"Challenges for audit committees"
Opening of the "Conference of Directors of the Institute of Internal Auditors"

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Good morning. Thank you, Sonsoles. And thanks also to the Institute of Internal Auditors for inviting me to this event. This is the first time I have participated in one of the Institute’s event, but the CNMV has been present on previous occasions and I am pleased to continue this practice.

Today's focus is on the challenges facing audit committees. But I would like to start by acknowledging the good work done by the audit committees in listed companies. This is what I am told by the CNMV teams, who have been closely monitoring the functioning of these committees for years, and this is also reflected in the data, which reflect a progressive improvement in their performance and composition, all of which contributes very positively to the good governance of companies.

Today, good corporate governance is particularly important for companies, given the complexity of the current situation and the need to respond to global challenges such as innovation and environmental sustainability, which are becoming increasingly important.

The economic environment in which we find ourselves illustrates this complexity well. It is an environment characterised by uncertainty, in which the recovery in activity that began after the pandemic is being threatened by rising inflation, supply problems in some commodities, and the effects of the Russian invasion of Ukraine, and it is not easy to foresee how events will unfold.

At the same time, the demands that accompany the role of directors are increasing. They are increasingly required to have more in-depth knowledge, in a diverse range of subjects, and the legal responsibility for their decisions and actions is growing. All in all, it is not a simple task.

That is why I insist on the need for companies to have sound corporate governance, with high ethical and control standards, to avoid reputational problems, to maintain investor confidence and, in short, to help them compete with other European companies as a destination for investment.

Today, in this forum on audit committees, I would like to focus on two novel aspects in which these committees play a very relevant role: firstly, in ensuring the quality and control of reporting and non-financial or sustainability information. Secondly, the new regulation on related-party transactions.

Information on sustainability

I am not going to expand on corporate sustainability reporting, as I have commented on it in several forums, but I would like to point out that it is an area that is gaining prominence in the agenda of the regulator and supervisor. And that this prominence will continue in the future.

In this context, it is essential that companies pay attention and devote increasing resources to this issue. For our part, we are doing so at the CNMV. This year, in fact, we have published, for the first time, the findings of the annual review of non-financial information of listed companies in a separate report[1].

In this report, in addition to summarising the main data, we include concrete recommendations on many aspects, such as the need to provide more detail on the dual materiality perspective, which as you know is one of the pillars of the European approach.

In addition to the recommendations, we also include our supervisory priorities for this year, which complement those already announced by ESMA[2]. And among these priorities, in addition to the review of the information derived from the taxonomy regulation, we are going to carry out a more detailed analysis of the breakdowns relating to the carbon footprint and we are also going to review the coherence between accounting information and non-financial information, among other issues. We are well aware of the current difficulties: we do not yet have common standards and a homogeneous reporting framework.

1 https://www.cnmv.es/DocPortal/Publicaciones/Informes/EINF_2020.pdf

2 ESMA published, in October 2021, common supervisory priorities for non-financial reporting, which relate to impacts arising from COVID-19, climate-related issues and disclosures relating to Article 8 of the European Taxonomy Regulation.

But the regulatory agenda is moving at a fast pace, both at European and international level, and the best strategy is to anticipate these demands, to follow the regulatory debate closely and to be prepared for the new requirements, which are bound to come.

Transparency on related parties

Continuing with transparency, the second aspect I would like to comment on refers to the new transparency regime on related-party transactions, i.e., on the transactions that listed companies carry out with their controlling shareholders, their directors or persons directly related to them. The aim of the regulation is none other than to increase the disclosure of these transactions and to make it easier for them to be under direct scrutiny by investors.

The current legal regime is quite new in Spain. We are not starting from scratch, as some obligations already existed, but a comprehensive and systematic approval regime was missing, nor was there an obligation to immediately publish information on related-party transactions above a certain threshold. We now have such a framework and it is harmonised throughout the European Union.

And how is it working? It is still too early to make a full assessment, as we do not have sufficient information on monitoring by institutions, but we do note that the quality of information being provided to the market is rather poor, with some exceptions. I describe it as weak mainly for two reasons: (i) on the one hand, because of the delay with which it is being published; (ii) and, more importantly, because insufficient information is provided for shareholders or investors to assess whether the transaction is fair and reasonable from the company's and shareholders' point of view. In many cases, companies simply report that the audit committee has verified it, but do not provide sufficient detail to allow the shareholder or investor to carry out the assessment, which is the spirit of the standard.

There are certainly exceptions that can be applied to limit information, either because of confidentiality concerns or because of possible harm to the entity by disclosing certain information. This is true and, indeed, we have reflected this in the question and answer document we published last November. But these exceptions must be limited and kept to a minimum. That is, we cannot make the exception the rule.

The European legislator wanted to establish a disclosure regime for related-party transactions and it is important that institutions apply the necessary transparency to these transactions.

The Q&A document I mentioned includes criteria, good practices and guidelines on the regime for reporting related-party transactions and is a good guide for the application of the new regulation, which I encourage you to follow.

Final reflections

And I will conclude by going back to the beginning, that is, by referring again to the proper functioning of the audit committees. A key to the success of these committees is precisely the status of their members and their degree of independence. There is no doubt that for an audit committee to adequately perform its supervisory and control duties, its members must not only have the capacity and competencies that are presumed, but it is also key to ensure their independence from the entity itself, its significant shareholders and its senior management. And here the members of the committee themselves are the first to ensure that it does not include directors whose activity could be conditioned by their possible links with the company. The aim is, after all, to avoid significant potential conflicts of interest that could affect the committee's supervisory and control function.

Finally, I cannot leave this forum without mentioning the internal auditors, who are the key to the good performance of audit committees. I am sure that without the invaluable work of the internal audit units, this good performance would not have happened, or at least not with the same intensity. Internal auditors are the eyes and arms of the audit committee, and are essential to ensure the quality of reporting, the assessment of risk exposure and the proper functioning of controls. It is a highly relevant function within organisations, which must have the necessary resources, and ensure its independence by reporting directly to the chairman of the audit committee or to the chairman of the board, if independent.

Thank you again for the invitation and I hope you enjoy the rest of the day.