Prioritizing a heavy audit committee agenda is never easy, and 2020 will be particularly challenging. The audit committee is operating against a backdrop of global volatility and economic uncertainty—e.g., mounting trade tensions, resurging debt, a looming market correction, geopolitical tensions, technology and business model disruption, cyber risk, regulatory scrutiny, investor demands for transparency, and political gridlock in the U.S., U.K., and elsewhere.

Drawing on insights from our latest survey work and interactions with audit committee members and business leaders, we’ve flagged seven issues that audit committees should keep in mind as they consider and carry out their 2020 agendas:

— Maintain (or regain) control of the committee’s agenda.
— Reinforce audit quality and set clear expectations for the external auditor.
— Closely monitor management’s progress on implementing FASB’s new credit loss standard.
— Redouble your focus on the company’s ethics, compliance, and whistle-blower programs.
— Understand how technology is impacting the finance organization’s talent, efficiency, and value-add.
— Reassess the scope and quality of environmental, social, and governance (ESG)/sustainability reports and disclosures.
— Help ensure internal audit’s eyes and ears are focused on key risks beyond financial reporting.

Maintain (or regain) control of the committee’s agenda.

This number one priority from last year holds true for 2020. Nearly half of the 1,300 audit committee members responding to our 2019 global audit committee survey said it is “increasingly difficult” to oversee the major risks on the audit committee’s agenda in addition to its 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—financial risks; cybersecurity and information technology risks; ESG risks; third-party, supply chain, and other operational risks; legal and regulatory compliance—have become more complex. Reassess whether the committee has the expertise and time to oversee the risks it has been assigned. Do cyber risk and data governance require greater attention from the full board—or perhaps a dedicated committee? Keeping the audit committee’s agenda focused—and its eye on the ball—will require discipline and vigilance in 2020.
Reinforce audit quality and set clear expectations for the external auditor.

Audit quality is enhanced by a fully engaged audit committee that sets the tone and clear expectations for the external auditor and monitors auditor performance rigorously through frequent, quality communications and a robust performance assessment. (See the Center for Audit Quality’s External Auditor Assessment Tool released in April 2019.) Pay close attention to the PCAOB’s quality control initiatives, as the PCAOB staff has announced that it is developing a concept release for the Board’s consideration and may seek amendments to the PCAOB’s quality control standards. Probe the audit firm on its quality control systems that are intended to drive sustainable, improved audit quality—including the firm’s implementation and use of new technologies. A September 2019 speech by PCAOB board member Duane M. DesParte (Improving Audit Quality through a Renewed Focus on Quality Control) highlighted key elements of a firm’s quality control (QC) system to include “areas of firm governance and structure, QC system risk assessment and monitoring, continuous improvement, and transparency.” In discussions with the external auditor regarding the firm’s internal quality control system, consider the results of PCAOB and internal inspections and efforts to address deficiencies. Remember that audit quality is a team effort, requiring the commitment and engagement of everyone involved in the process—the auditor, audit committee, and management.

Closely monitor management’s progress on implementing FASB’s new credit loss standard.

The effective date of the standard—January 1, 2020, for calendar-year public companies—is imminent, and implementation efforts should be nearing conclusion. Both financial services and nonfinancial services companies will be affected, as a variety of financial instruments are within the scope of the new standard. Given the magnitude of the implementation effort for many companies, we recommend two broad areas of focus for audit committees. First, understand how management has determined the transition impact of adoption—which must be disclosed in the company’s 2019 Form 10-K as a Staff Accounting Bulletin (SAB) 74 transition disclosure—and what the external auditor has 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 standard in 2020. Topics for discussion with management include the impact on internal control over financial reporting; new disclosure requirements regarding assumptions, models, and methods for estimating the allowance for credit losses; 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 unique position to provide insights on the company’s reporting processes and internal controls.

In November, the FASB issued an ASU to delay implementation of the credit loss standard for SEC filers eligible to be smaller reporting companies, public companies that are not SEC filers, and private companies, including not-for-profit entities and employee benefit plans. Those benefiting from the delay will be required to adopt the standard in 2023. Eligible companies should take advantage of this time to learn from the implementation issues encountered by larger SEC filers, confirm the preparedness of their technologies and systems (or develop new solutions) to comply with the new accounting and reporting requirements, and solidify their business processes and controls over implementation and subsequent accounting.

Redouble your focus on the company’s ethics, compliance, and whistle-blower programs.

The reputational costs of an ethics or compliance failure are higher than ever. Fundamental to an effective compliance program is the right tone at the top and culture throughout the organization, which supports the company’s strategy, including its commitment to its 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, and engage with more vendors and third parties across longer and increasingly complex supply chains. Coupled with the challenging global regulatory environment—the array of new data privacy, environmental, healthcare, financial services, and consumer protection regulations, as well as FCPA and the UK Bribery Act—compliance risks and vulnerabilities will require vigilance. Closely monitor the tone at the top and culture throughout the organization with a sharp focus on behaviors (not just results) and yellow flags. Does the company’s culture make it safe for people to do the right thing? 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. Focus on the effectiveness of the company’s whistle-blower reporting channels and investigation processes through a #MeToo lens. Does the audit committee see all whistle-blower 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 full display.

**Understand how technology is impacting the finance organization’s talent, efficiency, and value-add.**

Major technology changes impacting finance organizations present important opportunities for finance to reinvent itself and add greater value to the business. As audit committees monitor and help guide finance’s progress in this area, we suggest three areas of focus. First, recognizing that as much as 60 to 80 percent of finance’s work involves data gathering, what are the organization’s plans to leverage robotics and cloud technologies to automate as many manual activities as possible, reduce costs, and improve efficiencies? Second, how will finance use data analytics and artificial intelligence to develop sharper predictive insights and better deployment of capital? The finance function is well-positioned to guide the company’s data and analytics agenda and to consider the implications of new transaction-related technologies, from blockchain to crypto-currencies. As historical analysis becomes fully automated, the organization’s analytics capabilities should evolve to include predictive analytics, an important opportunity to add real value. Third, as the finance function combines strong analytics and strategic capabilities with traditional financial reporting, accounting, and auditing skills, its talent and skill-set requirements must change accordingly. Is finance attracting, developing, and retaining the talent and skills necessary to match its evolving needs? In this environment, it is essential that the audit committee devote adequate time to understand finance’s transformation strategy.

**Reassess the scope and quality of ESG/ sustainability reports and disclosures.**

Nearly all S&P 500 companies provide some form of ESG or sustainability reports today, but there are growing concerns by a range of stakeholders—investors, employees, customers, regulators, and activists—regarding the quality, comparability, reliability, and usefulness of these reports. ESG reporting has been of growing importance to institutional investors for many years, with investors demanding more information and seeking engagement with companies on core ESG issues and their impact on the company. Employee and consumer activism regarding ESG issues is in its early stages—but is growing—particularly among millennials. And, of course, we continue to see a large number of shareholder ESG proposals—particularly on the “E” and the “S” issues.

The Business Roundtable Statement on the Purpose of a Corporation (to benefit all stakeholders—customers, employees, suppliers, communities, and shareholders) will likely increase expectations for companies to articulate in ESG or sustainability reports how they are meeting their commitments to these stakeholders, including metrics. Given the increasing stakeholder demands for more transparent, higher-quality ESG reporting—and concerns about the lack of comparability of ESG data—the audit committee can serve as a catalyst, recommending that the board encourage management to reassess the scope and quality of the company’s ESG reports and disclosures. This may be a significant undertaking and would likely include benchmarking against peers, consideration of the methodologies and standards of various firms that rate companies on ESG practices, understanding the expectations of investors and other stakeholders, and reviewing various ESG reporting frameworks for possible use by the company. To bring the right focus and attention, a board committee, such as the audit or governance committee (depending on bandwidth and expertise), should oversee the effort. Management’s disclosure committee should be part of these discussions to help ensure that the company has the necessary infrastructure—including disclosure controls and procedures—to support its ESG reporting.

**Help ensure internal audit’s eyes and ears are focused on key risks beyond financial reporting.**

In recent years, a number of highly publicized corporate crises have damaged company reputations, due in part to failure to manage key risks such as tone at the top and culture, legal/regulatory compliance, incentive structures, cybersecurity and data privacy, ESG risks, and global supply chain and outsourcing risks. The audit committee should work with the chief audit executive and chief risk officer 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—and does it adjust to changing business and risk conditions? What’s 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? Are we 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.
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The KPMG Board Leadership Center champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programs and perspectives—including KPMG’s Audit Committee Institute, the WomenCorporateDirectors Foundation, and more—the Center engages with directors and business leaders to help articulate their challenges and promote continuous improvement of public- and private-company governance. Drawing on insights from KPMG professionals and governance experts worldwide, the Center delivers practical thought leadership—on risk and strategy, talent and technology, globalization and compliance, financial reporting and audit quality, and more—all through a board lens. Learn more at kpmg.com/us/blc.

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As 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/us/aci.

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