On the 2015 Audit Committee Agenda

Prioritizing a heavy audit committee workload is never easy, and 2015 will continue to be challenging given developments in the global risk, regulatory, and political environments. Drawing on insights from the latest Audit Committee Institute's *Global Audit Committee Survey* and interactions with audit committees and business leaders over the past 12 months, 10 things have been flagged that audit committees should keep in mind as they consider and carry out their 2015 agendas.

Maintain (or regain) control of the committee's agenda.

Half of the 1,500 audit committee members surveyed recently said it's "increasingly difficult" to oversee the major risks on the audit committee's agenda in addition to its core responsibilities (financial reporting and related internal controls, and oversight of internal and external auditors). Take time to reassess whether the committee has the time and expertise to oversee other major risks – e.g., cyber security and IT risks, supply chain and other operational risks, and legal and regulatory compliance. Does cyber risk require more attention at the full board level? Given the challenges posed by global economic conditions and geopolitical risks as well as new competitors and technologies, the risk of mission creep is expected to be high in 2015. Keeping the audit committee's agenda focused – and its eye on the ball – will require discipline and vigilance.

Stay apprised of global audit reform initiatives – potentially impacting the external auditor's role and relationship

Regulators in the EU and other countries around the world have undertaken initiatives focused on enhancing auditor independence, objectivity, and professional skepticism – from changes to the auditor's reporting model, to auditor tenure and rotation, and restrictions on non-audit services. Stay apprised of these initiatives and consider how they would impact the audit process, the audit committee's oversight, and the company. For example, expanding the auditor's report – to include discussion of key audit risks and the related audit response, and evaluating information outside of the financial statements – would impact your company because it will be included in your company's financial statements. Discuss the implications of these initiatives, and take the lead on ensuring audit quality: Set the tone and clear expectations for the external auditor, and actively monitor auditor performance through frequent, quality communications (formal and informal).

Monitor fair value estimates, impairments, and judgments of key assumptions underlying critical accounting estimates.

A company's greatest financial reporting risks are often in those areas where there's a range of possible outcomes and management has to make difficult judgments and estimates – fair value measurement, impairment, revenue recognition, etc. Over the past year, regulators have stepped-up their efforts on a number of fronts to help ensure that significant accounting judgments and estimates applied by management present a fair and accurate picture of the company's financial position and performance. The message: Quality financial reporting requires a disciplined, robust, and unbiased process to develop accounting judgments and estimates. To that end, understand management's framework, make sure that management has appropriate controls in place, and ask for the external auditor's views.

Consider whether the financial statements and other disclosures tell the company's story – and the audit committee's.

Investors want to understand the company's story; consider how the company's disclosures – and the audit committee's – can be improved to better tell it. Think about going beyond what's required to provide a clear picture not only of the company's recent performance, but where it's headed and the key risks it faces. In addition to traditional financial metrics, can the company provide investors with greater insight into the drivers of long-term growth – customer satisfaction, talent, innovation? Consider the recommendations of the Financial Reporting Council (FRC) Reporting Lab and the Audit Committee Collaboration Group (which includes the NACD and the Center for Audit Quality) on ways to enhance the audit committee's reporting. Given the audit committee's critical oversight role, "it is important for investors and others with a stake in the financial markets to understand and have confidence in the committee's work."

Understand the company's domestic and international tax positions, and the (very real) implications for the brand.

Pay particular attention to the global "tax transparency and morality" debate being driven by notions of "fairness" and "morality," and consider the impact of tax risk on the company's reputation. Tax is no longer simply an expense to be managed; it now involves fundamental changes in attitudes and approaches to tax globally. Ensure that tax decisions take into account reputational risks and not simply whether the company has technically complied with tax laws. Monitor OECD and governmental efforts globally to address perceived transfer pricing abuses. Help shape the company's tax risk appetite, and establish a clear communications protocol for the chief tax officer to update the audit committee regularly. Help ensure the adequacy of the company's tax resources and expertise globally.

Understand the implications of the new revenue recognition standard and other accounting changes on the horizon.

In May, the IASB and the FASB finalized a converged, principles-based standard on revenue recognition that will change the way many companies recognize revenue. The standard isn't effective until January 1, 2017 for calendar year-end companies (and the IASB and the FASB are assessing whether to delay the implementation date), but it will have a significant impact across the company – from systems, data, and accounting processes, to controls and business contracting processes. Companies should already be developing transition plans and identifying areas that require close attention. Also, stay apprised of other standard-setter projects – such as leases, financial instruments, and insurance – which have significant implications not only for the company's financial reporting and accounting, but for staffing, resources, and IT systems.

Make the most of the audit committee's time together: effectiveness requires efficiency.

As we noted in #1, keeping the audit committee's agenda focused on financial reporting and related internal control risk is essential to the committee's effectiveness – but meeting the workload challenge requires efficiency as well. Streamline committee meetings by insisting on quality pre-meeting materials (and expect pre-read materials to have been read), making use of consent agendas, and reaching a level of comfort with management and auditors so that financial reporting and compliance activities can be addressed efficiently (freeing-up time for more substantive issues facing the business). Do we leverage the array of resources and perspectives necessary to support the committee's work? Do we spread the workload among audit committee members, rather than relying on the audit committee chair to shoulder most of the work? Do we spend time with management and the auditors outside of the boardroom to get a fuller picture of the issues? Take a hard, honest look at the committee's composition, independence, and leadership. Is there a need for a fresh set of eyes? Is it time for rotation?

Quality financial reporting starts with the CFO and finance organization; maintain a sharp focus on leadership and bench strength.

Nearly 60 percent of the directors surveyed globally said their company does not have a formal succession plan for the CFO. Not good. Given the critical role the CFO plays in maintaining financial reporting quality – and the high rate of CFO turnover – the company should have a succession plan in place for the CFO (and other key finance executives – the controller, chief accountant, chief audit executive, treasurer, and perhaps the chief compliance and chief risk officers). How does the audit committee assess the finance organization's talent pipeline? Do they have the training and resources they need to succeed? How are they incentivized to stay focused on the company's long-term performance? What are the internal and external auditors' views?

Make sure the company's ethics and compliance programs are keeping up with new vulnerabilities to fraud and misconduct.

Globalization, information technology, and fast-changing business models have, in many ways, created a Wild West: Moving quickly to capitalize on opportunities in new markets, leveraging new technologies and data, and engaging with more vendors and third parties across longer and increasingly complex supply chains heighten the risk of fraud and corruption. Coupled with the complex global regulatory environment – FCPA and the UK Bribery Act, the SEC's whistleblower program, and the sheer volume and scope of new regulations – these vulnerabilities will require vigilance. Help ensure that the company's regulatory compliance and monitoring programs cover all vendors in the global supply chain and clearly communicate the company's expectations for high ethical standards. Recognize that the radical transparency enabled by Twitter, YouTube, Facebook, and other social media has effectively put every company in a fishbowl: the company's culture and values, commitment to integrity and legal compliance, and its brand reputation are on display as never before.

Position internal audit to be an indispensable resource.

At a time when audit committees are wrestling with heavy agendas – and issues like cyber security and global compliance are putting risk management to the test – internal audit should be a crucial voice on risk and control matters. (One out of every two audit committee members surveyed said internal audit "should be delivering greater value to the organization.") That means focusing not just on financial reporting and compliance risks, but critical risks to the business – key operational and technology risks, and related controls. Does internal audit have the stature – and a direct line to the audit committee – to ensure that its voice is heard and valued? Leverage internal audit as a barometer of the company's financial and operational health – helping the audit committee understand the quality of financial and operational controls, processes, and people. "High-performing departments stand apart in their mindset and how they approach their work," says IIA's CEO Richard Chambers. "They grasp the importance of delivering value, and they are seen by stakeholders as an indispensable resource."

Also see KPMG's "On the 2015 Board Agenda".

Contact the ACI

Wim Vandecruys
KPMG International
T +32 (0)11 28 66 31
E wvandecruys@kpmg.com

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