KPMG

On the 2018 audit committee agenda

Audit Committee Institute

Financial reporting, compliance, and the risk and internal control environment will continue to be put to the test in 2018—by slow growth and economic uncertainty, technology advances and business model disruption, cyber risk, greater regulatory scrutiny and investor demands for transparency, as well as dramatic political swings and policy changes in the U.S., UK, and elsewhere. Focused, yet flexible agendas—exercising judgment about what does and does not belong on the committee's agenda, and when to take deep dives—will be critical. Drawing on insights from our recent survey work and interactions with audit committees and business leaders over the past 12 months, we've highlighted seven items that audit committees should keep in mind as they consider and carry out their 2018 agendas:

Stay focused on job No. 1—financial reporting integrity.

In our 2017 Global Audit Committee Survey, nearly half of the 800 audit committee members who responded said it is "increasingly difficult" to oversee the major risks on the audit committee's agenda in addition to the committee's core oversight responsibilities (financial reporting and related internal controls, and oversight of internal and external auditors). Aside from any *new* agenda items, the risks that many audit committees have had on their plates for some time—cybersecurity and IT risks, supply chain and other operational risks, legal and regulatory compliance—have become more complex, as have the audit committee's core responsibilities. Reassess whether the committee has the time and expertise to oversee these other major risks. Does cyber risk require more attention at the full-board level—or perhaps the focus of a separate board committee? Is there a need for a compliance committee? Keeping the audit committee's agenda focused—and its eye on the ball—will require discipline and vigilance in 2018.

Financial reporting quality starts with the CFO and the finance organization; maintain a sharp focus on leadership and bench strength.

In our global survey, 44 percent of respondents were not satisfied that their agenda is properly focused on CFO succession planning, and another 46 percent were only somewhat satisfied. In addition, few were satisfied with the level of focus on talent and skills in the finance organization. Given the increasing demands on the finance organization and its leadership—financial reporting and controls (including implementation of new accounting standards), risk management, analyzing mergers and acquisitions and other growth initiatives, shareholder engagement, and more—it is essential that the audit committee devote adequate time to the finance organization, including the talent pipeline, training and resources, as well as succession plans for the CFO and other key executives in the finance organization. How is the finance team incented to stay focused on the company's long-term performance? What concerns do the internal and external auditors have about the talent and skills in the finance organization, including the organization's leadership?

Monitor management's progress on implementing FASB's revenue standard and other accounting changes on the horizon, and stay apprised of tax legislative and regulatory developments.

The scope and complexity of the implementation efforts for the new FASB standards and the impact on the business, systems, controls, disclosures, and resource requirements should be a key area of focus for audit committees. The effective date of the new revenue standard—January 1, 2018, for calendar year public companies—is imminent, and implementation efforts by companies are in high gear. Given the magnitude of the implementation effort for many companies (particularly those with large, complex contracts), we recommend two broad areas of focus for audit committees. First, understand how management has determined the transition impact of adopting the new standard, which must be disclosed in the company's 2017 10-K as a Staff Accounting Bulletin (SAB) 74 transition disclosure. What has the external auditor done to evaluate the transition impact? What are the external auditor's recommendations regarding the adequacy of the SAB 74 disclosure? Second, discuss with management and understand the company's readiness to operate and report under the new standard in 2018; key areas of focus include the impact on internal control over financial reporting, the standard's new disclosure requirements, and the impact on disclosure controls and procedures. Obtain the views of the external auditor regarding the company's readiness, as the auditor is in a position to provide insights on the company's reporting processes and internal controls.

Although the new revenue standard is the primary focus for most companies, implementation of the new leases and credit impairment standards follows closely (in 2019 and 2020, respectively). SEC staff will continue to closely monitor transition disclosures for these new accounting standards, and these disclosures should be a key area of focus for audit committees. As SEC staff has emphasized, these disclosures should evolve and become more detailed as companies progress in their implementation efforts.

Finally, given the prospects for significant tax legislative and regulatory changes on the horizon—including U.S. tax reform, EU member country initiatives related to the EU Anti-Tax Avoidance Directive, and any tax developments associated with Brexit—audit committees will want to receive periodic updates from management regarding any tax legislative and regulatory developments and their impact on the company.

Focus internal audit on the company's key risks, beyond financial reporting and compliance.

As recent headlines demonstrate, failure to manage key risks—tone at the top, culture, legal/regulatory compliance, incentive structures, cybersecurity, data privacy, global supply chain and outsourcing risks, and environmental, social, and governance risks, etc.—can potentially damage corporate reputations and impact financial performance. The audit committee should work with the chief audit executive to help identify the risks that pose the greatest threat to the company's reputation, strategy, and operations and to help ensure that internal audit is focused on these key risks and related controls. Is the audit plan risk-based and flexible? Does it adjust to changing business and risk conditions? What has changed in the operating environment? What are the risks posed by the company's digital transformation and by the company's extended organization—sourcing, outsourcing, sales and distribution channels? Is the company sensitive to early warning signs regarding safety, product quality, and compliance? What role should internal audit play in auditing the culture of the company? Set clear expectations and help ensure that internal audit has the resources, skills, and expertise to succeed and help the chief audit executive think through the impact of digital technologies on internal audit.

Reinforce audit quality and transparency.

The need for increased transparency around the audit process—both by the auditor and the audit committee—remains in the spotlight. In October, the SEC approved the PCAOB's standard on the **auditor's reporting model.** While retaining the current pass/fail model, the new standard will require the auditor to communicate in the auditor's report critical audit matters (CAMs) arising from the current period's audit, or state in the report that the auditor determined there were no CAMs. The standard defines CAMs as matters that were communicated or required to be communicated to the audit committee, are related to accounts or disclosures that are material to the financial statements, and involve especially challenging, subjective or complex auditor judgment. In addition, under the new standard, the auditor's report will disclose the tenure of an auditor, state that the auditor is required to be independent, and also include the phrase "whether due to error or fraud" in describing the auditor's responsibility under PCAOB standards to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

For large accelerated filers, the requirement to communicate CAMs will be effective for audits of fiscal years ending on or after June 30, 2019; for all other companies, it will be effective for audits of fiscal years ending on or after December 15, 2020. Other requirements of the new standard are effective for audits of fiscal years ending on or after December 15, 2017. Audit committees and management should take advantage of the time before the reporting requirements for CAMs take effect to discuss the new reporting requirements with their auditors. Early dialogue will be key for effective and timely implementation of this aspect of the new standard.

There continues to be an increased focus on the audit committee's report, particularly on voluntary disclosures regarding the audit committee's oversight of the external auditor. In fact, according to the Center for Audit Quality's *2017 Audit Committee Transparency Barometer,* many audit committees are expanding their voluntary disclosures about how they oversee the external auditor. Consider expanding the audit committee's report to provide investors more insight into how the committee carries out its oversight responsibilities, particularly its role in helping to maintain audit quality.

Monitor the impact of the business and regulatory environment, as well as tone at the top and corporate culture, on the company's compliance programs.

In recent years, a number of highly publicized corporate crises that have damaged company reputations were due, in part, to failures to manage key risks posed by the company's culture, tone at the top, and incentive structures. Fundamental to any effective compliance program is the right tone at the top and culture throughout the organization, including a commitment to the company's stated values, ethics, and legal/regulatory compliance. This is particularly true in a complex business environment, as companies move quickly to innovate and capitalize on opportunities in new markets, leverage new technologies and data, engage with more vendors and third parties across longer and increasingly complex supply chains, and, as a result, face heightened compliance risks.

Closely monitor the tone at the top and culture throughout the organization, and be particularly sensitive to early warning signs. Help ensure that the company's regulatory compliance and monitoring programs are up-to-date, cover all vendors in the global supply chain, and clearly communicate the company's expectations for high ethical standards. Take a fresh look at the effectiveness of the company's whistleblower program. Does the audit committee see all whistleblower complaints? If not, what is the process to filter complaints that are ultimately reported to the audit committee? As a result of the radical transparency enabled by social media, the company's culture and values, commitment to integrity and legal compliance, and brand reputation are on display as never before. Ask for internal audit's thoughts on ways to audit/assess the culture of the organization.

Make the most of the audit committee's time together—*effectiveness requires efficiency.*

As noted previously, keeping the audit committee's agenda focused on financial reporting and related internal control risk is essential to the committee's effectiveness, but meeting the workload challenge requires efficiency as well. Streamline committee meetings by insisting on quality premeeting materials (and expect premeeting materials to have been read), making use of consent agendas, and reaching a level of comfort with management and auditors so that financial reporting and compliance activities can be "process routine" (freeing-up time for more substantive issues facing the business). Does the committee leverage the array of resources and perspectives necessary to support its work? Does the committee spread the workload by allocating oversight duties to each member, rather than relying on the committee chair to shoulder most of the work? Does the committee spend time with management and the auditors outside of the boardroom to get a fuller picture of the issues? Take a hard, honest look at the committee's composition, independence, and leadership. Is there a need for a fresh set of eyes? Is it time for a rotation?

Also see KPMG's *On the 2018 Board Agenda* at www.kpmg.com/blc.

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Part of the Board Leadership Center, KPMG's Audit Committee Institute focuses on oversight of financial reporting and audit quality and other issues of interest to audit committee members, including risk oversight, internal controls, and compliance. Learn more at kpmg.com/aci.

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