, EY’s Americas deputy vice chair of public policy, led a conversation on current policy matters that included updates on legislative and regulatory matters, and other important issues being discussed in Washington.

Ms. Neill noted that the discussion on the PCAOB is timely, as the PCAOB is undergoing an extensive review of its operations and priorities, including with the publication of its draft strategic plan. In addition to having a new board, the PCAOB’s is in the process of putting in place new division leaders across all its divisions.

Several issues dominated the conversation:

- **Understanding the implications of the midterm elections.** Ms. Neill noted that dating back to the Civil War, the President’s party has almost always lost seats in the House of Representatives in mid-term elections. As a result of historical and recent trends, most still expect the House of Representatives to flip to the Democrats, with anywhere from 25-to-45 seats likely to change parties. In the Senate, 26 of the 35 seats up for election are currently held by Democrats, and ten of those 26 are in states that voted for President Trump in 2016. If Democrats take control of the House, Ms. Neill suggested significant new legislation of the scope of the recent tax legislation is unlikely, given the Senate is more likely to remain in control of the Republicans. However, increased legislative oversight would be likely, including some potential scrutiny of regulatory agencies. With these scenarios in mind, Ms. Neill highlighted a few areas that are likely to have bipartisan support: a focus on data security and privacy, and trade, particularly finalizing trade agreements to replace NAFTA.

- **The Trump administration is delivering on its campaign promises.** Ms. Neill noted that despite a degree of “noise”, the administration has been successful in fulfilling a number of “Candidate Trump’s” campaign promises, in part due to the benefit of single party control it has had. For example, slowing the pace of new regulations and naming many new judges to the federal court system.

Updates on the SEC and the PCAOB

- **SEC priorities.** *“At this moment, with Commissioner Roisman confirmed, there is a full compliment of commissioners. This will likely facilitate [Chairman] Clayton advancing his priorities.”* The SEC’s priorities are likely to continue to focus on capital formation and disclosure effectiveness, including scaling disclosure requirements, and promoting IPOs and healthy equity markets.
- **The PCAOB opening to engagement and feedback.** The PCAOB has recently increased engagement with key stakeholders, including audit committees, by seeking public comment on its strategic plan and open dialogue with audit committee chairs. Ms. Neill suggested this was part of a series of changes underway at the Board. While some members welcomed this shift, others expressed concern about the unintended consequences of their engagement with audit committees: *“Where is it in the scope of the PCAOB to be in conversation with audit chairs? In recent years, they’ve provided best practices for audit committees, and what it did was give us another checklist that we have to cover.”*
- **Improving the PCAOB’s inspections and reporting processes.** Ms. Neill noted that the head of inspections has yet to be appointed and that change will begin to advance once this leadership role is filled. She said, *“Right now, inspections are in a continuation stage. Dramatic change in the inspections or reporting process will not expected during the current cycle. There is an expectation, however, that significant change will happen.”* Some members remained skeptical and questioned why filling key roles has taken so much time. Ms. Neill emphasized the current dialogue the PCAOB is engaged in with audit chairs and many others and encouraged the audit committees to share their views with the PCAOB.
- **Keeping up with technological change in the audit profession.** According to Ms. Neill, *“There is a strong awareness of a learning curve and an information gap between the agencies and those they regulate. The Big Four have spent a significant amount of time engaging with the PCAOB and SEC, informing them on the tools being deployed to enhance the audit. The PCAOB is aware of the gap and are open about it in their strategic plan.”*
- **The reporting of critical audit matters (CAMs).** The requirement to disclose CAMs will come into effect during 2019 for audits of large accelerated filers. External auditors have undertaken dry runs with companies and audit committees this year to provide an

opportunity for early quality control. Ms. Neill emphasized that successful implementation of disclosure of CAMs is a key focus of the PCAOB and SEC: “*The SEC and PCAOB are invested in CAMs success.*” Both agencies are focused on successful implementation and prepared to issue guidance where warranted. The PCAOB has indicated it will undertake a post implementation review.

- **Developing audit quality indicators (AQIs).** Ms. Neill noted that in 2015, the PCAOB published a concept release for AQIs, and the profession since then has worked to voluntarily adopt AQI, including in their firm level audit quality reports. The PCAOB has included AQI in their PCAOB strategic plan and is exploring their role, including whether to require a minimum set of AQI to achieve *consistency*. She noted that in 2015 several audit committee members weighed in preferring instead AQI tailored to their needs. Ms. Neill encouraged members to consider this further and weigh in with the PCAOB moving forward.

Board oversight of social media

In a members-only conversation over dinner, SEACN members discussed emerging issues boards are tackling. One area of particular interest was social media and the board’s oversight of executive communication through these platforms. Recent news headlines reveal the pitfalls that can ensnare executives who engage with the public and employees through social media, especially regarding political or social issues. Some members advised companies to maintain a strict policy prohibiting executives—and in some cases all employees—from making political statements online, noting the potential harm to the business. One member asked, “*Where does reputational risk mitigation come into play? There are things that the company does need to take a stand on.*” Most members agreed on the importance of raising this issue at the board level, conducting regular monitoring of social media, and having a public-relations firm on retainer in case of a crisis involving social media and reputational risk.

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About this document

The Southeast 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.

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. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.

Meeting participants

The following SEACN members attended all or part of the meeting:

- Kerri Anderson, Laboratory Corporation of America
- Carolyn Byrd, Regions Financial
- Denise Dickins, Watsco
- Tom Hough, Equifax
- Doug Johnson, Aflac
- Scott Kuechle, Kaman Corporation
- Karole Lloyd, Aflac
- Richard Macchia, Fleetcor
- Connie McDaniel, TSYS
- Rick Mills, Commercial Metals Company
- Jason Papastavrou, United Rentals
- Terry Rappuhn, Quorum Health Corporation
- David Walker, Chico's FAS, CommVault Systems, and CoreLogic
- Rick Williams, Crawford

EY was represented by the following:

- Jim Estes, Southeast Assurance Regional Managing Partner
- Sam Johnson, Vice Chair, Southeast Region Managing Partner
- Bryan Yokley, Georgia/Alabama/Tennessee Market Segment Leader, Assurance Partner