



On the 2022 audit committee agenda

KPMG Board Leadership Centre



Emerging from two years of pandemic-driven crisis and disruption, we continue to see how important trust and transparency are – not only to the functioning of the capital markets, but also to customer relationships, brand reputation, and the health and well-being of employees. For shareholders – and, increasingly, from a broader stakeholder perspective – much of that trust and transparency is grounded in the quality of the company’s corporate reporting and disclosures, and the story they tell. To that end, the audit committee’s oversight role has perhaps never been more important or more challenging.

The crises of 2020–21 and disruptions they’ve triggered – from accelerating technology transformations to upending long-standing “norms” of the workplace, business models, and the economy – have added significant stress and strain to financial reporting processes and the risk and control environment. That pressure is likely to continue given the demands for more and better climate and environmental, social, and governance (ESG) reporting, increased cybersecurity risks and ransomware attacks, a war on talent, a fast-changing regulatory landscape, and other factors impacting the global risk environment – including the direction of COVID-19.

Drawing on insights from our conversation with audit committees chairs and business leaders, we’ve highlighted ten issues to keep in mind as audit committees consider and carry out their 2022 agendas.

Stay focused on financial reporting and related internal control risks – job number one

It’s clear from our conversations with audit committee members that overseeing major risks on the audit committee’s agenda beyond the committee’s core oversight responsibilities (financial reporting and related internal controls, and oversight of internal and external auditors) is increasingly difficult. Aside from any additional agenda items (such as climate and ESG risks), the risks that many audit committees have had on their plates for some time – cybersecurity and IT risks, supply chain and other operational risks, legal and regulatory compliance – have become more complex, as have the audit committee’s core responsibilities. Reassess whether the committee has the time and expertise to oversee these other major risks. Do climate and other ESG issues and cybersecurity risks require more attention at the full-board level – or perhaps the focus of a separate board committee?

The pros and cons of creating an additional committee should be weighed carefully; but considering whether a finance, technology, risk, sustainability, or other committee would improve the board’s effectiveness – and whether the board has the resident skill sets to oversee these issues – can be a healthy part of the risk oversight discussion.

As the financial reporting, accounting, and disclosure impacts of COVID-19 continue to unfold in 2022, key areas of focus should 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 – continue to make COVID-related disclosures a top area of focus. At the same time, the strains on supply chains will make financial forecasting even more difficult. Key areas requiring audit committee attention include: Disclosures regarding the current and potential effects of COVID-19 (e.g., Strategic Report, risks and uncertainties, liquidity, and operating results of operations); preparation of forward-looking cash-flow estimates; impairment of non-financial assets, including goodwill and other intangible assets; accounting for financial assets (fair value); going concern and longer-term viability; and use of non-GAAP metrics.

With companies making more tough calls in the current environment, regulators are emphasising the importance of well-reasoned judgments and transparency, including contemporaneous documentation to demonstrate that the company applied a rigorous process. Given the fluid nature of the long-term macro-economic environment (inflation, interest rates, supply chain, etc.), changes in judgments, estimates, and controls may be required more frequently.

— *Internal control over financial reporting and probing control deficiencies.* Internal controls will continue to be put to the test in the coming year. When control deficiencies are identified, it's important to probe beyond management's explanation and help provide a balanced evaluation of the deficiency's severity, cause and whether the failing or weakness indicates poor decision-taking, a need for more extensive monitoring or a reassessment of the effectiveness of management's on-going processes. Is the audit committee – with management – regularly taking a fresh look at the company's control environment? Have controls kept pace with the company's operations, business model, and changing risk profile, including cybersecurity risks?

How is the company approaching the proposed changes to the UK framework for reporting on internal controls (UK SOx)? Does management talk the talk *and* walk the walk?

Also, stay on top of new accounting standards such as *IFRS17 Insurance Contracts* and new and emerging disclosure requirements such as TCFD and other ESG related disclosures.

Monitor climate and other ESG disclosures and clarify the audit committee's related oversight responsibilities

Companies are facing increasing demands – from investors, research and ratings firms, activists, employees, customers, and others – for more transparent and higher quality information about corporate sustainability efforts. How is the company addressing climate and other ESG risks and issues – from diversity, equity, and inclusion (DEI) efforts to the company's "purpose" and how it's considering the interests of stakeholders, including employees, suppliers, and the communities in which it operates?

We can also expect increasing stakeholder demands for more detailed climate/ESG reporting. Audit committees should encourage management 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 various ESG raters – particularly those used by the company's investors, understanding the expectations of investors and other stakeholders, and considering the appropriateness of ESG reporting framework(s) for the company.

But it's important to note that the company's efforts should be about more than just ESG ratings. It is also about how climate and other ESG risks and opportunities are managed and their impacts on the creation of long-term value. Investors want to understand which climate and other ESG risks pose a threat to the company's strategy, operations, and financial condition, and are of strategic significance to the company.

How is the company addressing climate and ESG as long-term strategic issues and embedding them into the company's core business activities (risk management, strategy, operations, 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?"

Oversight of a company's climate, ESG, and DEI activities is a formidable undertaking for any board and its committees. Audit committees typically have responsibility for oversight of the company's related disclosures, including the selection of a disclosure framework(s), consideration of where the disclosures should be made, management's disclosure controls and procedures, and any third-party assurance. The audit committee can also play an important catalyst role by helping to ensure that board and committee oversight responsibilities are clear, and that communication and coordination among the board and its committees are effective. It is quickly becoming clear that ESG issues touch multiple board committees, and oversight responsibilities should be allocated accordingly.

Help sharpen the company's focus on ethics and compliance

The reputational costs of an ethics or compliance failure are higher than ever, particularly given the increased fraud risk due to employee financial hardship, pressures on management to meet financial targets, and increased vulnerability to cyberattacks. Fundamental to an effective compliance program is the right tone at the top and culture throughout the organisation, 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 complex supply chains.

Closely monitor the tone at the top and culture throughout the organisation with a sharp focus on behaviors (not just results) and yellow flags. Is senior management sensitive to ongoing pressures on employees (both in the office and at home), employee health and safety, productivity, engagement and morale, and normalising work-from-home arrangements? As we've learned from the events of 2020–2021, leadership and communications are key, and understanding, transparency and empathy 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 remain up to date, cover all vendors in the global supply chain, and clearly communicate the company's expectations for high ethical standards.

Fraud continues to be a hot topic for audit committees as employee financial hardship, changing working practices and pressures on management to meet financial targets impact the key elements of the fraud triangle – the incentives to commit fraud; the opportunity to commit fraud; and the rationalisation that allows a person to commit fraud.

Do you understand and know where fraud risks are in your organisation? When was the last time management carried out a specific fraud risk assessment? Being able to identify and understand your current fraud risk profile is paramount to being able to demonstrate you have actively tried to prevent and detect fraud. It will also provide an opportunity to identify control weaknesses or gaps that require strengthening.

Focus on the effectiveness of the company's whistleblower reporting channels and investigation processes. Does the audit committee see all whistleblower complaints, obtain information on how such complaints are resolved and receive information that enables the committee to understand trends?

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.

Remain focussed on cybersecurity risks and the increased risk of ransomware attacks

The rapid shifts that companies have made during the pandemic to keep their businesses up and running – remote work arrangements, supply-chain adjustments, and increased reliance on online platforms – have been a boon to organised crime, hackers, and nation-states. Cyberattacks of all types proliferated during the pandemic, highlighting the far-reaching implications for supply chains and operations, as well as the ongoing cybersecurity challenge facing companies.

Boards and/or audit committees have made strides in monitoring management's cybersecurity effectiveness – for example, with greater IT expertise on the board and relevant committees, company-specific dashboard reporting to show critical risks, and more robust conversations with management. Despite these efforts, the acceleration of digital strategies, remote work and hybrid work models, increased regulatory scrutiny of data privacy, and the growing sophistication of cyber attackers all point to the continued cybersecurity challenge ahead – whether overseen by the board or the audit committee. It is no longer a matter of if you will experience a cyber-security incident, but rather a matter of when and how you respond to it.

Keep abreast of the audit reform agenda and encourage management to take any necessary 'no regret' actions

Pay close attention to the audit reform agenda – in particular the proposals to introduce a stronger framework for internal control reporting in the UK along the lines of that required by the Sarbanes-Oxley Act in the US.

However the proposals are implemented, there will be a huge amount for audit committees to think about and prepare for. What no regret actions can organisations take now to ensure a smooth transition to any new framework?

How will you oversee any necessary cultural shift? Are the benefits of any changes clearly articulated? How can technology be best leveraged? Is there agreement as to the organisation's principal risks starting with the key risks with a financial statement impact? If you don't know where your principal risks are you will end up with the wrong control environment.

Beyond internal controls over financial reporting, consider how the audit committee (and board) will respond to the calls for:

- A business resilience statement, to replace the existing going concern and viability statements
- Increased reporting in relation to fraud risk
- An audit committee regulatory framework potentially defining minimum audit committee standards along with regulatory powers to place observers in audit committee meetings
- A three year rolling Audit and Assurance Policy describing the board's approach to seeking assurance, internal and external, on the information reported to shareholders
- A new regulatory regime where all relevant directors will be held to account for breaches of their financial reporting and audit duties – not just those who are members of professional accounting bodies
- The publication of individual corporate reporting review reports and audit quality review reports on individual audits
- The introduction of managed shared audits to increase competition within the audit market

Reinforce audit quality and set clear expectations for the external auditor

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. (See the ACI's [External Auditor Assessment Tool](#)).

Setting clear expectations and frequent quality communications with the external auditor is vital. In setting expectations for 2022, consider the lessons learned from 2021 – potentially the first audit in a remote working environment.

Audit committees will want to discuss with the auditor what aspects of the 2022 audit will be conducted remotely, and what aspects of the audit will be done differently in 2022. What worked well in 2021, and what are the opportunities for improved efficiency in 2022? What complexity does working remotely add to the audit? How have the company's financial reporting and related internal control risks changed? What are both management's and the auditor's plans to keep the 2022 audit and the interim review on track?

Set clear expectations for frequent, open, candid communications between the auditor and the audit committee – beyond what's required. The list of required communications is extensive, and includes matters about the auditor's independence, as well as matters related to the planning and results of the audit. Taking the conversation beyond what's required can enhance the audit committee's oversight, particularly regarding the company's culture, tone at the top, and the quality of talent in the finance organisation.

Audit committees should also probe the audit firm on its quality control systems intended to drive continuous improvement in 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, consider the results of the FRC's AQRs and any internal inspections and efforts to address any deficiencies. Remember that audit quality is a team effort, requiring the commitment and engagement of everyone involved in the process – the auditor, audit committee, and management.

Understand how technology is impacting the finance organisation's talent, efficiency, and value-add – along with the implications of the war on talent and changing workforce trends

In 2022, we can expect continued scrutiny of how companies are adjusting their talent development strategies. The challenges of finding, developing, and retaining talent, amid a shifting working trends and a labour constrained market has created a war for talent – particularly for finance functions and internal audit. Also, think through the potential knock on effects on wellbeing, systems and controls as people adapt to new ways of working – whether that be people returning to the workplace or embarking on long-term remote and/or hybrid working.

The acceleration of digital strategies and transformations that many companies are undertaking are impacting finance organisations and presenting 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?

What risks are associated with such technology and how are they being addressed and mitigated?

- 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 cryptocurrencies. 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? This remains challenging in the current labor constrained environment. In this environment, it is essential that the audit committee devote adequate time to understand finance's transformation strategy.

Stay apprised of global tax developments and risks – now an important element of ESG

Disruption and uncertainty describe the global tax environment today – particularly multinationals. The OECD is leading efforts to achieve consensus among 137 countries, including the UK, for global tax reform to enable jurisdictions to tax automated digital services – so that technology-enabled services and customer-facing services are taxed in the jurisdictions in which those activities are happening. The OECD is also leading efforts among countries to establish a global minimum tax. At this time, there is much uncertainty around the success of the OECD efforts.

Tax has also emerged as an important element of ESG, with stakeholders expecting companies to conduct their tax affairs in a sustainable manner, measured in terms of good tax governance and paying a "fair share." Many stakeholders view the public disclosure of a company's approach to tax, the amount of taxes paid, and where those taxes are paid as important elements of sustainable tax practice.

In this environment, it is important for audit committees to engage with the management in at least three areas:

- Understand the risks posed by the uncertainty and complexity of this evolving tax landscape, as it is likely to have a significant effect on the company in the coming years.
- Help articulate the company's tolerance for reputational risk associated with tax choices that are being made including developing a global tax strategy which is aligned to the company's broader ESG agenda, and evaluate the extent to which the corporate governance framework and associated controls are in place to minimise this risk and or improve sustainability scores.

- Help determine the right approach to tax transparency, as there is no consensus as to what level of reporting constitutes “good tax transparency.” Management teams will need to consider stakeholder expectations, relevant standards, regulators, and the tax transparency disclosures of their peers.

Help ensure that internal audit is focused on the company’s critical risks

Is the internal audit plan risk-based and flexible – and does it adjust to changing business and risk conditions? This is an increasingly common question that audit committees are (or should be) asking the Head of Internal Audit (HoIA). While a global pandemic was perhaps not on internal audit’s list of likely risk events heading into 2020, audit committee members we recently surveyed said, by and large, that their internal auditor pivoted effectively to reviewing management’s updated risk assessments as well as management’s remediation plans and controls for those risks.

Going forward, the audit committee should work with the HoIA and CRO to help identify the critical risks – such as tone at the top and culture, workforce trends, legal/regulatory compliance, incentive structures, cybersecurity and data privacy, ESG risks, and global supply chain and outsourcing 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. Ask again whether the audit plan is risk-based, flexible, and can 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? 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 HoIA think through the impact of digital technologies on internal audit.

Make the most of the audit committee’s time together

Effectiveness requires efficiency. As we noted at the outset, 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 “process routine” (freeing-up time for more substantive issues facing the business). Other key questions to pose periodically:

- Does the audit committee leverage the array of resources and perspectives necessary to support the committee’s work?
- Does the committee spread the workload by allocating oversight duties to each audit committee member, rather than relying on the audit committee chair to shoulder most of the work? Does the committee have the expertise to oversee all of the issues delegated to it?
- Is sufficient time spent with management and the auditors *outside of the boardroom* – to get a fuller picture of the issues?

Also take a hard, honest look at the committee’s composition, independence, and leadership. Is there a need for a fresh set of eyes, or deeper (or different) skill sets?

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