

Audit Committee Leadership Network

March 2023

ACLN

SUMMARY of THEMES

Innovation in internal audit, audit committee and external auditor relationships, artificial intelligence, and economic uncertainty

On March 1-2, 2023, the Audit Committee Leadership Network (ACLN) met in New York City to discuss:

- **Innovation and Evolving Practices in Internal Audit** with Nadir Darrah, Chief Auditor, Citigroup; Marc Sabino, Chief Auditor – Head of Innovation, Citigroup; and Brandi Thomas, Vice President and Chief Audit Executive and Chief Diversity Officer, GE
- **The Audit Committee and External Auditor Relationship** with EY leaders Julie Boland, Americas Area Managing Partner and US Chair and Managing Partner; John King, Americas Vice Chair—Assurance; Patrick Niemann, Americas Leader, Audit Committee Forum; Linda Hill, Global Client Service Partner; and Norm Prestage, Global Client Service Partner
- **What’s Next for AI—Is Your Board Ready?** with Steve Weber, Professor, Graduate School, University of California, Berkeley, and Partner, Breakwater Strategy
- **Responding to Economic Uncertainty: Considerations for Boards During a (Potential) Recession and Volatile Markets** with Jason Furman, Nonresident Senior Fellow, Peterson Institute for International Economics, and Aetna Professor of the Practice of Economic Policy at Harvard Kennedy School and the Department of Economics at Harvard University

Below is a summary of each discussion.¹ Forthcoming *ViewPoints* will provide additional detail on the innovation in internal audit and audit committee and external auditor relationship topics.

Innovation and evolving practices in internal audit

As regulatory and risk environments become more complex, so too does the role of internal audit (IA) in public companies. In this session, audit executives from Citigroup and GE described how they approach keeping up with the full range of risks facing large, global companies. And while the “*how*” of internal audit continues to evolve, Mr. Darrah emphasized that its mission has not: “*Nothing has changed with respect to ‘why.’ The role of internal audit is to provide assurance, agitate within the organization, and try to drive positive change. What has changed is the ‘what’ and the ‘how.’*” So too has the “*who*,” as expanded portfolios require new and different types of skillsets on the IA team.

Audit executives are focusing on several key areas to ensure their teams remain efficient and effective:

- **Consider the big picture and make the most of IA’s enterprise-wide lens.** Highlighting an ever-changing risk landscape with considerations from geopolitical shifts, energy security, cyber risk, supply chains, etc., Mr. Darrah highlighted the need for IA teams to think about the operational resilience of the company. *“It’s really becoming a resilience story across organizations,”* he said. *“IA should be looking at its abilities to serve its customers and build in resilience in the face of all these challenges and changes happening.”* A member added, *“The internal audit team has a powerful vantage point, and the organization should be leveraging that.”*
- **Leverage technology and innovation to allow teams to focus on higher-value work.** *“Data allows the internal audit team to connect the dots and identify interesting patterns,”* Mr. Sabino said, adding, *“The benefit of these innovations is we can redeploy that productivity to other areas because there is never enough time. Innovation and technology should be viewed as augmenting the work of humans and adding capabilities, skills, and insights.”* For example, testing whole populations rather than sampling can not only improve audit quality but also free the auditor to focus on insight rather than process management.
- **Be strategic about human capital.** Although GE had a long tradition of strong internal audit, it decided to disband its corporate audit team and start from scratch. Ms. Thomas worked with her audit committee to answer the question, *“How do we build an internal audit team fit for purpose today? What does that look like without legacy issues?”* In addition to focusing on emerging issues, such as technology and cyber risk, she emphasized building a diverse leadership team. Ms. Thomas encouraged members to *“find talent where it is. We are often biased to think what we need is outside of the business and that’s not always the case.”* Mr. Darrah agreed adding that functionally diverse talent is also important. Citi’s internal audit team of more than 2,500 people *“isn’t just formed of accountants, but technologists, data scientists, and others.”*
- **Balance IA’s approach to emerging issues.** When members asked about IA’s role in emerging issues such as ESG, guests acknowledged the tension between regulatory requirements, business objectives, and stakeholder views. Ms. Thomas said that she has taken the approach of setting up an umbrella container for ESG so *“whatever the businesses ultimately decide, we can fit them into the overarching infrastructure and processes we’ve created.”* Mr. Darrah agreed, *“As we move more and more toward ESG reporting, there are more implications and challenges balancing business objectives, widely differing political views, and reporting requirements ... It makes for a really critical balancing act for companies, and you have to really look to your strategy. That’s where IA comes in: to make sure all parts of the organization are following that narrow line available to us.”*

- **Understand IA’s mandate and enlist the audit chair as an ally.** Whether a company is looking to maintain the status quo or have a total IA makeover, CAEs should be clear on their mandate. To be most effective in executing on that mandate, audit executives need a supportive audit chair. *“The two things I think are critical for the CAE to be able to do their job are for the audit chair to help protect their independence and protect their credibility,”* said Mr. Darrah, continuing: *“As an audit chair, make sure you are keeping an eye out for how your audit team is keeping its independence from and credibility with management. How do you hear management talk about IA? How and when do they involve IA? If they aren’t involving IA, if audit operates on the sidelines, you have a problem.”* A member emphasized this point: *“Management needs to recognize that the stature and independence of IA is paramount.”*

The audit committee and external auditor relationship

A strong working relationship between the audit committee and the external auditor is vital to the effectiveness of both groups. Members described a wide range of practices for interacting with their external auditors.

The broader themes discussed included:

- **Create open communication and trust with the engagement partner.** While audit chairs described the need for a careful balance between trust and auditor independence, all agreed that the relationship with the lead engagement partner is fundamental. Specifically, an open line of communication is critical, and the auditor should feel comfortable to raise potential issues quickly. *“Audit firms are our eyes and ears,”* said a member; *“We need safe spaces where both the audit committee and external auditor can discuss issues openly and truthfully.”*
- **Establish relationships with others on the audit team ...** Members described the importance of building relationships with the broader audit engagement team. Several audit chairs described various ways they meet and interact with the external audit teams beyond the lead partner. EY’s Julie Boland emphasized the effect this has: *“Do not underestimate the importance to our teams of the audit chair taking time to meet and speak with them. It’s like gold ... you create a culture that our teams want to be a part of and helps attract our best people.”*
- **... and senior leaders at the audit firm.** Since the audit committee typically works with an external firm beyond any individual audit partner’s tenure, members stressed that developing relationships at the audit firm more generally is important. This can be especially helpful when partner rotations are occurring. One member recommended asking the audit firm’s senior leadership to provide insight about potential new audit partners. *“During the partner rotation process, I think audit chairs should reach out to the CEO or other leaders of the audit firm and ask, ‘Is this the right partner for my audit? What*

do you know about this candidate?’ We think this is so important that we disclose in our proxy that we make this part of our process when selecting a new audit partner.”

- **Start early and develop criteria to ensure smooth partner rotations.** Members emphasized that planning ahead for a partner rotation allows time to find the right new partner and helps ensure continuity. Audit chairs also find it useful to establish explicit criteria for selecting audit partners considering such factors as experience, industry expertise, global nature of previous assignments, diversity, and availability for overlap with the outgoing partner. Most members agreed that there is now a greater degree of flexibility in terms of where the audit partner resides, as long as they are willing to be in-person as needed.
- **Consider the external auditor’s role in emerging issues.** As audit committees gain oversight responsibility of emerging issues such as ESG, members discussed when and how they consider external auditors’ involvement. They recalled the early days of the Sarbanes-Oxley Act, where transformational changes were often needed to achieve compliance, noting that ESG will require a similar transformation of systems and controls. But with regulatory and reporting requirements still in flux, audit chairs continue to evaluate the expertise and skillsets that will be most relevant for both finance teams and external parties that provide assurance on ESG information.
- **Determine how the audit committee will assess the external auditor.** Members emphasized that assessing the competence, communication, ability, service, Public Company Accounting Oversight Board (PCAOB) inspection reports, global presence, and value add of the external auditor is an important aspect of ensuring a productive relationship. The frequency and format of evaluations varied, with some audit committees using written questionnaires or templates and others conducting assessments less formally.

What’s next for AI—Is your board ready?

Artificial intelligence (AI) has dominated headlines in recent months with the release of “generative” AI applications like ChatGPT (natural language generation) and DALL-E (image creation). These have captured the public’s attention and rapidly attracted billions of dollars in investment. Members were eager to learn more about how the technology has progressed and its implications for global companies.

To start the conversation, guest Steve Weber asked members, *“Is this emergence of generative AI analogous to 1994 when the World Wide Web appeared and started to sweep across everything? Is it as big as 2007 when the iPhone transformed mobile? If so, what does that mean for board oversight and governance?”* He made three key points about the technology:

- **AI is a type of machine learning.** *“What is the difference between AI and machine learning?” a member asked. Mr. Weber advised members to think of AI as one type of machine learning. “It helps to demystify it,” he explained. “Saying ‘artificial intelligence’ can lead people astray and into science fiction. If you think about it as machine learning, it acknowledges the risks and opportunities like any other technology.”*
- **Generative AI capabilities are outpacing its developers’ goals.** Generative AI is a subset of the technology that uses machine learning methods to create new, original content, such as language or images, increasingly mimicking what were long considered distinctive human behaviors. While the underlying research and development have been going on for years, the capabilities of new generative AI applications are vastly exceeding expectations. *“Even the research community is surprised by what they created,” Mr. Weber said.*
- **What lies ahead remains uncertain, because even experts don’t fully grasp some aspects of the technology.** *“There is a fundamental uncertainty about what we’ve created; we don’t know all that is at stake,” Mr. Weber cautioned. As an example, he described how generative AI uses statistical methods to predict the best next word in a sentence, functioning in some respects like a “fancy auto complete.” But it turns out, he said, that “If you only take the highest-ranking word 80% of the time—instead of 100% of the time—you get language that sounds like how we speak colloquially. No one knows why. Science is progressing not based purely on theory but also on practice.”*

Members wondered about the risks and opportunities for global companies. Mr. Weber advised that *“planning for multiple scenarios at different magnitudes of disruption and time horizons is becoming really important. Plans need to be customized for each company, but there are some key considerations for boards.”* The group highlighted several:

- **Be aware of early-stage commercialization risk.** The more people use AI technologies, the faster they develop and improve. This sets up a powerful *“first mover advantage,”* Mr. Weber said. But he cautioned that there are risks in premature commercialization. *“I don’t think that ChatGPT should be out in the world just yet.”* What is more, he said, *“Commercialization risk cannot be separated from the race for victory in the cloud.”* By providing OpenAI, the developer of ChatGPT and DALL-E, with investment in the form of cloud computing resources, Microsoft has not only secured a powerful position in a technology leader, but also ensured continued demand for its Azure cloud platform.
- **Prepare for generative AI’s involvement in geopolitical issues.** There is significant risk of AI models becoming tools of political actors, Mr. Weber cautioned. The use of the technology for rapid, large-scale communication, including disinformation, will become more prevalent as the US 2024 presidential election draws near. It is also likely to play a major role in China’s domestic and foreign maneuvering.

- **Consider adopting a zero-trust approach.** While many leaders are asking how to build more trust in AI technologies, Mr. Weber argued that in practice, *“Humans are more likely to trust than they should be.”* He advised boards to consider a *“zero-trust attitude”* as their companies begin implementing more advanced forms of AI. *“Just as with cybersecurity you assume the person logging on is not authorized and force them to authenticate on an ongoing basis, you can place the burden on the machine to prove to you that what it is saying is real, rather than it being your burden to figure out if that is the case.”*
- **Don’t evaluate AI based on expectations of legacy technologies.** Members pointed out that businesses have a vital role to play in experimenting with AI technologies and helping them evolve. Mr. Weber agreed and provided additional advice: *“Don’t evaluate new technologies by asking how it deals with the same problems that older technology solves.”* For example, the first iPhones received negative reviews purely as telephones. But in short order, the technology revolutionized media and mobile computing.
- **Consider the opportunities.** Mr. Weber encouraged boards to explore opportunities for deploying generative AI, especially given a tight market for knowledge workers: *“Ask your company’s management, ‘What’s your plan for experimenting so we can determine where it’s effective and efficient to deploy these tools?’”*

For a list of questions corporate directors should consider asking their CEOs about the impact of generative AI on large companies, as generated by OpenAI’s ChatGPT, see [Appendix 2](#).

Responding to economic uncertainty

Economic uncertainty continues to persist in 2023. Many corporate leaders worry about a potential recession, but conflicting indicators make it *“a confusing time,”* as one audit chair put it. Members met with economist Jason Furman to discuss the economic outlook and how audit committees and boards are responding. Themes included:

- **The pandemic helped bring us to this point.** In Mr. Furman’s view, government pandemic relief payments—and supply chain disruptions as a distant second—were the primary drivers of high inflation and current economic conditions. *“All of the advanced economies thought we were going into another financial crisis. Knowing that in the last one they did too little, this time they overcorrected and did too much. They thought it was a normal recession where you need to fight it with lots of money; instead, it was more like a natural disaster where things shut down and then bounce back fairly quickly.”* He added that *“Everything got turbocharged. People were spending less and had higher incomes.”* Supply chain disruptions added to price inflation in specific areas—new cars, for example.
- **It will be hard to avoid a recession while bringing inflation down.** Mr. Furman puts the odds of the US entering a recession in 2023 at approximately 40% but argues that there is a 75% chance that inflation will remain high. *“It is difficult to bring inflation down without a recession,”* he said; *“So if I’m right about the stubbornness of inflation, it will continue until*

there is a recession. If not in 2023, then in 2024.” Other scenarios like a soft landing are possible, but less likely in Mr. Furman’s view.

- **A stronger push by the Federal Reserve may be needed to fight inflation.** Many leaders thought inflation was transitory, Mr. Furman said, but when certain conditions improved—economies and schools reopened and oil prices came down, for example—inflation remained high. He noted that recent data showed significant changes in the past two months. The three-month annualized core Personal Consumption Expenditures (PCE) rate rose from 2.9% to 4.7%; based on these factors, Mr. Furman very recently argued that the Federal Reserve should take a more aggressive course of action to fight inflation.²
- **Audit chairs remain concerned and cautious.** When polled during the meeting, most ACLN members said they are concerned and expect at least some form of economic downturn. Members reported that a potential global recession, geopolitical instability, tight supply chains, inflation, and labor challenges all remain top concerns—not only near-term but also long-term due to changing trends and their implications. *“There are no mitigating actions to take with the global recession, inflation, and supply chain issues. We view it as not in our control, which is more than a little disturbing,”* one member said. Another discussed the geopolitical environment: *“The CHIPS Act, for example, what happens over next 10 years? How does it change the dynamic around wages? What investments do we need to make sure we have right workforce in place?”*
- **Widening risk apertures and broadening scenario planning are essential for global companies.** In uncertain economic conditions, members emphasized that taking a broader view of risks is increasingly important. One explained, *“Our scenario planning provides a much greater spectrum of potential assumptions and outcomes.”* Another added, *“Typically, a sensitivity analysis would range from 5% to 15%. But we’ve now lived through 50-100% sensitivities, so that changes risk management.”* Mr. Furman agreed and added a point of further caution: geopolitical instability could create unprecedented and significant changes. *“We’ve talked about the 85% probability where things evolve in a normal way. Outside of that, there are also unusual factors. The Russia-Ukraine war could take quite an ugly turn in terms of its consequences. There is a lot of uncertainty with China. Could something turn the wrong way in the Middle East? There are a whole range of geopolitical risks.”*

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Appendix 1: Meeting participants

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



Judy Bruner
Audit Committee Chair,
Applied Materials and
Seagate Technology



Jeff Campbell
Audit Committee Chair,
Aon



Anne Drinkwater
Audit Committee Chair,
Equinor



Bill Easter
Audit Committee Chair,
Delta Air Lines



Bella Goren
Audit Committee Chair,
Marriott International



Robert Herz
Audit Committee Chair,
Morgan Stanley and
Fannie Mae



Dagmar Kollmann[†]
Audit Committee Chair,
Deutsche Telekom



Arjun Murti
Audit Committee Chair,
ConocoPhillips



Ann Marie Petach
Audit Committee Chair,
Jones Lang LaSalle



Tom Schoewe
Audit Committee Chair,
General Motors



Leslie Seidman
Audit Committee Chair,
GE



Tracey Travis
Audit Committee Chair,
Meta



Jim Turley
Audit Committee Chair,
Citigroup



Robin Washington
Audit Committee Chair,
Salesforce

[†] Member of the European Audit Committee Leadership Network

Appendix 1: Meeting participants (continued)

The following members participated virtually in part of the meeting:



Alison Carnwath[†]
Audit Committee Chair,
BASF and Zurich
Insurance Group



Ted Craver
Audit Committee Chair,
Wells Fargo



Pam Daley
Audit Committee Chair,
BlackRock



Gretchen Haggerty
Audit Committee Chair,
Johnson Controls



Liz Hewitt[†]
Audit Committee Chair,
Novo Nordisk and
Melrose PLC; Non-
Executive Director,
National Grid Group
PLC



Charles Holley
Audit Committee Chair,
Amgen



Lori Lee
Audit Committee Chair,
Emerson Electric



Nancy McKinstry
Audit Committee Chair,
Abbott



Kimberly Ross
Audit Committee Chair,
Cigna

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



Julie Boland
US Chair and Managing
Partner and Americas
Area Managing Partner,
EY



John King
Americas Vice Chair -
Assurance, EY



Pat Niemann
Americas Audit
Committee Forum
Leader, EY

[†] Member of the European Audit Committee Leadership Network

Appendix 2: Reflection questions for corporate directors on generative AI—written by AI

OpenAI’s ChatGPT generated the following list of questions when asked: “What questions should corporate directors be asking their CEOs about the impact of generative AI on large companies?”

Corporate directors should be asking their CEOs a variety of questions about the impact of generative AI on their companies. Here are some key questions they could consider:

- ? **What is our company's current strategy for incorporating generative AI into our operations, and what specific benefits do we expect to see from it?**
- ? **What are the potential risks associated with using generative AI in our business, and how are we managing these risks?**
- ? **How are we addressing ethical concerns related to the use of generative AI, such as bias or privacy issues?**
- ? **How are we preparing our employees for the changes that generative AI will bring to their roles and responsibilities?**
- ? **What new opportunities might arise from the use of generative AI, and how can we best position ourselves to take advantage of them?**
- ? **How are we ensuring that the data we use to train our generative AI models is accurate and representative of our customer base?**
- ? **What steps are we taking to ensure that our generative AI models are transparent and explainable, so that stakeholders can understand how decisions are being made?**
- ? **How are we balancing the potential benefits of generative AI with the need to protect our intellectual property and maintain our competitive advantage?**
- ? **What impact do we expect generative AI to have on our overall business strategy and long-term goals, and how are we preparing for these changes?**

By asking these and other probing questions, corporate directors can gain a better understanding of the potential impact of generative AI on their companies and ensure that their organizations are well-prepared to navigate this rapidly evolving landscape.³

Endnotes

¹ *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.

² Jason Furman, "[To Fight Inflation, Fed Tightening Should Go Faster and Farther](#)," *Wall Street Journal*, March 2, 2023.

³ OpenAI, ChatGPT response to question from the author, March 8, 2023.