



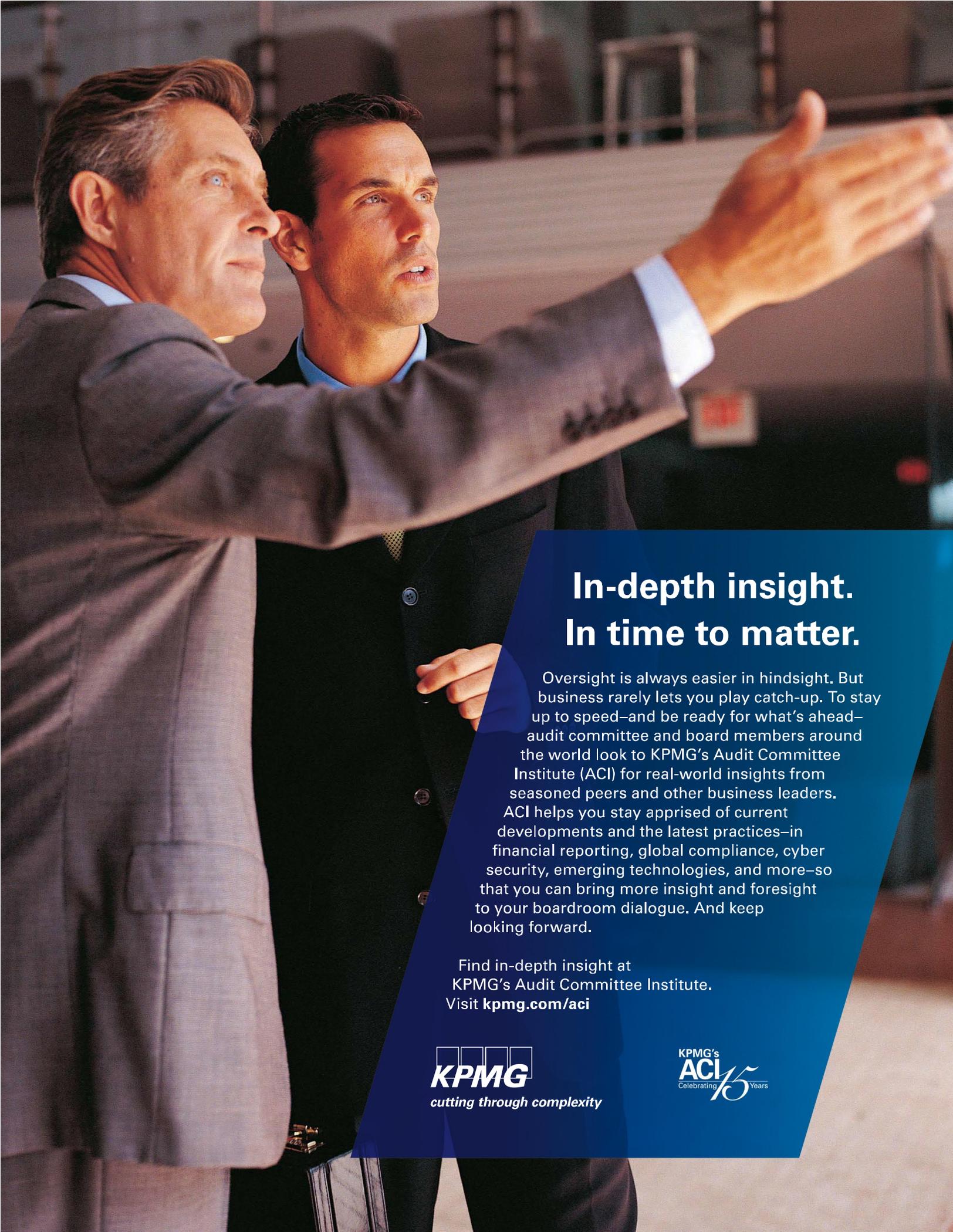
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KPMG's Audit Committee Institute

# Audit Committee Priorities for 2014

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# Audit Committee Priorities for 2014

In 2014, audit committee (and board) agendas clearly will be shaped by continued economic uncertainty, globalization and geopolitical turbulence, increased government regulation, and an interconnected world where technology is accelerating everything. Focused, yet flexible agendas, exercising judgment about what belongs (or does not belong) on the committee's agenda, and taking deep dives on key risks and challenges facing the business will be critical. To help audit committees meet the governance challenges of the coming year we offer KPMG's Audit Committee Priorities for 2014.

## AUDIT COMMITTEE PRIORITIES

- Stay focused on job #1: Financial accounting and reporting.
- Monitor key PCAOB proposals potentially impacting the external auditor's role.
- Leverage internal audit as a barometer of the company's financial health—helping the audit committee understand the quality of financial controls, processes, and people.
- Make sure the company's ethics and compliance programs are keeping up with new vulnerabilities to fraud and misconduct.
- Understand the company's significant tax risks and tax risk appetite; pay particular attention to the global "tax morality" and "tax transparency" debates, and assess the impact of tax on the company's brand.

## BROADER GOVERNANCE MATTERS

- Understand how technology is continuing to transform the competitive landscape—and assess whether the board's oversight processes enable directors to help lead the company forward.
- Recognize that good risk management entails both defense and offense.
- Set the tone and closely monitor leadership's commitment to that tone, and actively "listen to the conversation" below senior management and outside the corporate office.





## Audit Committee Priorities

### **Stay focused on job #1: Financial accounting and reporting.**

Challenging global economic conditions, coupled with major public policy initiatives—deficit reduction and tax reform, healthcare, financial services regulation, new accounting standards, and a challenging regulatory environment—will require the attention of every audit committee. Continue to monitor fair value estimates, impairments, and management's judgments of key assumptions underlying critical accounting estimates, and understand management's framework for making accounting judgments and estimates. Stay apprised of key FASB projects—revenue recognition, leases, financial instruments, and insurance—which have significant implications not only for the company's financial reporting and accounting, but also staffing and resources, processes, and—perhaps most significantly—IT systems.

Financial reporting quality starts with the CFO and finance organization, so maintain a sharp focus on leadership and talent, make sure they have the resources to succeed, and encourage them to stay focused on the company's long-term performance. Is there a formal CFO succession plan in place—and a process for the audit committee to gain visibility into the finance organization's bench strength, one and two levels below the CFO?

### **Monitor key PCAOB proposals potentially impacting the external auditor's role.**

The PCAOB has a number of initiatives focused on enhancing auditor independence, objectivity, and professional skepticism as part of an ongoing campaign to improve audit quality. The PCAOB's projects—particularly its inspection process, audit quality indicators initiative, and proposed changes to the auditor's reporting model—may have a significant impact on the audit process. From expanding the auditor's report to potentially include discussion of critical audit matters and the auditor's responsibilities related to fraud, to evaluating information outside of the financial statements, your external auditor's report may change dramatically (as early as 2016). If there is an expanded auditor's report, it will impact your company because it will be associated with your company's financial statements. Stay apprised of these projects and their implications, and take the lead on ensuring audit quality—weighing key indicators, such as the knowledge and experience of the engagement team, the audit firm's internal quality reviews, and PCAOB inspection findings. Also, consider expanding the audit committee's report to provide investors with more insight into how the committee carries out its oversight responsibilities (see "Enhancing the Audit Committee Report" at [www.thecaq.org](http://www.thecaq.org)).

### **Leverage internal audit as a barometer of the company's financial health—helping the audit committee understand the quality of financial controls, processes, and people.**

Help clarify internal audit's role in the implementation of COSO's new 2013 Internal Control – Integrated Framework, and determine whether (and when) the company plans to adopt the 2013 Framework (which supersedes the 1992 Framework in December 2014). Understand management's process for adopting the new framework, including how it will identify any gaps between the old COSO Framework and



the new. Be sure that internal audit focuses on the adequacy of management review controls (i.e., the precision of those controls and documentation that demonstrates that precision).

Also consider the need to refine internal audit's role, potentially sharpening internal audit's focus on key areas of risk and the adequacy of the company's risk management processes generally. Internal audit is most effective when it is focused on the critical risks to the business, including key operational and technology risks, and related controls—not just compliance and financial reporting risks. What has changed in the operating environment? What are the risks posed by the extended global organization—sourcing, outsourcing, sales, and distribution channels? Set clear expectations and assess whether internal audit has the resources, skills, and expertise to succeed in the role that management and the board envision.

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

Whether moving quickly to capitalize on growth opportunities in new markets, leveraging new technologies and data, or engaging with more vendors and third parties across longer and increasingly complex supply chains, companies face heightened risk of fraud and corruption. These vulnerabilities, coupled with the complex global regulatory environment—including FCPA and the U.K. Bribery Act, the SEC's whistleblower program, and the sheer volume and scope of new regulations—will require continued attention. 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 standards of ethics and social responsibility. The SEC's recent shift from a "neither admit, nor deny" settlement policy to requiring admissions of wrongdoing in certain cases has heightened the reputational risk of ethics and compliance lapses. More broadly, 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, its commitment to integrity and legal compliance, and ultimately, its brand reputation are on display as never before.

Also, with the first specialized disclosure (SD) for the SEC's Conflict Minerals rules due May 31, 2014 (covering calendar year 2013), understand where the company's compliance process stands and whether the audit committee or some other committee will oversee this effort on behalf of the board.

### **Understand the company's significant tax risks and tax risk appetite; pay particular attention to the global "tax morality" and "tax transparency" debates, and assess the impact of tax on the company's brand.**

The days are gone when tax was solely an expense to be managed. Companies today must deal with fundamental changes in attitudes and approaches to tax globally, with notions of "fairness" and "morality" influencing the debate. Understand the company's international tax risks and the reputational implications—particularly in light of the U.S., OECD, and government efforts globally to address perceived base erosion and profit shifting techniques. Be prepared for individual countries to implement formal "tax transparency" requirements, including quantifying the "total tax contribution" made to the reporting jurisdiction. Ensure that tax decisions take into account potential reputational risks and not simply whether the company has technically complied with the tax laws in various jurisdictions. Also, ensure that the tax function is monitoring the federal tax reform debate in Washington and analyzing the impact of possible legislative change. Given the importance and sensitivity of tax risk today, help determine and articulate the company's tax risk appetite. Establish a clear communications protocol for the chief tax officer to update the audit committee regularly. Ensure the adequacy of the company's tax resources and expertise globally.





## Broader Governance Matters

Beyond their core areas of oversight, audit committees can play an important role in supporting the board (and coordinating with other board committees) on the following governance matters:

**Understand how technology is continuing to transform the competitive landscape—and assess whether the board's oversight processes enable directors to help lead the company forward.**

The convergence of social media, the cloud, mobile devices, and big data—what Gartner calls “The Nexus of Forces”—is fundamentally changing the competitive landscape and creating new business opportunities, and the pace of change is accelerating. Do we understand the transformational implications of these technologies for the company's strategy and business model? Do we have the right leadership and talent to make the most of these technologies? Do we know where our next competitors will come from?

The key challenge for boards today is to help shape the company's strategy and manage the related risks in a business environment undergoing massive change. That requires more than oversight. Does the board have *insight* and *foresight* about these technologies and their impact on the business, the industry, and the competitive environment? Are discussions within the traditional boardroom structure sufficient? Do we need a Millennial perspective?

**Recognize that good risk management entails both defense and offense.**

For years—particularly in the aftermath of the financial crisis—risk management has been viewed largely through a “defensive” lens: identifying and assessing, managing and mitigating, and communicating about risk. While a solid defense is essential, more companies today also see good risk management supporting their offense—as a strategic capability helping people throughout the organization make smart risk-adjusted decisions, shaping strategy, and adding competitive value.



Here are four key areas for the board to probe: First, do we have a clear risk philosophy and appetite—e.g., What risks are acceptable and how do they align with strategy? How much financial risk is the company willing to take? What risks are we unwilling to take, no matter how low the probability? Second, do we have a true understanding of our risks, reflecting the realities of the business and operating environment—and always adapting to changes in the environment, whether it is a new technology or macroeconomic conditions? Do we have robust risk discussions—and are we conscious of our biases? Third, have we clearly allocated management's risk responsibilities and decision rights? And finally, observe how decisions are being made and evaluate the thought process, with the goal of continually refining the decision-making process so the company is intelligently taking profitable risks.<sup>1</sup>

Also, consider whether the board's current allocation of risk oversight responsibilities—particularly those assigned to the audit committee (such as compliance, financial, technology and cyber risk)—is appropriate.

**Set the tone and closely monitor leadership's commitment to that tone, and actively "listen to the conversation" below senior management and outside the corporate office.**

With the business environment changing so rapidly and profoundly, and the pressures on management intense, be acutely sensitive to the tone from (and example set by) leadership. Reinforce the right culture—i.e., what the company does, how it does it, and the culture of compliance, including a commitment to financial reporting integrity throughout the organization. Is the board hearing views from those below senior management and outside the corporate office and beyond? Are there dissenting voices? Recognize when asymmetric information risk—the reliance on senior management's information and perspective—is too high. Make time to visit company facilities and attend employee functions. Does the board have a good sense of the tone and culture in the company's global operations and extended organization, far away from headquarters? Is management actively "listening to the conversation" on social media to better understand the risks, opportunities, and changing attitudes and perceptions about the company?

<sup>1</sup> See KPMG's Quarterly Webcast, "Managing Risk for Strategic Value and Competitive Advantage," with Michael W. Hofmann, September 2013.



## KPMG's Audit Committee Institute

Throughout the year, KPMG's Audit Committee Institute (ACI) interacts with audit committee members, board directors, and leaders in business and governance across the U.S. and around the world—providing insights into the challenges and priorities driving audit committee and board agendas. This ongoing dialogue—through ACI's peer exchanges, national conferences, local roundtables, and quarterly Webcasts—sheds important light on how audit committees and boards are strengthening their oversight of compliance, risk, and strategy as they help guide their companies forward.

### **Dennis T. Whalen**

*Partner in Charge & Executive Director,  
Audit Committee Institute*  
713-319-2764  
dtwhalen@kpmg.com

### **John Verdonck**

*Partner, Audit Committee Institute*  
212-872-5727  
jverdonck@kpmg.com

### **Patrick A. Lee**

*Senior Advisor*  
201-505-2674  
patrickalee@kpmg.com

## **ACI Team**

### **Susan M. Angele**

*Director, Research & Education*  
201-307-8198  
sangele@kpmg.com

### **David A. Brown**

*Director, Content & Communications*  
201-505-2119  
davidabrown@kpmg.com

### **Christine E. Haring**

*Director, Marketing*  
201-307-7133  
charing@kpmg.com

### **Jeremy C. Hellwig**

*Director, Programs*  
816-802-5954  
jhellwig@kpmg.com

### **Ari Weinberg**

*Associate Director,  
Communications*  
201-307-7819  
aweinberg@kpmg.com

## **ACI Network Partners**

### **Kapila K. Anand**

312-665-5094  
kanand@kpmg.com

### **Nancy E. Calderon**

212-909-5570  
ncalderon@kpmg.com

### **Edward G. Cannizzaro**

408-367-4902  
ecannizzaro@kpmg.com

### **Max S. Carrier**

214-840-2590  
mcarrier@kpmg.com

### **Lisa L. Daniels**

480-459-3510  
ldaniels@kpmg.com

### **Robert J. Lipstein**

703-286-6090  
rlipstein@kpmg.com

### **Hector S. Mojena**

305-913-2641  
hmojena@kpmg.com

### **Ann C. Nelson**

206-913-4192  
anelson@kpmg.com

### **Philip R. Smith II**

614-249-1996  
philiprsmith@kpmg.com

### **Chris N. Trattou**

212-872-5523  
cntrattou@kpmg.com

### **Timothy G. White**

585-263-4027  
tgwhite@kpmg.com

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[www.kpmg.com/aci](http://www.kpmg.com/aci)

[auditcommittee@kpmg.com](mailto:auditcommittee@kpmg.com)

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