



# 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 uncertainty, technology advances and business model disruption, cyber risk, greater regulatory scrutiny, as well as dramatic political swings and policy changes in the US, UK, and elsewhere. Amidst this rapidly changing landscape, stakeholders are demanding increased information and transparency, especially in relation to key issues that auditors have focused on in their communications with audit committees. The role of the audit committee is evolving to respond to stakeholder expectations to also provide their views on the Key Audit Matters (KAMs) raised by the auditors. Drawing on insights from our recent survey work and interactions with audit committees and business leaders over the past 12 months, we have highlighted eight items that audit committees should keep in mind as they consider and carry out their 2017 agendas.

– **Irving Low**, KPMG in Singapore, Head of Risk Consulting



**Clarify the audit committee's role in reviewing and commenting on the Key Audit Matters in the enhanced auditor's report.**

The Singapore Standards of Auditing 700-720 set out the enhanced audit requirements that apply to audits of financial statements for the periods ending on or after 15 December 2016. In addition to reviewing the enhanced auditor's report (including the auditor's views on KAMs, Other Information and Going Concern), Singapore audit committees are now

encouraged to prepare 'commentary' in relation to the KAMs. In preparing the audit committee commentary, the audit committee should ensure there is a process in place to engage with the auditor and management to review and consider the KAMs. In addition, audit committees should establish a process to form a view on the KAMs and clarify where the audit committee commentary will be included in the annual report. Engaging in early and open communication with the auditor is crucial in this regard.



### **Reinforce the audit committee's direct responsibility for the external auditor.**

—specifically overseeing the auditor selection process including any (mandatory) tender process and auditor independence. Audit tenders are quickly gaining momentum in many countries around the world—legally required or otherwise. The audit committee should ensure the tender process is carried out in an efficient and effective manner.

Read ACI's *Audit Tendering Guide* to ensure the tender process delivers lasting benefits to your company. To ensure the auditor's independence from management and to obtain its 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.



### **Redouble the company's focus on ethics, compliance, and culture.**

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 whistle-blower programme. Does the audit committee see *all* whistle-blower 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, its 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 and effectiveness of the company's risk management and internal control systems.**

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—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-added model, it should become an increasingly valuable resource for the audit committee.



### **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 January 1, 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.



**Give non-GAAP financial measures a prominent place on the audit committee agenda.**

Following the European Securities and Market Authority's final report on alternative performance measures published in 2015, regulators (and investors) in the U.S., UK and elsewhere have expressed concerns about misleading non-GAAP financial measures and published additional guidance to help companies evaluate the usefulness and acceptability of non-GAAP financial information. SEC Chair Mary Jo White said: "In too many cases, the non-GAAP information, which is meant to supplement the GAAP information, has become the key message to investors, crowding out and effectively supplanting the GAAP presentation." In this environment, it is critical that non-GAAP financial measures 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 non-GAAP financial measures it provides, their correlation to the actual

state of the business and results, and whether the non-GAAP financial measures are being used to improve transparency and not to distort results.



**Quality financial reporting starts with the CFO and finance function; maintain a sharp focus on leadership and bench strength.**

In our latest pulse survey, 50 percent of Singapore audit committees were not satisfied that their agenda is properly focused on CFO succession planning, and the other 50 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 also for other key finance executives—the controller, chief accountant, chief audit executive, treasurer—and perhaps the chief compliance and chief risk officers. How does the audit committee assess the finance organisation's talent pipeline? Do employees 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 is 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 understand the tone, culture, and rhythm of the organisation.

Also see KPMG's *On the 2017 Board Agenda* at [kpmg.com.sg/aci](https://www.kpmg.com.sg/aci)

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