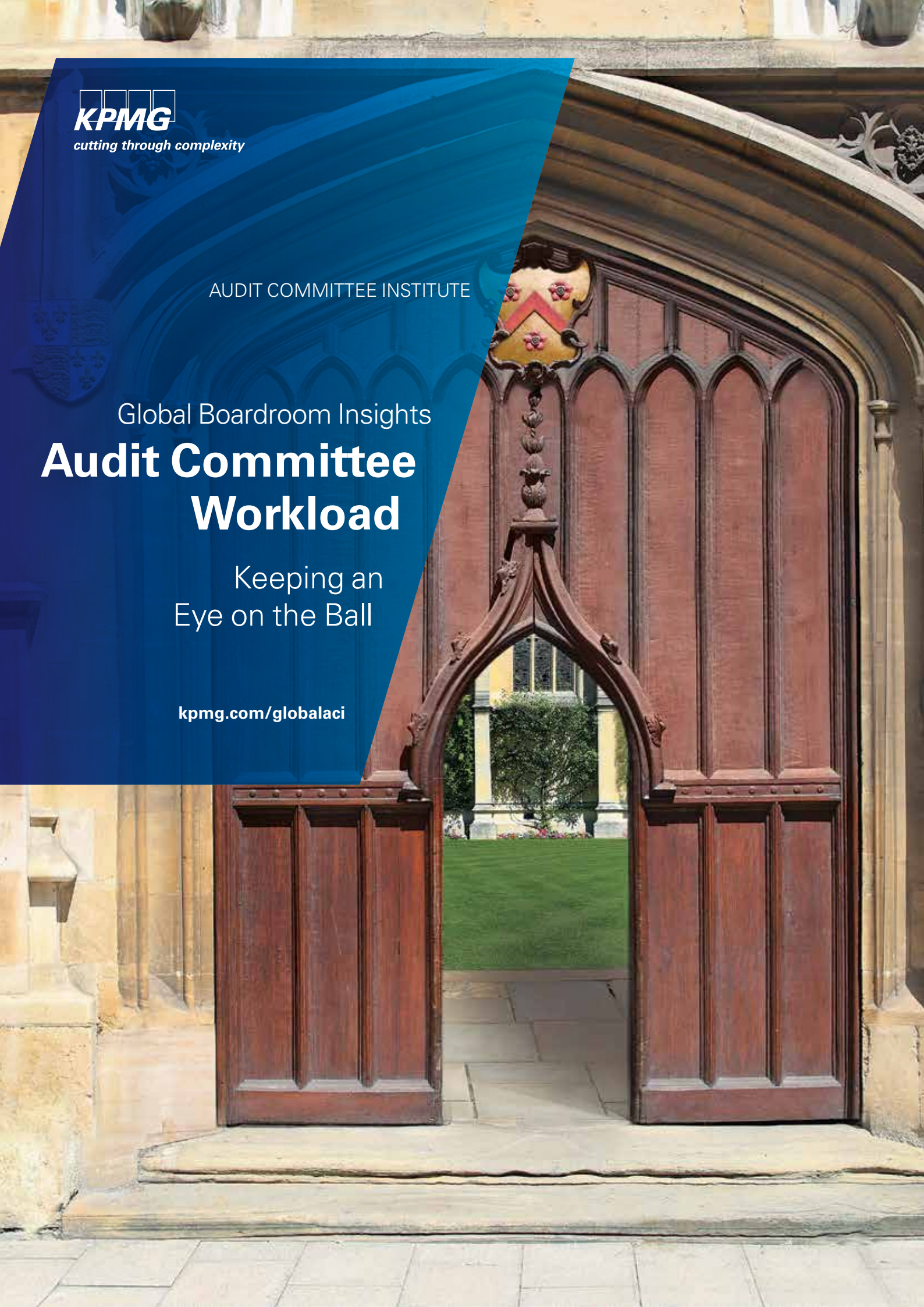

KPMG
cutting through complexity

AUDIT COMMITTEE INSTITUTE

Global Boardroom Insights

Audit Committee Workload

Keeping an Eye on the Ball

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About

KPMG's Audit Committee Institutes

Sponsored by more than 30 member firms around the world, KPMG's Audit Committee Institutes (ACIs) provide audit committee and board members with practical insights, resources, and peer exchange opportunities focused on strengthening oversight of financial reporting and audit quality, and the array of challenges facing boards and businesses today – from risk management and emerging technologies to strategy and global compliance.

To learn more about ACI programs and resources, contact us at:

auditcommittee@kpmg.com

Interviewees

A note from KPMG's ACIs

Audit committee chairs, by nature, are detail-oriented and demanding, eager to tackle complex issues, and good at managing heavy agendas and telling it like it is. So when a chorus of seasoned audit committee chairs – like those we interviewed in this edition of *Global Boardroom Insights* – say the audit committee's workload may be reaching a tipping point, every board's antenna should go up.

Agenda overload is not a new issue for audit committees, but our latest survey work shows that it's becoming a major concern: 75 percent of the 1,500 audit committee members responding to our 2015 *Global Audit Committee Survey* said the amount of time required to carry out their audit committee responsibilities has increased moderately (51%) or significantly (24%) over the past two years. And 40% said it's becoming increasingly difficult to oversee all the major risks on its agenda given the committee's agenda time and expertise. Interestingly, 35% said their board had recently reallocated risk oversight responsibilities to better balance the workload among its committees – a good sign.

As noted in our interviewees, oversight of financial reporting and audit is a significant undertaking in itself. Add to that the heavy risk-agendas that many audit committees are shouldering today – cyber security, global compliance, financial risk, risk management processes – and ever-expanding regulatory compliance requirements ("must-do's") and you have one of the most demanding (and vital) oversight roles in governance today. Efficiency and effectiveness is at a premium.

In this edition of *Global Boardroom Insights*, our interviews shed light on how audit committee agendas are evolving, and approaches that seasoned audit committee chairs are taking to help the committee focus its time and energy on the issues that matter most. Starting with "learn to say no", key insights from the interviews are highlighted on the next page; but we encourage you to read the full interviews. You're sure to find common challenges, and perhaps a few uncommon approaches, to making the most of the audit committee's time, expertise, and value to the business.

Perhaps not surprisingly, our interviewees said risk will be a top priority in the year head: cyber risk, public policy and regulatory issues, and reputational risk will continue to be front-and-center in 2015, as will the audit committee's role – and the scope of its responsibilities – in risk oversight activities.

Dennis T. Whalen
Audit Committee Institute
KPMG in the U.S.

Tim Copnell
Audit Committee Institute
KPMG in the U.K.

Sidney Ito
Audit Committee Institute
KPMG in Brazil

Guillermo Calciati
Audit Committee Institute
KPMG in Argentina

Interview Insights – At-a-Glance

Learn to say no. New issues and risks are often allocated to the audit committee by default, rather than by design. Be wary of "mission creep," and consistently question whether new and ongoing issues belong on the audit committee's agenda, given the time and resources required to oversee its core responsibilities.

Face-time in the boardroom is precious. Audit committee meetings should be well thought-out and structured in a way that allows the committee to make the most of its time together. Limit (or exclude) PowerPoint presentations in favor of quality discussion; expect pre-read materials to have been read before the meeting; reach a level of comfort with management and auditors so that financial reporting and compliance activities can be "process routine," freeing up time for more substantive issues facing the business; focus on the three or four most important matters that need attention.

Spend time with management and auditors outside of the boardroom. Informal meetings with the CFO, controller, auditors, and others outside of regularly scheduled meetings can help the audit committee chair (and the committee) stay up to speed and sharpen the committee's formal meeting agendas. "You often get a much clearer picture of the issues."

Tap all resources at the committee's disposal. Internal auditors. External auditors. The C-suite. Outside experts. The audit committee should fully leverage the array of resources and perspectives necessary to support the committee's work. "The committee should always be asking itself whether it's getting the information and support it needs. Are we properly resourced? Are we hearing from those who have a point of view to offer?"

Spread the committee's workload. Allocate oversight duties to each audit committee member, rather than relying on the audit committee chair to shoulder most of the work. "In many instances the only person who seems to be running at light speed is the audit committee chair. We really need to utilize the entire committee…for deep dives into particular areas of interest or concern."

Take a hard look at the board's risk oversight approach. Does the allocation of risk oversight activities make sense in light of how the risk and regulatory environment has changed recently? Is there a need for another committee, additional expertise, or better communication and coordination on risk oversight among committees? Committee reports should be robust, and "committee chairs should be communicating regularly to make sure they know what's going on in the other committees."

Ronald Sugar Apple / Chevron (U.S.)

"The challenge for an audit committee and its chair is to step back and try to figure out what's most material to the fortunes of the company, and make sure that between the audit committee, the financial management team, and the external auditor, everyone's focusing their efforts on those things."

Dr. Ronald Sugar served as Chairman and CEO at Northrop Grumman Corporation from 2003 until his retirement in 2010. Previous to Northrop, he held executive positions at Litton Industries and TRW Inc., where he was chief financial officer. He serves on the boards of Amgen Inc. and Air Lease Corporation, as well as Apple Inc. and Chevron Corporation, where he serves as audit committee chair. Dr. Sugar is a senior advisor to the private investment firm Ares Management LLC, a member of the National Academy of Engineering, and a former chairman of the Aerospace Industries Association.

ACI *In our work with audit committees, one of the biggest challenges they point to is an ever-expanding agenda. The combination of compliance requirements and responsibilities for significant areas of risk – beyond financial reporting – seems to be pushing audit committee agendas toward a tipping point. Is that what you're seeing?*

Ronald Sugar: Well, let's start with where we've been. Going back a decade or so, as we all know, audit committees were just deluged, dealing with significant issues associated with financial accounting – hink Enron, WorldCom, and subsequently Sarbanes-Oxley. At Northrop Grumman, our audit committee meetings in those days were often four hours or longer, with added sessions in between.

The good news today is that for most major corporations in this country, the rules are clearly understood. We have a well-defined body of controls and certifications. We're all playing from the same rule book, and our independent auditors are expert in helping us with that. So the chances of finding a WorldCom or an Enron today is significantly diminished.

That said, there's clearly a creeping set of must-do's and regulatory box-checks that audit committees have to take care of to fulfill as part of their charters. And if you're not careful, those activities can crowd out other important issues.

ACI *As an audit committee chair, how are you tackling all the regulatory must-do's without getting deluged?*

Ronald Sugar: In my view, the audit committee has to develop a high level of comfort with both management and the external auditor that the basic mechanics of the company's financial reporting and controls are, in fact, under control.

And while we don't want to give short shrift to that part of it, we want to be in a position that I would call "process routine," so that we can apply most of our work capacity and our focus as a committee to those things which could be more material and important to the fate of the company going forward.

But this approach means that you have to have good processes in place and the right people in the finance function. You need to feel confident about that.

ACI *How does "process routine" work in terms of meeting mechanics?*

Ronald Sugar: I'm not sure there's a magic elixir, but first we try to address all the mandatory things on our charter – we move through those items relatively quickly, unless there's something which requires special discussion. For example, at one company I was involved with a couple of years ago, revenue recognition had become a big deal – it was material to the way the financial statements were presented. So every quarter, with the 10-Q and the 10-K, we would do a deeper dive on revenue recognition. And over time, that settled down into a routine practice that we became comfortable with. So we didn't need to spend much time on that anymore, and we could focus on things that were more seriously impactful to the company.

This was a company specific example of course, but the audit committee needs to make sure it has surge capacity to deal with more complex issues beyond financial reporting. Cyber-security – if that's assigned to the audit committee's charter – is a good example. Compliance with the ever-increasing set of governmental regulations in the U.S. and around the world is another example.

I think the challenge for an audit committee and its chairman is to step back and try to figure out what's most material to the fortunes of the company, and make sure that between the audit committee, the financial management team, and the external auditor, everyone's focusing their efforts on those things.

I'm a big fan of the 80-20 rule – focus on those few things with greatest impact. If you try to focus on everything equally, you just get overwhelmed. You end up with audit committee meetings that go on and on, which is when you can lose focus and miss important things.

ACI *How does the 80/20 approach play out in terms of the audit committee's interaction with management and auditors?*

Ronald Sugar: For example, we try not to let the management team brief us with PowerPoints. We ask for pre-reads that are thorough but focused, so at the meeting we can say – okay, assume we've all read the pre-reads, now help us zero-in on the two or three most critical things that we should really understand better. What issues concern you the most? What should we be watching? We want to hear their narrative – so no PowerPoint.

And later on, in private executive sessions with various individuals, I always start out by saying – great presentation, I think we got it. What else would you like to share with the committee? What's bothering you? What's keeping you up at night? What do you need help on? Where do you think we should be spending our time?

And what's interesting is that occasionally they'll say – "Well, you know, this could be a bigger problem than we said." And as a committee, that's what you want to hear, because it helps sharpen your focus.

ACI *Given that oversight of financial reporting risk is such a major undertaking in itself, is there a point at which the audit committee needs to push back on the board and rethink how significant risks – like cyber security or regulatory compliance – are allocated among its committees?*

Ronald Sugar: Absolutely. How risks are assigned to board committees, of course, depends on the company. If you're a financial institution of any scale, most likely you'll have a dedicated risk committee, which appropriately offloads the audit committee from certain duties.

In a pharmaceutical company, you may have a compliance committee, which would be focused on the full range of issues associated with all the U.S. and global regulations around pharmaceutical compliance – how you sell your drugs, how you do clinical trials, and so forth.

I've mentioned cyber security. Few boards in the U.S. have board members who are experts in this area. So, to which committee do you assign it? Do you put it in the governance committee? The public policy committee? The compliance committee? Very often it lands in the audit committee.

The one thing you cannot debate is that financial reporting risk clearly belongs to the audit committee. But even there, you need to be clear about financial reporting versus finance. One of the committees I chair is an Audit and Finance Committee, which covers both. So not only do we look at the company's financial reporting historically – through the rearview mirror – we also try to look at upcoming financial decisions through the front windshield. If the company makes an unsound investment – even though it's all accounted for and reported correctly – then we really haven't done our job.

Other companies elect to separate the finance committee and audit committee functions. Every company is different. The point here is that the board needs to be conscious about where risk oversight responsibilities are assigned, and that it's all covered.

ACI *Our surveys show that quite a few audit committees have responsibility for oversight of cyber security, and that additional technology expertise would be a big help to the committee. Is this an issue for your audit committees? And does it point to the broader question of the committee's composition?*

Ronald Sugar: Yes, we've talked about both of those issues – and I think a lot of audit committees are probably thinking about the expertise they have on the committee and what they might need going forward.

I think it's helpful to have at least one member of the committee who, if not an expert, at least has a familiarity with and an interest in information technology. For example, I'm not an expert in cyber security – I certainly can't go toe to toe with the hackers – but because I ran Northrop Grumman, and we were deeply involved in cyber defense issues, I do have a sense of the landscape here.

The committee needs to be able to ask the right questions. The committee has to have confidence that management is not only adequately supported with internal talent and skills, but is also using the right outside advisors.

In the worst case scenario, if you begin to lose confidence in the company's IT security function, then I think it's fully appropriate for the audit committee to engage outside experts in the cyber world and ask them to do an independent assessment of where the company stands. But that should only be a last resort.

I also look to the company's internal auditor as an additional resource. At one of the companies I'm involved with, our internal audit head brought in some great resources and has taken a leadership role in the cyber risk area. You may have a chief information security officer (CISO) or a CIO playing the lead role on cyber security, but having internal audit as another set of eyes – with a direct reporting line to the audit committee – adds another level of comfort that the issue is being covered.

ACI *Can you talk about the work that happens in between audit committee meetings – and how that impacts the committee's effectiveness?*

Ronald Sugar: I think it's entirely appropriate and desirable for the committee chair to meet with members of management and the outside auditor in between regularly scheduled committee meetings, to have more in-depth discussions on some issues that are developing.

I like to say it's good to sit down with key folks in their 'native habitat,' without an agenda. Just visit them in their office and have a conversation about things that are on their radar or yours. Treasury is a good example. The company has X millions of dollars of cash on-hand, a lot of it is overseas, and treasury has a certain level of desired return they're looking for. Are they comfortable with the risks they're seeing out there? How are they dealing with those risks? How are they ensuring adequate liquidity? Informal discussions like that can be really insightful. You often get a much clearer picture of the issues.

A special privilege of being an audit chairman is that you can go anywhere in the company at any time. You're paid a little extra to be the chairman, so you ought to do a little more work – and then make sure the other committee members are exposed to what you've learned. Committee members will appreciate the chairman's leadership in this regard, and it certainly helps take some of the pressure off the entire committee's workload.

ACI *How well an audit committee juggles its workload speaks to its overall efficiency and effectiveness, but in your experience, do committee self-evaluations get to this issue?*

Ronald Sugar: Well, that's a little tricky. I've seen committee self-evaluations approached in different ways. There are committee self-assessments that are done perfunctorily, and the committee determines that they're absolutely awesome – any questions? In some cases, the committee goes through an elaborate checklist of the committee's charter, which typically shows that everything we said we'd do in the charter was in fact done – and therefore we must be a very effective

committee. It's a necessary approach, but not necessarily a sufficient one.

Certainly, you don't want to have any gaps between what your charter says you were supposed to do, and what you actually did over the course of the year. What I've found to be very effective is to sit down with my committee members and just have a good, thoughtful conversation. How are we feeling about the company? How are we feeling about the financial function? How are we feeling about ourselves as a committee? It seems like a high level discussion, but it can actually be pretty deep and introspective.

In one case, this sort of introspective discussion turned up an important issue. For example, one member said, you know, I think overall we're okay, but I'm concerned that we're doing a lot of swaps and forward contracts.

We think the company is in good shape there, but are we really? Do we have potential risks or a surprise lurking here? It was a great point, I made note of it, and we dove deeper into it during the next several committee meetings.

I also like to ask our outside auditor and our CFO to tell me how our committee can be more effective. So, from my perspective, a good committee assessment is about getting honest feedback from all sides, and then turning that feedback into actionable behaviors.

ACI *And that gets back to the 80-20 rule that you mentioned.*

Ronald Sugar: Exactly, but there's a distinction which I also used with my own management teams when I ran a company. There are lots of things that are urgent, and some things that are also truly important.

Urgent means you're filing a 10-Q, you're certifying, and you need to go through a set of all the checklist items to release the earnings in time, and if you don't meet the deadline it's a real problem for the company and the shareholders.

And then there are other things that are also truly important to the long-term success of the company – for example, do we know what really differentiates us from our closest competitors? Are we really better than them, or are we just lucky? Do we have a concern about backdoors into our IT system through contractors? Those kinds of issues are what I would call important. And it may not be something you can solve immediately, but you need to put that challenge to your management team and make sure you have sufficient time for it on the agenda over the course of the year.

As an audit committee chair, seeing a really good company get surprised by a major problem is what keeps me up at night. I'm not management and I'm not running the company, but I do have an oversight responsibility – to hopefully prevent something from happening or to be positioned to respond quickly in a constructive way with management. And those become the important things, over and above the day-to-day urgent things.

ACI *What will your top priorities be as an audit committee chair in the year ahead?*

Ronald Sugar: First and foremost is enterprise risk management – the risk overlay for the whole company. We want to make sure that the key risks are appropriately being addressed inside the company and oversight has been allocated to the appropriate committees. Where should we be focusing our attention as a committee and encouraging management and auditors to focus their attention? What could really ruin our day as a company? I would put cyber risk into that category, for example.

I also think there's a growing set of political and regulatory risks out there, and I'm beginning to lump those together because, in many cases, there's a political agenda associated with the regulatory enforcement. So it becomes not only a compliance issue, but a reputational and public policy issue as well.

These issues often go beyond the purview of the audit committee, certainly, but they're risk management issues that may impact the company materially, so they're two areas that I think should get more attention.

ACI *Other priority issues for 2015?*

Ronald Sugar: One other issue that I'll be focusing on is the increasing presence of activist investors – of all shapes and sizes – who come knocking with what they see as opportunities to improve shareholder value. While they are often disruptive, I'm not saying activists are inherently bad for a company. They are part of the natural functioning of a market system. I do think a board has to be thoughtful about the ideas activists are bringing to the table.

Investor activism probably touches at the edge of an audit committee's charter. But to the extent that there are investor questions about the company's valuation – for example, does our accounting methodology understate or overstate the company's value? – the audit committee needs to help the board think about what makes most sense for the company and its shareholders. ❖

Donna Cordner Carlsberg (Denmark)

"Meeting agendas need careful planning to ensure there is enough time to focus on the priority issues."

Donna Cordner is the Audit Committee Chairwoman of Carlsberg A/S where she has been a member of the Supervisory Board since 2012. She is also a member of the Advisory Board of Vosges Haut Chocolat, managing partner of OKM Capital and CEO of HelpAge U.S. Formerly a non-executive director of Millicom International Cellular SA and Managing Director and Global Head of Telecommunications and Media Structured Finance at Citigroup, she has also held senior positions at Société Générale and ABN Amro Bank N.V. in the U.S. and Europe. She has been CEO of HOFKAM Limited, the largest rural microfinance company in Uganda, and held the positions of Executive Vice President of Corporate Finance and Treasury, Market Area Director and CEO for Russia at Tele2 AB.

ACI *Has the audit committee workload increased in the past few years?*

Donna Cordner: I would say the workload is increasing. There's no doubt that businesses are becoming much more complex and the risks associated with the corporate world are increasing in complexity. Take, for example, security. Not so long ago we would focus on basic systems integrity and user access. Now we have to worry about things like hacking and how integrated the systems are – it sometimes feels like you need an IT degree to fully understand the risks! The regulatory environment has changed too, and transparency and reporting. When we add it all up, it's clear that both the workload and responsibility placed upon audit committees has increased.

ACI *Have audit committees taken on too much? In particular, are there aspects of risk oversight that might be best addressed by the board as a whole or by a specialist risk committee?*

Donna Cordner: I think it depends on what committees the board has. The boards I have served on have generally had the three standard committees – nomination, compensation and audit – and sometimes a capital structure or an investment committee. But, the audit committee is really about dealing with the risks associated with the business so IT risk, for example, should be on the committee's agenda. Also, the audit committee is the place where you can really dig down into each issue – and this can mean taking a little more time. When I took over as audit committee chair at Carlsberg we increased the audit committee meetings by an hour and I think that's a trend that's set to continue. Time is a real issue as you just can't get through everything in two hours. We are at three hours now but will probably have to take it to four at some stage in the future – and we also have calls in between meetings.

ACI *Is that call with audit committee members or management and the auditors?*

Donna Cordner: I talk to the chairman of the board pretty regularly, but its internal audit I talk to most frequently – weekly – and the CFO and CEO around every other week and then with the audit committee more or less on a monthly basis (though we communicate by email more frequently than that).

ACI *Is there a tension between the meetings being long enough to get through the material but not so long as members lose focus?*

Donna Cordner: It's tough but the problem is that we usually have the financial statements, press releases and the external auditors reports – so that is easily over an hour. And then you have the internal audit reports on top of that – and that's nothing extraordinary.

ACI *Is there a difference between the way boards and audit committees approach these issues in different jurisdictions?*

Donna Cordner: Yes. For example, U.S. listed companies have SOx which has a bad reputation with some commentators but can be really helpful in changing the control mentality within a company. Also, the disclosure regime in the U.S. is generally much more onerous than it is in Europe. On the downside, it can be hard to source audit committee members in the U.S. as it's a lot of work and there are liability issues too.

ACI *What sort of people sit on audit committees and does this need looking at as audit committee remits increase?*

Donna Cordner: Audit committees comprised of ex-Big 4 partners are quite rare these days; far more likely to have ex-CFOs, CEOs and other people with strong finance process skills. There is a lot of support, both within companies and within the audit firms, on the accounting side. It's the other areas you really need some good thinking and foresight.

ACI *Even with good people on the audit committee, there is still the issue of keeping abreast with audit, accounting, regulatory and business developments. How do you tackle that challenge?*

Donna Cordner: Audit committees rely in part on management. In terms of managing the agenda, it can help to focus each meeting on a different area – perhaps with a presentation from the business or some form of training. However, the audit committee can't depend solely on management. On some of these areas you have to get a broader view – potentially exposure to third party expertise.

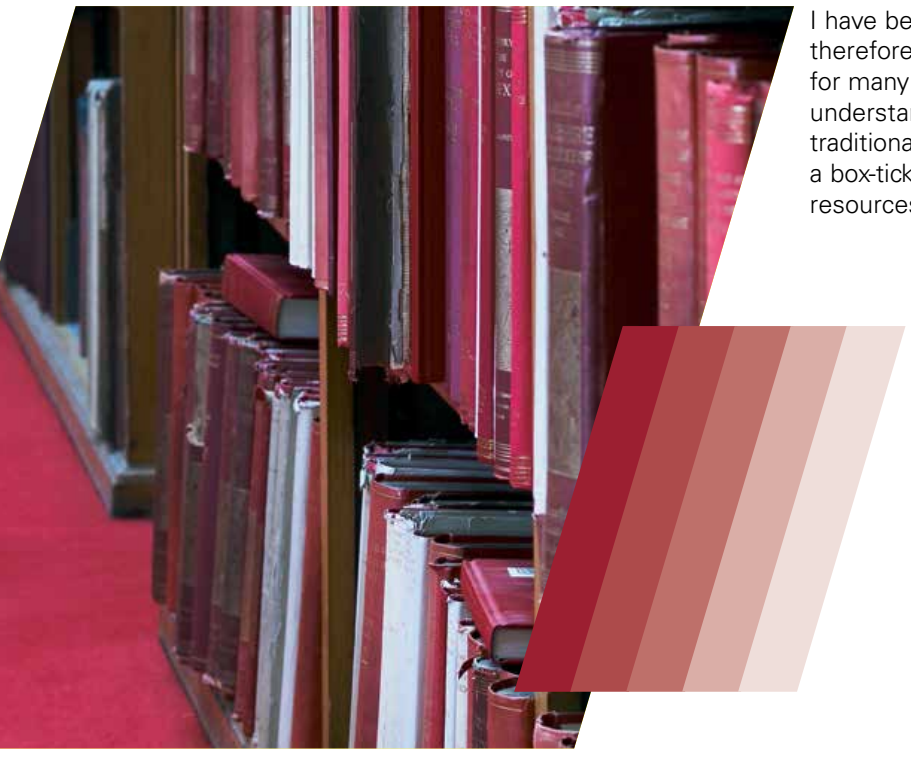
ACI *What areas have been taking more time on the audit committee agenda over the past few years?*

Donna Cordner: I think internal audit has taken more time as companies become more global and more complex. It's all too easy to sit at the corporate headquarters and not know what's going on around the world. There is also a role for the audit committee in helping internal audit take a broader perspective and see the company-wide trends, overarching risks and challenges arising from their work. Risk is hugely important, so risk mapping and risk management

systems are taking more audit committee time too. And from the board perspective, strategic issues and the inherent risks are taking more time.

ACI *Are audit committees well served by internal audit functions – perhaps the "eyes and ears" of the audit committee?*

Donna Cordner: I think internal audit is an incredibly tough job, not least because what the audit committee wants from internal audit and what management want from internal audit is often not the same thing. It's incredibly important that the audit committee ensures the internal audit function is motivated and involved at an appropriate level.



ACI *As the workload becomes more and more dominated by regulatory matters, how does the audit committee combat "box-ticking" or an over emphasis on process at the expense of debate and challenge?*

Donna Cordner: Meeting agendas need careful planning to ensure there is enough time to focus on the priority areas. One idea to have some kind of presentation or dedicated session on a key risk or issue early on each meeting agenda. We also meet, just as a committee, at the end of each meeting to reflect on the meeting.

ACI *What do you think is the top priority in terms of audit committee effectiveness over the year ahead?*

Donna Cordner: I would say that each audit committee I have been on has had different characteristics and therefore different priorities. Perhaps a common theme for many though is making sure the committee really understands all the different risk areas – not just the traditional risk areas – and making sure it doesn't get into a box-ticking mentality and that we have enough time, resources and expertise to do the job. ❖

Mark Williamson Imperial Tobacco Group PLC (U.K.)

"The audit committee should be ensuring that the right skills are within the executive team rather than bringing those skills into the audit committee itself."

Mark Williamson is the Chairman of Imperial Tobacco Group PLC and Senior Independent Non-Executive Director and Chairman of the Audit Committees of National Grid plc and of Alent plc. Previously, Mark has been the Group Financial Controller of Simon Group plc and Chief Financial Officer of International Power plc

ACI *Is the audit committee workload is increasing?*

Mark Williamson: There are a number of additional responsibilities that have been added to the agenda recently, such as cyber risk for example. Also, risk management, anti-bribery and corruption are all subject to ever more focus in all businesses. Beyond that, some of the "basic" matters such as revenue recognition need to be forced back onto the agenda every now and again along with the control environment and considering the culture within which the finance function operates.

At my companies I have recently spent additional time thinking about the finance function, how it's structured, how it interacts with other parts of the business and how it manages outsourced functions. And whether controls are universally strong across the business. All these things need to be dealt with on top of what are already pretty full agendas – particularly at the full and half year committee meetings.

ACI *That must lead to some very time consuming meetings?*

Mark Williamson: Yes, but how the full year and half year meetings have evolved is also interesting. If I rolled back the clock five years or so, the whole gamut including key judgements and estimates, difficult or unusual transactions and how they are being accounted for would be dealt with in the final committee meeting. Whereas today, committees are better at getting complex issues discussed at an earlier stage, which allows for more consideration and input from the committee to ensure management have followed the right processes to get to the right answers. This is a good thing although it seems to increase the workload earlier in the year but doesn't actually reduce the time required to get though a year end meeting.

With regard to some of the new items on the audit committee agenda – cyber, for example – I think some committees want to get a deep understanding of the risks and mitigation controls in place rather than running the process on behalf of the Board. My view is that responsibility for risk sits firmly at the full board and that the audit committee should remain focused on making sure that the processes for managing and reporting risk are fit for purpose and working as intended.

ACI *Recent regulatory changes have changed the audit appointment environment, introduced new 'long-form' audit reports and brought additional disclosures about the role of the audit committee. Is this business as usual or more work for the audit committee?*

Mark Williamson: These things are taking more time. Audit rotation in particular is proving to be difficult for audit committees as a number of Big 4 firms can be conflicted and committees have to carefully consider whether the firms outside of the Big 4 have the resources to deal with the very major companies. So, what initially looked pretty straightforward is actually proving to be quite difficult and time consuming in practice. Even just getting to the initial list of firms that have the expertise and scale to take part in the tender process can be time consuming. Having recently been through a tender process as an executive, I am also aware that it is extraordinarily time consuming for the whole business, not just the finance function and doing this too frequently cannot be a good thing.

The new disclosures around the review of the external audit process is one of those areas that is likely to become boiler-plate and therefore unhelpful to readers of the financial statements. The standard of audits by each of the Big 4 is already high, so while it is important from an audit committee perspective to have a process in place to ensure quality remains high, there are other areas of greater concern to committees.

ACI *Are there additional considerations for international businesses where many of the issues are far removed from the corporate head office?*

Mark Williamson: Most definitely. It's absolutely critical that all Board members, not just audit committee members, get out of head office and into the business proper to better understand the issues facing the business and the culture within which the finance function operates. There is always a concern that the control environment is well understood and implemented close to home but is not fully operational elsewhere in the group. It is therefore important to understand the business at a grass roots level and this can only be achieved by site visits. This also increases the reliance on both internal and external audit to ensure that issues with the control environment are identified and promptly reported to the committee – and culture is a big part of this. Whistle-blowing processes are also a critical control mechanism in large multinational companies and ensuring that such processes are fully embedded and effective in the businesses is also vital.

ACI *And do audit committee chairs have appropriate access to the auditors of major subsidiaries or geographies?*

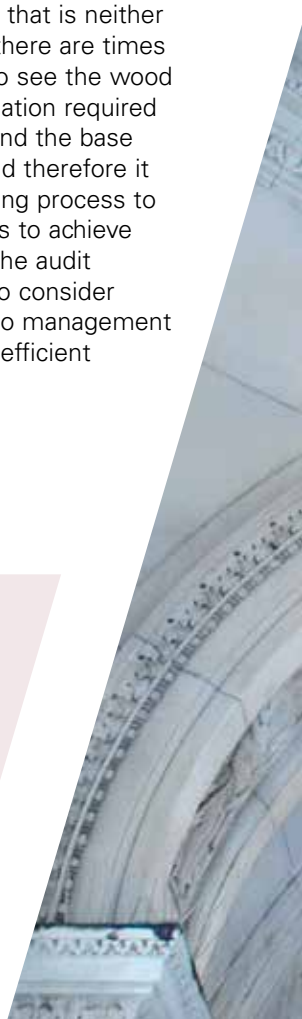
Mark Williamson: That's a really good question. As a CFO I would always discuss significant issues with the local auditors of all major subsidiaries – normally just at the year end but sometimes at the half year as well. As audit committee chair, I require overseas auditors to attend the audit committee where they audit a very significant part of the business or where particularly difficult issues have arisen. But normally we rely on the management team and the group auditor to bring the issues that have arisen at local subsidiaries up to the group audit committee. Perhaps we should do more here?

ACI *I suppose that leads to the broader question as to how deep the audit committee can go given that it is both non-executive and at an information disadvantage viz a viz management?*

Mark Williamson: With the proviso that non execs should never lose their independence, they should go as far as they need to go to ensure the financial statements fairly present the business. As a non-executive director you have a serious information deficit relative to management but that simply means you need to use your experience and follow your instinct on things that don't feel right. And if that means visiting subsidiaries to properly understand issues that are troubling you, you should not hesitate to make the visit.

ACI *Is there a magic formula for getting the balance of information at the audit committee right?*

Mark Williamson: Audit committee papers can always be improved. Sometimes papers are a little light on detail and this requires additional time in the meeting to drill down to fully understand the issues – and that is neither efficient nor effective. On the other hand there are times that long winded papers make it difficult to see the wood for the trees. The different levels of information required will vary according to the circumstances and the base knowledge of the committee members and therefore it is important that there is a continual learning process to get the balance right. There are many ways to achieve this but I have a 15 minute meeting with the audit committee members after each meeting to consider what constructive feedback can be given to management to make the meetings more effective and efficient going forward.



ACI *What can external audit do to help the audit committee?*

Mark Williamson: I think external audit is in a pretty good place generally. I think the quality of papers from external auditors are generally of a very high standard and the audits themselves are well thought through – understanding the risks in the businesses and then developing an audit plan that takes into account those risks is done to a very high standard.

Perhaps one area where audit firms could help the committee (around the margins) would be to promptly explain the extent to which they are not able to rely on internal controls and accordingly need to compensate with additional substantive testing. On occasions you find out relatively late in the day that there has been more substantive testing than originally planned because the controls weren't operated to the standard expected. It would be helpful to discuss the control weaknesses early to encourage the appropriate remediation rather than simply going down the substantive testing route.

ACI *So, better articulation of the audit plan and whether and why it's changed?*

Mark Williamson: The audit committee must approve all changes to the audit plan. I have experienced changes to materiality levels that were not discussed with the audit committees and this is totally unacceptable, albeit rare.

In terms of internal audit, I think the processes tend to work well these days and the scope and depth of coverage is now very well thought through. What troubles me more is how little internal audit (and external audit) do to help audit committees understand poor general environment controls, including key cultural issues such as undue pressure on achieving profit or cash flow targets – not just in one location but across the business as a whole.

ACI *The Institute of Internal auditors guide on internal audit in the financial services sector promotes the auditing of culture, but also calls for a much stronger link between the head of internal audit and the audit committee chair. Similarly, the Audit Reform initiatives – both with the European Union and the UK Competition and Markets Authority (CMA) – seek to rebalance the relationship between the external auditor, management and audit committee almost to the extent that some would say the audit committee is fulfilling a quasi-executive role. Do you think this is a good idea?*

Mark Williamson: It's not a good idea and I feel strongly about this.

It comes back to the information deficit that exists – and arguably needs to be there to retain independence. It is critical that there is a strong relationship between management and the external auditor. However, it's also very important for the chairman of the audit committee to have open lines of communication across the business but particularly with the finance, tax and treasury functions, and internal audit – as well as having open lines of communication with the CFO and the external auditor.

The guidance is moving towards chairman of audit committees taking on what I consider to be executive duties, such as negotiating audit fees and supervising competitive audit tender processes. I believe it is virtually impossible to get the necessary levels of understanding to properly negotiate fees without compromising independence. I think audit fees should continue to be negotiated between the CFO and audit firm, and that the audit committee should approve these fees. This balances the commercial judgement and deep knowledge of the CFO with the audit committee's need to ensure the audit firm is being adequately remunerated to do a first class job. The private meetings with the external auditors are important to ensure that undue fee pressure doesn't compromise audit quality.

ACI *Do today's audit committees have the right skill sets in the light of the increasing workload and the wide range of issues often falling within the committee's remit?*

Mark Williamson: To some extent the composition of the audit committee is dictated by the size and composition of the board and smaller boards are generally deemed to be more effective. Once you have ticked off all the key requirements for a Board member – such as, independence, deep experience, commercial acumen, high ethics – to start looking for (say) expertise in cyber risk is probably a step too far. I believe it is therefore important that the terms of reference of the committee should clearly state that the responsibility of the committee is to ensure there is strong governance over the business, including all elements of control and risk. The point is that the audit committee should be ensuring that the right skills are within the management team rather than bringing those specific skills into the audit committee itself.

On a different but related point, I am becoming concerned that risk management may be getting in the way of the board's primary responsibility to create value for shareholders by operating in an entrepreneurial way. I think risk processes have come a long way over the last five years but may be driving Boards to becoming too risk adverse. The processes are generally very good at identifying, evaluating and mitigating risks, but perhaps more thought needs to be given to the appetite for risk, which may indicate the need to consciously take increased risk in various elements of the business.❖

José Ecio Pereira GAFISA (Brazil)

"I am devoting progressively more time developing the audit committee's agenda, going into more in-depth analyses with management, and holding more meetings with internal and external auditors."

José Ecio Pereira da Costa Jr. was an audit partner of Deloitte Touche Tohmatsu in Brazil, where he worked until May 2007. He is board member of GAFISA (a Brazilian public company listed on the NYSE) and chairman of its audit committee, member of the audit committee of FIBRIA, coordinator of the audit committee of Votorantim Cimentos and Votorantim Metais and board member of Princecampos Participações. He was also coordinator of the audit committee of VID - Votorantim Industrial until May 2014 and of board member of Grupo NOSTER until May 2013.

ACI *In general, it's fair to say that audit committee workloads are increasing year after year: What have the main changes been according to you in your audit committee's oversight activities in this respect over the last years? How has your role as chair and the dynamics of the committee as a whole evolved to deal with these changes in order to stay effective?*

José Ecio Pereira: The audit committees' workload has really increased over the last few years, mainly as a result of the new issues that have to be addressed, such as the greater involvement in the monitoring of risk management, matters related to ethics and conduct, anti-corruption law, new compliance programs (e.g. legal and environmental matters) and greater complexity in post IFRS adoption accounting. In my capacity as the audit committee coordinator, I am devoting progressively more time developing the committee's agenda, going into more in-depth analyses with management, and holding more meetings with internal and external auditors.

ACI *What would you recommend as best practices in terms of managing the audit committee's agenda-setting process?*

José Ecio Pereira: I believe that the most important thing is to start shaping the audit committee agenda in order to be able to spread the topics to be addressed throughout the year – making sure not to overload certain meetings. Priority items are the accounting area (e.g. judgments and estimates like impairment and fair value), a better understanding of the risk mapping process and the subsequent monitoring of the risk management and compliance programs. Whistle-blowing hotlines are very effective but also require more forensic work on the part of internal audit and the audit committee. In general, more time has to be planned for audit committee meetings. The committee's current monthly meetings usually take about 5 hours compared to 3 to 4 hours a couple of years ago.

ACI *What kind of additional expertise have you recently added, and would you consider adding, to the audit committee. If so, why? Is that through new members or training/development or third party expertise?*

José Ecio Pereira: Audit committees require further expertise with respect to risk management and operational management processes. In our case, these new expertise requirements have been met by means of the inclusion of members with greater managerial and business advisory expertise. Also, for example in certain committees, a greater understanding might be required of derivative financial instruments management, which in some cases requires the help from consultants to bridge the gap.

ACI *As agenda's become more and more dominated by compliance and regulatory matters: How do you and your committee keep winning the fight against "box-ticking" and how do you make sure that sufficient time remains to be devoted to challenging debates?*

Over the years, I have devoted more time (as coordinator) reviewing the presentations of executives before the audit committee meeting takes place. This is done in order to direct the committee to the most significant issues upfront and to enable these issues to receive the attention from the committee that they need. With respect to taking sufficient time for debates, there are always issues that require more time for in-depth discussion than initially planned. In those cases, the agenda dedicated to these issues is extended in order not to impair depth of discussion. However, we also keep in mind our role of monitoring and offering guidance, as opposed to managing, making sure that management does the detailed work and further analysis and that the theme is picked up again at the next committee meeting.

ACI *With less time available to you and your committee members, do you leverage management, your auditors or any other parties to a greater extent to free up time for the committee?*

José Ecio Pereira: We made efforts to provide guidance with respect to the topics we wish to have covered in the presentations of management and auditors. For example, in the monitoring of internal audit work, we only request presentation of the scope, deliverables and action plans for engagements assessed as critical and, in addition, their report must summarize the whole work in just one or two slides. It is also worth mentioning that the meeting's pace should be carefully managed by the coordinator – thus speeding up presentations and keeping focus on the most significant points for the committee.

ACI *How has the audit committee's (or board's) approach to risk management changed over the last years with more and more risk piling up on a company's plate?*

José Ecio Pereira: Several companies have been reorganizing their risk management departments, and performing risk allocation exercises. Subsequently, as part of the risk monitoring program, the committee has been periodically monitoring the progress of such work during its meetings. We have also provided guidance so that the planning of the internal audit work is focused on the main risks identified and monitored by management.

ACI *What is your top priority in terms of audit committee effectiveness/workload management in your audit committee(s) for the year ahead?*

José Ecio Pereira: In terms of the committee's effectiveness, more importance needs to be given to the assessment aspects of the committee's work, interaction with management and mainly to the frequency of communications with the board. ❖

Kenneth Daly National Association of Corporate Directors (U.S.)

"Audit committees need to learn to say "no". You can't do everything – and if you try, you'll probably end up not doing anything particularly well."

Ken Daly is the president and CEO of the National Association of Corporate Directors (NACD), the world's largest member-based organization for board directors. As a recognized expert on corporate governance and board transformation – with experience serving on and chairing audit committees – Daly routinely lends his regulatory expertise to counsel audit committees and boards in critical areas, such as risk oversight. Prior to joining the NACD, he was an audit partner at KPMG, where he also served as the partner-in-charge of the firm's national risk management practice. Upon his retirement from KPMG in 2005, Daly assumed the role of executive director of KPMG's Audit Committee Institute.

ACI *We're seeing audit committee agendas continue to expand – with a combination of compliance must-do's and major risk oversight responsibilities pushing audit committee agendas toward a tipping point. Are there some best practices you're seeing – or emphasizing – in terms of how audit committees are dealing with heavy agendas?*

Kenneth Daly: Yes, we're seeing that as well – and I think it's a serious issue. First and foremost, audit committees need to learn to say "no." There's an interesting dichotomy here. On the one hand, audit committees complain about the fact that they have a lot to do, that their agendas are overloaded. At the same time, a lot of audit committees will fight tooth and nail to keep ownership of everything on their agenda.

Audit committees need to be able to say, no, we're not interested in that topic; no, we're not interested in that person coming to speak to us; and no, we're not interested in 500-page documents. Just as importantly, they need to be aware of scope creep. Conflict minerals is a prime example. A lot of audit committees in the U.S. got themselves involved in overseeing the company's conflict minerals disclosure activities. I don't think there's any particular reason the audit committee has to be involved with that, particularly given the time and effort required to oversee financial reporting and audit. To be blunt, you can't do everything – and if you try, you'll probably end up not doing anything particularly well. So the audit committee needs to be very, very careful about scope creep.

ACI *Until the audit committee gets good at saying no and avoiding scope creep, any thoughts on managing a heavy agenda?*

Kenneth Daly: You can only do three things in a meeting – educate, persuade, and have a call to action. Because actual face-time is so incredibly precious, anything that happens in the audit committee meeting ought to be well thought-out so that you're not spending valuable time trying to educate or persuade, which should happen outside of the meeting. When you're in the meeting, the discussion should be highly focused and to the point. What are the three critical things we have to do today? What are the action items? And focus on those action items, one, two, and three. Otherwise, by the time it comes to the call for action, the committee has three minutes left, and it's very, very difficult to have a meaningful discussion about action items in three minutes or even 30 minutes. So, the thought process as to what is actually discussed in the face-to-face meeting – and making sure the committee is making the most of its time together – is incredibly important.

ACI *Other thoughts on the audit committee's workload?*

Kenneth Daly: I think audit committees in general, and audit committee chairs in particular, need to get much better at asking for help, especially from the chief audit executive, the lead audit partner, and other resources that can be brought into the boardroom. A lot of that support can and should happen outside of the formal meeting as part of the "educate and persuade" elements that I mentioned. The committee should always be asking itself whether it's getting the information and support it needs. Are we properly resourced? Are we hearing from those who have a point of view to offer?

ACI *If the audit committee's workload is heavy—and getting heavier – what are the implications for the audit committee chair?*

Kenneth Daly: It is very interesting to me that in many instances the only person who seems to be running at light speed is the audit committee chair. Audit committees need to divvy-up the committee's duties. We really need to utilize the entire committee – you'll be the point person for that, you'll be the point person for this – so that when it comes time to meet as a committee, different members will have taken deep-dives into particular areas of interest or concern. I really question how much of that is being done today.

ACI *Forming an additional committee – as some boards have – to focus on risk or technology or compliance would seem to take some of the weight off of the audit committee's shoulders.*

Kenneth Daly: Well, there's clearly more focus on whether additional committees like a risk committee would be helpful, but it brings its own problems and challenges. For example, are there enough directors to go around every time you form another committee? Without really good information flow, another committee could potentially fragment the board's oversight. If you form a risk committee, does that create a false sense of security among the rest of the committees and the board that the risk committee has it all covered, so everybody else doesn't need to get involved with risk?

Every time you form another committee, you have to carefully consider what its duties are, who resources it, and how it fits into the board's structure. It's not a silver bullet. Each new committee has the potential of becoming a problem in and of itself. Creating more committees may work for some boards, but generally speaking I don't think it's all that helpful, and could actually make things worse.

ACI *You mentioned fragmentation of the board's oversight. Any sense of whether or not communication and coordination between committees is getting better?*

Kenneth Daly: No, actually, I don't think it's getting better. In many cases, the committees are all incredibly busy, and don't seem to have a clear mandate on what they're expected to report to the full board or even how they're supposed to deliver it.

This is a great example of where the chair of the nominating and governance committee or lead director should be stepping up and articulating what committee reports should look like and what they're supposed to achieve. When I interview chairs of committees and ask that question, it is a rare committee chair who says, oh yes, we meet periodically to talk about that. That's generally not what happens. More often, they'll say, well, I ask my committee members what they think I should report – but that's usually inadequate. Committee chairs should be communicating regularly to make sure they know what's going on in the other committees.

ACI *The NACD's "Director 2020" initiative is now in its second year of exploring issues that are shaping corporate governance and the skills that directors will need in the future. Are there insights from this initiative that are particularly relevant to the audit committee?*

Kenneth Daly: Director 2020 has been focused on what we see as seven major disruptors to businesses – the environment, competitive issues, demographics, economic, geopolitical, innovation, and technology. Many of these disruptors are affecting the boardroom, and specifically the audit committee.

The big takeaway for us is that people and culture are changing – in some ways, radically. The half-life of products keeps getting shorter. We've found that people really don't get digital at all. They think they do, but the reality is that companies keep getting surprised by the pace of technology change and what digital really means. Uber and Lift are car services, but it's basically a digital business model. I don't think taxicab companies figured it out until the very last instant. Consider what's happened to retailers like BestBuy and Circuit City. They've become places for window shopping. People still want to see the product, but they can buy it very easily elsewhere.

One of the big things I think boards need to focus on in that realm is risks posed by new product development. There are all kinds of issues, whether it's the cybersecurity implications of a new product, or the speed at which somebody else is going to grab your idea and develop something new, which means the half-life just went down. This is obviously a full board issue, but from a risk oversight perspective, the audit committee can help spark some important discussions.

We've also learned that people have a hard time figuring out what the future is going to bring. In the main, you can't predict the future, but we're actually not very good at even thinking about the future and focusing on the horizon. The learnings from Director 2020 will clearly have practical insights for audit committees and how they carry out their responsibilities going forward – and in fact, audit committee members have been a valuable part of our Director 2020 discussions.

ACI *Audit committees typically play a central role in overseeing the company's risk processes. Do you see that evolving at all?*

Kenneth Daly: Whether or not the audit committee oversees the risk process, or some other committee or the full board takes on that responsibility, it clearly has to be done. But I think the audit committee's responsibility to oversee financial reporting risk is a significant undertaking in itself. Once you get past financial reporting and you get into other risks like cyber security – which in my mind is a full board matter – there needs to be a robust discussion and clear understanding of where and why a particular risk is assigned to a committee or the full board.

In the case of cyber security, I don't think audit committees are particularly well-placed to take on that responsibility beyond any financial reporting aspects. That's just one example, but the risk environment continues to get more complex and it may be time for audit committees and boards to reconsider how risk oversight is being allocated. It goes back to the Caremark case on how we monitor the mitigation of risk and the risk process. In my judgment, that clearly goes beyond the audit committee.

ACI *Does the audit committee's expanding workload reflect a broader challenge for corporate governance?*

Kenneth Daly: I think we have fairly definitive proof that it's a canary in the coal mine. What we are now beginning to hear – not just from the audit committee, which has historically voiced this concern, but from other committees as well – is that succession planning at the committee level is a real problem. Committee chairs are telling us pretty consistently that they're having trouble getting people to rotate onto their committee, let alone to chair the committee.

The time commitment is huge. The amount of information, knowledge, and experience you need are significant. Despite charters that say the audit committee chair position should rotate every three or four or five years, we're seeing chairs going into their seventh or eighth or ninth year and they can't find anybody to take their place. It's a real challenge in terms of both committee composition and board composition. Do we have the right people sitting around the table as we think about the emerging risks and opportunities that in our industry?

The fact that the director community is becoming much more active in risk oversight is causing a reconsideration of the people sitting around the table. It's a critical question for the audit committee and the full board. ❖

Amadeo R. Vasquez Tenaris (Argentina)

"The economic world has a changing nature, with more unknowns than certainties, in which learning the new and unlearning the old is crucial to be sustainable. This also applies to the audit committee."

Since 2003, Amadeo R. Vazquez is the audit committee chairman of Tenaris S.A., a global industrial group based in Luxembourg and board member of various renowned companies in Argentina. He also used to chair the board of directors of Telecom Argentina and served on its audit committee. Until 2004, he was audit committee chairman of BBVA and until 1997 he served as deputy chairman of the board and CEO of Banco Rio in Argentina.

ACI *In general, it is fair to say that audit committee workloads are increasing year after year: What have the main changes been according to you in your audit committee's oversight activities in this respect over the last years?*

Amadeo Vazquez: Nowadays, regulators clearly recognize that good corporate governance is an essential factor for healthy domestic and global economic performance. The financial crisis that hit the United States as Europe as from 2008 and the related social and economic distress changed the criteria from market self-regulation and self-adjustment to regulatory standard setting and supervision.

Changes in public opinion, in politics and in economic thought pushed the audit committee's responsibilities beyond completeness and transparency of financial reporting, fraud and oversight of internal and external audit, extending them to oversight of an array of new business areas – consumers, corporate taxation, data protection, anti-money laundering, sustainability, terrorism and other geopolitical issues (Iran, Russia, IS, etc.). With risk maps changing, the dynamics of the committee adapted accordingly.

However, in my view, the career paths, managerial and academic experience of most audit committee members allowed them to face those changes easily and with true interest. Clearly this can only be true if the audit committee is able to rely on the consistent performance of the company's management, its internal structures and auditors.

Best practices are only truly effective when they are embedded in the DNA of the organization. As in any human activity, there are failures and breaches, but a culture and systems aimed at prevention, detection, investigation and remediation systems is what matters.

The chair's contribution to the new committee dynamics lies is its interaction with top management, internal and external audit, compliance and legal advisors – discussing change and making sure any new significant issues or tasks are added to the agenda and balanced with the other tasks on the audit committee's plate.

ACI *What would you recommend as best practices in terms of managing the audit committee's agenda-setting process?*

Amadeo Vazquez: Of course, we must comply with the oversight standards across jurisdictions in which we operate and factor this into the audit committee agenda. But on top of that, the agenda is further tailored to actual needs and time allocated by weighing risks and priorities. Focus is directed towards new market risks, acquisitions, joint ventures, macro crises, or weaknesses identified in any area of the organization.

ACI *What kind of additional expertise have you recently added and would you consider adding to the audit committee?*

Amadeo Vazquez: A changing world makes boards, management and the audit committees endure the stress of a continuous improvement process. Committee members should regularly update their understanding of business risks, regulatory trends, economic and institutional dynamics to anticipate on future problems. To quote Bill Gates: "Success is a lousy teacher. It seduces smart people into thinking they can't lose." Indeed, sufficient time needs to be devoted to find out what went wrong because mistakes are very valuable sources of learning.

And of course, in addition to individual and group continuous education, it is useful for the committee to be provided with advice and experience by subject matter specialists when necessary.

ACI *As agendas get more and more dominated by compliance and regulatory matters, how do you and your committee keep winning the fight against "box-ticking"?*

Amadeo Vazquez: In complex global organizations, the best way for the committee to win the game is to work together with the organization as a whole.

The committee is not part of management – it can and must be industrious and qualified but it cannot be everywhere and does not have the eyes of God. The audit committee should be embedded in the company's values and culture – being able to help drive the company's vision, strategy, incentives and businesses. If the committee is just perceived as a compliance burden, the risk of misbehavior is usually high – a moral drawn from "The scorpion and the frog" fable.

To win the game against box-ticking, a proper tone at the top from the board, management, audit, internal control and compliance are needed to drive the organization towards an effective corporate culture. Only in such an environment, the committee will be able to fully accomplish its mission.

As in the construction of a building, the first and most fundamental task of any audit committee is to support and monitor its design and foundation – the values of corporate governance.

ACI *With less time available for you and your committee members, do you leverage management, your auditors or any other parties to a greater extent to free up time for the committee?*

Amadeo Vazquez: During my time spent in the banking industry, I realized the importance of "learning and unlearning", because banks are a little like confessionals and observatories of successes and failures. The economic world has a changing nature, with more unknowns than certainties. It has no "permanence" as conceived by Parmenides, rather it is a "universal flux" as described by Heraclitus, since it is governed by "creative destruction", in which learning the new and unlearning the old is crucial to be sustainable. This also applies to the audit committee.

Also you learn more by listening than talking, so it's vital to leverage on knowledge available in the organization and insights from external auditors, legal advisors and qualified third parties. All this, from a judgment-free viewpoint.

ACI *What would be your number one tip to your external auditor to help you gain efficiency in terms of the audit committee workload?*

Amadeo Vazquez: Auditors must preserve their skepticism, their critical thinking and their ability to inquire thoroughly and pay special attention to inconsistencies that might reveal risks when interacting with management and the committee.

Auditor's independence is an attribute goes beyond rotation. The company is best served when the auditor does not takes anything for granted.

ACI *What is your top priority in terms of audit committee effectiveness / workload management in your audit committee(s) for the year ahead?*

Amadeo Vazquez: Focus would primarily be on two key issues: overseeing risks associated with the industry, markets and macroeconomic and geopolitical climate and staying ahead of changes in regulations.

The success of organizations lies in their innovative talent and culture, vision, strategy, structure and action plans. The challenge is to fuel the industrial passion and entrepreneurial spirit and to adapt them to the context, while seeking the balance between optimism and pessimism required by modern times. In the words of Bob Woodward, former Associate Editor at the Washington Post, "We can be optimistic if we preserve the critical spirit, work with enthusiasm and do the right thing." ❖

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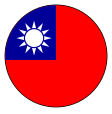
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Contact the ACI

Wim Vandecruys
KPMG International
Tel: +32 (0)11 28 66 31
e-Mail: wvandecruys@kpmg.com

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