



On the 2023 audit committee agenda

KPMG Board Leadership Center



The business and risk environment has changed dramatically over the past year, with greater geopolitical instability, surging inflation, and the prospect of a global recession added to the mix of macroeconomic risks companies face in 2023.

Audit committees can expect their company's financial reporting, compliance, risk and internal control environment to be tested by an array of challenges in the year ahead—from global economic volatility and the Russia-Ukraine war to supply chain disruptions, cybersecurity risks and ransomware attacks, and social risks—including the tight talent market. The increasing complexity and fusion of risks, and the unexpected interconnectedness of these risks, put a premium on more holistic risk management and oversight.

In this volatile and opaque operating environment, demands from regulators, investors, and other stakeholders for action as well as increased disclosure and transparency—particularly around climate and other environmental, social, and governance (ESG) risks—will continue to intensify.

Drawing on insights from our interactions with audit committees and business leaders, we've highlighted eight issues to keep in mind as audit committees consider and carry out their 2023 agendas:

- Stay focused on financial reporting and related internal control risks—job number one.
- Clarify the role of the audit committee in overseeing the company's climate and other ESG risks—particularly the scope and quality of ESG reports and disclosures.

- Maintain a sharp focus on leadership and talent in the finance organisation.
- Reinforce audit quality and set clear expectations for frequent, candid, and open communications with the external auditor.
- Help ensure internal audit is focused on the company's key risks—beyond financial reporting and compliance—and is a valuable resource for the audit committee.
- Sharpen the company's focus on ethics, compliance, and culture.
- Stay apprised of global tax developments and risks and understand that tax has become an important element of ESG.
- Take a close look at the audit committee's composition and skill sets.



Stay focused on financial reporting and related internal control risks—job number one.

Focusing on the financial reporting, accounting, and disclosure obligations posed by the current geopolitical, macroeconomic, and risk landscape—including the Russia-Ukraine war, supply chain disruptions, cybersecurity, inflation, interest rates, market volatility, and risk of a global recession—will be a top priority and major undertaking for audit committees in 2023. Key areas of focus should include:

Forecasting and disclosures: Making tough calls

The uncertainties posed by the current geopolitical, macroeconomic, and risk landscape, coupled with the extensive use of forward-looking information in financial statements, continue to make disclosures about matters that directly or indirectly impact the company's business a top area of focus. Among the matters requiring the audit committee's attention:

- Disclosures regarding the impact of the Russia-Ukraine war and sanctions, supply chain disruptions, heightened cybersecurity risk, inflation, interest rates, market volatility, and the risk of a global recession
- Preparation of forward-looking cash-flow estimates
- Impairment of nonfinancial assets, including goodwill and other intangible assets
- Accounting for financial assets (fair value)
- Going concern.

With companies making more tough calls in the current environment, regulators are emphasising the importance of well-reasoned judgements and transparency, including contemporaneous documentation to demonstrate that the company applied a rigorous process. Given the fluid nature of the long-term environment, disclosure of changes in judgements, estimates, and controls may be required more frequently.

Internal control over financial reporting (ICOFR) and probing control deficiencies

Given the current geopolitical, macroeconomic, and risk environment, as well as changes in the business, such as acquisitions, new lines of business, digital transformations, etc., internal controls will continue to be put to the test in the coming year. Audit committees should discuss with management how the current environment affects management's disclosure controls and procedures and management's assessment of the effectiveness of ICOFR. When control deficiencies are identified, it's important to probe beyond management's explanation for "why it's not a material weakness" and help provide a balanced evaluation of the deficiency's severity and cause. Is the audit committee—with management—regularly taking a fresh look at the company's control environment? Have controls kept pace with the company's operations, business model, and changing risk profile, including cybersecurity risks? Does management talk the talk and walk the walk?

Audit committee members continue to express concern that overseeing major risks on the committee's agenda—beyond its core oversight responsibilities (financial reporting and related internal controls, and internal and external auditors)—is increasingly difficult. Demands for expanded disclosures regarding ESG risks have heightened concerns about audit committee bandwidth and "agenda overload."

Reassess whether the committee has the time and expertise to oversee these other major risks. Do cybersecurity, climate, ESG, and "mission-critical" risks such as safety require more attention at the full-board level—or perhaps the focus of a separate board committee? The pros and cons of creating an additional committee should be weighed carefully; but considering whether a finance, technology, risk, sustainability/ESG, or other committee—and perhaps the need for directors with new skill sets—would improve the board's effectiveness can be a healthy part of the risk oversight discussion.



Clarify the role of the audit committee in overseeing the company's climate and other ESG risks—particularly the scope and quality of ESG reports and disclosures.

Intensifying demands for higher quality ESG disclosures should prompt boards to reassess their oversight of ESG risks and disclosures. As investors, regulators, ESG rating firms, and other stakeholders seek ESG information that is decision-useful, accurate, and comparable, clarifying the role and responsibilities of the audit committee should be a priority.

Boards are taking various approaches to overseeing climate, cybersecurity and other ESG risks. *Also see [On the 2023 board agenda](#) for a discussion of cybersecurity risk.* For many, that oversight is a full-board function, with much of the heavy lifting done at the committee level. ESG/ Sustainability committees or designated working groups for ESG matters are becoming more common, but the audit, remuneration, and nomination committees all may have some responsibility.

For example, the remuneration committee will likely oversee any ESG related performance incentives, while the nomination committee will be concerned to ensure the right skills and experience are in place around the boardroom table and on the senior management team.

The audit committee typically has responsibility for overseeing ESG disclosures and disclosure frameworks, financial risks, legal/regulatory compliance risks, and perhaps the adequacy of the company's Enterprise Risk Management (ERM) processes generally.

With board standing committees playing a vital role in helping boards carry out their oversight responsibilities related to ESG risks (as well as broader strategic issues such as the ability of an organization to raise finance), there is a premium on information sharing and communication and coordination among committees so that the full board and the committees have important information they need for their ESG oversight. From the audit committee's perspective, given the financial reporting and internal control implications associated with ESG risks, the issue is particularly acute; audit committees need to recognise the types of input that other committees require from the audit committee, and these other committees must appreciate the information needs of the audit committee. Key areas in which information sharing is critical include:

- Considering where ESG information is disclosed— e.g., sustainability reports, and company websites.
- Helping to ensure that ESG information that is voluntarily disclosed is subject to the same level of rigor as financial information, including disclosure controls and procedures.
- Selection of an ESG reporting framework(s).
- Overseeing senior management on ESG disclosure management, including:
 - Clarifying the roles and responsibilities in connection with disclosures contained in ESG report, other ESG information that is voluntarily disclosed, websites, etc. — including coordination with cross-functional management of ESG team(s) or committee(s).
 - Reassessing the composition of the senior management on ESG disclosure management. Given the intense focus on ESG, the senior management on ESG disclosure management should include appropriate functional leaders from ESG, supply chain, information security and human resources.

- In preparation for the ESG disclosure, encouraging senior management to work with cross-functional management ESG team(s) to identify gaps, consider how to gather and maintain quality information, and closely monitor the rulemaking process.



Maintain a sharp focus on leadership and talent in the finance organisations.

Finance organisations face a challenging environment today—addressing talent shortages, while managing digital strategies and transformations and developing robust systems and procedures to collect and maintain high-quality ESG data both to meet investor and other stakeholder demands and regulatory requirements on ESG disclosure. At the same time, many are contending with difficulties in forecasting and planning for an uncertain environment.

As audit committees monitor and help guide finance's progress in these areas, we suggest two areas of focus:

- Many finance organisations have been assembling or expanding management teams or committees charged with managing a range of ESG activities, including enhancing controls over ESG information being disclosed in sustainability reports, e.g., identifying and recruiting climate and ESG talent and expertise, developing internal controls, and putting in place technology, processes, and systems.
 - Does the finance organisation have the leadership, talent, skill sets, and other resources necessary to address climate and other ESG reporting and to ensure that quality data is being collected and maintained?
 - How far along is the finance organisation in its preparations for new/ enhanced ESG disclosures?
- The acceleration of digital strategies and transformations that many companies are undertaking continues to affect finance organisations, presenting important opportunities for finance to add greater value to the business. As the finance function combines strong analytics and strategic capabilities with traditional financial reporting, accounting, and auditing skills, its talent and skill-set requirements must change accordingly.

- Is finance attracting, developing, and retaining the talent and skills necessary to match its evolving needs?

It is essential that the audit committee devote adequate time to understanding finance's ESG reporting and digital transformation strategies and help ensure that finance has the leadership, talent, and bench strength to execute those strategies.



Reinforce audit quality and set clear expectations for frequent, candid, and open communications with the external auditor.

Audit quality is enhanced by a fully engaged audit committee that sets the tone and clear expectations for the external auditor and monitors auditor performance rigorously through frequent, quality communications and a robust performance assessment.

In setting expectations of the external auditor for 2023, audit committees should discuss with the auditor what worked well in 2022, and the opportunities for improving audit quality in 2023? What complexity does hybrid or remote work add to the audit? How have the company's financial reporting and related internal control risks have changed in 2023 in light of the geopolitical, macroeconomic, and risk landscape—including the Russia-Ukraine war, supply chain disruptions, cybersecurity, inflation, interest rates, market volatility, climate change and other ESG issues, changes in the business, and the risk of a global recession? What are the auditor's plans to keep the 2023 audit and the 2023 interim reviews on track?

Set clear expectations for frequent, open, candid communications between the auditor and the audit committee—beyond what's required. The list of required communications is extensive, and includes matters about the auditor's independence, as well as matters related to the planning and results of the audit. Taking the conversation beyond what's required can enhance the audit committee's oversight, particularly regarding the company's culture, tone at the top, and the quality of talent in the finance organisation.

Audit committees should also probe the audit firm on its quality control systems that are intended to drive sustainable, improved audit quality—including the firm's implementation and use of new technologies.

In discussions with the external auditor regarding the firm's internal quality control system, consider the results of external and internal inspections and efforts to address deficiencies. Remember that audit quality is a team effort, requiring the commitment and engagement of everyone involved in the process—the auditor, audit committee, internal audit, and management.



Help ensure internal audit is focused on the company's key risks—beyond financial reporting and compliance—and is a valuable resource for the audit committee.

At a time when audit committees are wrestling with heavy agendas—and issues like ESG, supply chain disruptions, cybersecurity and data governance, and global compliance are putting risk management to the test—internal audit should be a valuable resource for the audit committee and a crucial voice on risk and control matters. This means focusing not just on financial reporting and compliance risks, but on critical operational and technology risks and related controls, as well as ESG risks.

ESG-related risks are rapidly evolving and include human capital management—from diversity, equity, and inclusion (DEI) to talent, leadership, and corporate culture—as well as climate, cybersecurity, data governance and data privacy, and risks associated with ESG disclosures. Disclosure controls and procedures and internal controls should be a key area of internal audit focus. Clarify internal audit's role in connection with ESG risks and ERM more generally—which is not to manage risk, but to provide added assurance regarding the adequacy of risk management processes. With the tight labour market, does internal audit have the talent it needs? Do management teams have the necessary resources and skill sets to execute new climate and ESG initiatives? Recognise that internal audit is not immune to talent pressures.

Given the evolving geopolitical, macroeconomic, and risk landscape, reassess whether the internal audit plan is risk-based and flexible enough to adjust to changing business and risk conditions. Going forward, the audit committee should work with the chief audit executive and chief risk officer to help identify the risks that pose the greatest threat to the company's reputation, strategy, and operations, and to help ensure that internal audit is focused on these key risks and related controls.

- What's changed in the operating environment?
- What are the risks posed by the company's digital transformation and by the company's extended organisation—sourcing, outsourcing, sales, and distribution channels?
- Is the company sensitive to early warning signs regarding safety, product quality, and compliance?
- What role should internal audit play in auditing corporate culture?

Set clear expectations and help ensure that internal audit has the resources, skills, and expertise to succeed—and help the chief audit executive think through the impact of digital technologies on internal audit.



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

The reputational costs of an ethics or compliance failure are higher than ever, particularly given increased fraud risk, pressures on management to meet financial targets, and increased vulnerability to cyberattacks. Fundamental to an effective compliance program is the right tone at the top and culture throughout the organisation, including commitment to its stated values, ethics, and legal/regulatory compliance. This is particularly true in a complex business environment, as companies move quickly to innovate and capitalise on opportunities in new markets, leverage new technologies and data, engage with more vendors and third parties across complex supply chains.

Closely monitor the tone at the top and culture throughout the organisation with a sharp focus on behaviours (not just results) and yellow flags.

- Is senior management sensitive to ongoing pressures on employees (both in the office and at home), employee health and safety, productivity, and employee engagement and morale?

As we have learned, leadership and communications are key, and understanding and compassion are more important than ever.

- Does the company's culture make it safe for people to do the right thing?
- It is helpful for directors to get out in the field and meet employees to get a better feel for the culture.

Help ensure that the company's regulatory compliance and monitoring programs are up to date, cover all vendors in the global supply chain, and communicate the company's expectations for high ethical standards.

Focus on the effectiveness of the company's whistleblower reporting channels (including whether complaints are being submitted) and investigation processes. Does the audit committee see all whistleblower complaints? If not, what is the process to filter complaints that are ultimately reported to the audit committee? With the radical transparency enabled by social media, the company's culture and values, commitment to integrity and legal compliance, and its brand reputation are on full display.



Stay apprised of global tax developments and risks, and understand that tax has become an important element of ESG.

Disruption and uncertainty continue to describe the global tax environment today for corporations—particularly multinationals.

Tax has also emerged as an important element of ESG, with stakeholders increasingly expecting companies to provide greater transparency and to conduct their tax affairs in a sustainable manner. Many ESG stakeholders view the public disclosure of a company's approach to tax, the amount of taxes paid, and where those taxes are paid as important elements of sustainable tax practice. We have now seen several shareholder proposals calling for companies to report on their tax practices on a country-by-country basis under the Global Reporting Initiative. In this environment, it is important for audit committees to engage with management in at least three areas:

- Understand the risks posed by the uncertainty and complexity of this evolving tax landscape, as it is likely to have a significant effect on the company in the coming years.
- Help articulate the company's tolerance for reputational risk associated with tax choices that are being made, and evaluate the extent to which the corporate governance framework and associated controls are in place to minimise this risk and/or improve ESG scores.
- Help determine the right approach to tax transparency, as there is not yet a consensus as to what level of reporting constitutes "good tax transparency." Management teams will need to consider stakeholder expectations, relevant standards, regulators, and the tax transparency disclosures of their peers.



Take a close look at the audit committee's composition and skill sets.

As the role and responsibilities of the audit committee continue to expand and evolve beyond its responsibility for financial reporting and control risks, the committee should revisit whether it has the right composition and skill sets.

In making that assessment, we recommend three areas to probe as part of the committee's annual self-evaluation:

- Does the committee include members with the experience and skill sets necessary to oversee areas of risk (beyond its core responsibilities) that the audit committee has been assigned—such as cyber and data security, supply chain issues and geopolitical risk, ESG risks and disclosures, or climate?
- How many audit committee members spent their careers working on financial accounting, reporting, and control issues? Is the committee relying only on one member to do the “heavy lifting” in the oversight of financial reporting and controls? A dialogue among two or more committee members with a deep understanding of the issues is essential.

- As the audit committee's workload expands to include oversight of disclosures for nonfinancial information—including climate, environmental and social issues—as well as related disclosure controls and procedures and internal controls, does the committee have the necessary financial reporting and internal control expertise to effectively carry out these responsibilities as well as its core oversight responsibilities? Does the committee need to hire experts in order to discharge its oversight duties?

With investors and regulators focusing on audit committee composition and skill sets—as well as audit committee agenda overload—this is an important issue for audit committees.

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