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AUDIT COMMITTEE INSTITUTE

Quarterly 27

The audit committee's job continues to get more difficult

What does your corporate web presence reveal?

Are companies doing enough to safeguard against the risks of bribery and corruption?

Joint ventures – the challenges

Integrity risks and third-party business relationships

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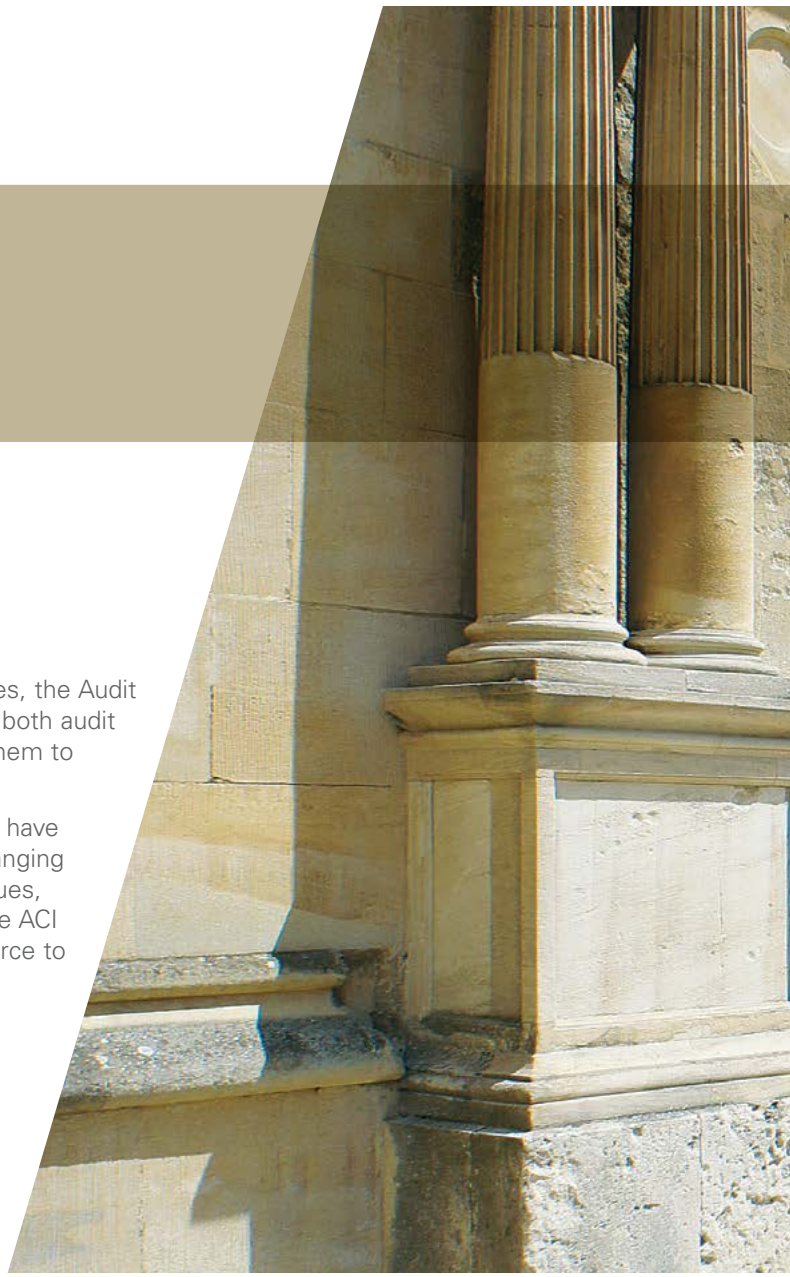
Background



About the Audit Committee Institute

Recognising the increasing importance of governance issues, the Audit Committee Institute Ireland (ACI) was established to serve both audit committee members and non executive directors to help them to adapt to their changing roles.

Historically, those charged with governance responsibilities have largely been left on their own to keep pace with rapidly changing information relating to governance, remuneration, audit issues, accounting and financial reporting. Supported by KPMG, the ACI provides knowledge to non-executive directors and a resource to which they can turn at any time for information, or to share knowledge.

Our primary objective is to communicate with all senior business people to enhance their awareness and ability to implement effective board processes.

The ACI aims to serve as a useful, informative resource for members in such key areas as:

- Governance, technical and regulatory issues
- Sounding board for enhancing all board committees' processes and policies
- Surveys of trends and concerns.

The ACI is in direct contact with over 1,000 members. For more information on the activities of the ACI, please visit our website at: www.kpmg.ie/aci.

Contents

For more information on the work of the ACI please see our website www.kpmg.ie/aci or contact:

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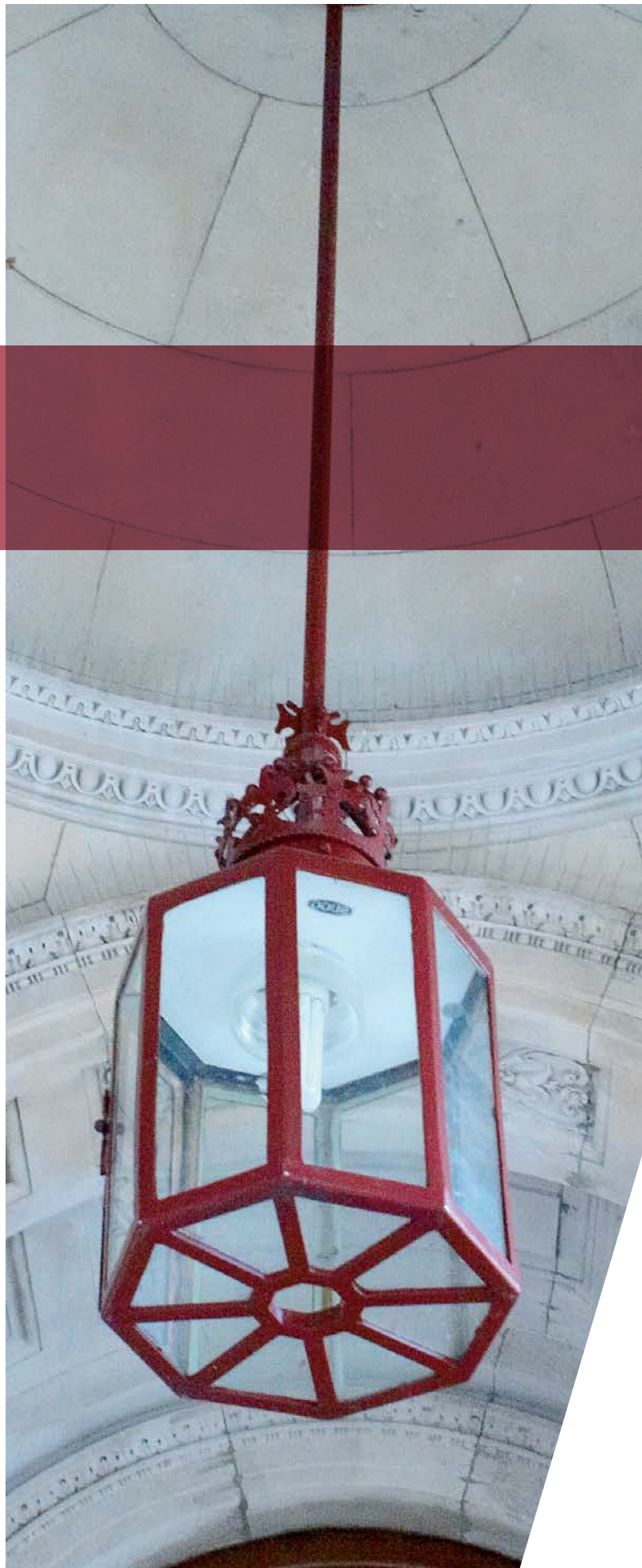
Welcome



Welcome to the latest edition of **Quarterly**, a publication designed to help keep audit committee members and non executive directors abreast of developments in areas of corporate governance and related matters.

The key topics covered in this issue include:

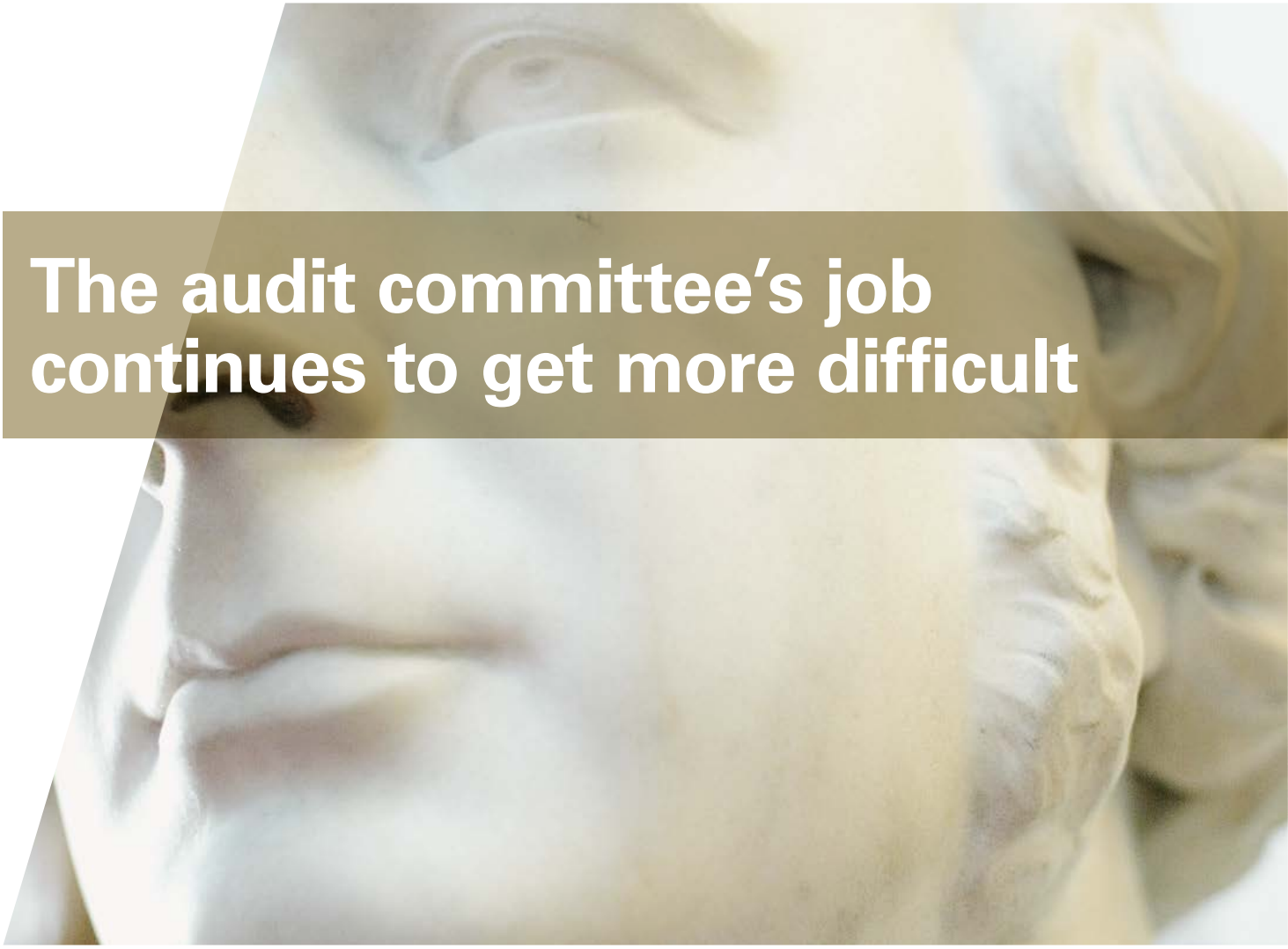
- The audit committee's job continues to get more difficult
- What does your corporate web presence reveal?
- Are companies doing enough to safeguard against the risks of bribery and corruption
- Joint ventures – the challenge
- Integrity risks and third-party business relationships

I hope you will continue to enjoy the ongoing benefits of ACI. Please contact us at at aci@kpmg.ie with any comments or suggestions of topics you would like to see covered and visit our website at www.kpmg.ie/aci for further information.

David Meagher
Chairman
Audit Committee Institute Ireland
Partner Audit
KPMG in Ireland

The Audit Committee Institute recently published a summary of the results from its 2014 Global Audit Committee Survey.

This is an annual survey which presents views of approximately 1,500 audit committee members from across the globe (including a sample from Ireland).



The audit committee's job continues to get more difficult

On a global basis key themes emerging are:

- Regulation, uncertainty and volatility, and operational risk are top challenges today.
- The audit committee's job continues to get more difficult.
- The quality of information about cyber risk, technology and innovation, and global systemic risk is falling short.
- Most companies don't have a CFO succession plan in place.
- Leading indicators and non-financial drivers of long-term performance are often elusive.
- Internal audit should also be looking at risk management, IT, and operational risk - but may lack necessary skills and resources.

Outlined here are some of the topics and concerns which became evident from the survey. These show how the global concerns compare to the attitudes of those audit committee members in Ireland who responded. Broadly, survey topics came under the headings of:

- Audit Committee's workload and agenda
- Risk and information quality
- CFO and finance function
- Corporate performance
- Internal audit's role

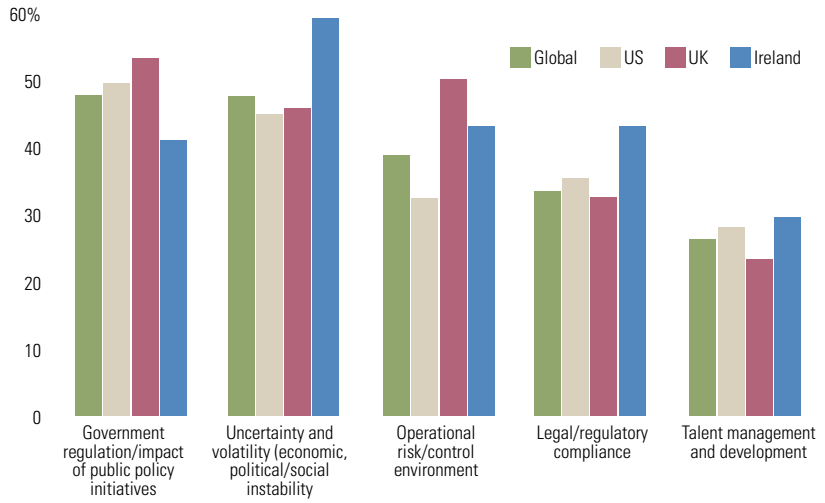
1. Audit committee's workload and agenda – risks posing greatest challenges

Respondents were asked to select three risks (aside from financial reporting risk), from a list of 12, which pose the greatest challenges for their company. Global responses identified the following as the top five risks:

- Government regulation/impact of public policy initiatives
- Uncertainty and volatility (economic, political/social instability)
- Operational risk/control environment
- Legal/regulatory compliance
- Talent management and development.

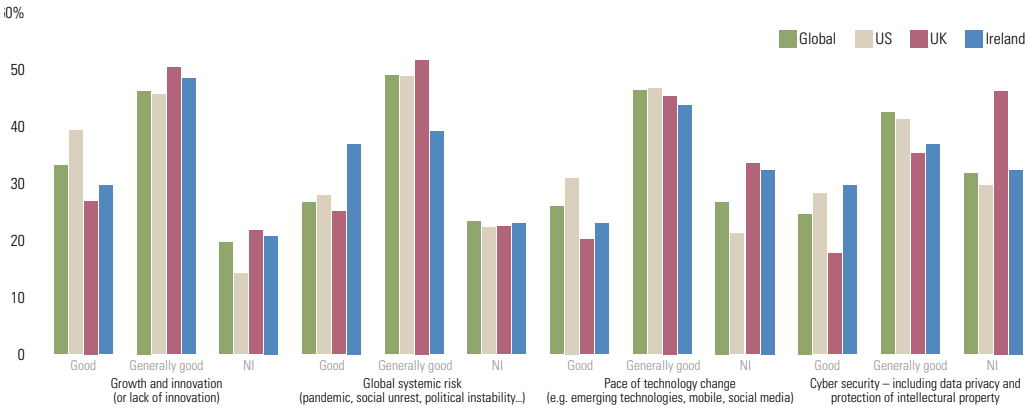
Of the 44 Irish audit committee members who responded, 59% selected "Uncertainty and volatility (economic, political/ social instability)". US (45%) and UK (46%) peers did not have the same concentration on this risk. On a global basis only Thailand (74%) and Slovenia (70%) had a higher selection rate on this risk. Timing of the survey might go some way to explaining the Irish responses. The survey was conducted during September 2013, shortly before the December 2013 bailout exit, and at a time when there was intensifying discussion about what type of exit support Ireland would receive.

1. Audit Committees workload & agenda



A positive from Irish audit committee members perspective is that 7 out of 10 people who selected this risk were satisfied that the audit committee and / or board devoted sufficient agenda time to this topic.

2. Risk & information quality



2. Risk and information quality – quality of the information received about risks and their potential impact on the company

Audit committees globally are satisfied with the quality of information they receive on legal/regulatory compliance, government regulation/impact of public policy initiatives, operational risk/control environment, tax risk, uncertainty and volatility (economic, political/social instability), possible disruption to the business model, and supply chain risk. In each case less than 20% of respondents on a global level, as well as US, UK and Irish levels, identified a need for improvement ("NI") in the information.

On risks such as growth and innovation (or lack of innovation), global systemic risk (pandemic, social unrest, political instability…), pace of technology change (e.g., emerging technologies, mobile, social media), and cyber security (including data privacy and protection of intellectual property), audit committees identified a need to improve the quality of information they receive. In particular on the topic of Cyber security, with UK respondents (47%) identifying a more pronounced need for improvement than the global average (32%). Irish responses were in line with the global average. Over the past year or so there have been high profile security breaches and cyber attacks on UK and Irish companies. Between January and June 2013, KPMG in the UK assessed the FTSE 350 companies to replicate the initial steps that hackers and organised criminals would perform when profiling a target organisation for attack. These results[1] were illuminating noting:

- an average of three potential web server vulnerabilities were identified per company, with the highest incidence at 32 for one company.
- an average of 41 internal usernames and 44 email addresses per FTSE 350 company were obtained during the research.

1. Relevant research is included in the UK Audit Committee Institute publication Audit Committee Quarterly 42, available at www.kpmg.co.uk/aci/acq/index.cfm.

3. CFO and finance function - greatest challenges for the CFO/ finance organisation

Respondents were asked to select three items which posed the greatest challenge for their CFO. The chart shows the number of respondents that selected each item, out of 1,420 globally and 44 in Ireland. The results are similar in both charts. Audit committees would like to see the CFO contributing more to the company's strategy and risk management efforts.

Responses to other questions in this section demonstrated that only 40% of respondents said that their company has a formal succession plan in place for the CFO, and that there is a need to focus on developing talent/bench strength to ensure the CFO and finance team have the resources to succeed.

4. Corporate performance - nonfinancial drivers of long-term value that are most important to the successful execution of your company's strategy

Customer satisfaction and operational efficiency are overwhelmingly viewed as most important to the successful execution of the company's strategy, with 66% and 56% of respondents globally selecting these. While talent management and brand/reputation are next globally (42% each) Irish respondents place more emphasis on the latter, 59%, and less on the former, 25%. Over the past few years Irish companies have been exposed to potential reputational damage, whether this is in the form of issues with the supply chain, or data breaches as mentioned earlier. This may be manifesting itself in the Irish results.

With internal audit expanding its remit beyond traditional financial reporting and controls it is important to assess whether internal audit has the resources, skills and expertise to execute this role. This may require hiring specialists onto the internal audit team or using external resources to assist in specific projects.

When asked whether they believed internal audit function had the necessary skills and resources, 92% responded as being satisfied or somewhat satisfied that this was the case.

5. Internal audit's role – desired areas of focus

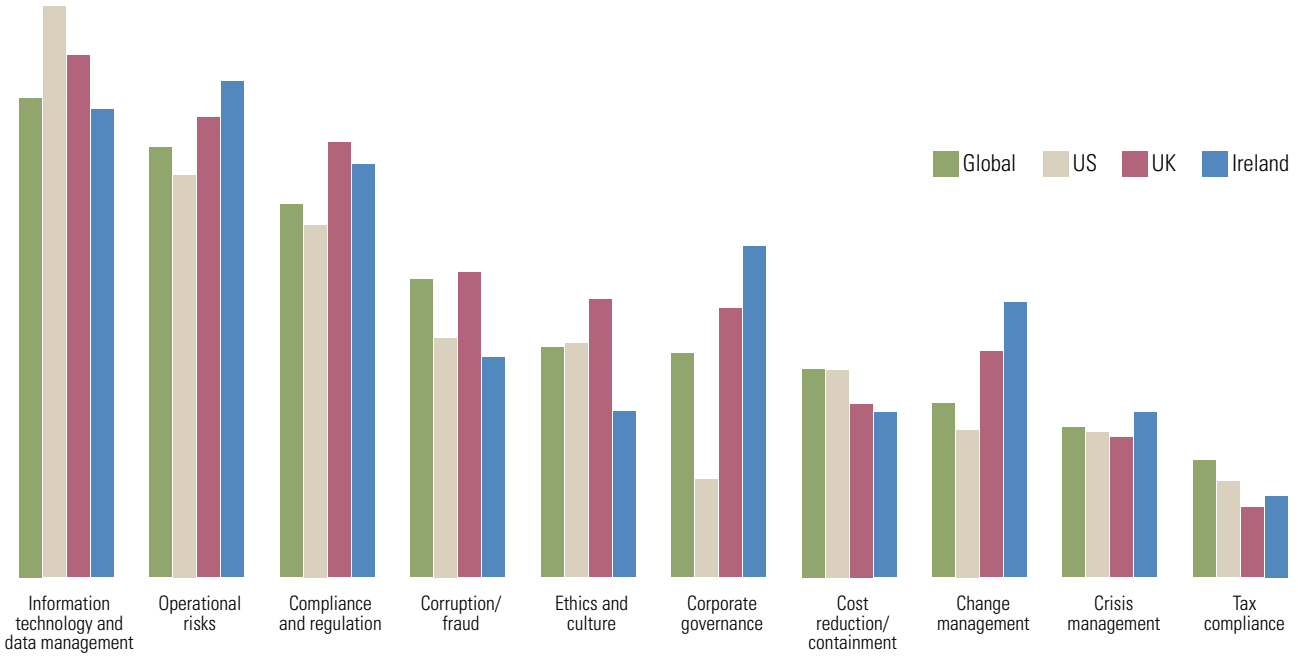
The majority of respondents (8 out of 10) agree that internal audit's role/responsibilities should extend beyond the adequacy of financial reporting and controls, to include other major risks and challenges facing the company. The chart shows areas where respondents would like the internal audit function to devote more of its time and/or sharpen its focus. While Irish respondents agree that internal audit involvement in risk management is paramount, they would have their next focus on operational risks. US respondents identified IT and data management as their number one area where more time should be devoted by internal audit.

With internal audit expanding its remit beyond traditional financial reporting and controls it is important to assess whether internal audit has the resources, skills and expertise to execute this role. This may require hiring specialists onto the internal audit team or using external resources to assist in specific projects. When asked whether they believed internal audit function had the necessary skills and resources, 92% responded as being satisfied or somewhat satisfied that this was the case to execute this role. This may require hiring specialists onto the internal audit team or using external resources to assist in specific projects. When asked whether they believed internal audit function had the necessary skills and resources, 92% responded as being satisfied or somewhat satisfied that this was the case.

Article by

John Corrigan
Director, Audit in KPMG Ireland

5. Internal Audit's role



What does your corporate web presence reveal?

Following a series of high-profile security breaches over the past year, including a cyber attack on the Co. Clare based LoyalityBuild which resulted in the breach of personal data of some 1.5 million individuals, Irish executives are quickly becoming aware of the significant risks posed by the loss of data.

Many Irish companies believe that they can protect their IT systems and data by investing in anti-virus software and other IT security solutions and products. However, cyber criminals are becoming more sophisticated in their attacks and are targeting companies using a number of different methods and strategies.

Information regularly ends up online through negligence, deficient document publishing procedures, or as a result of earlier security breaches, and is useful to hackers as it helps profile the target firm's IT and employees. Information which may inadvertently be made available through an organisation's website, but can be leveraged by cyber criminals, includes employee contact names and email address, IT system and software versions and security policies indicating the types of security mechanisms in place to protect IT systems and data.

Audit committees can play a role in addressing this risk. Firstly, a review of what information their organisation may be leaking can be performed. It is critical that partner businesses and third-party suppliers form part of this review. As enterprise security programs get more robust, it's easier for attackers to access a trusted neighbour's network, which typically has more security deficiencies. Hackers may seek out a weak link, such as a smaller and relatively poorly protected supplier, as an avenue of attack to the larger target organisation.

Over a six month period, KPMG performed research in this domain focussing on the Forbes 2,000: an annual ranking of the top 2,000 public companies in the world created by Forbes magazine. The aim of this research was to perform the same initial steps that cyber attackers and organised criminals execute when profiling a target organisation for attack. All information was sourced from the public documents located on their corporate websites, document metadata, search engines and public internet forums, and no hacking or illegal actions were performed.

Vulnerable web servers

Corporate websites are supported by a number of web technologies and when a website is accessed, the web server often reveals its software version which is typically hidden from a web browser's view. Such information can prove to be of significant value to an attacker when profiling a remote target site and server. During KPMG's review it was found that 16% of Forbes 2,000 corporate web servers are vulnerable to cyber attack due to missing security updates or out-dated software. Any web server on the Internet running versions of web server software which has not received security updates is vulnerable to a remote cyber attack.

Sensitive information leaked within meta-data

Document meta-data is information 'about' a document, or information on its properties. It often specifies who created a document and when or where it was created. This information can provide cyber criminals with a very useful view of a target organisation's IT environment including usernames, email addresses, software versions and information on the internal IT network. During KPMG's research it was found that 78% of Forbes 2,000 corporate websites leak some form of potentially useful information through document meta-data.

Online forums, chat rooms and newsgroups

Cyber attackers will spend time trawling through online forums, message boards and newsgroups for information relating to potential targets. By participating in online IT related discussion boards and special interest groups, cyber criminals can garner very useful information about different organisations IT applications, systems and network which can be used to identify vulnerabilities which can be exploited.

During KPMG's research it was found that companies involved in technology and software post far more information to online forums and newsgroups than all other sectors combined.

How to minimise your exposure

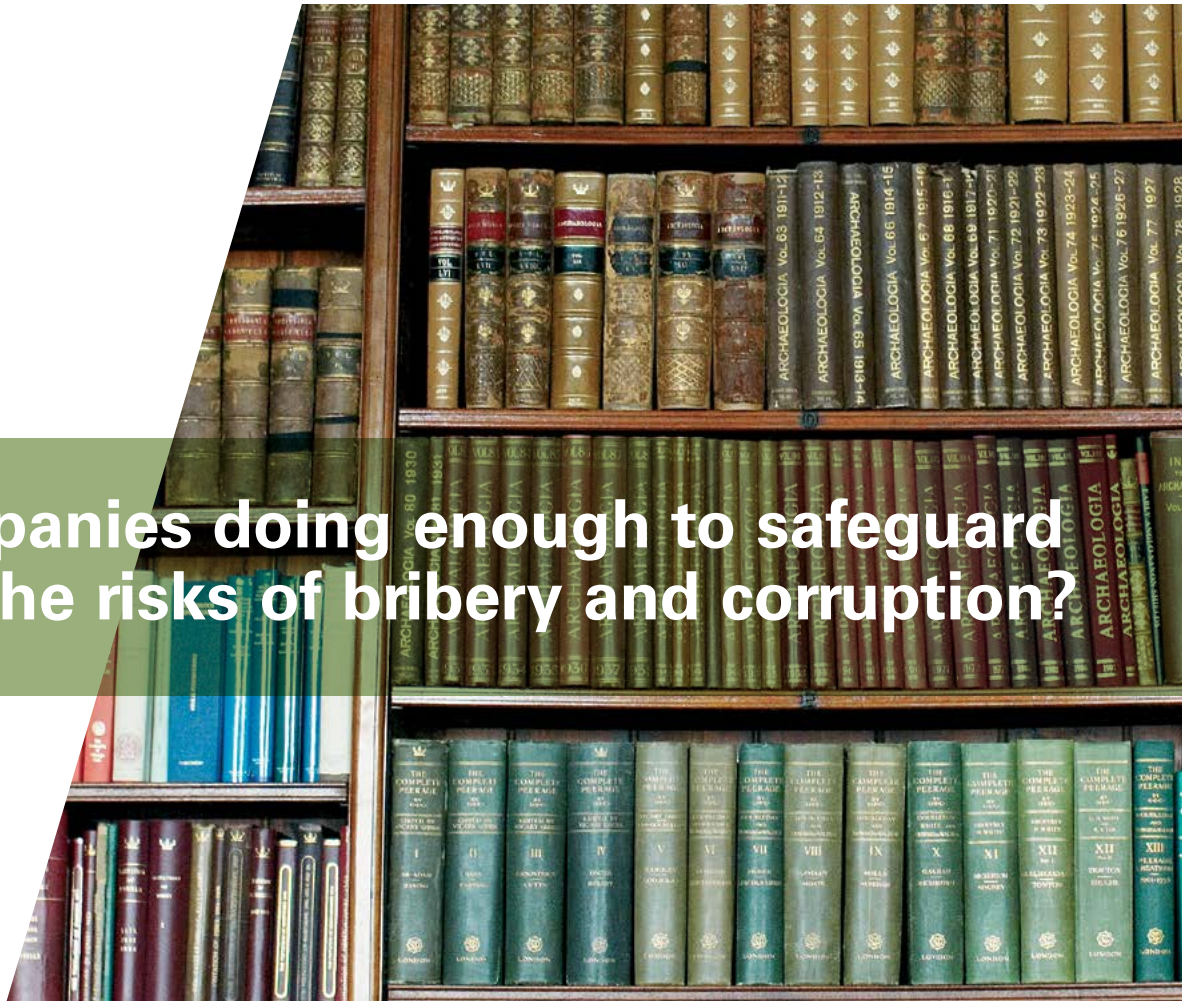
Audit committees and senior executives need to continuously review and challenge what they are being told by their teams about information security and cyber defences. Just as cyber attacks have evolved, companies must evolve by re-evaluating their own ability to detect, defend and respond to cyber attacks. Companies need to establish what controls are in place and how these are being tested to ensure that they are sufficiently protecting the organisations IT systems and data in the ever evolving cyber crime threat landscape.

Practical steps can be taken to improve cyber security through reducing the amount of data which companies expose on the internet. First, an assessment of what an organisation and its suppliers currently leak can be conducted. Then, where possible, meta-data can be cleansed from existing published documents and steps taken to ensure all corporate devices are protected through the application of relevant security updates.

In addition, an important proactive measure which audit committees can encourage is to ensure that all employees understand the value and sensitivity of the information they possess and, more importantly, how to protect it. This behavioural change can be supported by policy changes aimed at minimising unintentional or undesired corporate information appearing on the internet, either directly or through suppliers.

Article by

John Clarke
Manager, Risk Consulting in KPMG Ireland



Are companies doing enough to safeguard against the risks of bribery and corruption?

Bribery and Corruption seem to be unfortunate "buzz words" lately – there are simply too many negative headlines where businesses have fallen short in terms of their policies and procedures to try and prevent Bribery and Corruption in the first place. Unfortunately for them, the headlines don't stop there with many businesses facing unlimited fines, significant reputational damage and even imprisonment for those involved.

The knock on effect is that Audit Committees and Non-Executives need to not only ask the question of management as to whether they are doing enough to safeguard the company and its shareholders against these risks, but to prove it at each Audit Committee or Board meeting.

A recent survey[1] of 132 executives found that only 1.5% said that Bribery and Corruption had been stamped out altogether in their business, with over 25% of respondents saying that bribery was now more frequent than ever.

The legislation

For international businesses, it can be hard to determine which laws apply. The UK Bribery Act 2010 is regarded by many as the most stringent Anti-Bribery and Corruption Legislation in the world. It is not restricted to UK businesses – many Irish groups who have UK subsidiaries, sales offices, agents or even suppliers and customers in the UK can be subject to the UK legislation and its strict consequences for non-compliance.

In Ireland, the legislation is not quite as clear. While the UK has one definitive and direct piece of legislation, the rules around Anti-Bribery and Corruption in Ireland are fragmented in various case law and statutes, including the Prevention of Corruption Acts 1889 to 2010 and the Proceeds of Crime (Amended) Act 2005. Given the complex nature of the Irish Law, we may shortly see the Irish authorities implement Anti-Bribery and Corruption laws in the near future that mirror that of our neighbours in the UK.

Where companies have US based businesses, they will also have to comply with the Foreign Corrupt Practices Act (FCPA).

The examples

From a relatively simple internet search, you might be surprised to see the types of businesses who have suffered in relation to Bribery and Corruption. It would not be unreasonable to assume that, prior to these events, the business in question probably thought that they had the risks adequately covered.

Retail

A well-known retailer recently was the victim of a bribery scam that resulted in them overpaying for goods to the tune of over £9m, and in return their senior buyer was enjoying the contents of brown envelopes filled with cash and lavish "trips" disguised as corporate hospitality from one of their suppliers. Appropriately, those individuals' accommodation circumstances now are less lavish and consist of an 8' by 10' jail cell for their roles in accepting and requesting the bribes (Active and Passive Bribery).

Insurance

Despite visits and warnings from the Regulator, a London insurance broker was recently fined £315,000 (reduced from £450,000 for early settlement) by the UK Financial Conduct Authority for systematic weaknesses in preventing Bribery and Corruption in their business. The Regulator noted that the broker had failed to ensure that they had proper systems and controls in place to counter the risks of Bribery and Corruption in their business activities.

Energy

A Scottish based oil and gas company agreed to hand over £5.6m in cash after it admitted benefitting from corrupt payments. The company investigated itself and then reported the findings to the prosecutors. The penalty payment represented the profit the company earned as a result of the corrupt activities, which included corrupt payments to an overseas oil and gas company.

Technology

Internationally, a leading technology company has been fined over $100m for bribing officials to win lucrative technology contracts. The case included paying more than $2m through multiple shell companies, laundered through offshore bank accounts into a fund for officials in order to win the first phase of a $100m+ contract. Some of the payments were cash, but some were also disguised as gifts and entertainment.

Where to start?

Given the significant potential consequences of non-compliance, now is an opportune time to take a fresh approach and review what management have in place to protect the shareholders of the businesses you are involved with in your capacity as audit committee member or non-executive director.

Given that it is widely regarded that the UK Bribery Act is the most stringent Anti-Bribery and Corruption legislation in the world, regardless of the jurisdictions where your businesses are based, it's worth considering this level of compliance as a minimum standard. Under the UK legislation, the consequences for non-compliance include:

- Unlimited cash fines
- Significant reputational damage (including negative press headlines)
- Imprisonment for up to 10 years for those involved.

You also need to be aware that under the UK legislation (which will apply to many Irish businesses), it is also an offence where a commercial organisation fails to prevent persons associated with them from committing bribery on their behalf.

1. The "Grocer" Trade Magazine, UK, July 2012

Can you have any defence?
Actually, yes. The Secretary of State for Justice in the UK issued a guidance document in conjunction with the issue of the UK Bribery Act 2010. In that publication he noted that it was not the intention of the legislation to prohibit reasonable and proportionate hospitality and promotional expenditure. Importantly, the guidance notes that it is a full defence for an organisation to prove that, despite a particular case of bribery, it nevertheless had adequate policies and procedures in place to prevent persons associated with it from bribing. The question of what constitutes "adequate policies and procedures" can only be resolved by the courts taking into account the particular circumstances of each case.

I'm a non-executive or audit committee member – what should I do right now?
It's important that you feel comfortable that management have put adequate policies and procedures in place to prevent Bribery and Corruption in the first place. The table will assist you:

What specific questions should I consider asking of management?
Below are potential questions you could ask of management in your next meeting – their responses should assist you in determining whether or not you feel the measures implemented are sufficient for the organisation, or whether further work in this area is required to ensure that the organisation, and its shareholders are adequately protected.

Step	Action
Proportionate procedures	A commercial organisation's procedures to prevent Bribery by persons associated with it should be proportionate to the Bribery risks it faces and to the nature, scale and complexity of business activities. They should be clear, practical, accessible, effectively implemented and enforced
Top level commitment	In your role, together with the Board, you should collectively be committed to preventing Bribery by persons associated with your organisation. You should foster a culture within the organisation that Bribery is never acceptable
Risk assessment	Together with the Board and management, you should assess the nature and extent of exposure to potential internal and external risk of bribery. This assessment should be periodic, informed and documented
Due diligence	Apply due diligence procedures, taking a proportionate and risk based approach, in respect of employees, customers, suppliers and any other persons who perform, or will perform services on behalf of the organisation
Communication and training	Seek to ensure that bribery prevention policies and procedures are embedded and understood throughout the entire organisation, including evidence that training is understood by employees
Monitoring and review	Critically, the last step is to ensure that information is monitored and reviewed, so that it can be managed and controlled. Also, to ensure that policies and procedures designed to prevent bribery and periodically reviewed for appropriateness, and improvements made where necessary.

Is an appropriate Anti-Bribery and Corruption policy in place – is it current and relevant?

- How do we know that our employees have read and understood our policy document?
- Have our employees provided periodic confirmation that they do indeed understand their responsibilities and consequences for non-compliance?

How to we train our staff in relation to Anti-Bribery and Corruption?

- Do we utilise online e-learning where training completion can be monitored and tracked efficiently and effectively?
- Does the training contain a form of assessment to confirm the employee understands the content of the training
- Is the training up to date, relevant and delivered at appropriate intervals (monthly, annually, etc)?

How do we monitor gifts, entertainment and hospitality?

- If a manual process is in place, is it effective?
- Can we adopt an accessible online methodology for our employees to easily record gifts, entertainment and hospitality either given or received in the normal course of business (lunches, dinners, flights, match tickets, etc)
- Do we have the capability to report and monitor the level of gifts, entertainment and hospitality to management and potentially at each Audit Committee / Board meeting?

Are we doing enough to enforce our Zero-Tolerance policy on Bribery and Corruption throughout the year?

- Are our employees made aware at just one particular time or periodically?
- Do our employees confirm to us periodically that they are aware of their responsibilities and the consequences for non-compliance with our policies?
- Do our employees actually confirm to us that they have not been involved in, or know of any, bribery and corruption within our business?

Article by

Rónán Harper
Chief Executive Officer, Fincom Solutions™

Joint ventures – the challenge

More and more businesses are entering into strategic alliances and joint ventures. Some now deliver over a quarter of their revenues from such arrangements. This proportion and trend is set to continue, as companies seek access to higher growth markets, and many host governments insist on local partnerships and/or limited foreign investment.

Are joint ventures different and difficult?

The risks associated with joint ventures are often underestimated or overlooked. They include:

- Lack of transparency – 'normal' reports and procedures may be inadequate or inappropriate.
- Late detection of issues – unforeseen cost overruns are a common symptom.
- Late or ineffective management intervention – often caused by a fear of offending the joint venture partner.
- Lack of direct control – titles count for nothing; knowing who and how to influence is critical.

Not to mention the misnamed 'softer' challenges of unfamiliar culture and values. Nuances of meaning, levels of authority, ethical and business standards can all vary enormously, even without differences of language.

Political and regulatory challenges

The business press regularly reports examples of host governments and foreign partners flexing their muscle with western joint venture partners – be that seizing corporate assets, rescinding previously granted licences or targeted regulatory investigations.

The Board response

Boards in sectors as diverse as oil & gas, food and drink, life sciences and telecoms are beginning to question their own management's capability to negotiate and run joint ventures effectively in today's market. This concern is especially acute where companies have a minority shareholding and/or their partner is a state-owned enterprise.

Where such companies have a large portfolio of joint ventures, these questions include:

- Have our internal controls and risk processes kept pace with external changes, for example in technology, regulation or market conditions?
- What sort of due diligence did we do when we signed the agreements? Would we sign the same deals now?

Where companies have no or very little joint venture experience, questions might include:

- How much experience does our M&A team have of negotiating joint venture agreements?
- What alternative structures are possible and have we fully weighed the options?

Mounting pressure

Concerns about joint venture risk tend to be labelled within companies as 'too difficult' or to fall between management stools as 'not part of my remit'. This can lead to delay or inaction, damaging companies' financial returns and sometimes even their reputation.

So, ironically, less robust standards of professionalism and rigour are commonly applied to joint ventures and alliances, just where the opposite is demanded by the intrinsic reduction in control and transparency involved in such arrangements.

The challenge for audit committees

How confident are audit committee members that:

- Management's business model analysis clearly and appropriately identifies the nature and scale of their joint venture business?
- The process to identify the organisations significant risks adequately encompasses complex challenges of joint venture arrangements?
- Management are not underestimating the level of risk - and consequently overestimating the real value of their joint venture related assets and investments?

Audit committees can and should play a leading role in overcoming the tendency to treat joint ventures as 'too difficult' to get to grips with, and should robustly encourage management to 'up its game' in joint venture governance, control and reporting.

They could do worse than start by requesting a summary of their company's current joint venture arrangements, focusing on controls in one or two specific areas of concern (e.g., intellectual property protection, HSSE enforcement, or Anti-Bribery & Corruption compliance). They may be surprised by how long this takes to compile and what it reveals.

Article by

Marc van Grondelle
Head of Global Joint Ventures
KPMG in the UK

The global nature of commerce and increasing regulatory scrutiny means who you are doing business with in familiar, as well as unfamiliar markets, really matters.

Integrity risks and third-party business relationships

Failure to adequately evaluate clients, vendors, agents and business partners, and to know how they operate, can result in avoidable reputational damage, operational risk and government investigations.

In September 2013, KPMG International published the results of its analysis of around 8,000 integrity due diligence reports, that its corporate intelligence teams have produced about third parties on behalf of clients across the globe. The intention was to understand the 'big picture' in terms of the scale and type of risks which are being encountered by organisations every day.

Most surprising, was the prevalence of risk which organisations are exposed to – and not just organisations operating in high-risk sectors in high risk parts of the world. Nearly nine out of ten integrity due diligence reports identified some kind of risk that warranted review and 23%, had an overall risk rating of red. A 'red' rating means that the third party which an organisation was considering working with was associated with significant risks such as allegations or incidences of corruption, fraud, money laundering or other unethical or illegal practices.

66% of reports were rated "amber" overall, meaning risk issues were identified, but these were not necessarily serious. These risks refer to the likes of opaque ownership structures, association of the subjects with politically exposed persons or significant involvement of the subject in civil litigation. Only 12% of reports received a "green" rating and the all-clear from an integrity risk perspective.

This fact alone should act as a call to action for audit committee members – it's not just other organisations in other parts of the world which are exposed to risks as a result of their third-party business relationships.

Fighting fraud

The analysis showed that the most prevalent risk to be uncovered from due diligence reports is fraud associated with third parties – regardless of sector or geographical location. Again, this was a surprising result, even to those regularly conducting integrity due diligence work for clients.

This fraud risk exceeds all other risks, including regulatory violations, bribery and corruption, money laundering, business disputes, sanctions and politically exposed person associations. The analysis therefore demonstrates that due diligence on third parties can be a useful tool to proactively manage fraud risk. This is a further policy consideration for audit committee members, who need to ensure that the systems for mitigating this type of risk are fit for purpose. Internal audit have a role to play here in providing the audit committee with assurance.

People pose the highest risks

The analysis also considered the underlying factors behind 'red flagged' reports. The most significant factors concerned 'negative' information identified in respect of the directors and/or owners of the third party. This shouldn't be unexpected; after all, bribes and other misdemeanours are perpetrated by individuals, not legal entities.

The findings clearly demonstrate that third-party due diligence that is focused solely on the subject organisation (as is common) and not towards its principals, shareholders and ultimate beneficial owners, can miss some significant risks: it is the people behind the organisation that really matter and this is often the single largest risk factor – not helped by the challenge of accurately identifying shareholders and ultimate beneficial owners in some jurisdictions.

Analysis also indicates that country risk remains an important factor in determining the overall risk assessment of a third party. Central and Eastern Europe (incorporating Russia), Central Asia and the Middle East and North Africa stand out as the three regions posing the highest third party risks. More than half of the reports in each of these regions were rated as red.

Better protected

If an organisation's third-party due diligence policy is based on sanctions and press searches alone, our analysis shows that a significant proportion of potential integrity risks are likely to be missed. Technology and automation play an increasingly important role in the third-party due diligence process, but ultimately a degree of manual and iterative research is required in many jurisdictions to accurately capture risks.

Organisations need to consider going beyond a standard, sanctions and press searches screening solution when considering which parties to form a business relationship with. Too many potential risks are likely to be missed, and with the continuing trend for regulators and consumers to hold companies accountable for the actions of their third parties, organisations cannot afford not to do their due diligence.

Article by

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KPMG in the UK

Local regulatory update

As we head towards the summer break, the Companies Bill is to be considered by the Seanad and the EU Audit Regulations awaits approval by the Council of Minister and publication in the Official Journal. The Financial Reporting Council has been active in pursuing its agenda of advancing corporate governance and enhancing the work performed by auditors. The Central Bank of Ireland has also been busy during the period and there have been developments in the Pensions and Charity area.

Companies Bill

The Report Stage of the Companies Bill was completed on 2 April 2014 when all the amendments tabled by the Department of Jobs, Enterprise and Innovation were agreed to. The Final Stage was then taken, when the Bill, as agreed to be amended in the Report Stage, was passed by the Dáil. The majority of the changes agreed during the Report Stage were of a technical nature, or were being inserted for the purpose of clarification. The next step will be for the Bill to be sent to the Seanad for approval. The Seanad will have 90 days to consider the Bill. Amendments proposed by the Seanad will need to be approved by the Dáil.

EU Audit Reform

After nearly three years of discussion, the final Directive and Regulation have been decided on and will formally become EU legislation after their publication in the Official Journal of the EU, expected during the summer of 2014. There is a two year transition period which means that the legislation will become applicable in the 28 Member States of the European Union in 2016.

These measures will bring in Mandatory Firm Rotation (MFR) for public interest entities (which includes all companies listed on a regulated market in the EU) as well as many more restrictions on non-audit work and enhanced audit report requirements.

MFR will be required after a maximum duration of 10 years, though Member States may opt for a shorter maximum duration. Member States will have an option to allow public interest entities (PIE) to extend the maximum duration by

- a further 10 years where a public tendering process is conducted for the statutory audit subject to a maximum of 20 years
- a further 14 years where there is a joint audit arrangement to a maximum of 24 years.

The Regulation contains a list of non-audit services which the statutory auditor of a PIE and all members of the statutory auditor's network are prohibited from providing to the PIE itself or to that PIE's EU controlled undertakings or its EU parent undertaking. The prohibitions include, inter alia, tax compliance, tax advice, corporate finance and valuation services. However, Member States may avail of an option to allow certain tax and valuation services in certain limited circumstances.

http://www.auditcommitteeinstitute.ie/documents/eu-audit-reform-imminent.pdf

FRC (Financial Reporting Council) developments

Consultation on the UK Corporate Governance Code published

The FRC published a consultation paper, consulting on its two-yearly review of changes to the UK Corporate Governance Code which builds on previous consultation relating to, inter alia, risk management, internal controls and going concern.

The proposed changes to the UK Corporate Governance Code are that:

- greater emphasis be placed on ensuring that remuneration policies are designed with the long-term success of the company in mind, and that the lead responsibility for doing so rests with the remuneration committee
- companies should put in place arrangements that will enable them to recover or withhold variable pay when appropriate to do so, and should consider appropriate vesting and holding periods for deferred remuneration
- companies should explain when publishing AGM results how they intend to engage with shareholders when a significant percentage of them have voted against any resolution
- companies should state in their financial statements whether they consider it appropriate to adopt the going concern basis of accounting and identify any material uncertainties to their ability to continue to do so
- companies should robustly assess their principal risks and explain how they are being managed and mitigated
- companies should state whether they believe they will be able to continue in operation and meet their liabilities taking account of their current position and principal risks, and specify the period covered by this statement and why they consider it appropriate. It is expected that the period assessed will be significantly longer than 12 months
- companies should monitor their risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report.

Consultation on operating procedures for reviewing corporate reporting

The FRC published a consultation paper proposing changes to the Conduct Committee's Operating Procedures for the review of company reports and accounts. It is proposed that when a Conduct Committee enquiry gives rise to a significant correction or improvement in a company's report and accounts a formal procedure is introduced to give the Conduct Committee the opportunity to comment on whether the company's explanation of the correction or improvement is fair and balanced. The consultation period closed 16 June 2014. Read the consultation paper here: **https://frc.org.uk/Our-work/Publications/Corporate-Reporting-Review/Consultation-Paper-Revised-operating-procedures-fo-File.pdf**

Fraud Risks and Laws and Regulations

The FRC published its report Audit Quality Thematic Review into auditors' identification of and response to fraud risk, and their consideration of compliance with laws and regulations by audited entities.

The report provides insights into how auditors identify fraud risk factors when assessing the risks of financial statements being materially misstated due to fraud. The report highlights a number of areas in which auditors could improve their audit procedures, and provides an overview of best practices identified. The report also identifies areas in which the Audit Committee's oversights of the audit process relating to fraud risks and laws and regulations may be enhanced.

Read the report here:
https://www.frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Thematic-Review-Fraud-Risks-and-Laws.pdf

Financial services

The Corporate Governance Code for Credit Institutions and Insurance Undertakings 2013

In our last issue we discussed "The Corporate Governance Code for Credit Institutions and Insurance Undertakings 2013" ("the Code") which sets out the corporate governance obligations which apply to credit institutions and insurance undertakings ("institutions"), excluding captive insurance and captive reinsurance undertakings, with effect from 1 January 2015. Institutions will continue to be subject to the existing Code requirements (as issued in 2010) until 1 January 2015.

In March 2014, the Central Bank issued a Frequently Asked Questions ("FAQ") document which will take effect from 1 January 2015, and is to be read in conjunction with the Code. The existing FAQ document (issued in 2010) will continue to apply in the interim period.

The Capital Requirements Directive IV (CRD IV) and Capital Requirements Regulation (CRR)

On 31 March 2014, the Minister for Finance, Mr. Michael Noonan T.D., signed into Irish law two regulations to give effect to CRD IV. The European Union (Capital Requirements) Regulations 2014 give effect to the Capital Requirements Directive (Directive 2013/36/EU) and the European Union (Capital Requirements) (No. 2) Regulations 2014, give effect to a number of technical requirements in order that the CRR can operate effectively in Irish law. The Capital Requirements Directive IV (CRD IV) and Capital Requirements Regulation (CRR) represent the European Union's (EU) implementation of Basel III.

The Implementation Notice on Competent Authority Discretions and Options in CRD IV and CRR on foot of these Regulations was published in May. This updated Implementation Notice sets out the Central Bank of Ireland's approach in relation to provisions contained within CRD IV and CRR, as transposed into Irish law, where the competent authority (i.e. the supervisory authority) can or must exercise its discretion. The Implementation Notice will encompass competent authority discretions and options that may apply either specifically or generally to credit institutions and investment firms.

This Implementation Notice will not include discretions and options retained by the Member State (i.e. the Minister for Finance) in CRD IV and CRR, except where it has been confirmed that these discretions are to be allocated to the Central Bank.

Reserving Requirements for Non-Life Insurers and Non-Life and Life Reinsurers

On 7 May 2014, the Central Bank of Ireland published Reserving Requirements for Non-Life Insurers and Non-Life and Life Reinsurers ("the Requirements"). The purpose of the Requirements is to strengthen the reserving framework for non-life insurers and non-life and life reinsurers. The Requirements set out a series of requirements in areas such as the role of Signing Actuary, internal and external audits, reserving policy and issues which should be considered by the Board when setting the margin for uncertainty. The Requirements are being introduced on a statutory basis as a condition of authorisation and are effective for the financial years ending on or after 31 December 2014.

The Central Bank also published the Guidance on Best Estimate and Margin for Uncertainty and the Feedback Statement containing the feedback received from industry following the publication of Consultation Paper CP 73 in September 2013. The Feedback Statement includes the Central Bank's response on the matters raised within the industry feedback.

Central Bank – Review of the Credit Union Sector

On 2 May 2014, the Central Bank of Ireland published a paper on the findings of its assessment of governance and risk management standards and practices across the Credit Union sector. During the course of its Probability Risk and Impact SysteM ("PRISM") risk assessment engagements, the Central Bank identified areas of best practice which set standards for the sector, alongside a number of specific areas for development.

In the course of the review the Central Bank found a number of credit unions had sound standards and good practices, were prudently managing risks, and had embedded sound risk management and

compliance practices. These credit unions could become models for the wider sector to follow.

The review did find a number of issues in credit unions which require improvement. Since commencing risk-based supervision of credit unions in May 2012, the Central Bank has completed on-site risk assessment engagements with almost 200 credit unions representing approximately three quarters of the sectors total assets and savings. These credit unions have been issued with risk mitigation programmes requiring them to address the issues.

Governance, credit, operational and strategy/business model risk accounted for eight out of ten of the material risks issues needing remediation with weaknesses in governance and credit highlighted as areas requiring improvement.

Pensions Board Update

The Social Welfare and Pensions (No. 2) Act

The Social Welfare and Pensions (No. 2) Act 2013 ("2013 Act") came into force on 25 December 2013. It introduced two new wind-up priority orders and expands the type of benefit reductions which the Board may direct under section 50 of the Pensions Act 1990.

For all schemes which start to wind up on or after 25 December 2013, one of two priority orders will apply:

The single insolvency order will apply if the scheme's employer is solvent at the date of wind up. The double insolvency order will apply if the scheme's employer is insolvent at the date of wind up. In a multi-employer scheme, all participating employers must be insolvent for the double insolvency order to apply.

Details of the Single and Double Insolvency Orders are set out in the act. **http://www.welfare.ie/en/downloads/swpact_no2_13.pdf**

Charities Regulatory Authority

On 30 April 2014, the Minister for Justice and Equality, Alan Shatter TD, announced the appointments to the Board of the Charities Regulatory Authority that will be established later this year under the terms of the 2009 Charities Act.

The Charities Regulatory Authority will be an independent regulator for our charities. It will have powers under the Charities Act to introduce robust yet proportionate measures to improve the accountability and transparency of our charity sector.

Active Central Bank consultations

Date of issue	Title	Closing date	CP Number	Status
19 Mar 2014	**Handling of Protected Disclosures by the Central Bank of Ireland** Consultation into handling of protected disclosures by the Central Bank of Ireland	19/06/2014	CP79	Active
7 Mar 2014	**Carrying out depositary duties in accordance with Article 36 of AIFMD** Consultation on carrying out depositary duties in accordance with Article 36 of the AIFMD	30/05/2014	CP78	Active

This section provides an overview of the key developments in IFRS and UK/ Irish GAAP since our last edition.

Financial reporting update

The period since the last edition of ACQ has seen numerous developments in UK and Irish GAAP. The Financial Reporting Council (FRC) issued new accounting and reporting requirements for entities with insurance contracts as set out in FRS 103 ***Insurance Contracts***. The FRC released a number of editorial amendments to FRS 102 ***The Financial Reporting Standard applicable in the UK and Republic of Ireland*** and also issued staff education notes for the convenience of users of FRS 102 which aim to illustrate certain requirements of the standard to aid entities with the transition to new GAAP. Meanwhile the IASB issued a number of standards or amendments during the period which generally will be applicable from 1 January 2014.

The future of UK and Irish GAAP

In March 2013, the FRC issued new accounting and reporting requirements for entities with insurance contracts which is set out in FRS 103 ***Insurance Contracts***. The new requirements apply to companies that apply FRS 102 as the basis for their accounting and therefore FRS 103 adds to new UK and Irish GAAP. For more detailed information, please access the FRC website: **https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2014/March/FRC-issues-new-accounting-standard-for-insurance-c.aspx**.

Following the publication **FRS 102: The Financial Reporting Standard applicable in the UK and Republic of Ireland** by the FRC, during the quarter it has issued editorial amendments to that standard (shown top right).

The FRC has published the editorial amendments in respect of the matters in a compendium which can be accessed on the FRC website: **https://www.frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/The-future-of-UK-GAAP.aspx** and by viewing the FRS 102 –editorial amendments and clarification statements section.

The FRC has also published 15 staff education notes relating to FRS 102 to assist entities with the transition to new GAAP. These education notes can be accessed on the FRC website: **https://frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/The-future-of-UK-GAAP/Staff-Education-Notes.aspx**.

Ongoing Projects

The FRC has a number of ongoing projects in respect of new UK and Irish GAAP which are set out in the second table to the right.

Further detail on the ongoing projects being undertaken by the FRC can be accessed at the following address: **https://www.frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/The-future-of-UK-GAAP/On-going-Projects.aspx**.

Date of issue	Section of FRS 102	Issue
19 Mar 2014	Section 11 ***Basic Financial Instruments***	Editorial amendment regarding presentation requirements for financial instruments when an entity chooses to apply the recognition and measurement provisions of IAS 39 or IFRS 9 and/or IAS 39.
19 Mar 2014	Section 12 *Other Financial Instruments Issues*	Editorial amendment regarding presentation requirements for financial instruments when an entity chooses to apply the recognition and measurement provisions of IAS 39 or IFRS 9 and/or IAS 39.
19 Mar 2014	Section 35 ***Transition to this FRS***	Editorial amendment regarding transitional exemptions in relation to accounting for service concession arrangements.

Project	Status
FRED 54: Basic financial instruments classification	This FRED was issued on 13 February 2014 which proposes to allow a wider range of debt instruments to be measured at amortised cost. The comment period closes on 30 April 2014.
Future of the FRSSE (review of FRSSE in light of new EU Accounting Directive)	The FRC has commenced a review project of the FRSSE in light of the new EU Accounting Directive, which significantly revises the small companies' regime, and to consider how the FRSSE aligns with new GAAP. The FRC has now invited comments from users of the FRSSE with an exposure draft expected to be issued in June 2014.
XBRL Project – Accounting Taxonomies	The FRC is aiming to release draft versions of the new XBRL taxonomies for new GAAP & EU adopted IFRS during May 2014 for public consultation. Target release of final versions is September 2014 for implementation from 1 January 2015.

Standard or Interpretation	Issued date	Effective date
IFRS 14 Regulatory Deferral Accounts	January 2014	1 January 2016*

*Please note this standard has not yet been endorsed by the EU for use by IFRS as adopted by the EU.

IASB activity

New IFRS standards and interpretations

The above new IFRS standard was published by the IASB since our last update.

KPMG publications summarising this standard are available by clicking the links that follow:

- IFRS 14 Regulatory Deferral Accounts (KPMG In the Headlines publication) **https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/In-the-Headlines/Pages/ITH-2014-01.aspx**
- IFRS 14 Regulatory Deferral Accounts (KPMG First Impressions publication) **http://www.kpmginstitutes.com/aci/index.aspx**

IFRS - Narrow scope amendment or Interpretation	2014 Q2
IFRS 9 *Financial Instruments:*	
Classification and Measurement (Limited Amendments)	
Impairment	✓
Revenue Recognition	✓
Acquisition of an Interest in a Joint Operation (Proposed amendments to IFRS 11)	✓
Bearer plants (Proposed amendments to IAS 41)	✓
Clarification of Acceptable Methods of Depreciation and Amortisation (Proposed amendments to IAS 16 and IAS 38)	✓
Equity Methods: Share of Other Net Asset Changes (Proposed amendments to IAS 28)	✓
Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Proposed amendments to IFRS 10 and IAS 28)	✓

IASB exposure drafts and discussion papers

The exposure draft (table below) was published by the IASB during the period since the last edition of Quarterly.

- Exposure Draft: IAS 1 Presentation of financial statements. The Exposure Draft proposes to make a number of narrow focus amendments to IAS 1 that will clarify some of its presentation and disclosure requirements to ensure entities are able to use judgement when applying the standard.

A KPMG publication summarising the above proposal is available by clicking the link below:

- Exposure Draft: IAS 1 Presentation of financial statements; **https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/In-the-Headlines/Documents/ITH-2014-05.pdf**

The following request for information paper was published by the IASB during the period since the last edition of ACQ.

- *Request for information*: *Post implementation review IFRS 3 Business Combinations*. This request for information paper is designed to obtain views and comments from the public in relation to the effect of the application of IFRS 3 on financial reporting since its implementation. The closing date for comments to IASB is 30 May 2014.

Further information on these projects is available on the IASB website at: **http://www.ifrs.org/Pages/default.aspx**

- Exposure Draft: IAS 1 Presentation of financial statements. The Exposure Draft proposes to make a number of narrow focus amendments to IAS 1 that will clarify some of its presentation and disclosure requirements to ensure entities are able to use judgement when applying the standard.

Exposure draft	2014 Q2	2014 Q3
Elimination of gains or losses arising from transactions between an entity and its associate or joint venture (Proposed amendments to IAS 28)	✓	
Fair Value Measurement: Unit of Account (Proposed amendments to IFRS 13)	✓	
Investment Entities: Clarifications to the accounting for interests in investment entities and applying the consolidation exemption (Proposed amendments to IFRS 10 and IAS 28)	✓	
Recognition of Deferred Tax Assets for Unrealised Losses (Proposed amendments to IAS 12)	✓	
Classification of liabilities (Proposed amendment to IAS 1)		✓
Annual improvements cycle 2013 – 2015 (IFRS 1: Short term exemptions from IFRSs).		✓

A KPMG publication summarising the above proposal is available by clicking the link below:

- Exposure Draft: IAS 1 Presentation of financial statements **https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/In-the-Headlines/Documents/ITH-2014-05.pdf**

In addition as a reminder, for those companies which have adopted EU IFRSs with a 31 March 2014 year end, the following will also apply for the first time in their annual financial statements:

- Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)
- Government Loans (Amendments to IFRS 1)
- Disclosures: Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)
- IFRS 13: Fair Value Measurement
- IAS 19: Employee Benefits (2011)
- IFRIC 20: Stripping Costs in the Production Phase of a Surface Mine

In addition as a reminder, for those companies which have adopted EU IFRSs with a 31 March 2014 year end, the following will also apply for the first time in their annual financial statements:

- Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)
- Government Loans (Amendments to IFRS 1)
- Disclosures: Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)
- IFRS 13: Fair Value Measurement
- IAS 19: Employee Benefits (2011)
- IFRIC 20: Stripping Costs in the Production Phase of a Surface Mine

A KPMG publication providing an overview of newly-effective IASB IFRSs is available at: **https://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/In-the-Headlines/Pages/ITH-2014-04.aspx**

Newly-effective IFRSs for 2014

Preparers and users will have a busy year ahead as the significant task of implementing the first wave of new standards that will become effective in the period 2014-2015 begins.

The IFRS standards as adopted by the European Union that are effective for the first time for annual periodsbeginning 1 January 2014 are:

- IFRS 10: Consolidated financial statements
- IFRS 11: Joint Arrangements
- IFRS 12: Disclosures of interests in other entities
- IAS 27: Separate financial statements (2011)
- IAS 28: Investments in Associates and Joint Ventures (2011)
- Amendments to IAS 32: Offsetting financial assets and financial liabilities
- Amendments to IFRS 10, IFRS 12 and IAS 27: Investment entities
- Amendments to IAS 36: Recoverable amount disclosures for non-financial assets
- Amendments to IAS 39: Novation of derivatives and continuation of hedge accounting.

Events and other news

Throughout the year the Audit Committee Institute hosts a number of informative seminars and training sessions.

Audit Committee Handbook

We recently launched an updated version of the Audit Committee Handbook.
This publication, written for both the Irish public and private sectors, highlights the Audit Committee's role and provides guidance to help Audit Committees gain a better understanding of the processes and practices that help create effective Audit Committees.
The guide is designed to be an easy reference guide to a range of topics from the Irish regulatory landscape to the duties of audit committees and communications with shareholders. The guide is available for download at http://www.auditcommitteeinstitute.ie/audit-committee-handbook.htm. Word versions of the various questionnaires, and other appendices, which can be customised to the companies specific circumstances are also included.

Let us know what you think

We are always grateful for feedback regarding topics for breakfast seminars, roundtables and Quarterly.

Let us know what you would like covered by phoning us at +353 (1) 410 1160 or e-mailing us at aci@kpmg.ie.

Events

For details of future events go to www.kpmg.ie/aci.

Training certificate

If you wish to receive a training certificate in relation to attendance at the ACI events, please e-mail us at aci@kpmg.ie or phone us at +353 (1) 410 1160.

ACI International

The Audit Committee Institute, sponsored by KPMG, is an international initiative with thousands of members sharing resources across borders. A list of affiliated sites is available at http://www.auditcommitteeinstitute.ie/aci-international-sites.htm.

Many members of ACI in Ireland are board members of international companies, or often spent a significant amount of time in other jurisdictions. Please feel free to follow the links of our affiliated members in order to register for publications from or events in their countries.

For ease of reference, registration for ACI UK can be completed here http://www.kpmg.co.uk/aci/contactus/index.cfm. Registration for ACI US can be achieved by following the instructions at http://www.kpmginstitutes.com/aci/index.aspx.

Notes

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