



# On the 2021 audit committee agenda

## KPMG Board Leadership Center

The events and crises of 2020—COVID-19, recession, extreme weather events, deep-seated social unrest, and an increasingly polarized America—paint a picture of a daunting and opaque business and risk environment for the coming year. Global volatility—driven by trade and geopolitical tensions, resurging debt, technology and business model disruption, elevated cyber risk, regulatory scrutiny, and political gridlock in the U.S. and elsewhere—will add to the challenge. The pressure on employees, management, the board, and governance will be significant.

Prioritizing a heavy audit committee agenda will be particularly challenging. Along with the business and the full board, the audit committee will continue to operate against a backdrop of tremendous uncertainty and an uneven economic recovery. Drawing on insights from our latest survey work and interactions with audit committees and business leaders, we highlight seven issues for audit committees to keep in mind as they consider and carry out their 2021 agendas:



### Take a fresh look at the audit committee's agenda and workload.

It is little surprise that more than 60 percent of audit committee members we surveyed report that COVID-19 has prompted the committee to reassess the scope of its agenda and risk oversight responsibilities.<sup>1</sup> Beyond financial reporting and related control risks, many audit committees indicate they have substantial oversight responsibility for a range of other risks, including financial risks such as liquidity and access to capital; legal/regulatory compliance; cybersecurity and data privacy; reporting of environmental, social, and governance (ESG) metrics; supply chain and other third-party risks; health and safety; and other operational risks posed by the COVID-19 environment.

Keeping the audit committee's agenda focused will require vigilance. Virtually all companies will continue to deal with significant disruption and uncertainty, and will grapple with reopening the business and managing a remote workforce, accelerating digital transformation,

building more resilient supply chains, and strengthening connections with customers—all while attempting to innovate and take advantage of opportunities arising from this disruption. To address the ongoing disruption, audit committees are asking management to update and stress test risk assessments, scenario planning, and crisis protocols. Does the audit committee have the time and expertise to oversee the major risks now on its plate? Does cyber risk require more attention at the full-board level—or perhaps a different board committee? Is there a need for a compliance or risk committee? Where does oversight of ESG metrics and reporting belong? Many boards are reluctant to create an additional committee, but considering whether a finance, technology, risk, sustainability, or other committee would improve the board's effectiveness can be a healthy part of the risk oversight discussion. Also consider reallocating risk oversight duties among the board's existing committees.



### Monitor the financial reporting and disclosure impacts of COVID-19 on the company's filings.

The financial reporting, accounting, and disclosure impacts of COVID-19 are far-reaching and will continue to unfold in 2021. Among the key areas of audit committee focus for the company's 2020 Form 10-K and 2021 filings:

- **Forecasting and disclosures.** The uncertain trajectory of COVID-19 and the economy—coupled with the extensive use of forward-looking

<sup>1</sup> KPMG Audit Committee Institute, [Challenges presented by COVID-19](#), October 5, 2020.

information in financial statements and SEC filings—have made disclosures regarding the current and potential effects of COVID-19 (e.g., risk factors, Management Discussion & Analysis (MD&A), liquidity, results of operations, and known trends and uncertainties) a top area of focus. As identified in our [survey](#), other prominent areas of audit committee attention 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 non-GAAP metrics. [CF Disclosure Guidance Topic No. 9A](#), issued by the staff of the Securities and Exchange Commission’s Division of Corporation Finance, provides companies affected by COVID-19 additional guidance on disclosure considerations for the financial statements and MD&A. The SEC wants companies to provide disclosure that allows investors to evaluate the impact of COVID-19 through the eyes of management and to revise and update that disclosure as circumstances change.

— **Accounting for government assistance.**

Assistance under the Coronavirus Aid, Relief, and Economic Security (CARES) Act may take different forms, including favorable loans (some or all of which may be forgiven) and loan guarantees, grants, credits, payroll and payroll tax support, and reimbursement of healthcare-related expenses and/or lost revenue. Loans and grants obtained under these programs generally impose significant restrictions on the recipient and some require the issuance to the U.S. Treasury of stock warrants or other equity interests. Companies receiving government assistance need to determine the appropriate revenue recognition model.

— **Internal control over financial reporting (ICFR).**

Companies are reassessing, enhancing, or establishing new internal controls due to COVID-19-related disruptions to business operations, including 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 the event of material changes in ICFR, disclosure is required.



**Reinforce audit quality and understand the impact of COVID-19 on the external audit process.**

Audit committees should understand what changes to the audit process auditors are making 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 assessing the risks of material misstatement (whether due to error or fraud), and design further audit procedures. What changes in audit scope and revisions to the audit approach are necessary? The Center for Audit Quality’s [Focus on the Auditor’s Risk Assessment](#) identifies new or different risks the auditor may need to consider, including:

- Liquidity, access to capital, debt covenant compliance
- Ability to continue as a going concern
- Cybersecurity, including data security in a virtual environment
- Changes in ICFR due to working in a virtual environment including information technology general controls
- Asset and goodwill impairment
- Fair-value estimates
- Third-party vendor considerations
- Industry-specific regulatory and economic considerations, including concentration risk
- Geographic-specific regulatory and economic considerations, including concentration risk
- Business interruption
- Heightened risk of fraud due to COVID-19.

The internal control environment is a critical area of focus. 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 auditor focus will be on how controls may have changed during COVID-19 to accommodate remote workforces and process flows. What new controls or changes to controls have been required as a result of risks posed by, among other things, the work-from-home environment, change in reporting lines or new people responsible for controls, and increased fraud risk due to employee financial hardship as well as management pressure to meet financial targets?

The PCAOB has highlighted the importance of frequent communication with the auditor as a result of COVID-19, and offered the following considerations:<sup>2</sup>

- Engage with the auditor and management to discuss potential challenges to a timely completion of the audit. Review and discuss the timeline for the phases of work.
- Determine a good cadence for communications that include both the auditor and management so that the audit committee receives the information it needs in a timely manner, while also considering the additional demands on auditors and management during the pandemic.
- 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.
- Discuss which disclosures may need to change as a result of COVID-19.

Finally, as the PCAOB noted, audit committees should discuss with the auditor the challenges and risks of conducting the audit remotely. For example, what alternative methods are available for conducting physical inventory counts? Will additional time be needed to get the audit work done remotely? What complexity does working remotely add to the audit?



### **Work with management to reassess and oversee the scope and quality of the company's ESG/sustainability reports and disclosures.**

For several years, companies have faced increasing demands—from investors, research and ratings firms, activists, employees, customers, and others—for more transparent and higher-quality information about 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? These demands increasingly have teeth, particularly from investors exerting pressure during shareholder engagement and director elections. For example, Institutional Shareholder Services (ISS) stated that, for annual meetings held on or after February 1, 2021, “demonstrably poor risk oversight of environmental and social issues, including climate change” may trigger a vote against or withhold from directors.<sup>3</sup> Boards also risk potential lawsuits and

exposure if the company discusses these issues (such as a commitment to diversity) in a manner that does not align with what is happening on the ground. We expect the 2021 proxy season to feature a significant number of ESG proposals.

The events of the past year—COVID-19, its disproportionate impacts on employees and communities of color, and the social unrest triggered after the death of George Floyd and others—have focused companies on the “S” in ESG. For example, how a company addresses employee issues such as diversity and racial inequality, health and safety, sick leave, 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. And stakeholder demands are not limited to social issues. Disclosure on climate issues continues to be a high priority for many institutional investors. More than 90 percent of respondents to Morrow Sodali’s Institutional Investor Survey 2020 expect companies to demonstrate a link between financial risks, opportunities, and outcomes with climate-related disclosure.<sup>4</sup>

Stakeholder demands for more detailed sustainability/ESG reporting include requests for comparable and consistent information that is actionable from an investment perspective (and an explanation of how it links to strategy and performance). Audit committees should encourage their management teams to reassess the scope and quality of the company’s sustainability/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, sustainability report, or in an SEC filing, 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 on the ESG information 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 and their impact on the creation of long-term value, whether investors elect to invest (or not) based upon a company’s ESG profile, and cost of capital. Stating its

<sup>2</sup> PCAOB—Conversations with Audit Committee Chairs: COVID-19 and the Audit, July 2020.

<sup>3</sup> Institutional Shareholder Services, Inc., “Americas Proxy Voting Guidelines Updates for 2021,” published November 12, 2020.

<sup>4</sup> Kiran Vasantham and David Shammai, Institutional Investor Survey 2020, Morrow Sodali, March 2020.

view that “a company’s ESG score will soon effectively be as important as its credit rating,” State Street Global Advisors said it would take voting action against directors at companies that were laggards based on their ESG scores (as determined by State Street) and that could not articulate how they planned to improve their score.<sup>5</sup> Similarly, BlackRock has indicated that it will also vote against directors for a lack of progress on ESG.<sup>6</sup>

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 issue 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 a clear commitment and strong leadership from the top as well as enterprise-wide buy-in? As one director commented, “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 you set and what are you doing to reach those targets?”

In light of the social justice protests and “S” commitments that business leaders have made to various stakeholders, expectations will continue to grow for companies to “show their work,” shortcomings and all. 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.



### Understand how technology is impacting the finance organization’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, opportunities, and risks 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 value.
- As the finance function combines strong analytics and strategic capabilities with traditional financial reporting, accounting, and auditing 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.



### Help ensure that internal audit remains focused on the most critical risks, including risks posed by COVID-19.

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 chief audit executives are asked by the audit committee. While a global pandemic was perhaps not on internal audit’s list of likely risk events as we headed into 2020, audit committee members responding to our survey by and large said that their internal auditor successfully shifted its focus to the critical risks posed by COVID-19—identifying emerging risks, reviewing management’s assessment of those risks as well as management’s remediation plans and controls for those risks, and assessing incremental fraud risks, as well as return-to-work plans and related risks.<sup>7</sup>

The audit committee should work with the chief audit executive and chief risk officer to help identify the COVID-19-related risks 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 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

<sup>5</sup> State Street Global Advisors, “CEO’s letter on our 2020 Proxy Voting Agenda,” January 28, 2020. State Street employs a proprietary rating system called R-Factor™ that leverages the SASB framework and draws on data from four providers.

<sup>6</sup> A Fundamental Reshaping of Finance, Larry Fink’s letter to CEOs, BlackRock, January 2020.

<sup>7</sup> KPMG Audit Committee Institute, [Challenges presented by COVID-19](#), October 5, 2020.

environment? What risks are posed by the company's digital transformation and the company's extended organization—sourcing, outsourcing, sales, and distribution channels? Is the company sensitive to early warning signs regarding safety, product quality, and compliance? 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 chief audit executive think through the impact of digital technologies on internal audit.



**Sharpen the focus on the company's ethics, compliance, and whistle-blower programs, recognizing the increased pressure on employees.**

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 employee financial hardship, and the pressure on management to meet financial targets. Fundamental to an effective compliance program is the right tone at the top and culture throughout the organization, which supports the company's strategy, including its commitment to its stated values, ethics, and legal/regulatory compliance. This is particularly true in a business environment made more complex by COVID-19, and 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 the challenging global regulatory environment—the array

of data privacy, environmental, healthcare, financial services, and consumer protection regulations, as well as the Foreign Corrupt Practices Act and the U.K. Bribery Act—compliance risks and vulnerabilities will require vigilance.

Closely monitor the tone at the top and culture throughout the organization with a sharp focus on behaviors (not just results) and yellow flags. Is senior management sensitive to the human resource issues stemming from COVID-19, particularly the pressures on employees (in the office and at home), employee health and safety, employee productivity, engagement and morale, and normalizing work-from-home arrangements? In a crisis of this magnitude, leadership and communications are key, and understanding, transparency, and compassion are more important than ever. Does the company's culture make it safe for people to do the right thing? Help ensure that the company's regulatory compliance and monitoring programs are up to date, cover all vendors in the global supply chain, and clearly communicate the company's expectations for high ethical standards. Focus on the effectiveness of the company's whistle-blower reporting channels and investigation processes. 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? 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 full display.

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The KPMG Board Leadership Center (BLC) champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programs and perspectives—including the KPMG Audit Committee Institute, the WomenCorporateDirectors Foundation, and more—the BLC engages with directors and business leaders to help articulate their challenges and promote continuous improvement of public- and private-company governance. Drawing on insights from KPMG professionals and governance experts worldwide, the BLC delivers practical thought leadership—on risk and strategy, talent and technology, globalization and compliance, financial reporting and audit quality, and more—all through a board lens. Learn more at [kpmg.com/us/blc](https://kpmg.com/us/blc).

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As part of the KPMG Board Leadership Center, the ACI provides audit committee and board members with practical insights, resources, and peer-exchange opportunities focused on strengthening oversight of financial reporting and audit quality, and the array of challenges facing boards and businesses today—from risk management and emerging technologies to strategy, talent, and global compliance. Learn more about ACI at [kpmg.com/us/aci](https://kpmg.com/us/aci).

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