KPMG

On the 2016 audit committee agenda

Audit Committee Institute

Prioritizing a heavy audit committee agenda is never easy, and 2016 will be particularly challenging given the level of global volatility and uncertainty—e.g., the geopolitical environment, commodity prices, interest rates, currency fluctuations, slowing growth in emerging markets—as well as technology advances disrupting established industries and business models. Drawing on insights from our latest surveys and interactions with audit committees and business leaders over the past 12 months, we've highlighted six items for audit committees to keep in mind as they consider and carry out their 2016 agendas:

Maintain (or regain) control of the committee's agenda.
This number-one item from last year holds true for 2016. In our 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; maximizing 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 recognizing 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 organization.

Quality financial reporting starts with the CFO and finance organization; maintaining a sharp focus on leadership, succession planning, and bench strength is critical.
In our 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 organization's talent pipeline? Do they have the training and resources they need to succeed? How are they incented to stay focused on the company's long-term performance? What are the internal and external auditors' views?

Monitor fair value estimates, impairments, and judgments 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. Recognize 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 judgments and estimates. The PCAOB has expressed concern about adverse inspection findings pertaining to critical accounting estimates, and the SEC's use of data and analytics to look for outliers in MD&As point to heightened scrutiny in this area. Quality financial reporting requires a disciplined, robust, and unbiased process to develop accounting judgments 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 FASB's new revenue recognition standard and for new country-by-country tax reporting.
The FASB and IASB have deferred the effective date of the new revenue standard by one year—until January 1, 2018 for calendar-year end public companies. The new standard, which will change the way many companies recognize 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 to finalize implementation plans, identify areas that require close attention, and implement the necessary changes to processes, systems, and controls. (The FASB plans to issue additional guidance on the revenue standard early in 2016.)

The obligation to report country-by-country tax information to all jurisdictions is also on the immediate horizon. 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. In October, the Organisation for Economic Co-operation and Development (OECD) released its final report—a 15-point action plan—focused on addressing the perceived profit-shifting behaviors of multinational enterprises that contribute to erosion of the tax bases of countries. Under the OECD's Base Erosion and Profit Shifting (BEPS) project, multinationals with more than 750 million euros in revenue will be required to provide, in a single country-by-country (C-by-C) report, detailed information about every jurisdiction in which they operate. The first C-by-C reports will relate to fiscal years beginning on or after January 1, 2016, with the report due one year later. (For multinationals with fiscal years ending December 31, 2016, the report would be due by December 31, 2017.) Many countries, including the U.S., have signaled their intent to adopt the OECD recommendations—including the C-by-C reporting requirements—immediately. 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. (See the Center for Audit Quality's *External Auditor Assessment Tool*.)[1] Pay close attention to the PCAOB's initiative 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 PCAOB and internal inspections and efforts to address any deficiencies. (See the PCAOB's *Audit Committee Dialogue*, released in 2015, for a summary of the PCAOB inspection process and insights into its findings.) 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—and the audit committee's.

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? Does GE's recently revamped form 10-K[2]—as well as disclosure initiatives undertaken by regulators—signal the beginning of a new generation of leaner and cleaner financial disclosures? Also, consider ways to enhance the audit committee's disclosures (in the audit committee report and elsewhere in the proxy) to provide greater insight into how the audit committee carries out its oversight responsibilities. In response to the SEC's Concept Release on Audit Committee Reporting Requirements,[3] the majority of comments supported a voluntary framework to enhance disclosures—a growing trend that's highlighted in the CAQ's 2015 *Audit Committee Transparency Barometer*.

Also see KPMG's "On the 2016 Board Agenda" at kpmg.com/blc.

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[1] *External Auditor Assessment Tool: A Reference for Audit Committee's Worldwide*, Center for Audit Quality, 2015
[2] *Next-Generation Financial Disclosures*, NACD Audit Committee Advisory Chair Council, October 2015
[3] SEC comment period closed September 30, 2015
