On the 2021 audit committee agenda

KPMG Board Leadership Centre

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KPMG Lower Gulf

Covid-19, recession and related uncertainties all paint a daunting picture of the risk environment for the year ahead. Global volatility – driven by trade and geopolitical tensions, resurging debt, technology and business model disruption, elevated cyber risk and regulatory scrutiny – will add to the challenge. The pressure on employees, management, boards, and the governance framework will be significant.

Prioritizing an already demanding audit committee agenda will be particularly challenging. Along with the business and the full board, audit committees will continue to operate against a backdrop of tremendous uncertainty and an uneven economic recovery. Drawing on insights from our surveys and discussions with audit committees and business leaders, we've flagged eight issues that audit committees should keep in mind as they consider and carry out their 2021 agendas.

1. Reassess the committee's agenda and workload

During Covid-19, many audit committees have reported having substantial oversight responsibilities for a range of risks beyond the core financial reporting and related control risks. This includes financial risks, such as liquidity and access to capital, legal/regulatory compliance, cybersecurity and data privacy, supply chain and other third-party risks, as well as health and safety, remote work, and other operational risks posed by the Covid-19 environment.

In 2021, virtually all companies will continue to deal with significant disruption and uncertainty, and will grapple with managing remote workforces, accelerating digital transformations, building more resilient supply chains, and strengthening connections with customers – all while attempting to innovate and take advantage of opportunities arising from this disruption.

Keeping the audit committee's agenda focused and effective will require vigilance with respect to emerging issues and expected market developments.

2. Maintain focus on the corporate reporting and control implications of Covid-19

The financial reporting, accounting, and disclosure impacts of Covid-19 are far-reaching and will continue to unfold in 2021. Areas of focus for audit committees include:

Forecasting and disclosures: The uncertain trajectory of Covid-19 and the economy – coupled with the extensive use of forward-looking information in financial statements – have made disclosures regarding the current and potential effects of the pandemic (e.g., the business review, principal risks and uncertainties, liquidity, results of operations, and known trends and uncertainties) a priority. Other prominent areas include preparation of forward-looking cash-flow estimates; impairment of nonfinancial assets, including goodwill and other intangible assets; accounting for financial assets, including fair value; going concern; and use of alternative performance measures.

Internal control over financial reporting (ICFR): Companies are reassessing, enhancing, or establishing new internal controls due to Covid-19-related disruption to business operations. For example, among the common disruptions prompting a closer look at internal controls include IT system access and authentication to enable a remote/virtual workforce, cybersecurity, entity level controls (communication and assignment of authority, segregation of duties, access review controls), return to work plans, and data privacy. In fact, ICFR-related regulations in the United Arab Emirates (UAE) had started to evolve prior to the pandemic. Examples include ICFR requirements introduced by the Insurance Authority[i] and the Abu Dhabi Accountability Authority[ii].

3. Understanding the impact of Covid-19 on the external audit process

Audit committees should understand the kind of changes external auditors are contemplating with respect to the audit process in light of Covid-19 and why. As a starting point, the external auditor needs to conduct incremental risk assessment procedures that are sufficient to provide a reasonable basis for identifying and evaluating the risks of material misstatement (whether due to error or fraud), and design further audit procedures where required.

What changes in audit scope and revisions to the audit approach may become necessary? New or heightened risks the external auditor may need to consider include:

- Liquidity, access to capital, debt covenant compliance
- Ability to continue as a going concern
- Cybersecurity risk and changes in internal controls over financial reporting due to virtual working
- Asset and goodwill impairment
- Fair value estimates
- Third-party vendor considerations
- Business interruption
- Fraud risk

The internal control environment is also critical. With the shift to remote working and financial reporting processes moving from in-person to virtual, there is an increased risk of internal control breakdowns. In evaluating the design and implementation of controls relevant to the audit, an important area of audit focus will be on how controls may have changed to accommodate remote workforces and process flows.

What changes to controls have been required as a result of the work from home environment, changes in reporting lines or new people responsible for controls?

Frequent communication with the external auditor is more important than ever.

- Establish strong communication protocols that include both the auditor and management so that the audit committee receives the information it needs in a timely manner.
- Discuss any changes to the audit plan with the auditor, including changes to areas of focus and how the auditor plans to address new or modified areas of risk.
- Discuss if there are changes to how the auditor will identify and test internal controls plans to address areas of new or modified risk.
- Discuss which disclosures in the financial statements may need to change as a result of Covid-19.

Also, consider discussing with the auditor the challenges and risks of conducting the audit remotely. For example, what alternative methods are available for conducting physical counts? Will additional time be needed to get the audit work done remotely? What complexity and risk does working remotely add to the audit?

4. Evolving risk management requirements

Oversight of the company's risk management processes can be a significant undertaking, which generally requires an understanding of the company's processes to identify, assess, mitigate, manage, and communicate about risk throughout the enterprise. Some risks which are technical in nature such as cybersecurity, data privacy and financial modeling related risks are particularly challenging to manage and oversee.

Given these challenges, a question to ask is, does the audit committee have the time and expertise to oversee these major risks? Is it reasonable to expect one committee to possess the knowledge requirements to oversee both financial reporting and other technical risks, such as cybersecurity and data privacy risks? Do such other technical risks require more attention at the full-board level – or perhaps a different board subcommittee?

5. Sharpen the focus on the company's compliance, ethics, and whistle-blower programs

The reputational costs of an ethics or compliance failure are higher than ever, and Covid-19 has increased the risk of such a failure, particularly given the changed control environment, increased fraud risk due to financial hardship, and the pressure on management to meet financial targets.

The effectiveness of a compliance program can be improved through a series of targeted compliance risk assessments. These should also aim to identify and assess the impact of Covid-19-related risks—particularly those that could impact the company's ability to achieve long-term strategic goals. The audit committee can instruct compliance executives to assess all laws and regulations that affect its business to discover what has changed and what is expected to change. There is potentially a great deal to be done on this front, as many companies in the UAE maintain global business relationships that are subject to a complex network of national and international laws and regulations.

Is the compliance function equipped to deal with a continually changing environment without becoming a bottleneck itself? Are more resources required, or is a total re-organization of the compliance function necessary? These are some of additional questions that can be answered through targeted compliance risk assessments.

In the current environment, what is considered "normal behavior" on the part of consumers and suppliers has also changed. Is there a need to re-assess what constitutes suspicious behavior?

According to the UAE's Financial Action Task Force (FATF) Mutual Evaluation Report of 2020, although local authorities have made significant improvements to the country's Anti-Money Laundering/ Combatting the Financing of Terrorism (AML/CFT) systems, there are opportunities for further enhancement[iii]. In response, the National AML/CFT Committee began implementing an ambitious National AML Strategy[iii] to strengthen the UAE's overall AML/CFT framework. Regulators are also increasing their enforcement efforts, as evidenced by the UAE Central Bank decision to fine 11 local banks for compliance failures in January 2021[iv]. Further, the Federal Tax Authority (FTA) also ramped up inspections across the UAE to ensure tax compliance[v].

In light of these developments, audit committees may strongly consider reviewing the AML/CFT and tax compliance controls and systems to obtain reasonable assurance that the company's practices are effective and aligned to the regulations.

The right tone at the top and culture are fundamental to an effective compliance program. This supports the company's strategy, including commitment to its stated values, ethics, and legal/regulatory compliance.

This is particularly true in a business environment made more complex by Covid-19—especially as companies move quickly to innovate and capitalize on opportunities in new markets, leverage new technologies and data, and engage with more vendors and third parties across increasingly complex supply chains. Coupled with a challenging global regulatory environment – the array of data privacy, environmental, and consumer protection regulations – compliance risks and vulnerabilities will require vigilance.

Also, focus on the effectiveness of the company's whistle-blower reporting channels and investigation processes remains critical. Does the audit committee see all whistle-blower complaints and receive reports on how they are handled? If not, what is the process to filter complaints that are ultimately reported to the audit committee?

6. Oversee the scope and quality of the company's ESG reports and disclosures

For several years, companies have faced increasing demands – from investors, research and ratings firms, employees, customers and others – for more transparent and higher-quality information about environmental, social, and governance (ESG) issues and risks. How does the company define its corporate purpose, and how does it consider the interests of stakeholders – employees, customers, suppliers, and communities – in addition to shareholders?

The events of the past year have prompted companies to increase their focus on the "S" in ESG. For example, how a company addresses employee issues such as diversity and inclusion, health, safety, and work-from-home arrangements and communicates with suppliers and customers regarding their Covid-19-related challenges highlights the importance of the "S" issues. How the company considers its stakeholders in creating sustainable long-term value may have a major impact on reputation.

The UAE continues to drive sustainability forward under the framework of UAE Vision 2021[vi], in alignment with the United Nation's Sustainable Development Goals (SDGs)[vii] and according to the Sustainable Stock Exchanges (SSE)[viii] initiative.

In line with this initiative and in order to drive market growth and sustainability in financial markets, the Dubai Financial Market (DFM)[ix] and Abu Dhabi Securities Exchange (ADX)[x] introduced ESG reporting guidelines. The objective is to promote leading practices and support listed companies seeking to incorporate ESG information into their reporting processes.

Audit committees should encourage their management teams to reassess the scope and quality of the company's ESG reports and disclosures – including benchmarking against peers, consideration of the methodologies and standards of ESG raters (which may vary widely) and ESG reporting frameworks. Whether on a website, in a sustainability report or in the annual report and accounts, the audit committee should ask, what controls are in place to ensure the quality of the ESG information being disclosed? Is it reviewed with the same rigor as financial information? Does (or should) the company obtain third-party assurance to provide investors with a greater level of comfort? Does the audit committee understand and receive reports on the basis for and processes used to generate the disclosures? Beyond ratings, this is about how ESG risks and opportunities are handled, their impact on the creation of long-term value and whether investors elect to invest or not.

Investors want to understand which ESG issues are of strategic significance to the company. How is the company addressing ESG as a long-term strategic objective and embedding it into the company's core business activities (strategy, operations, risk management, incentives, and corporate culture) to drive long-term performance and value creation? Is there clear commitment and strong leadership from the top, as well as enterprise-wide buy-in? Real transparency is not easy, and it's usually uncomfortable. But to make real progress and be accountable as a company today, you have to 'show your work.' What targets have been set and what is being done to reach those targets?

The company's progress on these ESG issues – from employee well-being to addressing social justice issues and climate risk – will be front and center for stakeholders as we head into a challenging recovery and a new reality.

7. Understand how technology is impacting the finance function's talent, efficiency, and value-add

With Covid-19, we have seen an acceleration of companies' digital transformation efforts. Technology changes also present important opportunities for finance to reinvent itself and add greater value to the business. As audit committees monitor and help guide finance's progress in this area, we suggest three areas of focus:

Recognizing that much of finance's work involves data gathering, what are the organization's plans to leverage robotics and cloud technologies to automate as many manual activities as possible, reduce costs and improve efficiencies?

Understand how the finance function is using data analytics and artificial intelligence to develop sharper predictive insights and better deployment of capital. The finance function is well-positioned to guide the company's data and analytics agenda and to consider the implications of new transaction-related technologies, from blockchain to crypto-currencies. As historical analysis becomes fully automated, the organization's analytics capabilities should evolve to include predictive analytics, an important opportunity to add real value.

As the finance function combines strong analytics and strategic capabilities with traditional financial reporting and accounting skills, its talent and skill-set requirements must change accordingly. Is finance attracting, developing, and retaining the talent and skills necessary to match its evolving needs?

In this environment, it is essential that the audit committee devote adequate time to understand finance's transformation strategy.

8. Help ensure that internal audit remains focused on the most critical risks, including any Covid-19 risks

Is our internal audit plan risk-based and flexible – and does it adjust to changing business and risk conditions? This is an increasingly common question that heads of internal audit are asked by the audit committee.

The audit committee should work with the head of internal audit and chief risk officer to help identify Covid-19-related and other risks that pose the greatest threat to the company's reputation, strategy, and operations – such as tone at the top and culture, legal/regulatory compliance, incentive structures, cybersecurity and data privacy, ESG risks, and global supply chain and outsourcing risks.

Ask again whether the internal audit plan is risk-based, flexible, and can adjust to changing Covid-19 and other business and risk conditions. What's changed in the operating environment? What are the additional risks facing the organization due to remote working conditions? What are the risks posed by the company's digital transformation and by the company's extended organization – sourcing, outsourcing, sales and distribution channels? Are we sensitive to early warning signs regarding safety, product quality, and compliance? Do we have optimal segregation of duties in case of staff reductions? What role should internal audit play in auditing the culture of the company?

Set clear expectations and help ensure that internal audit has the resources, skills, and expertise to succeed – and help the head of internal audit think through the impact of digital technologies on the internal audit function.

The KPMG Board Leadership Centre

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i https://ia.gov.ae/en/Documents/Circular%20No.(21)%20of%202019%20on%20Reporting%20Requirments%20of%202020%20for%20Insurance%20Companies.pdf

ii https://adaa.gov.ae/Documents/AASDPublications/IFRS%20Digest/2018/ADAA%20IFRS%20Digest%20Compendium%202017.pdf

iii https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/Mutual-Evaluation-Report-United-Arab-Emirates-2020.pdf

iv https://www.centralbank.ae/sites/default/files/2021-01/CBUAE%20imposes%20financial%20sanctions%20on%2011%20banks%20operating%20in%20the%20UAE_En.pdf

v https://gulfnews.com/business/uae-federal-tax-authoritys-inspections-ensure-tax-compliance-1.1613314272414

vi https://www.vision2021.ae/docs/default-source/default-document-library/uae_vision-arabic.pdf?sfvrsn=b09a06a6_6

vii https://sdgs.un.org/2030agenda

viii https://sseinitiative.org/wp-content/uploads/2019/12/SSE-WFE-Embedding-Sustainability-Report.pdf

ix https://www.dfm.ae/docs/default-source/default-document-library/esg-reporting-guide_en.pdf?sfvrsn=60fa7681_0

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