



On the 2020 audit committee agenda

2020 vision for the year ahead

KPMG Board Leadership Centre



Prioritising a heavy audit committee agenda is never easy, and 2020 will be particularly challenging as the audit committee operates against a backdrop of global volatility and economic uncertainty – e.g., mounting trade tensions, resurging debt, a looming market correction, geopolitical tensions, technology and business model disruption, cyber risk, regulatory scrutiny, investor demands for transparency, new ESG requirements, political gridlock, and coronavirus pandemic.

Drawing on insights from our latest survey work and interactions with audit committee members and business leaders, we have flagged eight issues that audit committees should keep in mind as they consider and carry out their 2020 agendas:

- Maintain control of the committee's agenda
- Assess the scope and quality of ESG disclosures
- Engaging in business continuity management and evaluate the adequacy of the crisis response plan
- Reinforce audit quality
- Focus on ethics and compliance
- Understand how technology is impacting the finance organisation's talent, efficiency, and value add
- Monitor corporate reporting
- Help ensure internal audit's eyes and ears are focused on key risks beyond financial reporting

Maintain control of the committee's agenda

This number one priority from last year holds true for 2020. Nearly half of the 1,300 audit committee members responding to our 2019 Global Audit Committee Survey said it's "increasingly difficult" to oversee the major risks on the audit committee's agenda in addition to its core oversight responsibilities over financial reporting and controls, and internal and external auditors.

Aside from any new agenda items, the risks that many audit committees have had on their plates for some time – those around financial planning; cyber security; IT; environmental, social and governance (ESG); third-party; supply chain; operations; legal and regulatory compliance; etc. – continue to become more complex.

Reassess whether the committee has the expertise and time to oversee the risks it has been assigned.

Do cyber risk and data governance require greater attention from the full board or perhaps a dedicated committee that might tap into relevant skills from outside the board?

Keeping the audit committee's agenda focused will require discipline and vigilance in 2020.

Assess the scope and quality of ESG disclosures

Nearly all listed companies provide some form of environmental, social, and governance or sustainability reporting, but there are growing concerns by a range of stakeholders – investors, employees, customers, regulators, and activists – regarding the quality, comparability, reliability, and usefulness of such information.

To address the growing concern on the quality of ESG information, the Stock Exchange of Hong Kong Limited (HKEX) released the revised ESG Reporting Guide in December 2019, requiring all listed companies with financial years commencing on or after 1 July 2020 to publish their ESG reports in accordance with the new disclosure requirements. The revised ESG Reporting Guide introduced mandatory disclosure requirements including a board statement setting out its considerations on ESG matters and a disclosure on the application of various reporting principles (i.e. materiality; quantitative; consistency; and balance) in ESG reports. Other key changes include introducing a new aspect on disclosure of climate related issues and updating the key performance indicators (KPIs) for assessing the company's contribution in the "environmental" and "social" categories. The deadline for publication of ESG reports has also been tightened to align with the publication of annual reports. With more stringent ESG requirements, is the audit committee clear on the company's regulatory responsibilities to comply with the revised ESG Reporting Guide?

Given the revised ESG reporting requirements and increasing stakeholder demands for more transparent, higher quality ESG reporting – as well as understandable concerns about the lack of comparability of ESG data – the audit committee can serve as a catalyst, recommending that the board encourage management to reassess the scope and quality of the company’s ESG reports and disclosures. This may be a significant undertaking and would likely include complex and time-consuming activities such as performing a gap analysis of the current ESG report against the revised ESG Reporting Guide; benchmarking against peers; consideration of the methodologies and standards of various firms that rate companies on ESG practices; understanding the expectations of investors and other stakeholders; and reviewing various ESG reporting frameworks for possible use by the company.

Does the current board have the right mix of skills to deliver on this? Should the audit committee consider acting as a formal oversight body for the activity? Consider the need for the company secretarial team to be part of these discussions to help ensure that the necessary infrastructure – controls and procedural – is in place.

The FSB Task Force on Climate-related Financial Disclosures (TCFD) is working to develop consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders. The Securities and Futures Commission (SFC) has announced an intention to enhance listed companies’ reporting by aligning with the TCFD Recommendations while taking into account the Mainland’s policy direction on mandatory environmental disclosure in 2020. Companies are advised to refine their frameworks and stay abreast of the latest ESG developments by referencing to the international guidance such as the TCFD recommendations.

Engage in business continuity management and evaluate the adequacy of the crisis response plan

Companies are exposed to incidents, natural disasters and malicious interventions that affect business operations. The US-China trade war, combined with the unprecedented protests against the extradition bill, and closely followed by the outbreak of coronavirus, posed tremendous pressure on many businesses especially those in mainland china and in Hong Kong.

Having a robust business continuity management (BCM) framework is important in managing crises and mitigating their impact. The goal of BCM is to enable an organisation to minimise risks through planning or restore quickly after a disaster has occurred.

The audit committee should ensure the existence of a comprehensive BCM framework that identifies critical risks causing business interruption, defines key business assets, functions and strategies available to mitigate losses in the event of crisis, and prepares for a business continuity plan through considering various scenarios. Plans already in place should be tested regularly and updated continuously to reflect modifications in infrastructure, systems, processes and other changes.

Reinforce audit quality

Audit quality is enhanced by a fully engaged audit committee that sets the tone and clear expectations for the external auditor and monitors auditor performance rigorously through frequent, quality communications and a robust performance assessment.

The audit committee should probe the audit firm on its quality control systems that are intended to drive sustainable and improved audit quality – including the firm’s implementation and use of new technologies.

In discussions with the external auditor regarding the firm’s internal quality control system, the results of the Financial Reporting Council (FRC) and any internal inspections and efforts to address deficiencies should be considered. Audit quality is a team effort, requiring the commitment and engagement of everyone involved in the process – the auditor, audit committee, and management.

Since early 2020, the outbreak of coronavirus has posed a challenge to many businesses in mainland china and in Hong Kong. Certain companies may encounter difficulties in financial reporting given that internal processes and operations were affected. The Hong Kong Monetary Authority (HKMA) has issued a circular in early February reminding banks to obtain approval for extension should they anticipate problems in meeting the statutory reporting timeline. On the other hand, to minimise the impact to the Hong Kong financial market amid the situation, the SFC and the HKEX have issued a Joint Statement requiring issuers to publish preliminary financial results by the original deadline if such results are available regardless of whether they have been agreed with the auditor. Under the absence of the external auditor’s report, the audit committee plays an important role in ensuring the quality of the unaudited financial information.

Focus on ethics and compliance

The reputational costs of an ethics or compliance failure are higher than ever.

Fundamental to an effective compliance programme is the right tone at the top and culture throughout the organisation, which supports the company's strategy, including its commitment to its stated values, ethics, and legal / regulatory compliance. This is particularly true in a complex business environment, as companies move quickly to innovate and capitalise on opportunities in new markets, leverage new technologies and data, and engage with more vendors and third parties across longer and increasingly complex supply chains.

Under the current Hong Kong administration, we are seeing a trend towards more regulations. Coupled with the challenging global regulatory environment – the array of new data privacy, environmental, healthcare, financial services, and consumer protection regulations – compliance risks and vulnerabilities will require vigilance. Companies operating in Hong Kong must remain focused on maintaining compliance standards to minimise risks.

The responsibility for directors to assess and monitor culture comes front and centre in setting an appropriate tone at the top as well as the culture throughout the organisation. In recent years, culture has been one of the focus areas of regulators. Organisations should adopt an effective framework to foster a sound culture at all levels, for example through promoting a prudent risk-taking culture, implementing a fair assessment mechanism, and encouraging an effective feedback culture. Does the company's culture encourage the right behavior, ensure a supportive yet accountable culture and make it safe for people to speak up when they see behaviour to the contrary? Does the audit committee work sufficiently with the internal audit function to ensure there is regular review and assessment of culture drivers that incentivise and reward desired behaviour?

The audit committee should help ensure that the company's regulatory compliance and monitoring programmes are up to date, cover all vendors in the global supply chain, and clearly communicate the company's expectations for high ethical standards. It is also essential to focus on the effectiveness of the company's whistle-blower reporting channels and investigation processes through a #MeToo lens. 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, commitment to integrity and legal compliance, and its brand reputation are on full display.

Understand how technology is impacting the finance organisation's talent, efficiency, and value add

Major technology changes impacting finance functions present important opportunities for them to reinvent themselves and add greater value to the business. As audit committees monitor and help guide progress in this area, we suggest three areas of focus.

First, recognising that as much as 60 to 80 percent of the finance function's work involves data gathering, what are the organisation's plans to leverage robotics and cloud technologies to automate as many manual activities as possible, reduce costs, and improve efficiencies?

Second, how will finance use 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 organisation's analytics capabilities should evolve to include predictive analytics, an important opportunity to add real value.



Third, 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 the finance team 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 the finance function's transformation strategy.

Monitor corporate reporting

In times of uncertainty, whether created by political events, general economic conditions or operational challenges, investors look for greater transparency in corporate reports to inform their decision-making.

Carefully consider the detail provided in those areas of the annual report which are exposed to heightened levels of risk; for example, how the going concern considerations have been approached, and all areas of material estimation uncertainty.

A specific issue affecting this season's year end reporting are the published amendments to IFRS 9 and IAS 39, reflecting the global reforms of interest rate benchmarks, such as LIBOR, the futures of which post 2021 are not clear in a number of cases. In terms of reporting, ensure that robust processes support the judgements as to whether the level of uncertainty is so high that the conditions for hedge accounting are not met. All companies that are parties to contracts referencing LIBOR, or any other rate subject to the reforms, should start planning now for the transition to new rates. This should include early consideration of the need to re-negotiate relevant contracts and agreements.

In Hong Kong, since both Hong Kong Interbank Offered Rate (HIBOR) and LIBOR are used extensively in the banking industry, it is crucial to prepare for the phasing out of LIBOR. The most significant risk is with legacy positions using LIBOR as the reference rate that will not expire before 2021. The audit committee shall identify and evaluate key risks arising from the reform and ensure there are regular quantification and monitoring on affected exposures.

Stand back and think about all the awkward areas where there might be some reluctance to be open. And keep at least a weather eye on what your key investors are thinking. Some investors are becoming increasingly vocal about what they want to see in corporate reporting – at a general level, at a sector level and at individual company level – but this may not be communicated directly to the audit committee or the CFO. Be conscious of what your peer companies are reporting and be prepared to be challenged on anything which appears inconsistent.

Help ensure internal audit's eyes and ears are focused on key risks beyond financial reporting

In recent years, a number of highly publicised corporate crises have damaged company reputations, due in part to failure to manage key risks 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. The audit committee should work with the head of internal audit (and chief risk officer) to help identify the risks that pose the greatest threat to the company's reputation, strategy, and operations and to help ensure that internal audit is focused on these key risks and related controls.

Is the audit plan risk-based and flexible – and does it adjust to changing business and risk conditions? What's changed in the operating environment? What are the risks posed by the company's digital transformation and by the company's extended organisation – sourcing, outsourcing, sales and distribution channels? Are we 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.

The KPMG Board Leadership Centre

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