European Growth Audit Network

EGAN SUMMARY OF THEMES

Board effectiveness, the board-management relationship, fraud, and Israel-Gaza

May 2024

On April 9, 2024, members of the European Growth Audit Network (EGAN) met in Madrid for the following discussions:

- **An effective board: considerations for high-growth companies** with Patrick Dunne OBE, chair, Boardelta; chair, Royal Voluntary Service; and chair, Education Sub Saharan Africa (ESSA)
- **Building a strong board-management relationship** with European Audit Committee Leadership Network (EACLN) members Liz Hewitt, audit committee chair, Glencore and Nathalie Rachou, audit committee chair, Veolia
- **Combating corporate fraud: governance over fraud risk in high-growth companies** with Sarah-Jane Boulos, partner, ESG lead, forensics and integrity services, EY

On April 10, EGAN members joined the European Audit Committee Leadership Network (EACLN) for a series of optional further discussions:[1]

- **Israel, Gaza, and the outlook for business** with Ronen Koehler, former IDF submarine captain, currently advisor to CEOs of Israeli technology companies
- **Discussion on proposals to enhance auditor procedures on fraud** with Jasper van den Hout, Director, International Auditing and Assurance Standards Board (IAASB)

For a list of meeting participants, see Appendix 1 (page 13)

This *Summary of Themes*[2] provides an overview of the following discussions:

Building a better working world

EGAN Meeting:

An effective board: considerations for high-growth companies

For a board of directors to deal with the myriad issues that come with a rapidly growing company, it must address its own structure and staffing. Mr. Dunne outlined his model for board effectiveness, which is built on three pillars:

- The board needs to have a clear and shared **purpose** that aligns with the vision and mission of the company,
- It needs a diverse and competent team of **people** who can collaborate and challenge constructively,
- And it requires **processes** that enable efficient and informed decision-making and oversight.

These elements will need to adapt and evolve as the company grows and faces new opportunities and risks. Members and Mr. Dunne discussed several themes:

- **Committees can be helpful but are not a panacea**. Mr. Dunne outlined the role of a committee: *"To take on work delegated by the board and to come back to the board with appropriate recommendations. By doing this a committee enhances the effectiveness of the board."* Every member noted that their board includes committees but highlighted a few issues. Committees to address environmental, social, and governance (ESG) issues, in particular, seemed to be a common concern: *"It's tricky, because even if you have ESG in a separate committee, it still needs coordination with other committees."*
    - **Boards can delegate work to a committee, but not responsibility.** A member said*: "I've seen too much trust in committees. Board members who aren't on the committee can think 'we have a committee for that, so I'm out of the woods on that issue.'"* Noting that she could be held personally responsible, another member noted, *"If I'm responsible for making decisions, I want the necessary information and proper risk assessment."*
    - **Ad hoc committees can be effective for addressing short-term issues.** Several members noted that their boards have created ad hoc committees. *"They are useful and very specific, with a clear beginning and ending, and a metric,"* said one member. Mr. Dunne said that boards where he has served have also organized informal 'huddles' for certain issues, *"A mix of executives and non-executives to focus on a specific question for the board and figure out what we're going to do."*

- **Formal architecture and process must not overwhelm sensible thinking.** Mr. Dunne said: "*If the board thinks the committee report is something to get through or a monster to be fed, then the committee tends to be sterile and ineffective.*"
- **The nominations committee has an outsized role to play.** *"They are looking at the organization and the model of leadership needed for this phase of development,"* said Mr. Dunne.

Next Generation Boards

Some companies are creating 'next generation' boards, where promising younger leaders shadow the main board, providing directors with fresh thinking. Mr. Dunne described a process where "super-bright people" are carefully selected from across the organization and given the job to challenge the board by reviewing its papers and taking part in strategic discussions. He described a case where a firm successfully involved a next generation board in developing a digital strategy. A scheme where each next generation representative has a 'board buddy' creates opportunities for two-way mentoring. But he warned against asking the next generation what it thinks and then ignoring the advice.

- **Some essential board skills do not appear on a traditional competency matrix.** Investors and regulators are pushing for more disclosures of director competencies, with some countries mandating disclosure. Members discussed the expertise that is most relevant and how best to obtain it, including the use of outside experts in areas such as cyber, AI, and ESG. But Mr. Dunne said that while competencies are important, *"The harder thing is to get the 'cocktail mix' of characters right."* Members noted key principles for board skill development:
  - **Three things to look for—judgement, interpersonal skills, and 'antennae'.** Effective board members must have good judgement in business situations and interpersonal skills to bring those judgements to bear. They have to be "*alive and awake and out there. They need not to just be aware of what's happening on the planet of your company—they need to understand the solar system where your company operates,"* said Mr. Dunne.
  - **Technical skills are not a substitute for judgement.** A member said, *"I wonder how useful it is to have deep experts on certain topics. It's more about having judgement and asking the right questions. People who are not well-versed in a topic sometimes ask better questions."*
  - **Fill seats according to your needs.** Mr. Dunne described the approach he took when hiring a CFO for a non-profit he established: *"We knew we would need a good CFO, but if we hired one too early it would be too expensive. I served as*

chair and finance director the first six months while we thought about what kind of CFO we wanted. And at the end of the first year when the money started to come in, we hired our CFO. We thought about where we wanted to end up, and we had a plan to get there."

- **Relying on a single expert comes with its own risks**. Members discussed the importance of continuous learning and not limiting a director to a particular expertise. A member's board had relied on one director to deal with activist investors, but then struggled when the director developed health problems.
- **External board assessments can generate useful insights**. One member described a process where an external assessor observed several board meetings, and provided advice that did not just address board dynamics but even *"a personal guide that included not just your strengths but also direction on how to ask better questions—I found it extremely useful."*

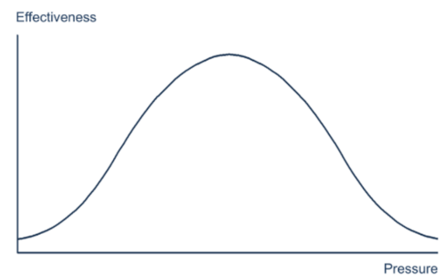
- **Tone, culture, and process need to positively reinforce one another.** For the board to effectively play its role, it must have a culture *"where it is okay to talk about things that are not okay,"* said Mr. Dunne. That primarily comes from the chair and the CEO, but the entire board has the job to *"know what culture it's got, what culture it wants, and how to get there if the two are different."*
  - **A diversity of styles can be highly productive.** A member reflected on Mr. Dunne's assertion that having a mix of extroverts and introverts on the board is good: *"The chair has to have a skillset to draw out the introverts and balance the extroverts and use the conversation to tease out the differences between what we are talking about today and what our priorities should be today."*
  - **Decision-making processes will always need to evolve.** Using the analogy of moving from a world of paper maps to satellite navigation, Mr. Dunne said that boards need to evolve their culture to make decisions based on the latest information. He cited the example of Zoom, which used dynamic budgeting to rapidly and successfully shift its strategy during the pandemic. He contrasted this with Peloton, which famously suffered for an inability to quickly adapt its business model as the pandemic waned.

    Mr. Dunne noted that some boards are using an 'early-mid-late' approach to decision making. He explained, *"In the first discussion we explore the issues and what information we need to have; in the second we review options with one preferred; and in the third we take the final decision and focus on scrutinizing the implementation plan."*
  - **Board members need to understand how they can help the executive team**. Mr. Dunne shared a figure from his book (see Figure 1) showing the relationship between effectiveness and pressure. *"If performance flags, the board's natural*

reaction is to increase pressure by asking *more questions."* A member described how her board adapted its approach when growth slowed, *"Our practice had been to discuss strategy every quarter, but this time we agreed to give the CEO time to focus on operations for one year. Now we're back to double digit growth."*

- **Board membership must also evolve and adapt.** One member said, *"A lot of people think they are on the board for as long as they want to be on the board. But sometimes boards shrink, and sometimes you need different players."*

Figure 1. Effectiveness and pressure curve



Source: Patrick Dunne, *Boards*. 2nd ed. (Great Britain: Governance Publishing and Information Services Ltd, 2019), 94.

Building a Strong Board-Management Relationship

A robust partnership between the board and executive management sets the foundation for rapid, sustainable growth. This alignment powers decision-making and agile execution, essential for navigating scaling challenges and opportunities. Ms. Hewitt and Ms. Rachou described practical steps for building a strong relationship with management:

- **Clearly define executive and nonexecutive functions.** Sometimes in high-growth companies, especially those that are starting out or with fewer resources, board members provide more hands-on support. *"One of the biggest challenges is splitting nonexecutive responsibilities from the executive function,"* said Ms. Hewitt. *"It needs to be clear who is executive and who is nonexecutive,"* said Ms. Rachou, *"Nonexecutives especially need to stick to the nonexecutive role. This can be difficult if they've come from an executive role, which is usually the case. The adjustment from executive to nonexecutive is not always easy, but keeping that separation is a critical aspect of governance. It reinforces the proper working relationship between management and the board."*

- **Communication must match the rapid pace of evolution.** In a fast-paced growth environment, keeping abreast of operational developments can be challenging. Members and guests identified good practices for effective communication:

  - **Between management and the board.** *"The faster a company grows, the more difficult it is to keep information flowing quickly enough. And information flow is critical; things move quickly in high-growth companies,"* said Ms. Rachou, *"Depending on the frequency of board meetings, you could be out of sync with management. There needs to be a way that information flows directly from the management team to the board because otherwise there could be* *such a discrepancy that the board won't be able to catch up. A top priority is making sure management gets the relevant information to board members in whichever way is feasible or suitable to the activities of the company. This could be a one-page memo, a list, two PowerPoint slides, or a quick call."*

- **Within the board.** Committee chairs often engage in deeper communication with specific C-suite executives. But these chairs should swiftly pass on information to the rest of the board or committee. Ms. Rachou advised, *"It is also essential that the same flow of information reaches all nonexecutive directors. When you're audit or risk chair and have specific information from interactions with management, if that information is not appropriately shared then you've got a two-tier board with informed and lesser-informed members, which is not a great situation to be in. The nonexecutives who don't have the full story feel excluded. It is very important to make sure this information flow is dealt with properly and efficiently."*
- **With employees and external parties.** *"Try to have another source of information apart from management,"* said Ms. Rachou, *"I've always relied a lot on external auditors as they can give you an independent view. You need to triangulate the information. It can't always come from management or fellow board members. You need an external party. A regulator can also be useful depending on the industry and how regulated it is. They have a different outlook on the company."* Several audit chairs emphasized the importance of engaging with team members below top management level to access significant information. One member said**,** *"If you want me to be audit committee chair, I'll be meeting with the finance team, external auditor, head of internal audit, and it will happen. Other nonexecutives can sit in too. I've scheduled private sessions with both internal audit and external auditors."*

- **Update controls to sustain company growth** Members discussed the importance of adapting controls as the company grows. Ms. Rachou said, *"In a fast-growth company, the nonexecutives must remind management that the faster the growth, the more stringent the controls should be. The nonexecutive director speaks out for what could be forgotten in the game of growth and if left forgotten, what could be very dangerous for the company."*
- **Develop a trusting relationship with the CEO.** Trust between the board and CEO fosters a cohesive strategic vision and facilitates transparent communication, critical for navigating the challenges of rapid expansion. Members and guests highlighted several ways a board can strengthen its relationship with the CEO:
  - **Build trust within the board.** A cohesive board that operates with collective responsibility strengthens its partnership with the CEO. While individual expertise and personal relationships are valuable, building trust as a unified

body is crucial. Ms. Hewitt said, *"Trust is important. It takes a long time to build. One thing that's important for the board to understand is that you all have collective responsibility. Some people bring more to different areas such as markets, products, governance, or strategy, but you all have a shared responsibility."*

- **Understand what motivates the CEO.** Developing a relationship with the CEO can help the board understand their motivations and build trust. As one member put it, *"Our board likes to build a relationship with the CEO because different CEOs have different personalities. You have to make an effort to get to know each one. They won't come to you; you have to go to them."* Ms. Hewitt agreed, *"You really need to understand your CEO. Is it somebody who is fully aligned with the business? In a high-growth company, does the CEO have lots of share options or equity to protect or is the company like their baby? Is the CEO towards the end of their tenure? If you know your CEO, you can build that relationship and know what motivates them. That helps build trust."*
- **Create opportunities for the CEO to meet alone with the board.** Dedicated sessions where the CEO engages in one-on-one discussions with the board can build trust and encourage difficult conversations. Ms. Hewitt explained, *"Sometimes you can use tools outside of meetings to build relationships. Some boards have board dinners that are not minuted. It's about getting the CEO to talk openly about strategy over the next three months or three years. Sometimes those off-record meetings where it's just the CEO can be really helpful. It should be a limited number of executives there so that the CEO can talk freely with the nonexecutives without thinking "I've got my finance person and HR person here."* Ms. Rachou agreed, *"Setting up quarterly dinners with chairs of committees and the CEO is a very good instrument to build deep trust. Don't have an agenda so you can talk about anything. You can have very direct dialogue and it's a level of information that's different than you'd get at the board. You can discuss tricky topics, like succession, and I think that works very well."*

Combating Corporate Fraud: Governance Over Fraud Risk in High-Growth Companies

Audit chairs continue to include fraud risks on their committee agendas, but the impact of other environmental developments and changes often draws the focus away from ongoing consideration of evolving fraud risks. One audit chair emphasized, *"You cannot spend enough time on fraud!"*

Members discussed the concept of fraud and how its definition is changing. *"The very definition of fraud is ambiguous and always has been. Different jurisdictions and legal* *systems have different definitions of fraud and what constitutes fraud. It is hard to understand in a legal sense,"* said Ms. Boulos. She noted that lack of clarity in the definition of fraud has amplified fraud risks. She described recent developments:

- **A shift from tangible to intangible assets**. An increase in the proportion of intangible assets and the challenge of quantifying and valuing them has given fraudsters the opportunity to manipulate or overvalue intangibles. *"It is difficult to detect and prosecute these types of fraud,"* she said.
- **Increased reliance on technology and digital platforms.** Ms. Boulos noted that that there is a debate around whether cyber is a fraud risk. *"Regardless of how the risk is classified, it needs to be dealt with,"* she said, *"Basically, fraud is a by-product of the cyber risk."* Members noted concerns about cyber-enabled criminals accessing manufacturing systems and making changes that may not be picked up before the products are sold.
- **New regulation**. Some countries are looking at new legislation and regulation around economic crime, and with it new or broadened definitions of what fraud encompasses. Ms. Boulos highlighted that, in some jurisdictions, fraud is no longer related only to financial misstatements, namely the UK's newly adopted Economic Crime and Corporate Transparency Act which makes a company criminally liable if it fails to prevent fraud. A broadened definition of fraud in some countries may now include, for example, untruthful environmental credentials, falsely stating credentials in the recruitment process, and falsifying pollution data.
- **Mandatory sustainability reporting as a fraud risk**. Much ESG reporting is based on internally generated information, which adds pressure and therefore creates real risks for fraud. Members discussed uncertainty about the data that is received from the supply chain, for which they are ultimately responsible. A member said, *"We are 100% responsible for reporting on the value chain even though we can't check it."* Even where there is external certification of this information, members still have concerns about its reliability. One said, *"Data reliability does not increase with goals and standards. That is why it is almost unavoidable that there may be problems even though it is not intentional."* To this point, Ms. Boulos emphasized the importance of ensuring companies have reasonable procedures in place to prevent and detect fraud.
- **Use of carbon credits**. Ambitious carbon reduction targets and tough external scrutiny may pressure companies into fraudulently overstating their carbon credits or investing in projects where their true impact has been inflated.
- **An unclear distinction between unethical behavior and fraud**. Ms. Boulos explained, *"This is a grey area. With fraud, there is a need to prove intent beyond reasonable doubt."* Members also discussed examples where an error had been

made, but not fixed. If errors are not dealt with in a timely way, more adjustments are needed to 'hide' the error, and eventually this may result in fraud. A member said, *"The misleading data got deeper and deeper to the point of no return. Initially it is not always such a big thing, it's smaller but it grows. As the growth problem evolves, your involvement grows."* Ms. Boulos highlighted the importance of creating a culture where it is safe to report issues and there is no risk of retaliation *"from grassroots to big things."*

- **The complexity of global supply chains**. Members noted that cultural differences in global supply chains can also heighten the risk of fraud. What may be considered fraud to a company may be an accepted way of doing business in another part of the world.

Ms. Boulos described additional fraud risks for high-growth companies, none of which are new: strong personalities leading the company, cultural norms exclusively focused on results and success, pressure to show profitability or secure funding, targets, etc. *"Overlaying this is often a lack of controls. In the same way that the accounting infrastructure does not keep pace with the rapid growth, neither does the compliance infrastructure. Leadership and management get stretched which leads to a lack of oversight. This climate of pressure and urgency can precipitate an environment ripe for fraud,"* she said. A member described a situation at a high growth company, *"It is not necessarily pressure, it is also cost containment. IT people were underpaid for too long and there was underinvestment in the IT systems. So, guess what happened. Unauthorized access to confidential information led to the whole IT department being let go,"* the member explained.

Members discussed governance over fraud. Ms. Boulos noted that the evolving nature of fraud made it difficult to determine who owns this risk: *"Traditionally it was internal audit and finance, however today it requires a cross company approach, with collaboration and coordination needed across multiple functions in the organization. Fraud is a company-wide pursuit. It is important to have the conversations about how fraud is manifesting in the company; you need to come together as an organization with tangible examples to understand where it could exist."* She added that budget constraints, lack of clarity of ownership, and lack of expertise often exacerbate fraud risk. She encouraged companies to *"slow down. The fast-paced high-pressure environment facilitates unethical behavior. You need to provide space to stop and have proper discussions to enable more ethical decisions to emerge. In the digital age, this won't happen organically. Intervention is needed."* Members noted other good practices:

- **Having external cybersecurity experts present at meetings**. One member noted how a cybersecurity leader from the FBI had joined a company meeting to advise on fraud prevention. The member also highlighted that some government security agencies help companies keep up to date with current developments around cybersecurity and other fraud threats.

- **Preventative forensics**. One company ensures that all new hires in internal audit have fraud experience; the internal audit team focuses on early prevention and detection of fraud before they become more significant.
- **Creating a speak up culture**. Members emphasized the importance of the flow of information and creating a culture that encourages sharing information, whether it is good or bad. Ms. Boulos added, *"Invest in ethics and compliance programs, and make it a strategic function—not a tick-the-box exercise. Prioritize culture and human behavior as part of this."*

Crossover sessions with EACLN members:

Israel, Gaza, and the outlook for business

Israel's technology sector has shown significant growth and global influence over the past decade. But it faces challenges. Mr. Koehler and members discussed the factors that contributed to Israel's success as a global leader in innovation and entrepreneurship and how they would continue to build business resiliency.

Discussion on proposals to enhance auditor procedures on fraud

As fraud evolves and remains pervasive, the IAASB has published changes to the International Standards on Auditing (ISAs) to enhance auditors' procedures on fraud and to make the fraud auditing standard consistent with its recently revised risk assessment standard. Mr. van den Hout explained that the objectives of the project are to clarify the role of the auditor with regard to fraud; to reinforce professional skepticism when undertaking auditing procedures; to promote consistent behavior and facilitate effective responses in the face of possible fraud; and to enhance transparency in reporting.

Members expressed concern about the volume of regulation for companies in Europe. A member noted that some new standards are also contradictory, and that *"all this legislation is making it impossible to focus on running the company. We already have dedicated time to ensure compliance of the company is many different jurisdictions, but the volume of regulation is making Europe less competitive than the rest of the world."* Citing differences in regulations globally, the member urged standard setters to *"find common ground. Make it simpler."* Mr. van den Hout appreciated the concerns and explained that the new fraud auditing standard will be globally adopted and will therefore not just affect Europe.

A member questioned the need for changes to the fraud auditing standard, describing a fraud that had occurred recently and speculating whether changes to the fraud auditing standard would have identified it. Mr. van den Hout explained the history of the project and the drivers of the need for the changes but highlighted that the procedures are aimed at auditors and not at companies themselves. He added that some of the changes reflect what good auditors would ordinarily be doing anyway. He noted that the changes do not extend the responsibilities of the auditor in relation to a financial statement audit, and do not go as far as to require forensic procedures.

Fraud is a complex topic, and all stakeholders have a role to play in combating it. A member stressed the importance of training and education on the proposed changes, *“otherwise it is just another rule.”* Ms. Delarue highlighted the importance of auditors’ processes for accepting or declining to audit clients, and the role of fraud risk in that process: *“The only protection of your brand is to sometimes walk away from a high-risk client.”* Members encouraged the IAASB to focus on processes for identifying fraud and on how auditors assess and manage risk. Audit chairs showed little appetite for any definitive statement about fraud being included in the auditor’s report. They emphasized the importance of maintaining professional skepticism throughout the audit.

Tapestry Networks intends to use the discussion to develop a comment letter to submit to the IAASB on its proposals on the audit of fraud in financial statements.

Appendix 1: Participants

The following EGAN members participated in all or part of EGAN and crossover meeting:

Nadja Borisova, BlaBlaCar and Pomegranate Investment AB
Carolyn Dittmeier, Illy Caffè
Brenda J. Eprile, Atlantica Sustainable Infrastructure plc, Westport Fuel Systems, Inc.
Ana García Fau, Cellnex
Christoph Hütten, Brockhaus Technologies
Linda McGoldrick, Alvotech, Compass Pathway, and Cranial Technologies
Antonella Mei-Pochtler, Westwing Group
Sandra Stegmann, Bechtle AG

The following EACLN members participated in all or part of the EACLN and crossover meetings:

José Miguel Andrés Torrecillas, BBVA
Germán de la Fuente, Santander
Ana de Pro Gonzalo, STMicroelectronics
Carolyn Dittmeier, Illy Caffe
Renato Fassbind, Nestlé
Byron Grote, Tesco and AkzoNobel
Marion Helmes, Heineken and Siemens Healthineers
Liz Hewitt, Glencore
Pilar López, Inditex
Benoît Maes, Bouygues
John Maltby, Nordea
Nathalie Rachou, Veolia
Maria van der Hoeven, TotalEnergies

EY was represented by the following in all or part of the EGAN and crossover meetings:

Marie-Laure Delarue, Assurance, Global Vice Chair, EY
Jean-Yves Jégourel, Country Managing Partner, Germany, EY
Hildur Eir Jónsdóttir, Assurance Managing Partner, EY
François Langlois, EMEIA Assurance, Managing Partner, Markets and Business Development, EY
Suwin Lee, EMEIA EY Private Leader, Transaction Tax Partner, EY
Hermann Sidhu, EMEIA Assurance Leader, EY
Julie Linn Teigland, EMEIA Area Managing Partner, EY

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

Beverley Bahlmann, Executive Director
Jonathan Day, Chief Executive
Todd Schwartz, Executive Director
Hannah Skilton, Associate
Abigail Ververis, Project and Event Manager

Endnotes

[1] These were optional sessions on the morning of April 10 with members of the European Growth Audit Network and European Audit Committee Leadership Network.

[2] *Summary of Themes* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Quotations in italics are drawn directly from members and guests in connection with the meeting but may be edited for clarity.