KPMG

On the 2017 audit committee agenda

Audit Committee Institute

Financial reporting, compliance, and the risk and internal control environment will continue to be put to the test in 2017 - by slow growth and economic and geopolitical uncertainty, technology advances and business model disruption, cyber risk, greater regulatory scrutiny and investor demands for transparency, and more. Focused, yet flexible agendas, exercising judgment about what does and does not belong on the committee's agenda, and when to take deep dives, will be critical. Drawing on insights from our recent ACI pulse survey work and interactions with audit committees and business leaders over the past 12 months, we have highlighted seven items that, in our opinion, audit committees should keep in mind as they consider and carry out their 2017 agendas:

Reinforce the audit committee's direct responsibility for the external auditor. Overseeing the auditor selection process including any (mandatory) tender process and auditor independence is a key part of an audit committee's role. Regular audit tendering and rotation is already 'business as usual', but the new regulatory regime includes some requirements that are difficult to navigate and in some cases will significantly impact the way audit committees of Public Interest Entities (PEI) operate in practice. Read ACI's Audit Tendering Guide to help ensure the tender process is carried out in an efficient and effective manner and can deliver lasting benefits to your company. 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.

Give non–GAAP financial measures a prominent place on the audit committee agenda. Following ESMA's final report on alternative performance measures (APMs) published in 2015, the FRC and others have expressed concern about the undue prominence given to alternative performance measures over the equivalent IFRS measures. While alternative performance measures can provide valuable insight into a company and the extent to which its business model is successful, the way alternative performance measures are presented and how they relate to the information presented in the financial statements should have a prominent place on the audit committee agenda. Have a robust dialogue with management about the process and controls by which management develops and selects the alternative performance measures it provides, their correlation to the actual state of the business and results, and whether the alternative performance measures are being used to improve transparency and not distort the balance of the annual report. (See our recent paper on APMs Presenting performance: the journey to greater clarity)

Monitor implementation plans and activities for major accounting changes on the horizon — particularly the new revenue recognition and lease international accounting standards. The scope and complexity of these implementation efforts, and the impact on the business, systems, controls, and resource requirements, should be a key area of focus for audit committees. The new revenue standard (effective 1 January, 2018 for calendar year–end companies) provides a single revenue recognition model across industries, companies, and geographical boundaries. While the impact will vary across industries, many companies - particularly those with large, complex contracts - will experience a significant accounting change when implementing the new standard. The new standard will require companies to apply new judgments and estimates, so audit committees will want to inquire about the judgment and estimates process, and how judgments and estimates are reached. Under the new lease standard (effective January 1, 2019 for calendar year–end companies) lessees will recognise most leases, including operating leases, on the balance sheet. This represents a wholesale change to lease accounting, and many companies will face significant implementation challenges during the transition. Implementation of these two new standards is not just an accounting exercise; audit committees will want to receive periodic updates on the status of implementation activities across the company (including possible trouble spots), the adequacy of resources devoted to the effort, and the plan to communicate with stakeholders.

Redouble the company's focus on ethics and compliance. Whether moving quickly to innovate and capitalise on opportunities in new markets, leveraging new technologies and data, and/or engaging with more vendors and third parties across longer and increasingly complex supply chains, most companies face heightened compliance risks. Coupled with the complex global regulatory environment - the array of new healthcare, environmental, financial services, and data privacy regulations - these compliance risks and vulnerabilities will require vigilance. Help ensure that the company's regulatory compliance and monitoring programmes are up–to–date and cover all vendors in the global supply chain, and clearly communicate the company's expectations for high ethical standards. Take a fresh look at the effectiveness of the company's whistleblower program. 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? 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. Ask for internal audit's thoughts on ways to audit/assess the culture of the organisation.

Focus internal audit on key areas of risk and the adequacy of the company's risk management processes generally. Internal audit is most effective when it is focused on the critical risks to the business, including key operational risks (e.g., cyber security and technology risks) and related controls - not just compliance and financial reporting risks. Help define the scope of internal audit's coverage - and if necessary, redefine internal audit's role. Is the audit plan risk–based and flexible? And does it adjust to changing business and risk conditions? What has changed in the operating environment? What are the risks posed by the extended organisation e.g. sourcing, outsourcing, sales and distribution channels? What role should internal audit play in auditing the culture of the company? Set clear expectations and make sure internal audit has the resources, skills, and expertise to succeed. Challenge internal audit to take the lead in coordinating with other governance, risk, and compliance functions within the organisation to limit duplication and, more importantly, to prevent gaps. Help maximise collaboration between internal and external auditors. As internal audit moves to a higher value–add model, it should become an increasingly valuable resource for the audit committee.

Quality financial reporting starts with the CFO and finance function; maintain a sharp focus on leadership and bench strength. In our latest global pulse survey "Is everything under control?" (to be published January 2017), 44 percent of audit committees were not satisfied that their agenda is properly focused on CFO succession planning, and another 46 percent were only somewhat satisfied. 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 - the financial controller, chief accountant, head of internal audit and treasurer - and perhaps the chief compliance and chief risk officers. How does the audit committee assess the finance team'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? What are the internal and external auditors' views?

Make the most of the audit committee's time together—inside and outside the boardroom. To address heavy workloads, many audit committees are focusing on ways to improve their efficiency and effectiveness - including refining their agendas and oversight processes, and reassessing their skills and composition. Keeping pace requires agendas that are manageable (what risk oversight responsibilities are realistic given the audit committee's time and expertise?); focusing 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; and ensuring the committee has the right composition and leadership. Leading audit committees recognise that the committee's efficiency and effectiveness in the boardroom increasingly hinges on spending time *outside of the boardroom* - visiting company facilities, interacting with employees and customers, and hearing outside perspectives - to truly understand the tone, culture, and rhythm of the organisation.

Also see KPMG's **'On the 2017 board agenda'** at kpmg.co.uk/aci.

Contact us:

Timothy Copnell
Audit Committee Institute
T: +44 (0)20 7694 8082
E: tim.copnell@kpmg.co.uk
www.kpmg.co.uk/aci