



Audit Trends

Volume 3

Talent, tech and turmoil are shaping the audit environment.

With a range of provocative data, insight and opinion gleaned from The Conference Board of Canada/KPMG survey of AC chairs and CFOs, *Audit Trends* examines seven key issues addressing corporate readiness, preparedness, and priority in a volatile business environment.

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Institute of Corporate Directors
Institut des administrateurs de sociétés



The Conference Board of Canada | Le Conference Board du Canada



Audit Trends at a glance

Top 7 issues on the minds of Audit Committees (ACs)

1 Talent & human capital

Board seats held by women: **21%**

Board seats held by minorities: **15%**

3 Disruption to business models

Organization agility and flexibility is a high priority for ACs

Use of artificial intelligence is a low priority for ACs

7 Environment & climate change

50% of businesses feel that climate change is a financial risk

But only **28%** of respondents view it as a "high" priority

2 Technology & cybersecurity

Businesses that reported cyber attacks in the previous 24 months: **81%**

Average cost of a single data breach for a Canadian company: **\$6M**

Top 3 industries prioritizing cybersecurity:

1. Finance and Insurance
2. Manufacturing
3. Mining

Top areas of concern for the Financial sector:

1. Cybersecurity
2. Technology infrastructure
3. Increased use of data analytics

4 Evolving regulatory landscape

ACs ranked the impact of new IFRS standards as a high priority

5 Political & economic uncertainty

Top areas of concern for the Manufacturing sector:

1. Economic volatility
2. Uncertainty around legal and regulatory changes in the US
3. Renegotiations of trade agreements

6 Changing reporting expectations

Reporting of enterprise risk assessments and their mitigation measures were rated as the highest priority

Areas of high AC preparedness

- Changing reporting expectations
- Evolving regulatory landscape
- Talent & human capital

Areas of low AC preparedness

- Political & economic uncertainty
- Disruption to business models
- Environment & climate change

Percentage of ACs who will increase time spent on these issues in the next three years

- Technology: **81%**
- Talent/Human capital: **53%**
- Business model disruption: **49%**
- Regulatory standards: **48%**
- Environment: **47%**
- Changing reporting: **36%**

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Foreword

Audit continues to change across the board

If there's one thing that KPMG's annual *Audit Trends* report consistently illuminates, it's that times have never been so challenging for audit committees (ACs) and CFOs. The vast and rapid changes we're seeing across business and economic landscapes are shifting expectations and expanding responsibilities in virtually every organizational area. To stay ahead of the trends, ACs and CFOs will need to embrace the fact that their role is evolving and leverage their teams more effectively to help manage and mitigate risk across their increasingly broad mandate.

The need to have the right teams on the job – ones with the skills and knowledge that meet rapidly evolving regulatory demands and understand technological change – speaks to the top trend identified in this year's Conference Board of Canada/KPMG survey of audit trends: "talent and human capital." Not surprisingly, given the ongoing prominence of large-scale cyber issues and events, "technology and cybersecurity" was the second major priority.

In third position, "disruption to business models" was cited (this being the top priority for the finance and insurance, manufacturing, and mining and energy sectors), suggesting ACs are more fully acknowledging their role in ensuring the organization is fully prepared to respond rapidly to both the risks and opportunities inherent in transformational

technological change. Interestingly, "environment and climate change" was the lowest priority trend of the seven named.

We were encouraged to see that AC chairs and CFOs are largely on the same page with respect to the priority issues identified. There is a growing understanding on the part of organizational leaders that innovation is the primary factor driving competitiveness – making it critical to adopt, and adapt to, developments such as bots, automation, machine learning, etc. Artificial intelligence (AI), though scoring somewhat lower than expected as a disruption priority, will certainly be a major factor, particularly in audit data and analytics (D&A) where it will be possible to conduct a more detailed evaluation of financial and other information, pinpoint data outliers and anomalies, and identify potential reporting, controls, or process issues more readily. Interestingly, although awareness of major issues was high among respondents, they did not on the whole feel they were highly prepared to address them. This perhaps highlights why we publish this report each year – to not only help organizations identify the top trends that will impact their business, but to prepare for and respond to them as well.

Aligning readiness and action with intelligence will be critical, for not only national but global competitiveness, and we hope the information and insights in this report help Canadian businesses realize that agenda going forward.



Kristy Carscallen
Canadian Managing Partner
Audit, KPMG



Rahul Bhardwaj, LL.B, ICD.D
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New concerns, ongoing issues, challenges ahead

It is our hope that *Audit Trends* will prove a helpful guide for ACs, as 2018 promises challenges that will range from anticipated and manageable to – if the past is any guide – unexpected and challenging.

With this edition of the Audit Trends report, KPMG again looks at the major trends ACs will see in the coming year. The information gleaned from the Conference Board of Canada/KPMG survey of ACs and CFOs provided KPMG a range of interesting and provocative data, insight and opinion – some that warranted a closer look. This report looks at seven key issues:

- 1. Talent and human capital**
- 2. Technology/cybersecurity**
- 3. Disruption to business models**
- 4. Evolving regulatory landscape**
- 5. Political and economic uncertainty**
- 6. Changing reporting expectations**
- 7. Environment and climate change**

While “technology/cybersecurity” is usually a top-ranked concern for ACs, it was somewhat surprising that “talent and human capital” tied for highest priority. More than 75 percent of respondents selected these two issues as “high” or “very high” priorities.

At the other end of the spectrum, another issue new to this report – “environment and climate change” – remains a peripheral issue for many ACs. Only 28 percent of respondents considered it as a “high” or “very high priority”; nonetheless, its emergence in this report as a significant trend signals a growing consciousness among ACs and CFOs.

“Disruption to business models,” the “evolving regulatory landscape,” “political and economic uncertainty” and “changing reporting expectations” were seen as a medium priority for most organizations.

The AC plays a critical role in helping organizations navigate today’s challenging business environment, providing guidance and oversight on a wide range of complex issues. This means audit committees must focus on ensuring the right skills are at the table and that all members continue to expand their knowledge in key areas. Encouragingly, more than 70 percent of respondents indicated that their board assesses its skills on an annual basis with an eye to facing evolving challenges.

When asked how prepared they were to deal with their top identified priorities, respondents’ awareness appeared higher than their preparedness.

The complex and evolving nature of these issues may be a factor in what seems a lack of preparedness; indeed, the issues that have been on the radar for some time, “reporting expectations” and “new regulatory requirements,” inspired the most confidence in organizational readiness. It is also worth noting that respondents in the finance sector were the most consistently confident in their preparedness across all trends.

Respondent roles played a big part in responses as well. Compared to the views of CFOs, ACs generally attached higher priority levels to all issues, with significantly more concern expressed around “business model disruption,” “regulatory requirements,” “political and economic uncertainty” and “environment and climate change.”

Figure 1

Priority – overall trends

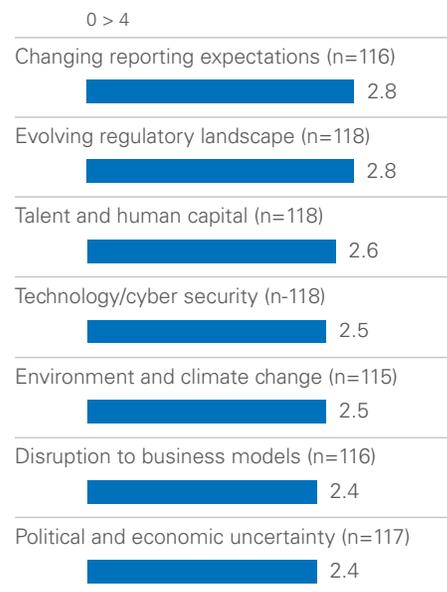


Scale: Level of priority:

- 0 = Not applicable
- 1 = Low priority
- 2 = Medium priority
- 3 = High priority
- 4 = Very high priority

Figure 2

Preparedness – Overall trends



Scale: Level of preparedness:

- 0 = Completely unprepared
- 1 = Mostly unprepared
- 2 = Fairly prepared
- 3 = Mostly prepared
- 4 = Completely prepared

1. Talent and human capital

This year's report identified the talent crunch as a top AC priority, a position in keeping with ongoing industry concerns. Clearly, companies are beginning to understand that, given the current level of business change and economic volatility, having a workforce that is not only highly skilled and motivated, but also diverse and inclusive, is a risk-critical strategy.

As the finance function rapidly evolves, due to both technological disruption and regulatory constraints, talent demands are changing dramatically. With leadership increasingly pressured to set the right tone from the top, efficiently manage efforts and resources, nurture the right risk appetite, increase financial analytical skills, and improve data quality and integrity, it's not surprising that roles like Chief Risk Officer (CRO), Chief Technology Officer (CTO), and Chief Financial Officer (CFO) are top of mind.

Strong finance, internal audit and risk management functions are key if organizations are to survive in the new business environment, where unnecessary risks (financial, reputational, regulatory, operational and more) can negatively impact organizations that do not effectively balance their technological constraints and capabilities.

In the cyber domain, for example, getting the right skills in the right place, clarifying roles and responsibilities, engaging the workforce – simply creating an overall risk-aware culture – are critical.

With respect to maintaining the overall finance talent pipeline, the capability focus is changing from basic professional

accounting skills to requiring critical thinking ability, as well as capabilities in risk monitoring, strategic data interpretation, and collaboration. Indeed, these will be needed to bring finance to the next required level of talent diversity and leadership inclusivity. Now, more than ever, finance has the opportunity to fill an integrator role, bringing together people from other functions to help make real changes to the first, second, and third lines of defense; reward the right risk appetite; and nurture a well-thought out "delegation of authority" that can develop insights into the challenges and risks ahead. Without effective talent and succession management and the bench strength to sustain it, talent mismatches, mistakes or lack of risk education exposes the organization to unnecessary risks and creates an environment where talent risk thrives.

Despite this potential for improvement in the corporate talent model, progress at the hiring level remains problematic, for example with visible minorities. By 2036, according to Statistics Canada, nearly half of Canadians will either be immigrants or children of immigrants, but companies are not keeping up. In Toronto alone " 3.3 percent of corporate boards and 9.2 percent of the private sector's senior management" were made up of visible minorities, despite the fact that they make up more than half the city's population, according to a recent report by Ryerson University's Diversity Institute. On the gender level, "progress on board diversity remains slow, with women in just 21 percent of board seats today and minorities in 15 percent among the top 200 largest companies" [Spencer Stuart Board Index as cited in KPMG's *On the 2018 Board Agenda* report].

"So much data gathering work is being automated now in internal audit and finance. Talent-wise, that means internal audit will be looking for people who are more astute on the levels of data and information analysis – people who can use data strategically to help the organization realize its vision and goals. We're really seeing the emergence of a different capability in internal audit, where it's moving from a 'doing' function to a 'leading/ influencing' function."

– **Soula Courlas**

Partner, National Leader, People & Change Services, KPMG in Canada



Survey highlights

- Top respondent concerns were the “talent pipeline within finance,” “CFO succession” and “ongoing learning and development for the finance function,” in that order.
- Despite the growing importance of risk management to achieving corporate goals and strategies, Chief Risk Officer (CRO) succession received low priority.
- Most respondents estimated that their organizations were only “fairly prepared” to “mostly prepared” for the talent challenges presented.
- Overall, ACs felt less prepared than CFOs with respect to talent issues, perhaps because ACs have access to less information when it comes to talent issues. Notably, on most other issues, ACs felt more prepared.

Talent and human capital



“The results of the Comply or Explain regulatory approach taken by certain European countries confirm that many organizations are ill-prepared and facing increased organizational risk in the absence of a rigorous approach to inclusion and diversity strategy. Despite diversity disclosure being added to the Canada Business Corporations Act (CBCA); changes coming to the Canada Labour Code (CLC) pertaining to workplace harassment; and institutional investor scrutiny continuing to increase, I’m still not seeing boards mitigating the risks associated with these trends. In fact, 60 percent of public company “inclusion and diversity” professionals recently surveyed indicated they are not designing new processes to prepare for the impending implementation of these laws.”

– Pamela Jeffery

Partner, National Lead, Inclusion and Diversity Strategy Group, KPMG in Canada

What should audit committees be asking?

- Do we currently do an annual review of finance, internal audit and risk talent? What types of human resources do we need to address the CEO’s strategic priorities?
- Do we have the right skills to meet new risks?
- Are we getting external advice to ensure succession planning is being done effectively?
- Is there a culture and diversity strategy in place at the leadership level?
- Do we clearly understand the changing landscape of our business and how that aligns with our workforce needs?
- Are we anticipating potential disruptive trends and innovations in demographics, technology, etc.?
- Do we truly have a long-term vision and focus, with a plan to realize it?
- Are we associated with educational institutions to help shape the changing skills and competencies of the function?

2. Technology and cybersecurity

Technology and cybersecurity consistently emerge as high priorities for ACs and finance departments, and this year was no different, with cybersecurity registering as a “high” to “very high” priority for ACs and CFOs. We have seen a number of high profile data breaches over the past year, and statistics tell a sobering story. For example, in a survey of 403 CIOs, CISOs, CTOs and CIOs in the automotive, banking, technology and retail sectors, KPMG found that 81 percent of executives said their companies had been compromised by cyber attacks in the previous 24 months.¹

We often associate cyber attacks with massive breaches of major multinational companies, but the fact is, everyone is exposed. According to some estimates, the average cost of a single data breach for a Canadian company is approximately \$6 million. Government and regulators are taking action, with both the US and Canada evolving measures requiring that public companies (the US) or those critical to national infrastructure (Canada) be able to demonstrate their cyber preparedness.

Cyber remains a top AC and CFO priority, but how are companies really doing?

Some survey responses raised interesting variances, such as cybersecurity rating at the top of “technology/cybersecurity”

concerns while an issue such as “protection of IP,” which might be considered a subset of cybersecurity, rated very low. It also seems likely that some claims with respect to preparedness may be over-confident, as rapid innovation has increased the challenge of keeping cybersecurity controls one hundred percent up to date. For example, there is not yet a broad understanding of how organizations will govern things like cloud services. While financial institutions, highly regulated and scrutinized as they are, may be well prepared, our experience suggests that other sectors could be more exposed.

While many cyber issues emerge in the report, KPMG has observed that the lack of discussion around upcoming legislation – potential or pending – is somewhat surprising. For example, mandatory cyber breach reporting is coming to Canada soon and multinational companies operating in the US may soon need a cybersecurity expert assigned to the AC. This and a range of other legislation should be on the AC radar.

Overall, it’s fair to say while dealing with ongoing cybersecurity issues can be challenging, maintaining that focus is not only a strong security measure, but a strategic one as well.

“Businesses really need to think harder about technology infrastructure, as it appears to be moving from a capex to an opex model. Organizations are unsure what their capital investment should look like going forward, as a pay-as-you-go approach is becoming more practical. This is an area that is changing at a tremendous rate and it just isn’t as well understood as it should be. For those that get it right, it could create significant innovation differentiation.”

– Yvon Audette

Partner and National Leader, IT Advisory, KPMG

¹ KPMG, July 26, 2016. Accessed at <https://home.kpmg.com/us/en/home/media/press-releases/2016/07/8-in-10-cyber-security-execs-admit-their-cos-have-been-breached-in-past-two-years-kpmg-survey.html>



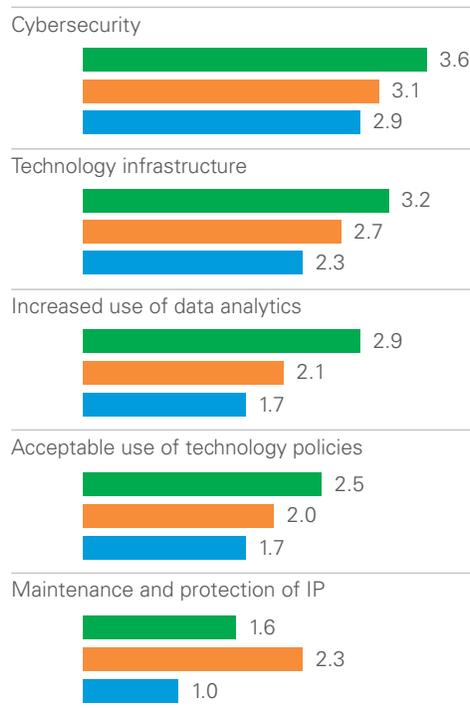
Survey highlights

- AC chairs and CFOs are broadly aligned on the high importance of cybersecurity on the AC agenda.
- Of the respondents representing the three largest industry sectors, those operating in banking and insurance assigned the highest priority to cybersecurity.
- Protection of IP (intellectual property) was identified as the most important priority for respondents in the manufacturing sector.
- Levels of preparedness for cybersecurity are highest in the financial sector, followed by technology infrastructure.
- Although respondents rated the increased use of data analytics as a high priority, levels of preparedness were the lowest in this space, with respondents rating themselves as only “fairly prepared.”

Technology and cybersecurity

Priority by industry

- Finance and insurance (n = 25)
 - Manufacturing (n = 14)
 - Mining (including energy) (n = 27)
- 0 > 4



What should audit committees be asking?

- Do we have a clear understanding of our enterprise risk profile with respect to cybersecurity?
- How is the organization managing risk around the goal of technological differentiation?
- Have we validated our level of preparedness with an external party, and have we developed strategies to deal with any gaps in our technology infrastructure?
- Is the organization engaged in data visualization, that is, using internally available and externally aggregated information to visually represent and assess its market performance?
- Does the AC have the right skills and competencies to address these issues?

3. Disruption to business models

Blockchain, app-based ridesharing, driverless cars, digital media streaming services, cloud computing – all are innovative technologies or platforms that have turned traditional business models on their heads.

Of course, truly disruptive innovations are by definition difficult to both anticipate and leverage – uncertainty is ingrained in the very concept. Yet ACs need to do their best, along with the board, to assess whether the organization is both alert to potential external disruptors, while also planning its own innovation strategy – one that will allow it to adapt quickly to change, leverage opportunity and manage the unavoidable accompanying risks.

Overall, CFOs and ACs in our *Audit Trends* survey rated disruption and innovation as one of their top three priorities, although neither – CFOs in particular – believed they were as prepared as they would like to be to respond.

When it comes specifically to the disruption of business models, the survey yielded some surprising results, especially the low priority assigned to “artificial intelligence.” This seems odd, as AI represents one of the biggest opportunities for organizations to improve efficiency and reduce risk. One explanation for this result may be that AI isn’t perceived to be as high on the negative risk spectrum – that is, its potential for adverse effects isn’t as prominent – as other business

model disruptors. However, that may unwisely overlook the opportunity spectrum – not only the critical chance to radically enhance efficiency, but also to reduce risk, for example, by minimizing the risk of manual human error in financial systems.

Companies that aren’t thinking of AI, and ACs that aren’t considering that agenda, could miss out on significant opportunities. The same is true for other disruptive innovations. For example, with the enormous amount of data becoming available to companies in real time, those mining data traditionally will miss out on far richer information and won’t be able to mitigate risk as effectively as their more innovative peers.

It’s critical for ACs to look beyond the risk of innovation to see its opportunities as well. To do this, they must become educated on disruptive technology and the principles of innovation – not only to challenge management on how they’re using technology to improve efficiency and reduce risk, but to understand the potential for new risks that may accompany technological adoption.

The AC isn’t generally seen as an organizational innovation driver, but if it gains the requisite knowledge around new technologies and innovations – by understanding how they can help reduce organizational risk – it may end up playing a more pivotal role than in the past.

“It is clear that the innovation agenda will continue to be a core focus for organizations, whether to optimize cost, differentiate the customer experience or grow new products and services. It is critical to move past the buzzwords and for ACs to truly understand the existing and future risks and opportunities posed through innovation disruption, which is occurring at an exponential rate.”

– Lee Alfrey

Partner, Audit Innovation, KPMG in Canada



Survey highlights

- Respondents gave the highest priority to “organizational agility and flexibility” and felt fairly prepared to navigate this issue.
- Artificial intelligence, despite its seeming prominence, was rated the lowest priority.
- Overall, respondents from the financial, manufacturing, and mining and energy sectors felt least prepared for artificial intelligence.
- Businesses of 20,000+ employees had, by a sizeable margin, the greatest concern about challenges to traditional business models.

Disruption to business models



What should audit committees be asking?

- How are both external and internal auditors leveraging technology to improve quality and reduce organizational risks?
- What steps need to be taken to ensure the security and privacy of data obtained for the use of technologies like D&A?

4. Evolving regulatory landscape

Boards and ACs are operating within a regulatory landscape that is increasingly complex and demanding. New reporting requirements and the challenges of expanded auditor reporting will require greater engagement by ACs, as well as improved internal coordination within the management team. In addition to familiarizing themselves with what is coming, ACs must also ensure management teams have a plan in place – as well as the capability to appropriately address it.

Although our survey data provides a fairly complete overview of what is on the horizon from a Canadian regulatory perspective, a broader North American perspective might provide additional insights. Specifically, Canadian companies cross-listed in the US should be paying close attention to new regulations coming from south of the border. A few additional observations might be made regarding the data. For instance, “mandatory firm rotation” is justifiably lowest priority, as such requirements have not been introduced in Canada and most organizations have dealt with these changes for impacted foreign subsidiaries. Expanded auditor reporting is a priority for both ACs and CFOs – not surprising given the recent developments in standard setting in both Canada and the US.

Finally, “country-by-country tax reporting” appeared as a low priority, presumably because it has been around for some time.

The changing tone of regulators – with many in the US going aggressively extra-territorial – also deserves some mention. The US Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB) are passing a range of regulations that Canadian regulators will likely review to determine their applicability to Canadian companies – for example, the SEC’s compensation clawback rules, which require the mandatory payback of executive incentive compensation following an accounting restatement. ACs should consider whether their organizations are allocating sufficient resources to address these issues.

The issue of “non-GAAP measures” continues to be a priority for both ACs and CFOs, although both feel prepared to deal with it. Due to the ongoing interest of securities regulators and investors in this area, ACs and CFOs should continue to review their management discussion and analysis (MD&A) disclosures and practices to ensure any non-GAAP measures are relevant, reliable, verifiable and understandable.

“In our globalized economy, organizations should start thinking not just about complying with regulations in other countries, but about whether their operations in those countries are living up to home country standards and regulations. This is particularly relevant given the rapid rise of social media and its use to highlight what individuals believe to be inappropriate corporate behaviour. Companies have a social responsibility to think about these issues, and their brand can be damaged if they are not properly addressed.”

– **John Gordon**

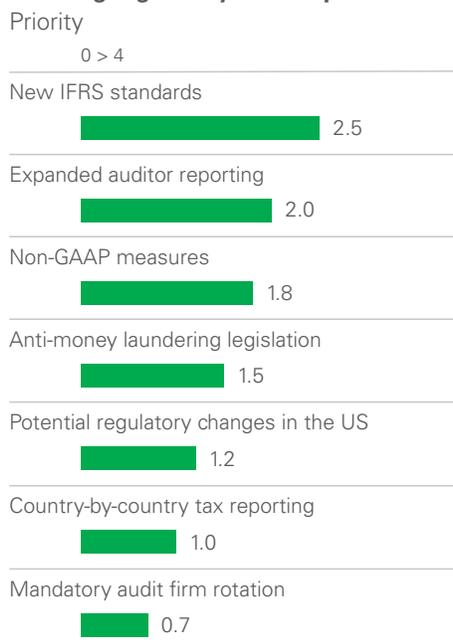
Canadian Managing Partner for Quality and Risk Management, KPMG in Canada



Survey highlights

- Respondents prioritized “new IFRS standards” the most highly, understandable given the amount of change coming in the next few years.
- ACs gave higher priority than CFOs to all issues, with the widest gaps in the cases of “new IFRS standards” and “expanded auditor reporting.”
- Respondents indicated a high level of preparedness across all regulatory issues and were confident in their ability to deal with the changing regulatory environment.
- Anti-money laundering rules were a “low” to “medium” priority for ACs and CFOs, who also felt only “fairly prepared” for this issue. Priority was predictably higher in the financial sector.
- Mandatory audit firm rotation received the lowest priority, which makes sense given that it is not required in Canada. Nevertheless, European subsidiaries of Canadian firms may be affected and should not ignore the issue altogether.

Evolving regulatory landscape



What should audit committees be asking?

- Are resources in place to ensure that implementation of the new IFRS standards goes smoothly? Has a gap analysis and impact assessment been conducted to understand how IFRS changes will affect the business overall?
- What is the purpose of the non-GAAP measures? Are they presented consistently, quarter to quarter? Is the presentation and disclosure of non-GAAP measures fair, balanced and transparent? Are they displayed with more prominence than the related GAAP measure?
- What is management’s process to calculate the non-GAAP measures? Are they subject to the same level of internal control as the results presented in accordance with GAAP? Should we consider obtaining assurance over the non-GAAP measures?
- What will expanded auditor reporting mean for the company? What are the key audit matters that will need to be disclosed?
- Is management monitoring regulatory developments globally to ensure they are prepared if and when such regulations come to Canada?

5. Political and economic uncertainty

Operating in an era of uncertainty is a major challenge for ACs today. Ongoing market volatility is exacerbated by a higher degree of geopolitical risk, evidenced by Brexit and the evolving stance of the US administration. Indeed, the prospect of changes to key US legislation and long-standing trade agreements is a significant area for AC attention.

Political and economic uncertainty is adding pressure to anticipate a broader range of potential business scenarios, and ACs must ensure the organization is prepared for multiple possibilities with widely varying potential impacts.

Much of this concern appears justified, as the US administration, for example, is taking an aggressive stance in NAFTA negotiations and is targeting traditional Canadian sectors such as dairy, softwood lumber and automotive. In this turbulent environment, ACs must be comfortable that management is positioned to respond as developments take place.

It's not surprising that economic volatility is at the top of respondent priorities, as so many other issues directly contribute to it. These results are certainly consistent with market experience, although relative priority depends largely on the industry. ACs and CFOs in forestry, for example, would rate the renegotiation of trade agreements much higher than those from other industries. Respondents in the tourism industry would have a similar reaction to the rise in US populism and protectionism. It's also clear that "uncertainty around regulatory change" weighs heavily, particularly on the manufacturing sector, given the significance of US trade relationships. It makes it difficult for companies to plan,

accurately forecast their financial future or confidently take strategic action.

With greater uncertainty on the horizon, a different mindset will be required – one that relies more on risk management and incorporates potential risk scenarios into corporate strategy. While organizations have a strong appreciation for the importance of managing strategic risk, some are still looking for more effective ways to put that knowledge into practice.

One critical action ACs can take, however, is to ensure that an enterprise risk management (ERM) framework that encompasses the three lines of defense – the business, compliance and internal audit – is in place to handle operational risks as they arise. A robust ERM framework can help an organization prepare for a range of challenges, such as disruptive technologies; regulatory changes that may impact them as investors or local players; operational concerns around hiring and firing; business growth issues; reviews of risk management controls; or what licences are required from the environmental or health and safety perspectives. When gauging the impacts of political uncertainty, organizations must cast their nets as widely as possible. Whether it be tax reform, NAFTA or Brexit, uncertainty will affect large corporations as well as private businesses. ACs must stay educated about political and economic uncertainty and ensure, through their oversight activities, that management is following and assessing the impact of those changes and putting the right ERM processes in place to better manage risks.

“For ACs to address risk issues around uncertainty – whether political or economic – they need access to, and engagement with, leading insights. Those insights can come from a variety of places: subject matter experts, experience gleaned from other boards, or external advisors who can assess the business and understand how the broad range of uncertainty-based risks applies.”

– Jonathan Kallner

Canadian Managing Partner, Clients and Markets, KPMG in Canada

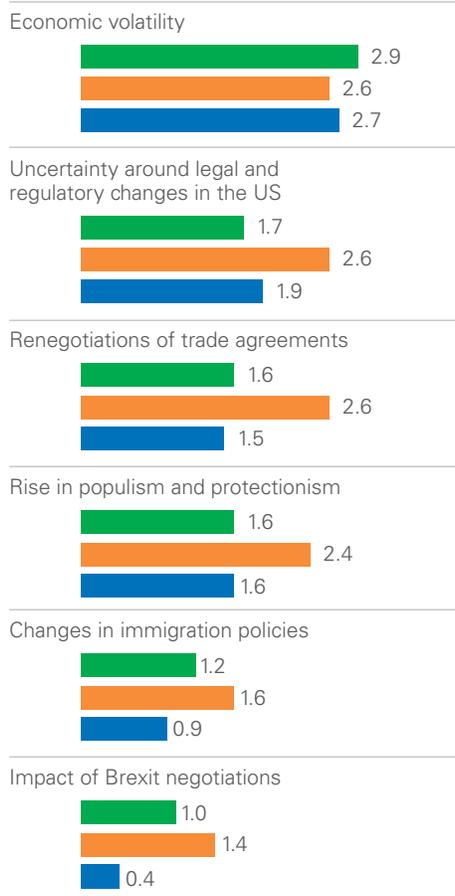
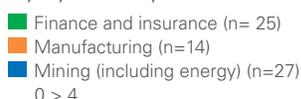


Survey highlights

- “Economic volatility” was by far the issue of highest concern for respondents.
- “Changes in immigration policies” and “the impact of Brexit” negotiations were rated as low priorities, possibly reflecting the fact that only a small number of Canadian companies have large UK and European operations.
- Issues related to the US – including “uncertainty around regulatory changes,” “renegotiation of trade agreements” and the “rise of populism and protectionism” – all rated as medium priority issues, perhaps reflecting their current unpredictability.
- Respondents from the manufacturing sector were the most concerned over regulatory changes, trade and protectionism – understandable given US market connections.

Political and economic uncertainty

Priority by industry



What should audit committees be asking?

- Do we know the business well enough to fully assess risks related to the current geopolitical and economic environments?
- Are we effectively engaging with the management team to understand how it is addressing these risks?
- Are we bringing relevant insights to the table and leveraging best practices from leading companies?

6. Changing reporting expectations

ACs are under increasing pressure as reporting requirements become more demanding; investor expectations around risk management disclosures rise; environmental, social and governance measures are scrutinized; and expanded reporting on key audit matters looms on the horizon. Although it remains important, the disclosure of financial information is only one of an expanding list of disclosure expectations. Striking the right balance when it comes to what is disclosed can put significant pressure on CFOs and ACs.

Boardroom discussions are now expected to be much more transparent than in the past. This changes the relationship between management and the AC as more information about risk is disclosed, and discussions will take place as to how this information should be conveyed to the public. Indeed, best practice organizations are already focusing on the future of reporting, staying ahead of the curve by pre-emptively adopting higher disclosure standards around risk management, key performance indicators (KPIs) and other emerging areas.

The survey data below reflects the current reporting preoccupations of Canadian businesses. Organizations are moving to report key performance indicators (KPIs) to provide investors with greater insights into how the business is being managed, as well as into future performance. Some types of KPIs, such as those reflecting customer retention rates

or greenhouse gas emissions, have not traditionally been disclosed, but they can be highly useful in providing investors, analysts and other stakeholders with a broad range of helpful reporting information.

There are, however, some issues around reporting KPIs. There are no current standards for many of these measures, so it can be hard for users to benchmark against them. KPIs and operational information that is derived from or appears outside traditional financial documents – for example, in a corporate responsibility report – may not be subject to the rigour and scrutiny of data found in a financial report. ACs should ensure management looks closely at the source of such information before it is published.

Underpinning the entire concept of reporting quality is that of enhanced quality of the audit itself. ACs should be thinking about how they assess audit quality, for example, by adopting a number of audit quality indicators (AQIs) or conducting an auditor assessment. AQIs can enhance audit quality by clarifying expectations between stakeholders and providing insights into how the audit is progressing. Whether an AC is conducting a comprehensive or an annual assessment of their auditor, insight into the quality of the engagement team and communications with the external auditor will be garnered.

“The importance of operational and non-financial metrics will only continue to increase. As a result, the finance function’s responsibilities will expand beyond traditional financial reporting and controls. Audit committees should ensure their finance function is taking the full range of externally reported KPIs into account and leveraging them to give external stakeholders more assurance around the accuracy of all reports.”

– **Doug King**

National Data & Analytics Leader, Audit, KPMG in Canada



Survey highlights

- Respondents rated the reporting of enterprise risk assessments and their mitigation measures as the highest priority in this category, but only a medium priority overall.
- Scrutiny of non-traditional communication channels (e.g., use of social media to communicate financial results) was given the lowest priority. With the increasing importance of social media as a communication platform, this is an issue that ACs are watching. ACs saw non-traditional communication channels as having a considerably higher priority than CFOs.
- Overall, levels of preparedness are less than for other trends, as most responses fall in the “fairly prepared” category. This is likely because these are all voluntary disclosures.

Changing reporting expectations



What should audit committees be asking?

- Do we have an oversight role for all financial and operational KPIs that are being reported by the organization?
- Do we understand and agree that the KPIs are key value drivers of performance?
- Who is accountable for the relevance, accuracy and reliability of the KPIs being used?
- Are we, as an audit committee, appropriately assessing the quality of the audit?
- What AQIs can we monitor that will provide better insight into the quality of the audit?

7. Environment and climate change

Climate change and its effects are clearly registering on the radars of Canadian organizations, with more than half of the 100 Canadian companies included in KPMG's 2017 Corporate Responsibility Reporting Survey (www.kpmg.com/crreporting) acknowledging climate change as a financial risk in their annual reports. Many of Canada's largest companies operate in the extractive, manufacturing and financial services sectors, where physical and transitional climate-related risks have become increasingly important strategic considerations. It's no surprise, then, that this global issue has made its way into this year's *Audit Trends* report.

The focus on climate change is certainly welcome as the potential business impacts of climate issues on corporations are significant. Interestingly, however, only 28 percent of respondents give the issue a "high" or "very high" priority. This level of response may be a problem going forward; many of the world's largest institutional investors are increasingly assessing companies' risk profiles based on their climate change exposures and related climate change mitigation and adaptation plans. The recently finalized recommendations of the Financial Stability Board-sponsored Task Force on

Climate-Related Financial Disclosures (TCFD) are providing impetus for this trend.

The lack of prioritization for public reporting may also be a red flag. Going forward, we expect climate disclosures to further increase due to rising expectations of securities regulators, the investor community and other stakeholders. Reporting issuers will need to provide more consistent information and may want to consider aligning their disclosures with the TCFD recommendations. We foresee expansion of forward-looking information and ultimately – especially for sectors that are significantly exposed to physical and transition risks – the inclusion of scenario analyses of potential impacts on their revenues and profitability.

Canadian securities regulators are now paying increased attention to climate change disclosures and challenging reporting issuers on the adequacy of their current filing documents in this regard. Accordingly, ACs should ensure that climate change considerations are formally incorporated within their organizations' disclosure governance practices and controls.

“Many of Canada's leading industry sectors could well suffer negative consequences from climate change if they don't take action. The cost of recent catastrophic weather events and the potential negative impact of climate change on business models and asset valuations are increasingly driving home this realization. To play an effective role, ACs have a responsibility to understand and ensure that management has addressed the potentially material impacts of climate change and related disclosure requirements.”

– **Bill Murphy**

National Leader, Climate Change & Sustainability Services, KPMG in Canada



Survey highlights

- The “impact of climate change on business,” “new environmental taxes and levies” and “increased pressure to report on environmental issues” were seen as low-moderate priorities by respondents, though their self-assessed levels of preparedness were higher.
- Environment and climate change issues are of considerably greater concern for AC chairs than for CFOs, a disconnect suggesting increased dialogue may be valuable.
- The finance and insurance sectors were most concerned about the business impacts of climate change, with lenders focused on loan security in the face of potential stranded assets and insurers focused on costs related to extreme weather events.
- Manufacturing, mining and energy companies showed more concern for potential new taxes and levies, consistent with various federal and provincial strategies to place an economic price on greenhouse gas emissions for large emitters.
- The mining and energy sectors felt most prepared to report on environmental issues, consistent with the longstanding scrutiny that the impacts of their extraction operations garner globally.

Environmental and climate change



What should audit committees be asking?

- Are environmental and climate change risks adequately reflected in the organization’s ERM framework?
- Are we aware of all external communications being made by the organization on climate change-related issues (e.g., sustainability reports, Carbon Disclosure Project responses, responses to stakeholder and analyst inquiries, community and regulatory presentations)?
- Has management received any inquiries from securities regulators regarding the sufficiency of our climate-related risk disclosures?
- Have the auditors been requested by management to provide assurance over any such disclosures?
- Has management familiarized themselves with the TCFD recommendations?
- Has management considered preparing scenario analyses to assess the potential impacts of climate risks and future regulations on the organization’s products, services, operations and market permissions?

Balancing past, present and future

Our survey clearly indicates that CFOs and ACs are largely aligned with respect to the coming year's priorities. This alignment, of course, bodes well for the future, but ACs in particular are facing an ongoing shift in their responsibilities, as well as in the knowledge and skill levels those responsibilities demand. Innovations such as AI, robotics, D&A, Blockchain and more promise an opportunity-rich but risk-intense future. Similarly, change continues apace in more traditional areas such as reporting and compliance.

No matter how their risk mandate expands and evolves, audit matters are still at the heart of the AC agenda; it's a balancing act that's becoming more difficult – and it demands an increasingly high level of excellence and leadership at the AC level. It's critical that ACs embrace this evolving and expanding role to provide oversight to the risk management process while staying agile enough to respond to emerging opportunities.

There is no blueprint for ACs to follow, but we believe some valuable practices can be gleaned from our report. Beyond ensuring they have the right makeup and skills to deal with the new technological reality, ACs can stay abreast of the regulatory landscape, not only in Canada but internationally; ensure management is taking steps to mitigate the effects of political and economic uncertainty; and confirm that management has begun to think about climate change as a business issue, not just a regulatory requirement.

While the coming year will be challenging, we hope the information and insights in this report will help both ACs and CFOs tackle the issues they've identified as most pressing – and perhaps help raise confidence that they're as prepared as they are informed.



Survey methodology

To identify and validate emerging key audit trends, KPMG commissioned the Conference Board of Canada to survey Audit Committees and Chief Financial Officers (CFOs) of Canadian companies. The goals were to understand AC priorities and gauge how prepared they are to meet current business challenges.

The survey was conducted from April 7 to June 8, 2017 and 118 completed responses were received from 51 AC members and 67 CFOs. Respondent companies came from the FP 500/800 and represented a cross-section of Canadian industries, with more than half of the sample coming from three sectors: finance and insurance; mining, oil and gas; and manufacturing. Some 70 percent of the respondents were from large firms, with employee numbers ranging from 500 to 20,000.

Understanding the responses

Respondents (both ACs and CFOs) rated their audit committees' levels of prioritization and preparedness for seven key issues: talent and human capital; technology/cybersecurity; disruption to business models; evolving regulatory landscape; political and economic uncertainty; changing reporting expectations; and environment and climate change. They used the following rating system:

Scale: Level of priority:

- 0 = Not applicable
- 1 = Low priority
- 2 = Medium priority
- 3 = High priority
- 4 = Very high priority

Scale: Level of preparedness:

- 0 = Completely unprepared
- 1 = Mostly unprepared
- 2 = Fairly prepared
- 3 = Mostly prepared
- 4 = Completely prepared

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