



# On the 2019 Audit Committee Agenda

KPMG Board Governance Center

Audit Committees can expect their company's financial reporting, compliance, risk and internal control environment to be put to the test in the year ahead. Among the top challenges and pressures: long-term economic uncertainty (with concerns about elections, mounting trade tensions, resurging debt, and market valuations), technology advances, business model disruption, cyber risk, regulatory scrutiny and investor demands for transparency, political swings and policy changes in Nigeria, US, UK, and elsewhere.

Drawing on insights from our interactions with audit committees and business leaders over the past twelve months, we've highlighted six items that audit committees should keep in mind as they consider and carry out their 2019 agendas:

## 1. Take a fresh look at the audit committee's agenda and workload

We continue to hear from audit committee members that it is increasingly difficult to oversee the major risks on the committee's agenda in addition to its core oversight responsibilities (financial reporting and related internal controls, and oversight of internal and external auditors). Aside from any *new* agenda items, the risks that many audit committees have had on their plates - cyber security and IT risks, supply chain and other operational risks, legal and regulatory compliance - have become more complex, as have the committee's core responsibilities. There needs to be a reassessment of whether the committee has the time and expertise to oversee these other major risks. Does cyber risk require more attention at the full-board level, or perhaps a separate board committee? Is there a need for a compliance or risk committee (if they don't already exist)? Keeping the audit committee's agenda focused will require vigilance.

## 2. Sharpen the company's focus on ethics and compliance

The reputational costs of an ethics or compliance failure are higher than ever. Fundamental to an effective compliance programme is the right tone at the top and culture throughout the organisation - one that supports the company's strategy and 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, and engage with more vendors and third parties across longer and increasingly complex supply chains. Audit committees should closely monitor the tone at the top and culture throughout the organisation with a sharp focus on behaviours, not just results. The Committee should also help ensure that the company's regulatory compliance and monitoring programmes are up-to-date, cover all vendors in the global supply chain and clearly communicate the company's expectations for high ethical standards. There should also be a focus on the effectiveness of the company's whistle-blower reporting channels and investigation processes. Does the audit committee see all whistle-blower complaints and how they have been addressed? If not, what is the process to filter complaints that are ultimately reported to the audit committee? As a result of the radical transparency enabled by social media, the company's culture and values, commitment to integrity and legal compliance, and its brand reputation are on display as never before.

### 3. Understand how the finance team will reinvent itself and add greater value in this technology and data-driven environment

Over the next two years, we expect finance functions to undergo the greatest technological transformation since the 90's and the Y2K ramp-up. This will present important opportunities for finance to reinvent itself and add greater value to the business. As audit committees oversee and help guide finance's progress in this area, we suggest several areas of focus.

First, recognising that the bulk of finance's work involves data gathering, what are the organisation's plans to leverage robotics and cloud technologies to automate as many manual activities as possible, reduce costs, and improve efficiencies? Second, how will finance use data and analytics and artificial intelligence to develop sharper predictive insights and better deployment of capital? As historical analysis becomes fully automated, the organisation's analytics capabilities should evolve to include predictive analytics, an important opportunity to add real value. Third, as the finance function combines strong analytics and strategic capabilities with traditional financial reporting, accounting, and auditing skills, its talent and skill-sets must change accordingly. Is finance attracting, developing, and retaining the talent and skills necessary to deepen its bench strength and match its evolving needs? It is essential that the audit committee devote adequate time to understand finance's transformation strategy.

### 4. Monitor corporate reporting as well as progress on implementing new standards

The scope and complexity of implementation efforts for the new IFRS standards and the impact on the business, systems, controls, disclosures, and resource requirements should be a key area of focus.

IFRS 9 *Financial Instruments* – effective for December 2018 year ends - will have the greatest impact on banks. Companies should be analysing the implications of adoption and considering the adequacy of transition disclosures. While the nature and extent of preparations will vary, companies need to thoroughly evaluate the effect of the standard and determine what changes are necessary. Companies may need to collect more data, update their documentation and significantly change their systems, processes, and internal controls.

Looking forward, the new leasing standard (IFRS16) is almost here - periods beginning on or after 1 January 2019 - and companies should now be in a position to explain the impact of the new requirements in their December 2018 annual

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reports. Finally, take time to stand back and reflect on whether the financial statements are really "true and fair" as the 'public' would expect. Is the annual report really "fair, balanced and understandable"?

Think about all the awkward things where there might be some reluctance to be open. And keep at least a weather eye on what your key investors are thinking. Some investors are becoming increasingly vocal about what they want to see in corporate reporting - at a general level, at a sector level and at individual company level - but this may not be communicated directly to the audit committee or the CFO.

### 5. Reinforce audit quality by setting clear expectations for the auditor

To ensure the auditor's independence from management and to obtain 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. Think about how technology innovation might drive the quality of the external audit and whether the audit firm is making the most of the opportunities available.

### 6. Focus internal audit on the company's key risks and controls – including those beyond financial reporting and compliance.

As recent headlines demonstrate, failure to manage key risks - such as tone at the top, culture, legal/regulatory compliance, incentive structures, cybersecurity, data privacy, global supply chain and outsourcing risks, and environmental, social and governance risks - can potentially damage corporate reputations and impact financial performance.

The audit committee should work with the Head of Internal Audit to help identify the risks that pose the greatest threat to the company's reputation, strategy and operations and help ensure that internal audit is focused on those risks and related controls. Is the audit plan risk based and flexible enough to adjust to changing business and risk conditions? Have there been changes 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? Is internal audit helping to assess and monitor the company's 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. Finally, think about how internal audit might leverage new technology and innovation. This receives less attention than technology within the external audit but probably presents the greater opportunity to both move to a continuous assurance model and enhance the quality of overall assurance.

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