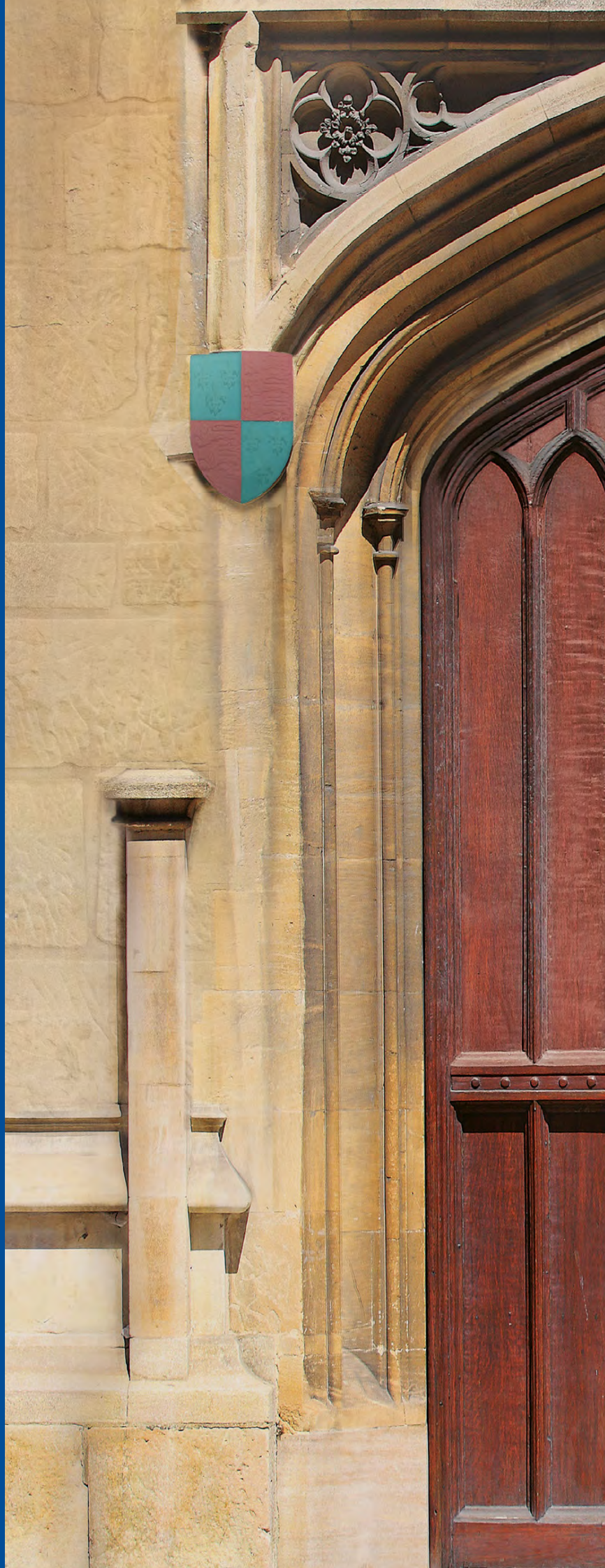
KPMG

Quarterly newsletter 28

Audit Committee Institute
KPMG Board Leadership Center



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About the Audit Committee Institute

The Audit Committee Institute (ACI) champions good corporate governance to help drive long-term corporate value and enhance investor confidence. Focusing on and supporting the director community, ACI engages with directors and business leaders to help articulate their challenges and promote continuous improvement. Supported by KPMG Board Leadership Center, ACI delivers actionable thought leadership—on risk and strategy, technology, compliance, financial reporting and audit quality—all through a board lens.

KPMG Board Leadership Center serves as a governance center, bringing together KPMG's various international board programmes—including the Audit Committee Institute—all under a single umbrella.

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Foreword

The first edition of 2017 of our *Audit Committee Institute Quarterly* kicks off with flagging ACI's priority items for audit committees and boards in carrying out their 2017 agendas and to help them keep their eye on the ball.

This is followed by an introduction to our new *Audit Committee Handbook*. Our *Audit Committee Handbook* is an all-in-one reference on audit committees, articulating the principles underlying the audit committee's role and providing a vast amount of non-prescriptive guidance to help audit committees and boards carry out their oversight responsibilities.

Next we bring the results of our 2017 *Global Audit Committee Survey.* Our survey aimed at polling what the challenges and priorities are for audit committees today and the results clearly showed that, against a backdrop of heavy economic and geopolitical uncertainty and in times of unseen technological change, risk management is the number one concern of audit committees.

We also zoom in on how the two major geopolitical events of the year—the UK Brexit and the U.S. Trump vote—are impacting financial reporting. We flag a set of attention points to make sure your company properly discloses the main effects of these events in the 2016 annual reports.

The sixth article in our newsletter is a piece on directors' liability. This important theme for board

directors is explored in a comprehensive overview of what directors' liability means in the Belgian context.

We finish this edition with a selection of timely financial reporting and other news from the corporate governance arena.

We hope this publication serves its intended purpose of briefing you on the important developments affecting your role.

If you require further information, please contact us at ACI@kpmg.be with any comments or suggestions of topics you would like to see receive attention.

Our ACI website (www.kpmg.com/be/aci) also provides additional information, including previous editions of the *Audit Committee Institute Quarterly,* our *Audit Committee Handbook* and other useful ACI publications, surveys, and other content.

Olivier Macq
Chairman ACI Belgium

Wim Vandecruys
Director ACI Belgium

On the 2017 audit committee agenda

Financial reporting, compliance, and the risk and internal control environment will continue to be put to the test in 2017 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 have highlighted eight items that audit committees should keep in mind as they consider and carry out their 2017 agendas.

Reinforce the audit committee's direct responsibility for the external auditor.
—specifically overseeing the auditor selection process including any (mandatory) tender process and auditor independence. Audit tenders are quickly gaining momentum in many countries around the world—legally required or otherwise. The audit committee should ensure the tender process is carried out in an efficient and effective manner. Read ACI's *Audit Tendering Guide* to ensure the tender process delivers lasting benefits to your company. To ensure the auditor's independence from management and to obtain its critical judgement and insights that add value to the company, the audit committee's direct oversight responsibility for the auditor must be more than just words in the audit committee's terms of reference or items on its agenda. All parties—the audit committee, external auditor and senior management—must acknowledge and continually reinforce this direct reporting relationship between the audit committee and the external auditor in their everyday interactions, activities, communications and expectations.

Give non-GAAP financial measures a prominent place on the audit committee agenda.
Following ESMA's final report on alternative performance measures published in 2015, regulators (and investors) in the U.S., UK and elsewhere have expressed concerns about misleading non-GAAP financial measures and published additional guidance to help companies evaluate the usefulness and acceptability of non-GAAP financial information. SEC Chair Mary Jo

White said: "In too many cases, the non-GAAP information, which is meant to supplement the GAAP information, has become the key message to investors, crowding out and effectively supplanting the GAAP presentation." In this environment, it is critical that non-GAAP financial measures have a prominent place on the audit committee agenda: Have a robust dialogue with management about the process—and controls—by which management develops and selects the non-GAAP financial measures it provides, their correlation to the actual state of the business and results, and whether the non-GAAP financial measures are being used to improve transparency and not to distort results.

Monitor implementation plans and activities for major accounting changes on the horizon—particularly the new revenue recognition and lease international accounting standards.

The scope and complexity of these implementation efforts and the impact on the business, systems, controls, and resource requirements should be a key area of focus for audit committees. The new revenue standard (effective January 1, 2018 for calendar year-end companies) provides a single revenue recognition model across industries, companies, and geographical boundaries. While the impact will vary across industries, many companies—particularly those with large, complex contracts—will experience a significant accounting change when implementing the new standard. The new standard will require companies to apply new judgments and estimates, so audit committees will want to inquire about the judgment and estimates *process* and how judgments and estimates are reached. Under the new lease standard (effective January 1, 2019 for calendar-year-end companies) lessees will recognize most leases, including operating leases, on the balance sheet. This represents a wholesale change to lease accounting, and many companies will face significant implementation challenges during the transition.

Implementation of these two new standards is not just an accounting exercise; audit committees will want to receive periodic updates on the status of implementation activities across the company (including possible trouble spots), the adequacy of resources devoted to the effort, and the plan to communicate with stakeholders.

Monitor key regulatory initiatives to enhance transparency of the audit process.

There continues to be significant discussion internationally about the need for increased transparency by the external auditor around the audit process. Under International Standards on Auditing (ISA 701)—while retaining the current pass/fail model—auditors will soon be required to describe in the audit reports of listed entities the key areas they focused on in the audit and what audit work they performed in those areas. In the U.S., the PCAOB is expected to issue a final standard on the auditor's reporting model, which is likely to require a description of "critical audit matters" in the auditor's report. Auditors may have the primary responsibility for implementing the requirements, but they are relevant to and affect other stakeholders as well, in particular the audit committee. Audit committees should interact comprehensively with the auditor from the audit planning stage through to the finalization of the audit report. In particular, consider whether disclosures in the financial statements or elsewhere in the annual report and/or in other investor communications need refreshing, otherwise the auditor might be disclosing more information about an item than the company. Engaging in early and open communication with the auditor is crucial in this regard.

Redouble the company's focus on ethics, compliance, and culture.

Whether moving quickly to innovate and capitalize on opportunities in new markets, leveraging new technologies and data, and/or engaging with more vendors and third parties across longer and increasingly complex supply chains, most companies face heightened compliance risks. Coupled with the complex global regulatory environment—the array of new healthcare, environmental, financial services, and data privacy regulations—these compliance risks and vulnerabilities will require vigilance. Help ensure that the company's regulatory compliance and monitoring programs are up-to-date and 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 whistle-blower program. 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, its commitment to integrity and legal compliance, and its brand reputation are on display as never before. Ask for internal audit's thoughts on ways to audit/assess the culture of the organization.

Redouble the focus on key areas of risk and the adequacy of the company's risk management processes generally. Leverage internal audit to the fullest extent in this respect.

In our 2017 Global Audit Committee Survey (see infra), more than 40 percent of audit committee members think their risk management program and processes "require substantial work;' and a similar percentage say that it is increasingly difficult to oversee those major risks. Audit Committees need to use all resources at hand in this respect, not in the least internal audit.

Internal audit is most effective when it is focused on the critical risks to the business, including key operational risks (e.g., cyber security and technology risks) and related controls, not just compliance and financial reporting risks. Help define the scope of internal audit's coverage and, if necessary, redefine internal audit's role. Is the audit plan risk-based and flexible, and does it adjust to changing business and risk conditions? What has changed in the operating environment? What are the risks posed by the extended organization—sourcing, outsourcing, sales, and distribution channels? What role should internal audit play in auditing the culture of the company? Set clear expectations and make sure internal audit has the resources, skills, and expertise to succeed. Challenge internal audit to take the lead in coordinating with other governance, risk, and compliance functions within the organization to limit duplication and, more importantly, to prevent gaps. Help maximize collaboration between internal and external auditors. As internal audit moves to a higher value-added model, it should become an increasingly valuable resource for the audit committee.

Quality financial reporting starts with the CFO and finance function; maintain a sharp focus on leadership and bench strength.

In our latest global pulse survey, 44 percent of audit committees 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 rate of CFO turnover and the critical role the CFO plays in maintaining financial reporting quality, it is essential that the company have succession plans in place not only for the CFO but also for other key finance executives—the controller, chief accountant, chief audit executive, treasurer—and perhaps the chief compliance and chief risk officers. How does the audit committee assess the finance organization's talent pipeline? Do employees have the training and resources they need to succeed? How are they incentivized to stay focused on the company's long-term performance? What are the internal and external auditors' views?

Make the most of the audit committee's time together—inside and outside the boardroom.

To address heavy workloads, many audit committees are focusing on ways to improve their efficiency and effectiveness—including refining their agendas and oversight processes, and reassessing their skills and composition. Keeping pace requires agendas that are manageable (what risk oversight responsibilities are realistic given the audit committee's time and expertise?), focusing on what is most important (starting with financial reporting and audit quality), allocating time for robust discussion while taking care of "must-do" compliance activities, and ensuring the committee has the right composition and leadership. Leading audit committees recognize that the committee's efficiency and effectiveness in the boardroom increasingly hinges on spending time *outside of the boardroom*—visiting company facilities, interacting with employees and customers, and hearing outside perspectives—to understand the tone, culture, and rhythm of the organization.

NEW Audit Committee Handbook

ACI celebrated its 10th anniversary with an exclusive Roundtable session on 25 October 2016, looking **back and to the future** of audit committees and launching our **new Audit Committee Handbook.**

Recognizing the challenges that audit committees face in meeting their increasingly demanding responsibilities, the Audit Committee Institute (ACI) is delighted introduce our new Belgian ACI Audit Committee Handbook.

The Audit Committee Handbook articulates, from a Belgian perspective, the principles underlying the audit committee's role and provides an array of non-prescriptive guidance to help audit committees and boards build and sustain effective audit committees.

What is in it for you?

— ACI's guiding principles for audit committees reflecting the current risk-heavy business environment and the ever-increasing workload of audit committees.

— Complete set of fundamentals, leading practices and ready-to-use tools to build and sustain an effective audit committee.

— EU audit reform: Belgian specific guidance on mandatory auditor rotation and non-audit services.

— Step-by-step guide on how to approach the audit tender process.

— Practice-aid on enhanced ISA 701 audit reports introducing key audit matters.
— Best practice guidance on audit committee member induction.

— Extended guidance for audit committee chairs.

— Risk oversight essentials for the years ahead.

— Reflections on external audit effectiveness in the digitalized world.

We sincerely hope you will find the combination of leading practices, guiding principles and ready-to-use tools useful to support you in your role.

We also would be delighted to come introduce our handbook or provide hardcopies of the handbook. Please contact us at ACI@kpmg.be

Audit Committee Institute

KPMG Board Leadership

Global Audit Committee Survey – Results

Given expectations for slow growth and economic and political uncertainty, technology advances and business model disruption, cyber threats, greater regulatory scrutiny, and investor demands for transparency, it's hardly surprising that most audit committees around the world point to risk management as the top challenge facing the company in the year ahead. More than 40 percent of respondents say their risk management systems require substantial work.

Audit committees, by and large, continue to express confidence in financial reporting and audit quality; yet, along with risk management, our 2017 Global Audit Committee Pulse Survey highlights ongoing concerns about legal and regulatory compliance, managing cyber security risk, and managing the control environment in the company's extended organization.

Of the more than 800 audit committee members responding to our survey, nearly 4 in 10 said the committee's effectiveness would be most improved by having a "better understanding of the business and key risks," while nearly a third said additional expertise related to technology or cyber security would be helpful.

Most audit committees say their organizations have a long way to go in their efforts to implement major new accounting standards. Fewer than 15 percent report a clear implementation plan for the new revenue recognition standard, and fewer than 10 percent reported a clear plan for implementation of the new leasing standard. And of those whose companies are affected by the Organisation for Economic Co-operation and Development's (OECD) country-by-country tax reporting, many expressed concern about the lack of clarity or communication with their committee on that issue. Survey respondents also cited ongoing opportunities to improve their company's ability to manage cyber risks.

Six takeaways

Risk management is a top concern for audit committees. The effectiveness of risk management programs generally, as well as legal/regulatory compliance, cyber security risk, and the company's controls around risks, topped the list of issues that survey participants view as posing the greatest challenges to their companies. It's hardly surprising that risk is top of mind for audit committees—and very likely, the full board—given the volatility, uncertainty, and rapid pace of change in the business and risk environment. More than 40 percent of audit committee members think their risk management program and processes "require substantial work," and a similar percentage say that it is increasingly difficult to oversee those major risks.

Internal audit can maximize its value to the organization by focusing on key areas of risk and the adequacy of the company's risk management processes generally. The survey results show that audit committees are looking to internal audit to focus on the critical risks to the business, including key operational risks (e.g., cyber security and technology risks) and related controls—and not just compliance and financial reporting risks. They also want the audit plan to be flexible and adjust to changing business and risk conditions.

Tone at the top, culture, and short-termism are major challenges—and may need more attention. A significant number of audit committee members—roughly one in four—ranked tone at the top and culture as a top challenge, and nearly one in five cited short-term pressures and aligning the company's short- and long-term priorities as a top challenge. Meanwhile, nearly the same percentage of audit committee members said they are not satisfied that their committee agenda is properly focused on those issues.

CFO succession planning and bench strength in the finance organization continue to be weak spots. Forty-four percent of audit committees are not satisfied that their agenda is properly focused on CFO succession planning, and another 46 percent are only somewhat satisfied. In addition, few are 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, risk management, analyzing mergers and acquisitions (M&A) and other growth initiatives, shareholder engagement, and more—audit committees want to devote more time to the finance organization, including the talent pipeline, training, and resources, as well as succession planning for the CFO and other key finance executives.

Two key financial reporting issues may need a more prominent place on audit committee agendas: Implementation of new accounting standards and non-GAAP financial measures. Few audit committees say their companies have clear implementation plans for two major accounting changes on the horizon—the new revenue recognition and lease accounting standards. Given the scope and complexity of those implementation efforts and their impact on the business, systems, controls, and resource requirements, those efforts should be a key area of focus. In addition, audit committees ought to consider whether to increase attention to any non-GAAP financial measures, which are an area of significant attention and comment by regulators worldwide. Nearly a quarter of those surveyed say their role with respect to the presentation of those metrics is very limited.

Audit committee effectiveness hinges on understanding the business. Audit committee members say a better understanding of the business and the company's key risks would most improve their oversight effectiveness. They also view additional expertise in technology/cyber security as being key to greater effectiveness, since it would strengthen their ability to oversee those risks.

Risk management is a top concern for audit committees.

The effectiveness of risk management programs generally, as well as legal/regulatory compliance, cyber security risk, and the company's controls around risks, topped the list of issues that survey participants view as posing the greatest challenges to their companies. It's hardly surprising that risk is top of mind for audit committees—and very likely, the full board—given expectations for slow growth and economic uncertainty, technology advances and business model disruption, cyber threats, and greater regulatory scrutiny and investor demands for transparency. But more than 40 percent of audit committee members think their risk management program and processes "require substantial work," and a similar percentage say that it is increasingly difficult to oversee those major risks.

From your perspective as an audit committee member, which of the following issues pose the greatest challenges to your company? (select up to three)

Multiple responses allowed

We are clearly seeing an increased focus by boards on key operational risks across the extended global organization—e.g., supply chain and outsourcing risks, information technology (IT) and data security risks, etc. And, at a higher level, boards are paying more attention to the capital "R" risks that may pose the greatest risk to the company. In today's business environment, it is more important than ever that the board be sensitive to the tone from, and example set by, leadership; reinforce organizational culture (i.e., what the company does, how it does it, including a commitment to compliance and the management of risk); and understand the behaviors that the company's incentive structure may encourage.

What is the status of your company's risk management program/process?

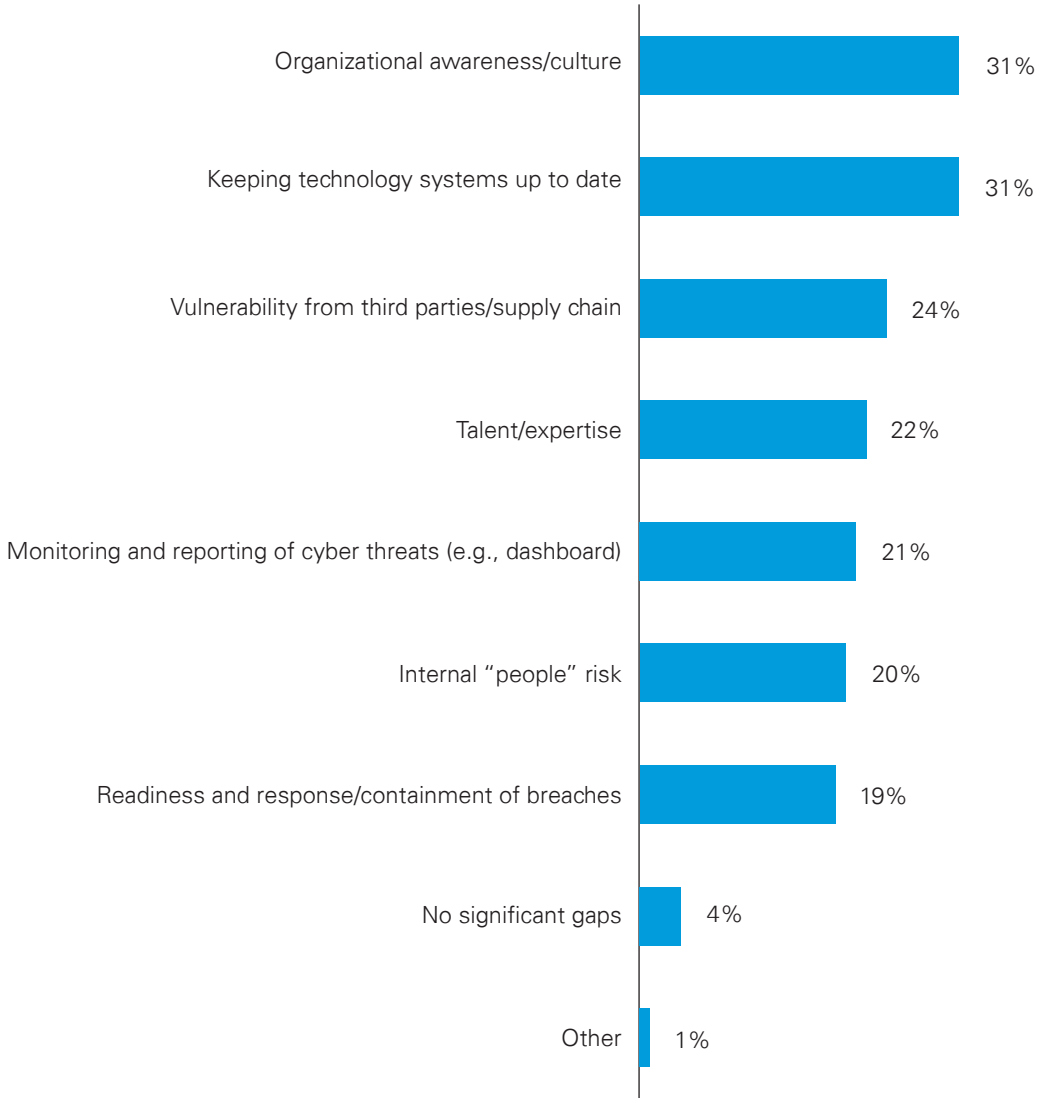
42%	**Risk management system implemented but requires substantial work**
38%	**Robust, mature risk management system in place**
15%	**Risk management system in planning/development stage**
4%	No active/formal effort to implement risk management system
1%	Other

Are you satisfied that your audit committee has the time and expertise to oversee the major risks on its agenda in addition to carrying out its core oversight responsibilities?

Time		Expertise
51%	**Yes**	46%
39%	**Yes – but increasingly difficult**	43%
9%	**No**	11%

May not equal 100% due to rounding

Q In your view, what are the most significant gaps in your company's ability to manage cyber risk? (select up to two)



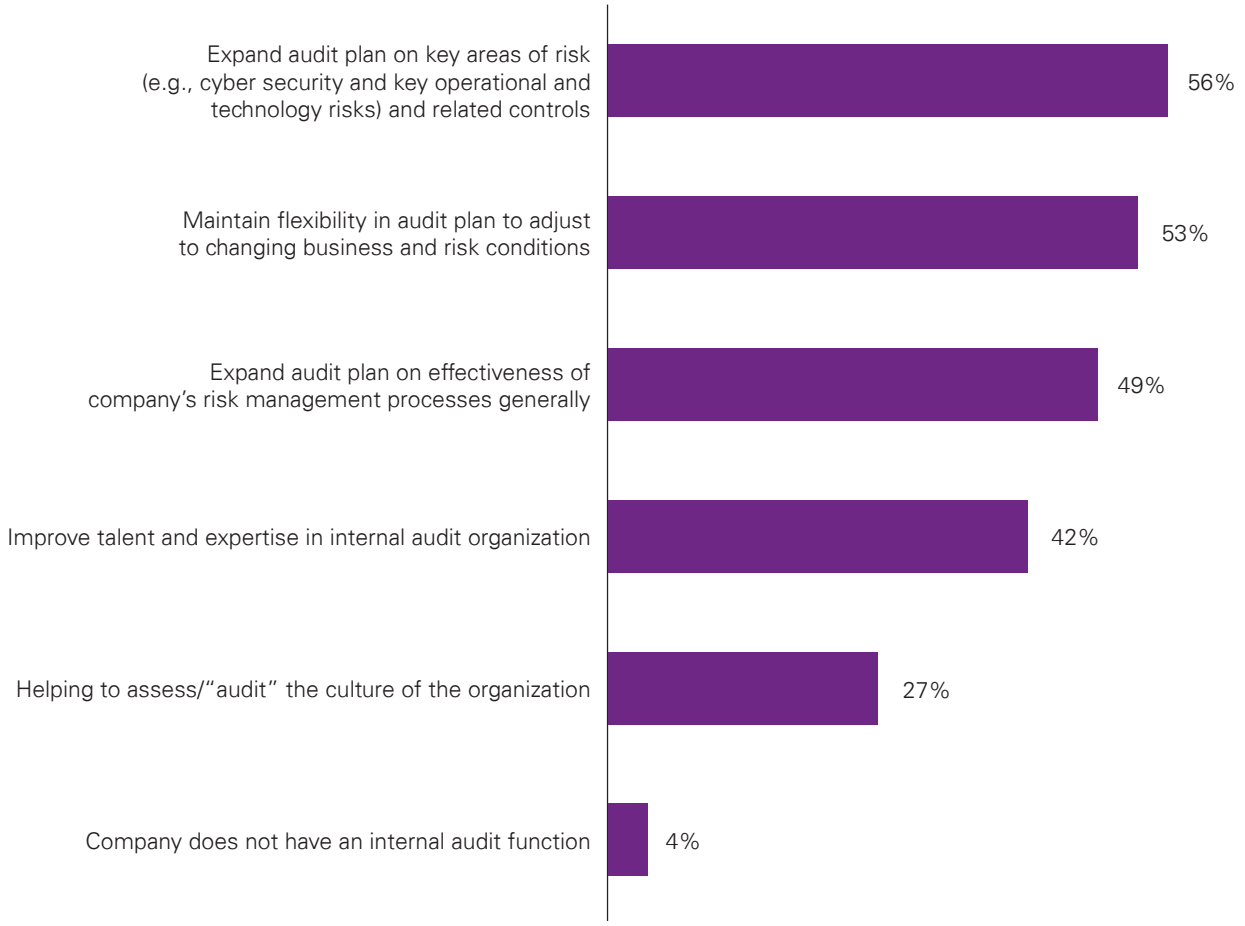
Multiple responses allowed

Despite the intensifying focus on cyber security, the cyber risk landscape remains fluid and opaque, even as expectations rise for more engaged oversight. As the cyber landscape evolves, board oversight—and the nature of the conversation—must continue to evolve. Discussions are shifting from prevention to an emphasis on detection and containment and are increasingly focused on the company's "adjacencies," which can serve as entry points for hackers. The board should help elevate the company's cyber risk mind-set to an enterprise level, encompassing key business leaders, and help ensure that cyber risk is managed as a business or enterprise risk—not simply an IT risk.

Internal audit can maximize its value to the organization by focusing on key areas of risk and the adequacy of the company's risk management processes generally.

The survey results show that audit committees are looking to internal audit to focus on the critical risks to the business, including key operational risks (e.g., cyber security and technology risks) and related controls—and not just compliance and financial reporting risks. They also want the audit plan to be flexible and adjust to changing business and risk conditions.

Q Beyond focusing on financial reporting and compliance risks, what steps can internal audit take to maximize its value to your organization? (select all that apply)



Multiple responses allowed

Internal audit is most effective when it is focused on the critical risks to the business, including key operational risks (e.g., cyber security and technology risks) and related controls—not just compliance and financial reporting risks. Help define the scope of internal audit's coverage—and if necessary, redefine internal audit's role. Challenge internal audit to take the lead in coordinating with other governance, risk, and compliance functions within the organization to limit duplication and, more importantly, to prevent gaps. Help maximize collaboration between internal and external auditors.

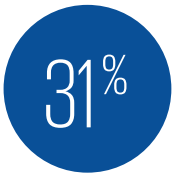
As internal audit moves to a higher value-added model, it should become an increasingly valuable resource for the audit committee.

Two key financial reporting issues may need a more prominent place on audit committee agendas: Implementation of new accounting standards and non-GAAP financial measures.

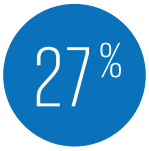
Few audit committees say their companies have clear implementation plans for two major accounting changes on the horizon—the new revenue recognition and lease accounting standards. Given the scope and complexity of those implementation efforts and their impact on the business, systems, controls, and resource requirements, those efforts should be a key area of focus.

In addition, audit committees ought to consider whether to increase attention to any non-GAAP financial measures, which are an area of significant attention and comment by regulators worldwide. Nearly a quarter of those surveyed say their role with respect to the presentation of those metrics is very limited.

What is your audit committee's role in considering how the company should present non-GAAP financial measures—and which ones to present? (select all that apply)



Audit committee discusses with management the process by which management develops non-GAAP financial measures



Discusses adequacy of disclosure controls and processes around development of non-GAAP financial measures

Company does not provide non-GAAP financial measures

24%	Discusses the correlation of the non-GAAP financial measures with actual state of the business and results
24%	Audit committee's role/input is very limited

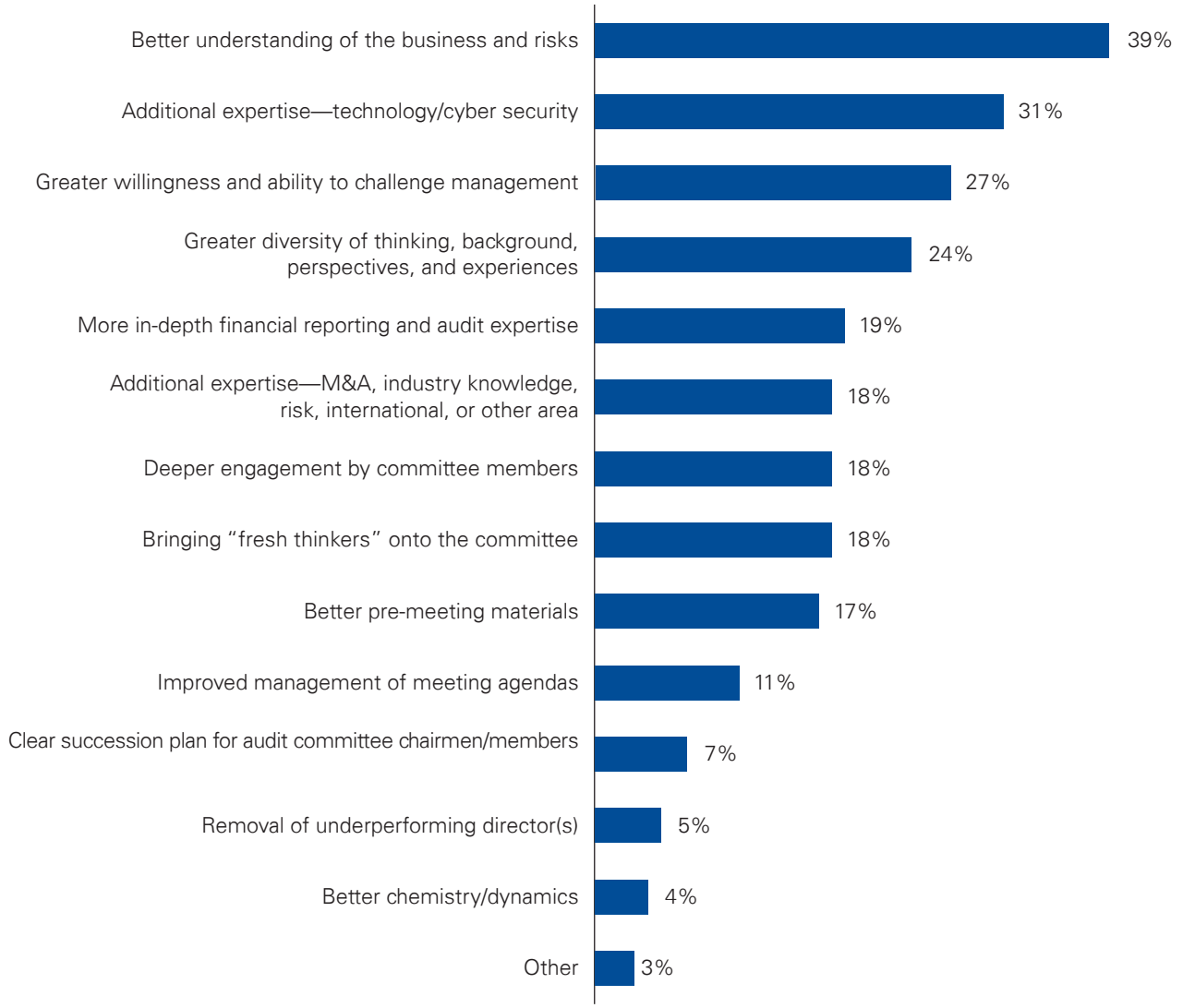
Multiple responses allowed

It is critical that non-GAAP measures have a prominent place on the audit committee agenda and that the committee have a robust dialogue with management about the process—and controls—by which management develops and selects the non-GAAP financial measures it provides and their correlation to the performance of the business and results. Among the questions to consider: What is the process by which the company decides whether to present non-GAAP measures—and which ones to provide? What is the role of management's disclosure committee? What is the role of the audit committee? Is the audit committee satisfied that non-GAAP measures are being used to improve transparency and not to distort results?

Audit committee effectiveness hinges on understanding the business.

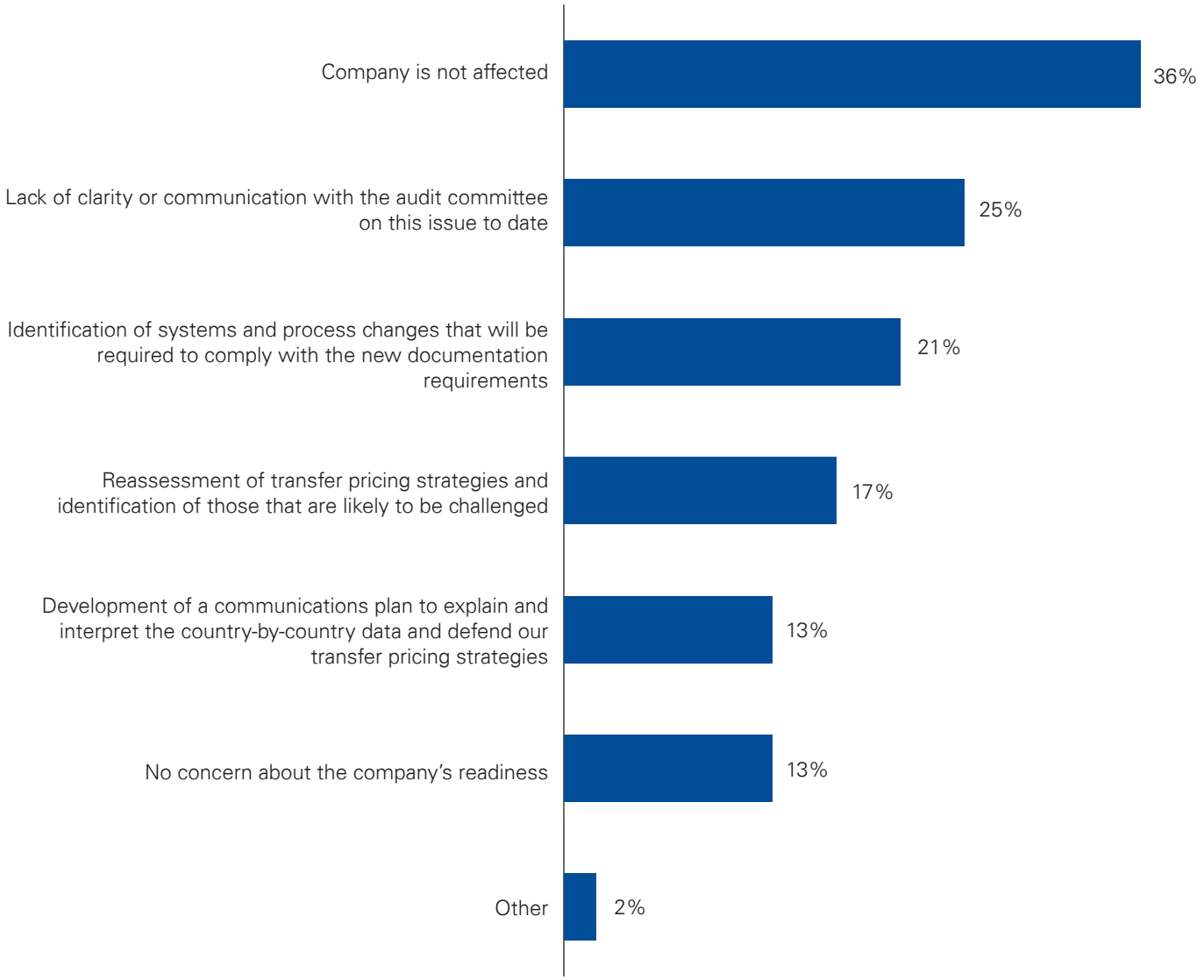
Audit committee members say a better understanding of the business and the company's key risks would most improve their oversight effectiveness. They also view additional expertise in technology/cyber security as being key to greater effectiveness, since it would strengthen their ability to oversee those risks.

Q What would most improve your committee's overall effectiveness? (select up to three)



Multiple responses allowed

Q Which—if any—of the following areas pose significant concern to you in terms of the company's readiness for the OECD's country-by-country tax reporting (first report due December 31, 2017, for calendar year companies)? (select all that apply)



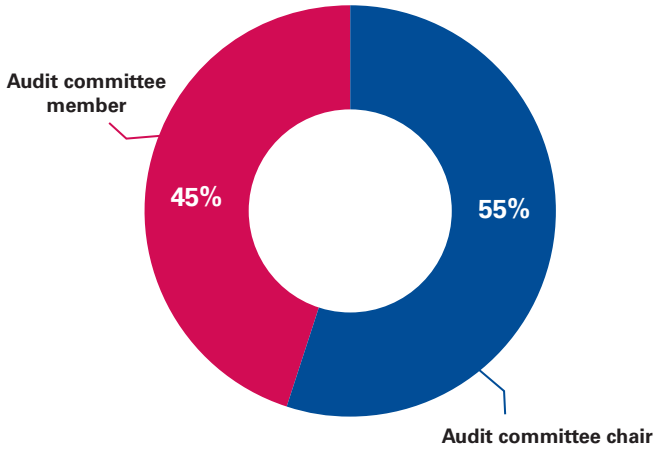
Multiple responses allowed

The obligation to report country-by-country tax information to all jurisdictions is also on the immediate horizon, and the impact on multinationals will be profound, with significant implications for tax compliance and reporting functions, transfer pricing policies, tax audits and controversies, and reputational risk. Audit committees of multinationals will want to assess their company's readiness: What systems and process changes will be required to comply with the new documentation requirements? Have we assessed our transfer pricing strategies and identified those that are likely to be challenged? Do we have an effective communications plan to explain and interpret the country-by-country data and appropriately defend our transfer pricing strategies?

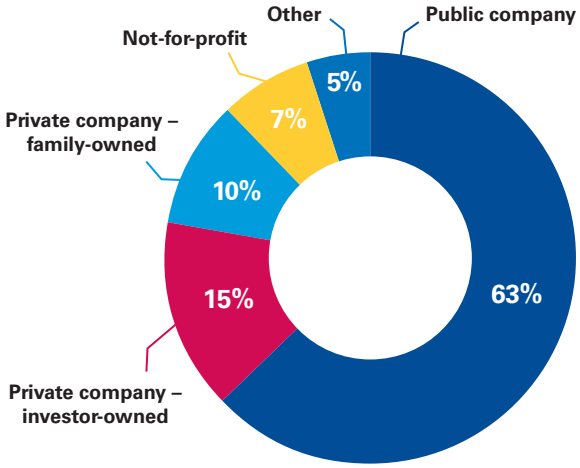
Survey respondents

Results are based on our global pulse survey conducted from August to October 2016.
Results shown are for 832 complete responses.

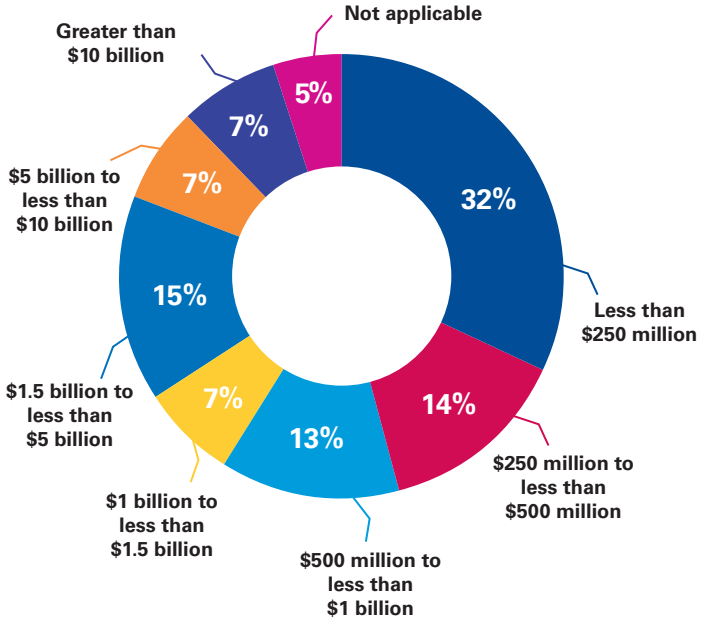
Role on the audit committee



Company type



Annual revenue



Brexit and Trump
Financial reporting implications

As businesses develop their responses to the outcome of the UK referendum on continued EU membership and the election of Donald Trump in the U.S., the business-as-usual of preparing financial reports and auditing continues. There are some short term accounting and reporting implications to consider when preparing annual financial reports.

It will be some time before the longer-term effects of the UK referendum result and the U.S. vote become clear. However, in the short-term, elevated geopolitical instability and economic uncertainty may result in increased market volatility for asset prices and exchange rates *inter alia.*

As a consequence, audit committees will be assessing the impact of the increased economic uncertainty and market volatility on annual financial statements and ensure management are monitoring developments to assess what impact, if any, these have on the business model, strategy, business plans, forecasts and financial reporting.

Communicating impacts and implications

Following the vote results, investors will want to understand how business models of companies active on UK and U.S. markets are exposed to each new opportunity and risk. Transparent business model disclosure and clarity over longer-term strategy will be more important than ever during this period of uncertainty.

Companies may need to reassess their principal risk disclosures in the context of the changed global business environment. Do the vote results create new risks to shareholder value, or change the scale and likelihood of existing risks?

The focus on communication of the implications of the referendum result also extends into the financial statements. Disclosures of accounting judgements, sources of estimation uncertainty and financial instrument risks may also need to be revisited. We may well see increased disclosure of sensitives of estimates to changes in assumptions—and of more key assumptions being identified for disclosure.

Though challenging, articulating the potential impact on the business model and longer-term strategy with as much clarity as possible will be more important than ever during this period of uncertainty.

Companies should consider whether their front-end narrative provides sufficient information to allow the implications of uncertainties, exit terms and strategic responses to be assessed.

Does reporting provide sufficient information to enable shareholders to assess the implications of exit scenarios, and is the tone and balance of the discussion appropriate? Companies are not required to quantify potential future performance impacts, but should provide relevant factual information to enable users to form their own assessment, for example through business model disclosures.

Narrative reporting

Risks	Response	Clarity
Viability	Assessment	Assumptions
Prospects	Expectation	Implications

Financial statements

Uncertainty	Estimates	Projections
Disclosure	Clarity	Sensitivity
Valuations	Assumptions	Information

Accounting in an environment of uncertainty and market volatility

Uncertainty and volatility put particular pressure on financial statement measures and forward-looking assessments such as asset valuations, inventory values, consideration of onerous contracts, deferred tax asset recognition, recoverability of receivables, hedge effectiveness testing and even the going concern assessment and covenant compliance.

Perhaps the greatest focus will be on impairment tests. There are various factors to consider, for example:

— Updating cash flows in value in use calculations: while long term implications may not be clear, and there are limitations on taking any planned restructurings into account, cash flow forecasts may still need updating to reflect changes in the competitive environment, growth rates or exchange rate implications.

— Determining discount rates: incorporating changes in risks and market conditions.

— Determining which assets are tested for impairment: do changes in the market, or in internal expectations mean that more assets need to be tested for impairment?

Valuations of assets or liabilities, such as properties, pension balances, or financial instruments will also be affected by market activity and so particular focus on the approach taken and assumptions used can be expected.

Together with foreign exchange implications, variability in such valuations might be expected to be one of the greatest areas of focus as users look at the impact on financial statement balances.

Annual reports

For annual financial reports, valuations and estimates involving observable market transactions may have more limited available relevant information at that date, and updated valuations may be required.

Annual reports could be expected to include additional discussion of factors relating to the vote results. Is the required explanation of events relevant to understanding the position of the entity complete—particularly where exchange rates have a significant impact, circumstances affect the fair value of financial instruments or where estimates have changed.

Audit considerations

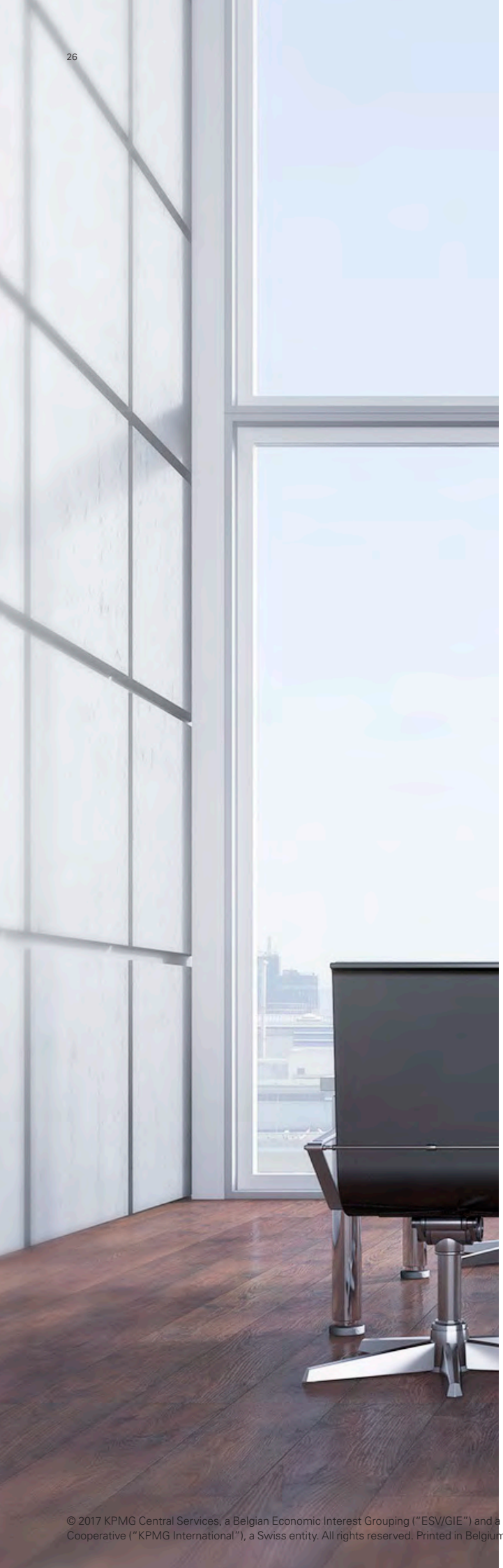
Audit plans—both internal and external—may need to be revisited in the light of the uncertainty resulting from the UK and U.S. votes.

For internal audit (and other internal assurance providers), question whether the plan continues to be focused on the key risks facing the business. Should some audits be accelerated? Does more need to be done about contingency planning or the robustness of key risk indicators which provide early warning of issues on the horizon?

Question whether the external auditors are still focused on the right audit risks. How have the changes to the geopolitical and economic environment been factored into the audit plan and are the planned responses to risks still appropriate? What impact does the increased uncertainty and market volatility have on the scope of the audit and audit materiality?

Consider whether the audit should be deploying more specialist expertise in the light of the impact on pensions, financial instruments and other valuations?

Are your auditors keeping you appraised of how their audit plans are changing? Do the changes accord with your understanding of how the uncertainties associated with Brexit and Trump are impacting your business model, strategy and the principal risks facing the business?



On the 2017 board agenda

In 2017, corporate performance will still require the essentials—managing key risks, innovating and capitalizing on new opportunities, and executing on strategy. But the *context* is changing quickly—and perhaps profoundly—as advances in technology, business model disruption, heightened expectations of investors and other stakeholders, and global volatility and political shifts challenge companies and their boards to rethink strategy development and execution, and what it means to be a corporate leader. Drawing on insights from our recent survey work and interactions with directors and business leaders over the past 12 months, we have highlighted seven items that boards should keep in mind as they help guide the company forward in the year ahead.

Recognize that connecting and calibrating strategy and risk is more important—and more challenging—than ever. What a difference a few months can make. The UK's Brexit vote and a Trump win in the U.S., which caught most observers—and many corporate strategies—flat-footed, will have major implications for global markets, and the geopolitical landscape at large. That so few had predicted these sea changes despite exhaustive analysis in the run-up to both events is a stark reminder to businesses of how marketplace signals can be fundamentally missed (be it status quo thinking, bias toward the familiar, or comfortable complacency) and the playing field fundamentally altered overnight. The geopolitical landscape will become clearer, but expect the competitive landscape to remain dynamic and cloudy, leaving little lead time. Technology advances and relentless innovation, business model disruption, the emergence of Millennials and other demographic shifts, evolving customer demands and employee expectations, and more will put a premium on corporate agility and the ability to pivot as conditions change. Think about constant transformation, talent risk management and the opportunities afforded by "new" technology. Does management have an effective process to monitor changes in the external environment and test the continuing validity of strategic and risk assumptions? Does this process provide early warning that adjustments may be necessary? Does the board have the right people and perspectives to make the necessary linkages between external forces and the company's strategy and risk profile? Make strategy an ongoing discussion (versus an annual "decision") that incorporates smart risk taking and robust scenario planning with plenty of what-ifs on the table. In short, "strategy and risk" should be hardwired together and built into every boardroom discussion.

Develop and execute the strategy based on total impact. As we noted at the outset, the context for corporate performance is changing rapidly as political, social, and regulatory forces reshape the competitive landscape. Consideration of the corporation's role in society is moving from the periphery to the center of corporate thinking as expectations of investors, customers, employees, and other stakeholders challenge companies to understand the total impact of the company's strategy and activities. Strategy development and execution requires a holistic approach, encompassing the full range of risks and opportunities—financial, reputational, regulatory, resource- and talent-related, and more—that impact the company and its many stakeholders over the long term.

Take a hard look at the board's composition: Is the talent in the boardroom aligned with the company's strategy and future needs? Given the demands of today's business and risk environment (and increasing scrutiny by investors, regulators, and the media), aligning boardroom talent with company strategy—both for the short term and the long term as the strategy evolves—should be a priority. Not surprisingly, 43 percent of respondents in our recent survey, *Building a Great Board*, cited "resistance to change" and "status quo thinking" as hampering their board-building efforts. Consider key recommendations of the NACD Report on *Building the Strategic Asset Board* and the WCD Commission/KPMG report, *Seeing Far and Seeing Wide: Moving Toward a Visionary Board*. As noted in these reports, directors should focus squarely on board composition/diversity and succession planning, robust evaluations, tenure limits, director recruitment and onboarding, board leadership, stakeholder communications, and continuing director education—all tailored to the company and industry. In short, "periodic board refreshment" should give way to robust, continual improvement and *active* board succession planning.

Pay particular attention to potential risks posed by tone at the top, culture, and incentives. While a robust risk management process is essential to prevent and mitigate risk events, it is not enough. As we have seen in recent years, many of the crises that have posed the most damage to companies—financial, reputation, and legal—have been caused by a breakdown in the organization's tone at the top, culture, and incentives. As a result, boards need to pay particular attention to these capital "R" risks, which may pose the greatest risk of all to the company. In today's business environment, it is more important than ever that the board be acutely sensitive to the tone from (and example set by) leadership and to reinforce the culture of the organization, i.e., what the company does, how it does it, and the culture of compliance, including a commitment to management of the company's key risks.

Reassess the company's crisis prevention and readiness efforts. Crisis prevention and readiness have taken on increased importance and urgency for boards and management teams, as the list of crises that companies have found themselves facing in recent years looms large. Crisis prevention goes hand-in-hand with good risk management—identifying and anticipating risks, and putting in place a system of controls to prevent such risk events and mitigate their impact should they occur. We are clearly seeing an increased focus by boards on key operational risks across the extended global organization—e.g., supply chain and outsourcing risks, information technology and data security risks, etc. Do we understand the company's critical operational risks? What has changed in the operating environment? Has the company experienced any control failures? Is management sensitive to early warning signs regarding safety, product quality, and compliance? Of course, even the best-prepared companies will experience a crisis; but companies that respond quickly and effectively—including robust communications—tend to weather crises better. Assess how well the company's crisis planning aligns with its risk profile, how frequently the plan is refreshed, and the extent to which management—and the board—conduct mock crisis exercises. Do we have communications protocols in place to keep the board apprised of events and the company's response?

Reassess the company's shareholder engagement program. Shareholder engagement is rapidly becoming a top priority for companies as institutional investors increasingly hold boards accountable for company performance and demand greater transparency, including direct engagement with independent directors. Institutional investors expect to engage with portfolio companies—especially when investors have governance concerns or where engagement is needed to make a more fully informed voting decision. In some cases, investors are calling for engagement with independent directors. As a result, boards should periodically obtain updates from management about its engagement practices:
Do we know and engage with our largest shareholders and understand their priorities? Do we have the right people on the engagement team? What is the board's position on meeting with investors? Which of the independent directors should be involved? Strategy, executive compensation, management performance, environmental and sustainability initiatives, and board composition and performance are likely on investors' radar.

Refine and widen boardroom discussions about cyber risk and security. Despite the intensifying focus on cyber security, the cyber-risk landscape remains fluid and opaque, even as expectations rise for more engaged oversight. As the cyber landscape evolves, board oversight—and the nature of the conversation—must continue to evolve. Discussions are shifting from prevention to an emphasis on detection and containment,

and increasingly focused on the company's "adjacencies," which can serve as entry points for hackers. The Internet of Things and the digital records that surround people, organizations, processes, and products ("code halos") call for deeper—if not wholly different—conversations. The board should help elevate the company's cyber-risk mind-set to an enterprise level, encompassing key business leaders, and help ensure that cyber risk is managed as a business or enterprise risk—not simply an IT risk. Do discussions about M&A, product development, expansion into new geographies, and relationships with suppliers, customers, partners, advisers, and other third parties factor in cyber risk? Help ensure that awareness of—and accountability for—cyber security permeates the organization, with a security mind-set, proper training, and preparation for incident response. Is cyber security risk given regular and adequate time on the board's agenda? Does the board need a separate committee to focus on it? Where are the company's biggest vulnerabilities, and how is it protecting its most critical data sets? Do we benchmark against others in the industry? Do we have a cybersecurity scorecard and a robust cyber-incident response plan? Do directors work under the assumption that any email could become public at any time?

Directors' liability considerations

Since in practice a lot of questions are raised concerning the liability of directors within a private limited liability company *("besloten vennootschap met beperkte aansprakelijkheid" / "société privée à responsabilité limitée)* and a public limited liability company *("naamloze vennootschap" / "société anonyme"),* we took the opportunity to set out in this newsletter the basic principles regarding such liability.

1. Civil contractual liability for shortcomings in management ("management error" - article 262 / 527 Companies' Code (hereafter referred to as "CoCo"))

As representative of a private or public limited liability company, being the two most popular forms of companies in Belgium, a director is liable towards the company for the execution of its mandate.

In order to determine whether or not management errors have been made, the managerial actions of a director are compared with those of a *"normal prudent and careful director acting under the same circumstances".* Thus, a director shall commit (a) management error(s) when a normal prudent and careful director acting under the same circumstances would not have performed the(se) action(s).

It concerns a contractual liability which can in principle only be invoked by the company. The claim can be initiated in name of the company by the general meeting of shareholders or by a minority shareholder under the conditions set out in article 290 CoCo (for a private limited liability company)

or article 562 CoCo (for a public limited liability company). The company needs to deliver proof of the management error, the damage it has suffered as well as the existence of a causal link between the management error and the damage.

The liability for management errors is in principle personal, hence, each director will be obliged to compensate the damage caused by his own actions. Nevertheless, the court can hold the directors liable "in solidum" (or even jointly and severally in case of joint errors), when their various erroneous actions have led to the same damage. Consequently the damage could be claimed from each director for the entire amount of indemnification. The director who has paid the total indemnification, will then be able to claim from the other directors their respective portion.

Examples of management errors are the following: closing an agreement under clearly disadvantageous conditions, granting a credit without further consideration, dismissing an employee in a way that obliges the company to pay a high compensation, involving the company in dubious operations, omission to subscribe to the necessary insurance policies, etc.

The limitation period for claims regarding directors' liability, based on the articles 262 / 527 CoCo (as described here above) amounts to 5 years. Furthermore, the director's liability can, in principle, no longer be invoked by the company in the event the general shareholders' meeting has granted discharge to the directors. Please note, however, that discharge has no effect whatsoever on the liability of the directors towards third parties, who can, notwithstanding the fact that the directors have received discharge, invoke the director's liability until the statute of limitation period has expired.

2. Civil liability for violation of the Companies' Code or of the articles of association (article 263 / 528 CoCo)

Directors are jointly and severally liable towards the company as well as towards third parties for all the damage caused by a breach of provisions of the Companies Code or of the articles of association of the company.

Directors will be held liable and an indemnification will need to be paid provided that the claimant has delivered proof of the violation and of his damage as well as of the existence of a causal link between said breach and damage.

In case of a breach of the Companies' Code or of the articles of association, the directors are presumed to be jointly and severally liable. A director can escape from this joint and several liability, provided that he can demonstrate that (which is rather difficult in practice):

— he did not take part in the violation;
— no fault can be imputed to him;
— he had no knowledge of the violation, or he has denounced such violation at the first general meeting of shareholders after he became aware thereof and the breach has been mentioned in the convocation to this general shareholders' meeting.

General examples of a violation of the articles of association or the Companies Code are: *omission to file the annual accounts,* omission to draw up the consolidated annual accounts, omission to convoke the general meeting of shareholders, performing actions that fall outside the scope of the corporate purpose of the company or that are in conflict with the companies' interest, violation of the conflict of interests procedure, etc.

As regards the limitation period for claims regarding directors' liability, the same rules apply as mentioned here above under 1.

3. Tortuous liability

According to article 1382 of the Civil Code, each person who has caused damage to another person is obliged to indemnify the latter for the damage suffered.

The tortuous liability can be invoked by either the company or by third parties, for the damage they suffered following a management act or omission *that does not qualify as a contractual fault.* The claimant will have to prove the director's fault, the damage (other than mere damage resulting from mismanagement or negligence in the execution of the director's mandate) and the existence of a causal link between the fault and the damage.

An act/omission is not considered to be of a mere contractual nature if it can be qualified as a violation of the general duty of care that applies to everyone, regardless of any contractual obligation, or, if this act or omission constitutes a criminal offence.

An example of such a fault towards third parties is, for instance, the execution of a sale-purchase agreement on behalf of the company, whilst the director knew or ought to have known that the company was insolvent.

The statute of limitation for a tortuous claim for director's liability amounts in principle to 5 years.

4. Special and criminal liabilities

The Companies' Code, the tax legislation and some (and in recent years quite a lot of) economic laws provide for several additional grounds for director's (criminal) liability, such as, a liability for the deficit in case of bankruptcy when a manifest grave error of a director that has contributed to the bankruptcy, has been established.

Moreover, directors can be held liable for the non-payment of withholding tax on professional income, the VAT, and social security contributions. According to this legislation, directors are on the one hand personally liable for the payment of the withholding tax on professional income or the VAT in case of a repeated lack of payment (i.e. in case of quarterly payments: non payment of two outstanding debts within one year and, in case of monthly payments: non payment of three outstanding debts within one year).

The liability of directors for social security contributions on the other hand only applies in case of bankruptcy or in case of a violation of the information duty as stipulated in article 40ter of the Law of 27 June 1969 reviewing the Resolution law of 28 December 1944 regarding the social security of employees.

Furthermore, directors can be held criminally liable as well. For example in case of late filing of the annual accounts (art. 126, §1, 1° CoCo), refusal to convene the general meeting of shareholders when validly requested, not or incorrectly (omission of required data) drawing up of the annual report, abuse of the company's assets (art. 492bis Criminal Code), etc.

According to article 5 of the Criminal Code, a legal entity will be held criminally liable for any offences that are inextricably related to the accomplishment of its object or the preservation of its interests or which, according to the factual circumstances, were committed on its behalf. If an individual (e.g. director) willfully and knowingly commits an offense, he can be held jointly liable with the company.

Also other specific legislation (such as environmental or economic legislation—if applicable) could impose criminal liabilities on the directors of the company.

5. Possible limitation mechanisms?

Finally we would like to point out that a number of mechanisms exist that can limit the (civil) liability of directors. For instance, a company can subscribe to a director's liability insurance for its directors or a hold harmless agreement could be agreed upon.

It goes without saying that tailored advice for the specific case or set-up at hand is required.

Article by Christophe Piette Counsel at Klaw

Financial reporting news

Regulators' focus for 2016 includes the impact of new standards and Brexit

The European regulator, ESMA, has issued a statement highlighting the common areas that European national regulators will be focusing on when reviewing listed companies' 2016 IFRS financial statements. Its three key priorities cover:

– disclosures of the impact of the new standards;
– presentation of financial performance, including the topical issue of alternative performance measures; and
– debt / equity classification.

For those companies potentially affected by Brexit, ESMA is also encouraging disclosure of the associated risks, and the expected impacts and uncertainties on their business activities. Although the topics included in ESMA's statement are those deemed to be most relevant at a European level, regulatory bodies outside of Europe are also likely to take notice, and to pay particular attention to many of the same topics.

Insights—Your tool for applying new and existing IFRS

With the effective dates for the new standards on revenue and financial instruments fast approaching—and leases close behind—this is a critical time for every company reporting under IFRS. Insights into IFRS will help you rise to the challenges ahead. It provides in-depth, easy-to-understand guidance and draws on the hands-on experience of our IFRS specialists. It can be used alongside our forthcoming suite of Guides to annual financial statements to form your complete guide to the year end.

Visit our website at www.kpmg.com/be/aci and download ***Insights into IFRS: An overview***, which provides a high-level briefing for audit committees and boards.

Revenue—Regulator calls for transparency on IFRS 15 impacts

The European regulator, ESMA, has issued a public statement promoting consistent application of IFRS 15 *Revenue from Contracts with Customers* and transparent disclosure in the lead up to initial application. In particular, the statement sets out ESMA's expectations with respect to an issuer's disclosures on the potential impacts of the initial application of IFRS 15 in its 2016 and 2017 annual financial statements and interim financial statements during 2017.

Read more of any of the publications above and more on IFRS:

– KPMG Belgium IFRS Institute: **www.kpmg.com/be/en/topics/ifrs–institute**
– KPMG Global IFRS Institute: **www.kpmg–institutes.com/institutes/ifrs–institute**

Other news and insights

GUBERNA / KPMG Directors Handbook

GUBERNA, supported by KPMG, published its Directors Handbook. The handbook aims to be the reference handbook for best practices in corporate governance. The handbook targets the individual director rather than focusing on overall board governance, which makes it one-in-a-kind.

The text features a comprehensive overview of leading practices and guidance related to the following questions:

– What to do before accepting a board position?
– What to do during the execution of the mandate?
– Why and how to evaluate the mandate?
– How to resign from a board position?

http://www.guberna.be/tools/handboek-voor-de-bestuurder

Harnessing the power of cognitive technology to transform the audit

This report takes an in-depth look at how advances in cognitive intelligence are being adapted to auditing and how its application can enhance audit quality through greater coverage, deeper analytics and broader perspectives on controls, processes and risks.

The use of computer technology has been a mainstay in financial statement audits for decades. However, recent advances in computing power will have a transformative impact on both how audits are conducted and the overall financial reporting landscape.

The application of cognitive technology will fundamentally affect the way audit information is used and understood. By significantly increasing the ability to evaluate larger volumes of both structured and unstructured data, cognitive technology will allow our audit teams to dig deeper into financial information for a more detailed and comprehensive audit. It will also enable us to sharpen our focus on higher value audit activities in areas of increased business risk and reporting complexity.

https://assets.kpmg.com/content/dam/kpmg/us/pdf/2016/11/us-audit-CognitiveFactSheet.pdf?logActivity=true

Are Expectations on Board Members Too High? Most Directors Think So. Global Survey of 4000+ directors reveals common boardroom attitudes and processes

Sixty percent (60%) of directors say that there is a gap between the expectations placed on boards and the reality of the board's ability to oversee a company, according to the 2016 Global Board of Directors Survey, conducted by Professor Boris Groysberg and Yo-Jud Cheng of Harvard Business School, Spencer Stuart, the WomenCorporateDirectors (WCD) Foundation, and researcher Deborah Bell.

– **Disconnect between expectations and reality around board's true oversight ability.** Of the 60% of directors who see a gap between the expectations placed on boards and the reality of the board's ability to oversee a company, 64% believe expectations moderately exceeded reality. Strikingly, 25% believed expectations far exceeded reality.

– **Other skills in demand on boards.** Behind the "top 3" of strategy and financial/audit expertise and specific industry knowledge, directors also cited risk management and international/global expertise as most important to board service today. Areas named least frequently as important were sales and marketing, and compensation and succession planning expertise.

– **Measuring performance—with consequences.** As greater regulatory requirements have put board performance under a microscope, many boards have instituted evaluations as part of their structure. Indeed, the survey revealed that more than two-thirds of boards conduct performance evaluations of directors. One-third of respondents have served on a board where evaluations were used to remove a director.

https://wcd.site-ym.com/news/313756/Are-Expectations-on-Board-Members-Too-High-Most-Directors-Think-So.htm

About ACI

The Audit Committee Institute (ACI) champions good corporate governance to help drive long-term corporate value and enhance investor confidence. Focusing on the audit committee and supporting the director community, ACI engages with directors and business leaders to help articulate their challenges and promote continuous improvement. Supported by KPMG Board Leadership Center, ACI delivers actionable thought leadership—on risk and strategy, technology, compliance, financial reporting and audit quality—all through a board lens.

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