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Disruptive trends: Regulation

Disruption on multiple fronts is putting audit committees on high alert

Audit Committee Institute part of KPMG Board Leadership Centre

The continuing increase in global regulatory complexity –much of it in response to the last financial crisis -has a potentially disruptive effect on companies and their audit committees.

There are a number of emerging regulatory issues that audit committees should be aware of going forward:

IFRS 9 –Financial Instruments The release of IFRS 9 completes a project launched by the International Accounting Standards Board (IASB) in 2008 in response to the financial crisis. The new standard includes

revised guidance on the classification and measurement of financial assets, including a new expected credit loss model for calculating impairment and introduces a more

principles-based approach to hedge accounting that is closely aligned with risk management. The mandatory effective date is 1 January 2018, however, the standard can be early adopted.

IFRS 15 –Revenue from Contracts with Customers

Recognising the need for more consistency around revenue recognition, the IASB and FASB have released a substantially converged standard to take effect in 2018. It will replace all existing IFRS and US GAAP revenue guidance.

IFRS 16 –Leases will fundamentally change the accounting treatment of leases for lessees establishing a single, on-balance sheet accounting model that is similar to current finance lease accounting. This standard will require companies to bring most leases on-balance sheet from 2019.

IFRS 4 – Insurance Contracts The IASB is finalising an amendment to IFRS 4, which would permit qualifying entities to temporarily defer implementation of IFRS 9 (with additional disclosures) or overlay an adjustment to re-classify some volatility from profit or loss to other comprehensive income.

Ensuring third-party adherence to regulatory mandates is becoming more important as organisations rely more on outsourced activities. Getting appropriate assurance over the effectiveness of controls throughout the supply chain, whether that be financial controls, cyber security or other matters – is increasingly important.

Anti-Money Laundering (AML) legislation is changing globally and the financial and reputational consequences of non-compliance are significant. With regulators raising stringency around financial institutions' obligation to better "know their customers," audit committees should pay increased attention in this area.

Privacy legislation The UK recently passed a privacy law holding that when a privacy breach or breach of consent happens to an organisation with operations in the UK, it can be fined 2% of global revenues. Audit committees should confirm that systems are in place to ensure compliance, while also being vigilant of generally increasing privacy legislation globally.

The audit committee's role in improving audit quality

From the discussion of audit quality frameworks and expanded auditor reporting, to how to assess professional scepticism, audit committees are trying to better understand the factors that determine a high-quality audit.

The FRC has issued a 'Practice Aid' to assist audit committees in their assessment of the effectiveness of the external audit process, however, there is no definitive approach for audit committees to really measure the quality of the audits they are getting. Going forward, there is a great opportunity for organisations, regulators and auditors to work together on these issues and create a more direct line between regulatory feedback and the actions organisations can take to ensure it's implemented.

The recent audit reforms also introduce legally binding requirements in relation to audit tendering/rotation and non-audit services that for many audit committees will represent a significant change to their role – see Audit Reform.

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