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On the 2016 audit committee agenda

Audit Committee Institute

Prioritising a heavy audit committee agenda is never easy, and 2016 will be particularly challenging given the level of volatility and uncertainty – e.g. the political environment, commodity prices, interest rates, currency fluctuations, slowing growth in key markets – as well as technology advances disrupting established business models. Drawing on insights from surveys and interactions with audit committees and business leaders over the past 12 months, the Audit Committee Institute has highlighted six items for audit committees to keep in mind as they consider and carry out their 2016 agendas:

Maintain (or retain) control of the committee's agenda.

This number-one item from last year holds true for 2016. In ACI's 2015 Global Audit Committee Survey, nearly half of the 1,500 audit committee members who responded said it is "increasingly difficult" to oversee the major risks on the audit committee's agenda in addition to its core responsibilities (financial reporting and related internal controls, and oversight of internal and external auditors). Even in the absence of any new agenda items, the risks that many audit committees have had on their plates for some time – e.g. cyber security and IT risk, supply chain and other operational risks, legal and regulatory compliance – have become more complex, as have the audit committee's core responsibilities. Keeping the committee's agenda focused – and its eye on the ball – in 2016 will require an agenda that's manageable and realistic given the audit committee's time and expertise; a sharp focus on what's most important (starting with financial reporting and audit quality); allocating time for robust discussion while taking care of "must do" compliance activities; maximising the value of internal audit (as the committee's "eyes and ears"); and ensuring the committee has the right composition and leadership.

Leading audit committees are recognising that efficiency and effectiveness *inside 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 organisation.

Quality financial reporting starts with the CFO and finance organisation; maintaining a sharp focus on leadership, succession planning, and bench strength is critical.

In ACI's global survey, 42 percent of respondents said their audit committee is "not effective" in CFO succession planning. 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 for other key finance executives, including the controller, chief accountant, chief audit executive, and treasurer, and perhaps the chief compliance and chief risk officers. How does the audit committee assess the finance organisation's talent pipeline? Do they have the training and resources they need to succeed? How are they incentivised to stay focused on the company's long-term performance?

Monitor fair value estimates, impairments, and judgements impacting key assumptions underlying other critical accounting estimates.

These issues, together with loss contingencies, pension funding shortfalls, going concern challenges, significant and unusual transactions, and financial relationships and transactions with executive officers should continue to be a major area of focus for the audit committee. Recognise that the company's greatest financial reporting risks are often in those areas where there's a range of possible outcomes and management has to make difficult judgements and estimates. Quality financial reporting requires a disciplined, robust, and unbiased process to develop accounting judgements and estimates. To that end, understand management's framework, help ensure that management has appropriate controls in place, and ask for the external auditor's views.

Assess the company's readiness for the new revenue recognition and leasing standards and for new tax reporting.

The IASB has deferred the effective date of the new revenue standard by one year – until January 1, 2018. The new standard, which will change the way many companies recognise the revenue from customer contracts, will have a significant impact across the company – from business terms, conditions, and contracting processes to systems, data, and accounting processes.

Companies should use the additional transition time for the new leasing standard, to finalise implementation plans, identify areas that require close attention, and implement the necessary changes to processes, systems, and controls.

New and increased tax reporting obligations are also on the immediate horizon. There has been a growing number of calls for global companies to be more transparent about where they operate, where they make their profits and how much tax they pay. This has resulted in a number of new regimes which require different levels of tax disclosures, some to the public and some to the tax authorities, for example:

- The ATO publicly disclosed information about certain corporate tax entities in December 2015
- The Board of Taxation recently released a consultation paper on the development of a proposed tax transparency code
- Recommendations from the 2015 Senate Inquiry into Corporate Tax Avoidance including adopting a country by country tax reporting regime, implementing a mandatory tax reporting code and a public register of tax avoidance settlements.

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 C-by-C data and appropriately defend our transfer pricing strategies?

Reinforce audit quality and set clear expectations for the external auditor.

Audit quality is enhanced by a fully engaged audit committee. Set the tone and clear expectations for the external auditor, and monitor auditor performance through frequent, quality communications and a robust performance assessment. Pay close attention to regulatory initiatives to identify audit quality indicators (AQIs) that may provide insights into audit quality. Have the audit committee, management, and the external auditor identified AQIs that will enhance understanding of the audit and how to maintain or improve audit quality? Does the audit committee's evaluation of the external auditor take those AQIs into account? Be sure to have discussions with the external auditor regarding the firm's internal quality control system – including results of regulatory and internal inspections and efforts to address any deficiencies.

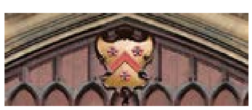
Stay apprised of global external audit reform initiatives focused on enhancing auditor independence, objectivity, and professional scepticism – particularly new requirements expanding the auditor's report.

Also, work with the auditor to understand how the audit process – both execution and results – may be impacted by the use of data and analytics (D&A), which most major audit firms are moving toward. Remember that audit quality is a team effort, requiring the commitment and engagement of everyone in the process – the auditor, the audit committee, and management.

Consider how the company's disclosures can better tell the company's story.

Think about going beyond what's required to provide a fuller picture not only of the company's recent performance, but also where it's headed and the key risks it faces. In addition to traditional financial metrics, can the company provide investors with greater insight into the drivers of long-term growth, such as customer satisfaction, talent, or innovation? Do "cut the clutter" disclosure initiatives signal the beginning of a new generation of leaner and cleaner financial disclosures? Consider ways to enhance governance policy disclosures to provide greater insight into how the audit committee carries out its oversight responsibilities.

About KPMG's Audit Committee Institutes



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