



On the 2021 audit committee agenda

2021 vision for the year ahead

KPMG Board Leadership Centre



The events of 2020 – COVID-19 and economic downturn – 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 and regulatory scrutiny – will add to the challenge. The pressure on employees, management, and governance will be significant.

Prioritising a heavy 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:

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 – including 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.

Keeping the audit committee's agenda focused will require vigilance. In 2021, virtually all companies will continue to deal with significant disruption and uncertainty, and will grapple managing a remote workforce and get back to work arrangements, 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. However, audit committees must also reassess their agenda and workload to ensure effective and sufficient oversight is provided.

When reassessing its agenda and workload, an audit committee must consider the following: Does the 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.

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. Among the key areas of audit committee focus are:

- **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 COVID-19 (e.g. the business review, principal risks and uncertainties, liquidity, results of operations, and known trends and uncertainties) a top area of focus. Other prominent areas of audit committee attention include: preparation of forward-looking cash-flow estimates; impairment of non-financial assets, including goodwill and other intangible assets; accounting for financial assets, including fair value; going concern; and use of non-GAAP metrics and alternative performance measures. Audit committees of issuers listed on HKEx should also consider disclosure if the outbreak has caused material disruptions to their business operations, reporting controls, systems, processes or procedures.



— **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.

Understand the impact of COVID-19 on the external audit process

Audit committees should understand what changes to the audit process auditors are contemplating 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? New or heightened risks the auditor may need to consider, include:

- Liquidity, access to capital, cash flow, debt covenant compliance
- Ability to continue as a going concern
- Changes in internal controls over financial reporting due to virtual working
- Asset and goodwill impairment
- Fair value estimates
- Exposure to third parties
- Business interruption
- Fraud risk

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 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, increased fraud risk due to employee financial hardship as well as pressure to meet financial targets?

Frequent communication with the auditor is more important than ever

- Engage with the auditor and management to discuss potential challenges to a timely completion of the audit. Review the timeline and stages 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.
- 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 if there are changes to how the auditor will identify and test internal controls.
- Discuss which disclosures 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 does working remotely add to the audit?

Maintain oversight of the information technology function and heightened IT-related risks exposure

With information technology function being a part of the broader internal environment and in view of the following trends during the pandemic situation, audit committees should ensure proper oversight of the function and heightened risk exposure:

- Work from home arrangement challenges the companies' IT capabilities in enabling digitalisation of documents, remote access to work files and efficient exchange of information among employees.
- Organisations moving to remote working conditions increasing the risks related to confidentiality, integrity and availability of information systems.
- Cyber criminals capitalising on the public's increasing desire for information and conducting phishing or ransomware events that may be introduced via emails or websites capitalising on the COVID-19 pandemic.

Some key questions for consideration include:

- How quickly can you recover from a disruption of data centre?
- Are you dependent on certain key IT personnel?
- Is your cloud or IT network capabilities readily scalable?
- Do you have a response plan for different kinds of cyber/IT incident?
- Are you making the best use of your resources?

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

With the launch of more stringent requirements on ESG reporting for listed companies with financial years commencing on or after 1 July 2020, it is vital for audit committees to evaluate the availability of knowledge and expertise in ESG, consider the adoption of a formal ESG governance structure and integration of internal risk management processes with ESG risk management. 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.

The events of the past year – COVID-19 and its disproportionate impact on specific communities – have focused companies on the “S” in ESG. For example, how a company addresses employee issues such as diversity and inclusion, health and 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. And stakeholder demands are not limited to social issues as disclosure on climate issues continues to be a high priority for many institutional investors.

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. 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 and 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 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? 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 “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 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:

- Recognising that much of finance'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?
- 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 organisation'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, 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 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 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 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 head of internal audit think through the impact of digital technologies on the internal audit function.

Sharpen the focus on the company's ethics, compliance, 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 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 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 business environment made more complex by COVID-19, and 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 increasingly complex supply chains. Coupled with the challenging global regulatory environment – the array of data privacy, environmental, financial services, and consumer protection regulations, and vulnerabilities will require vigilance. Closely monitor the tone at the top and culture throughout the organisation with a sharp focus on behaviours (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 normalising work-from-home arrangements? In a crisis of this magnitude, leadership and communications are key, and understanding 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.

The KPMG Board Leadership Centre

The KPMG Board Leadership Centre offers support and guidance to non-executive directors, whether managing a portfolio non-executive career or embarking on a first appointment. Membership offers you a place within a community of board-level peers with access to topical and relevant seminars, invaluable resources and thought leadership, as well as lively and engaging networking opportunities. We equip you with the tools you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business.

Learn more at kpmg/cn/boardleadership

Contact us

Shanghai:

Li Fern Woo

Partner

Tel: +86 (21) 2212 2603

lifern.woo@kpmg.com

Grace Chen

Partner

Tel: +86 (21) 2212 2780

grace.xh.chen@kpmg.com

Joyce Ge

Partner

Tel: +86 (21) 2212 3295

joyce.ge@kpmg.com

Bryan Hu

Director

Tel: +86 (21) 2212 3686

bryan.hu@kpmg.com

Sabrina Fang

Director

Tel: +86 (21) 2212 4197

sabrina.hl.fang@kpmg.com

Beijing:

Frank Mei

Partner

Tel: +86 (10) 8508 7188

frank.mei@kpmg.com

Jessica Xu

Partner

Tel: +86 (10) 8508 5952

jessica.xu@kpmg.com

Johnson Li

Partner

Tel: +86 (10) 8508 5975

johnson.li@kpmg.com

Vera Li

Director

Tel: +86 (10) 8508 5870

vd.li@kpmg.com

Haoyu Liu

Director

Tel: +86 (10) 8553 3343

haoyu.liu@kpmg.com

Medivh Luo

Director

Tel: +86 (10) 8508 5016

medivh.luo@kpmg.com

Aaron Ren

Director

Tel: +86 (10) 8508 5454

aaron.ren@kpmg.com

Hong Kong:

Alva Lee

Partner

Tel: +852 2143 8764

alva.lee@kpmg.com

Jia Ning Song

Partner

Tel: +852 2978 8101

jianing.n.song@kpmg.com

Jeffrey Hau

Partner

Tel: +852 2685 7780

jeffrey.hau@kpmg.com

Jens Kessler

Director

Tel: +852 2143 8584

jens.kessler@kpmg.com

Claudia Yu

Director

Tel: +852 2685 7898

claudia.yu@kpmg.com

Paul Cheng

Director

Tel: +852 28 47 5075

paul.cheng@kpmg.com

Guangzhou/Shenzhen:

Kelvin Leung

Partner

Tel: +86 (755) 2547 3338

kelvin.oc.leung@kpmg.com

Eric Chang

Partner

Tel: +86 (20) 3813 7088

eric.chang@kpmg.com

Joyce Xie

Partner

Tel: +86 (755) 2547 1261

joyce.xie@kpmg.com

kpmg.com/cn

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2021 KPMG Advisory (Hong Kong) Limited, a Hong Kong limited liability company and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. Printed in Hong Kong, China.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

