

Future trends in corporate governance: Five questions audit committees should ask



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1 Uncertainty, complexity, and competing priorities: Factors influencing the work of audit committees

Today's businesses operate in a world exhibiting wide economic, societal, and environmental challenges. Companies have always been exposed to external influence factors. And the successful ones have found appropriate answers to the challenges which impact their business most. Yet, the work of audit committees is becoming more demanding, challenging and time consuming. Why is that?

The level of uncertainty has increased significantly since the early 2000s¹, accompanied by increased volatility in the markets. Inflation, geopolitical tensions, climate change, and new sources of risks created by artificial intelligence are a reality for most businesses these days – to name only a few developments which have added to the mix of challenges. As Christine Lagarde, president of the European Central Bank stated in October 2023: «There are all these balls in the air. We are not exactly sure where they are going to land.»²

Adding complexity is the fact that companies need to balance challenges arising in the short-term with long-term risks and opportunities, which are significantly different.

The Copenhagen Institute for Future Studies («CIFS») laid out 15 megatrends in its Scenario Reports³ which may challenge today's way of doing business, including amongst others:

- Rise of the network economy: The digitization of society gives rise to the creation of value in a decentralized manner – both at local and global scale. Major examples of this trend include the sharing economy, crowd funding, and crowd creation. This benefits flat hierarchical structures and increases the importance of collaboration.

1 Refer to <https://worlduncertaintyindex.com>.
2 Darren Dodd (16 October 2023). Global economy faces new age of volatility. Financial Times. Delivered from: <https://www.ft.com/content/e8d192d9-e927-4958-97a4-e3ad4e927e27>, accessed May 2024.
3 Timothy Shoup et. al (2022). Scenario Reports NO 07: Global megatrends: Shaping the future of societies, economies, and values. CIFS.

- Use of AI and automation: «If a typical person can do a mental task with less than one second of thought, we can probably automate it using AI [...]» This statement from Andrew Ng, computer scientist and professor at Stanford, demonstrates how machine learning and robotics are not only changing the fundamentals of how we do business, leading to increased productivity and reliability. They are also going to shift labor markets towards more difficult and judgmental tasks for the workforce and may change the way individuals learn and consume.
- Environmental change and sustainability: More extreme weather conditions, shifting climate zones, and a growing environmental consciousness are going to push for sustainability, including how companies seek growth without degrading natural resources. Circular economy is one of the concepts expected to gain significantly more importance for business makers – especially considering the existing circularity gap of over 90% in Switzerland.⁴
- More individualization and empowerment: Continued growing individual liberty, social media usage and collective activism increase the number of different ways of living, working and consuming. Therefore, businesses are going to see increased stakeholder engagement, such as from activist investors, and additional demands from society in the form of new legislations and regulations from policy makers.

Megatrends are very high-level drivers of change over the coming decades – and how exactly they shape the future of the economy is, again, highly uncertain. On the other end of this spectrum are the immediate short-term risks arising from inflation, armed conflicts, and the risks arising from limited labor and social mobility (i.e. lack of economic opportunity).⁵ These may interrupt businesses’ pricing strategies, international supply chains, or access to skilled individuals.

In consequence, business responses which may work today and in the next one to two years may not be relevant when companies take a ten-year perspective in developing their strategies. This requires companies, their management and their boards, including audit committees («ACs»), to be highly adaptable to new circumstances, flexible in their ways of working, and to apply forward-looking thinking.

Couple the requirement for successful businesses to balance short-term risks with long-term trends with the information overload most senior leaders experience in the digital age, and the complexity of doing business gets an additional layer. With more information being available fast, and at a significantly lower cost than in the past, audit committees need to challenge what information is decision relevant.

Looking at the tasks within the AC’s realm, not surprisingly the challenges and priorities remain manifold according to Deloitte US’ and the Center for Audit Quality’s («CAQ») recently published Audit Committee Practices Report: *Common Threads Across Audit Committees*.⁶ The top-two priorities identified for the next twelve months were Cybersecurity and Enterprise Risk Management. However, already the third priority for audit committees was not quite clear, including finance and internal audit talent, compliance with laws and regulations, and finance transformation. This was followed by sustainability reporting and artificial intelligence governance being mentioned as a priority for over 20% of the respondents.

With uncertainty, complexity and competing priorities on the audit committee’s agenda: What are five questions ACs should ask themselves to ensure effective corporate governance in the future?

4 Andrew Keys et. al. (2023). Circularity Gap Report. Deloitte Switzerland. Delivered from: <https://www2.deloitte.com/ch/en/pages/risk/articles/circularity-gap-report-switzerland.html>, accessed May 2024.

5 World Economic Forum («WEF»). Global Risks Report 2024. Delivered from: https://www3.weforum.org/docs/WEF_The_Global_Risks_Report_2024.pdf, accessed May 2024.






6 Krista Parsons & Vanessa Teitelbaum (2024). Audit Committee Practices Report: Common Threads Across Audit Committees. Deloitte US/CAQ. Delivered from: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/audit/us-caq-deloitte-audit-committee-practices-report_2024-03-v2.pdf, accessed May 2024.

2 Five questions to help audit committees ensure the future effectiveness of corporate governance

Based on our collaboration with ACs and on the results of Deloitte Switzerland’s study conducted on Swiss Best Practices in Corporate Governance⁷, we see five areas which will be very likely impacted by the developments we have discussed: (1) the AC’s ways of working; (2) its oversight on how the company considers the most

⁷ Alessandro Miolo et al. (2023). Swiss Best Practices in Corporate Governance. Deloitte Switzerland. Delivered from: <https://www2.deloitte.com/ch/en/pages/audit/articles/corporate-governance.html>, accessed May 2024.

prevalent developments in society which may impact its business; (3) its oversight over the company’s value generation; (4) its communication and reporting with stakeholders, both external and internal; and (5) how ACs evaluate their own work, continue to educate themselves, and are supported by internal and external experts to enhance their governance. To assist ACs tackle some of the challenges ahead of them and help ensure the future effectiveness of their system of governance controls, we have developed a framework of five questions ACs should ask themselves – including some considerations which may help ACs as they work through their own responses. Figure 1 summarizes the five questions and key points for consideration.

The Audit Committee Future Effectiveness Framework	
Key Questions	Key Consideration Points
 <p>Ways of Working How can we increase effectiveness of our ways of working in the future?</p>	<ul style="list-style-type: none"> • Diversity of thinking • Adaptability, agility, and forward-looking thinking • Scenario planning • Cultural aspects and «tone in the middle»
 <p>Society What societal developments may impact our business, and hence need oversight by us?</p>	<ul style="list-style-type: none"> • Protection of data and personal rights • Sustainability (environment, social and governance) • Talent attraction, development and retention
 <p>Value Generation How does our company effectively sustain value generation in the future?</p>	<ul style="list-style-type: none"> • Balancing short-term results with long-term investments • Comprehensive approach to enterprise risk management, including opportunities • Entrepreneurial corporate governance
 <p>Communication and Reporting How should we communicate and report in the future?</p>	<ul style="list-style-type: none"> • Engaging dialogue with share- and stakeholders • Building trust • Integrated reporting
 <p>Maintaining Effectiveness How do we, as audit committees, ensure we remain effective?</p>	<ul style="list-style-type: none"> • Conduct regular effectiveness assessment • Leverage internal and external resources and functions (e.g. risk, compliance, internal and external audit) • Continued education

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2.1 How can we increase effectiveness of our ways of working in the future?

The AC's ways of working are highly characterized by the mindset and background each member brings to the committee, tools and techniques used to structure the discussion, and the culture it promotes within an organization.

To cope with the diverse future challenges, ACs are best served to increase diversity of thinking – allowing for an open discussion of alternative perspectives, diverging point of views, and an overall healthy challenge before consensus is reached. This requires AC members to bring relevant industry and leadership experience, in addition to finance, accounting and audit expertise.⁸ It also requires adaptability, agility, and forward-looking thinking.

Ensuring the AC spends sufficient time on topics which are relevant to the future development of a company's business is achieved by agenda setting. Additionally, putting the mechanisms and protocols in place to meet ad-hoc whenever a topic calls for it – e.g. to discuss a major acquisition opportunity – allows ACs to remain flexible and get involved at the right time. However, forward-looking thinking also requires the use of appropriate tools, and here scenario planning can help.

Scenario planning is a tool which only recently started to get attention; however, it has existed since the 1970s and was first used in the industry by RoyalDutch / Shell.⁹ Well executed scenario planning instills imaginative and creative thinking to better prepare an organization for the future – without having to go through detailed calculations, like computing «worst-case» and «best-case» forecast scenarios, also acknowledging they are likely not going to be accurate in the long-term. Rather, the goal of scenario planning is to «draw a circle around multiple possibilities and think about whether you are prepared to face the range of futures that might unfold».¹⁰

8 Readers should note that depending on an audit committee's specific areas of responsibilities, other expertise, such as IT/Cyber, ESG and risk management may be required to ensure effective collaboration.

9 David A. Garvin & Lynne C. Levesque (2006). A note on scenario planning. Harvard Business School, p. 1.

10 David A. Garvin & Lynne C. Levesque (2006). A note on scenario planning. Harvard Business School, p. 1.

As such, the tool may also serve ACs in taking a step back, extend their view beyond the annual reporting cycle, reflect on key decision-making topics for the organization, and contemplate which critical uncertainties may affect the company – ultimately resulting in a better challenge of management.

Lastly, ACs will have to consider cultural aspects within the organization to leverage their agenda setting and in setting direction for the future (e.g., what the desired level of risk appetite is). Given the rise of network economies discussed earlier, with inherent flat hierarchies and decentralized decision-making, ACs will have to ensure the traditional «tone from the top» extends to middle management. This helps to establish an appropriate «tone in the middle» and to emphasize guiding decision-making principles to the broader organization, which is essential to protect the company's interest.

2.2 What societal developments may impact our business, and hence need oversight by us?

Every business is different, operating in different environments and jurisdictions, and so there is no universal answer that fits every company. However, there are three trends in societal developments which we believe every company should continue to observe, as they will very likely impact business making: (1) data privacy and personal rights; (2) governance over sustainability matters; and (3) talent attraction, development, and retention.

Acts such as the EU's General Data Protection Regulation («GDPR») or the California Consumer Privacy Act («CCPA») – both effective in 2018 – marked the start of an increased focus on the protection of individual's personal data in recent years. And the focus on protection continues to increase: It is estimated that GDPR violations cost companies over two billion Euros in 2023, more than from 2019 to 2021 combined.¹¹ Also, new legislation, such as the EU AI act, demands additional protective measures of personal rights. Hence, ACs or other board committees will need to consider if their governance over data and personal rights remains appropriate.

11 Vytautas Kazuionis (2024). Five Data Privacy Trends to Watch in 2024. Forbes. Delivered from: <https://www.forbes.com/sites/forbestechcouncil/2024/01/29/five-data-privacy-trends-to-watch-in-2024/?sh=3e13498e4225>, accessed May 2024.

Similarly, increased demands from consumers, policy makers, and other stakeholders require companies to address sustainability topics, which include climate and social aspects, but also an effective system of governance controls. The «top of mind» areas to be addressed by boards according to the Deloitte Best Practices study are: (1) sustainability objectives in management remuneration systems; (2) formulating and communicating a sustainability strategy; (3) defining and measuring sustainability-related key performance indicators; and (4) assigning the duties to appropriate committees within the board. Data from the US shows that approximately 60% of the oversight duty lies with Nominating and Governance committees.¹²

However, regardless of where the responsibility within boards lies, ACs need to develop a solid understanding to assess at a minimum the implications of sustainability topics on a company's financial risks and reporting.

Amidst the challenges in labor markets – finding the right talent – and the expected shifts of the workforce towards more difficult and judgmental tasks, talent attraction, development and retention becomes key for the success of many businesses. According to a global Deloitte boardroom study¹³, more than 60% of senior leaders don't believe their board conversations are currently sufficient to explore the full talent agenda – including aligning strategic priorities with its investments in the workforce, building a talent pipeline, and nurturing a sense of belonging within the organization. And ACs do play – at a minimum – a critical role in overseeing finance talent topics.

2.3 How does our company effectively sustain value generation in the future?

Many of the challenges discussed previously – the digitalization of our society, or the increased environmental consciousness as well as workforce shortages and supply chain disruptions – call for ACs to oversee how a company's business model generates profits – today and in the future.

Ensuring a company achieves desired short-term results and has sufficient capital to make necessary long-term investment is one key aspect. Similarly, moving away from the traditional approach of purely managing risks, but also discussing with management existing and emerging opportunities they see within the business, is also helpful to develop a sustained business. Additionally, ACs are instrumental in supporting management build a resilient organization which can cope with unforeseen events and uncertainties in the markets – we discussed a possible technique, scenario planning, before.

Close to three quarters of respondents of a recent Financial Times study agree «that board members require a much deeper knowledge of company operations and competitors than ever before.»¹⁴ This ultimately calls for an entrepreneurial approach to governance for ACs to stay close to management and the organization – an approach e.g. followed by private equity.¹⁵

An entrepreneurial approach goes further than challenging management. It requires ACs to bring in an outside perspective, provide new impulses based on what AC members see elsewhere in the market, and draw upon their own leadership experience.

Actively understanding how a business creates value also requires AC members to spend time with front-line managers to gain intelligence about the business, understand how management is dealing with challenges and pressure – and potentially also identify the next rising star within the organization.

12 Maureen Bujno & Kristen Sullivan (2023). On the audit committee's agenda: Emerging trends in ESG governance for 2023. Deloitte Center for Board Effectiveness. Delivered from: https://www2.deloitte.com/content/dam/Deloitte/us/Documents/center-for-board-effectiveness/us-otaca_jan2023_vf_1-31.pdf, accessed May 2024.

13 Jo Iwasaki et al. (2024). Time to rethink talent in the boardroom. Delivered from: <https://www2.deloitte.com/us/en/insights/topics/leadership/prioritizing-workforce-issues-in-the-boardroom.html>, accessed May 2024.

14 THE GREAT BOARD REBOOT: Board members open up on changing roles and expectations (2021). Financial Times. Delivered from: https://professional.ft.com/_/view_pdf/file/1973/bec947c4c9c/-, accessed May 2024.

15 Refer for example to Jeffrey M. Cohn (2024). What Boards of Public Companies Can Learn from Private Equity. Harvard Business Review.

An active, entrepreneurial approach requires AC members to balance the benefits from insights they can bring based on their other commitments, such as other board or senior management leadership roles, with the need to spend sufficient time with the company's business.

2.4 How should we communicate and report in the future?

Legislation and compliance are one aspect to be considered in a company's approach to communication and reporting. It is obviously important for ACs to focus on the appropriateness and conformity of their financial reporting¹⁶ with applicable reporting standards.

Additionally, with today's phenomenon of information overload, boards and ACs need to find ways to engage in a dialogue with shareholders and other key stakeholders allowing to focus on key topics, and ultimately building trust.

One tool which can help is an integrated approach to the company's reporting. Different terms are used by practitioners these days, and they have similar meanings, such as impact reporting, value reporting, or integrated reporting.

According to the IFRS Foundations' framework, integrated reporting is «a concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation, preservation or erosion of value over the short, medium and long term.»¹⁷ The approach combines financial and non-financial reporting efforts, and ultimately seeks to communicate how a company generates value – a question we discussed before.

Besides integrated reporting, we see an increased focus of users on accessibility of information (e.g. how easily can annual reports be found on a company's website, searchability of documents, machine-readability) as well as clarity, conciseness and comparability of information (e.g. between periods, or different companies).

2.5 How do we, as audit committees, ensure we remain effective?

Ensuring an AC remains effective includes three dimensions: (1) an evaluation of the AC's work; (2) support by internal and external expert resources; and (3) continuous education.

The Swiss Code of Best Practice for Corporate Governance sets out in one of its principles that a self-assessment should be conducted at least once a year, and that a company shall publish such information in its annual report¹⁸ – emphasizing the importance of a regular evaluation of the AC's work. According to the Deloitte Best Practices Study, an evaluation can take many forms – either conducted internally in the form of a self-assessment or with the support of external advisors. Important is that they are conducted on a regular basis to help spot trends, and that the discussion within the AC is open, transparent, and engaging.

Furthermore, ACs can maintain – and increase – their effectiveness by leveraging various resources and functions – both internal and external. This includes a company's risk, internal audit, and compliance function, but also its external auditors. Additionally, ACs may seek expert advice, e.g. when dealing with questions of cyber security, internal controls, or key performance measures.

The last element ACs should consider is around their members' own continued education. While there are no regulatory requirements in Switzerland for boards on specific educational requirements, from a legal perspective AC members need to ensure they bring appropriate education and qualifications to serve on a board with the required duty of care.

¹⁶ and also the non-financial reporting, if applicable.

¹⁷ IFRS Foundation/International Integrated Reporting Council («IIRC») (2021). International <IR> Framework, p. 10.

¹⁸ *economiesuisse* (2023). Swiss Code of Best Practice for Corporate Governance, p. 12.

However, good governance goes beyond legal requirements – which is why e.g. the Swiss Code of Best Practice for Corporate Governance suggests training new board members appropriately. Considering the manifold aspects of the future work of ACs discussed in this article, continued education becomes key. From self-study, compact online trainings, learnings within AC sessions facilitated by external providers, to more extensive board programs as offered by universities or audit firms, education for ACs can take many forms.

More important than the form of education is the topic the AC selects for its learning. An AC's discussion with their auditors on emerging topics may provide additional inputs for learning, given their auditor's broad experience with many companies operating in various industries.

3 What can audit committees do now?

Uncertainty and volatility, megatrends shaping the next decade, and short-term challenges requiring immediate attention – the environment for making business is going to stay complex.

While we have provided a framework with five questions to help ACs maintain and increase their effectiveness in the future, ACs are advised to develop their own answers to these questions. This can happen with or without the support of external advisors. Regardless of how ACs decide to work through these questions, we believe they are going to experience immediate benefits from starting to apply some of the concepts discussed– mainly in the form of improved collaboration and an increased quality of their discussions with internal and external stakeholders.