ENGAGING WITH AUDIT COMMITTEES TO SUPPORT ACCOUNTANTS ADDRESSING NEW RESPONSIBILITIES

At their core audit committees play a crucial role in ensuring the provision of high-quality, decision-useful information about an organization to its investors and other stakeholders. But in the current environment, fulfilling this mandate is becoming increasingly more complex as organizations face greater uncertainty and risks and as audit committee oversight responsibilities continue to widen.

Professional accountancy organizations (PAOs) have a key role in supporting their members working on audit committees to continuously learn about new topics, risk areas and reporting requirements, and consider the implications on their organizations and work.

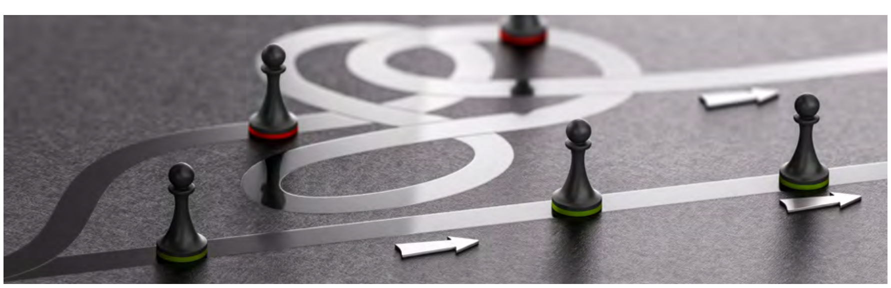
To help PAOs engage with audit committee members on these trends, the PAIB Advisory Group discussed and identified the following priority issues for consideration on audit committee agendas.

DEALING WITH ECONOMIC UNCERTAINTY

Continued fallout from the pandemic, coupled with geopolitical instability, have created an extremely challenging and volatile business environment with high inflation, pressured supply chains and macroeconomic uncertainty. In this context, areas for the audit committee to consider include:

Going concern and accounting estimates - has the audit committee sufficiently considered and challenged management's assessments, judgements and assumptions in areas such as going concern and other accounting estimates?

- In an environment of heightened uncertainty, management estimates and underlying assumptions including projections of revenue and future cash flow and fair value measurements may be more complex and will require a multiple scenario approach.
- The audit committee should also engage with the external auditor and carefully consider their work on accounting estimates as they may need to perform additional procedures to stress test going concern analysis, as well as assess whether the accounting estimates made by management and the related disclosures are reasonable in the context of the changing and uncertain economic environment.



EXAMPLE: CLIMATE-RELATED JUDGEMENTS AND ASSUMPTIONS

To enhance trust and confidence in what companies' report, auditors and the reports they issue may also need to address climate-related judgements and assumptions used in preparing the financial statements. For example, where an auditor determines that work to test and evaluate an estimate or assumption constitutes a key/critical audit matter, the matter may need to be highlighted in the audit report.

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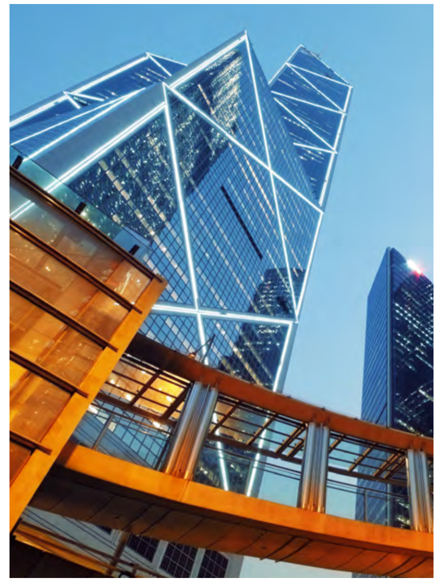
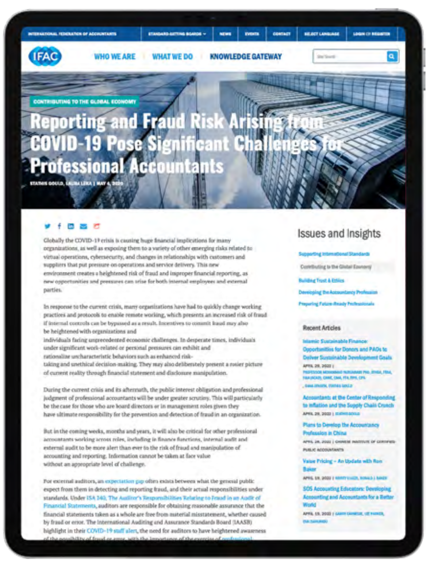
Enterprise risk management – how responsive are processes for identifying, assessing and managing uncertainty and related risks and opportunities?

For example, do they consider issues such as:

- Overall operational resilience, and whether the organization has the ability or agility to respond to disruption, and whether there is a crisis resilience plan, as well as post-covid recovery plans.
- Evaluation and management of supply chain pressures and vulnerabilities and the associated risks, including financial and regulatory risks.
- Monitoring of third-party risks, including collectability of receivables and the financial health of critical vendors/suppliers.
- Enabling successful risk-taking and decision-making at speed in a volatile environment.
- Internal audit plan responsiveness to new or emerging risks.





Heightened risk of fraud – does the uncertain environment increase the risk of fraud or material misstatement?

- Incentives to commit fraud can be heightened when organizations and individuals face unprecedented economic challenges. In challenging times, individuals under significant work-related or personal pressures can exhibit and rationalize uncharacteristic behaviors such as enhanced risk-taking and unethical decision-making. They may also deliberately present a more favorable picture of current reality through financial statement and disclosure manipulation.
- A re-assessment of fraud and reporting risk focused on material areas may be required to enable the board to effectively discharge its responsibility for preventing and detecting fraud. This may involve the audit committee heightening its attention on senior management fraud and including fraud risks as a recurring item on their agenda.

ESG/SUSTAINABILITY REPORTING

Embedding sustainability and ESG matters into strategy is a key priority for boards, and the reporting of sustainability related information is gaining momentum, particularly with recent developments in global sustainability standards. Many boards are turning to their audit committees to provide oversight of broader corporate reporting such as sustainability, TCFD-related disclosure and integrated reporting. In the European Union, the European Commission's proposed Corporate Reporting Directive would expand the audit committee's mandate to include sustainability reporting (see Accountancy Europe's publication, ESG Governance: Recommendations for Audit Committees). These changes in expectations and requirements will involve oversight of a broader set of business and reporting risks, internal controls and assurance processes. Considerations for the audit committee include:

Monitoring the control environment for sustainability/ESG information – has management established an effective approach to risk management and internal control as they relate to sustainability information? E.g.,

- Identification and management of ESG risks, including compliance risks and their potential impacts on the financial statements.
- Assessment of processes and controls to ensure the integrity of sustainability information and reporting, including whether the internal control approach is fit for purpose and operating effectively.

The connectivity and consistency between information – is ESG/sustainability information consistent between the financial statements and other reports and public disclosures?

Level of assurance over integrated reporting, ESG/sustainability and climate-related disclosures, including whether:

- Internal audit has the expertise to support internal assurance of ESG information and integrated reporting.
- Expertise is needed to provide assurance over specialized topics.
- The external auditor can provide wider assurance over ESG/ sustainability information outside of the financial statements as part of a separate engagement and any independence issues.
- The audit committee also needs to consider the integrity of reports not subject to audit or assurance and the reasons for not obtaining external assurance.

INTERNAL ASSURANCE

Coordinated ***internal*** assurance activities are vital for boards of directors to discharge their fiduciary duties and prepare responsibility statements. When embedded in a company's governance and reporting ecosystem, such assurance will improve the confidence that investors and other stakeholders can have in the information provided by the board in their reporting on their accountability, as well as better prepare the organization for external assurance.

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THE STATE OF PLAY IN SUSTAINABILITY ASSURANCE

IFAC and the AICPA & CIMA embarked on this global benchmarking study, in partnership with Audit Analytics, to better understand the extent to which companies are reporting and obtaining assurance over their sustainability disclosures, which assurance standards are being used, and which companies are providing the assurance service. Significant differences in practices across different jurisdictions show a situation that is still evolving, much like the road to a consistent set of standards for reporting sustainability information.

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POST-PANDEMIC WORKING ENVIRONMENT

The pandemic forced a shift in how and where work gets done, and as remote and hybrid working arrangements become the norm, audit committees should consider the implications on their organization's operations and risk environment as well as any impacts on the work of auditors. Considerations include:

Changes to the control environment – have any internal controls been impacted by remote or hybrid working practices, and how is the organization monitoring and maintaining an effective control environment?

- The credibility of reporting and information relies on a robust internal control environment. It is therefore important to identify and address any control deficiencies, for example security of systems being accessed remotely, appropriate segregation of duties, manual vs automated controls.
- Auditor evaluation and testing of the operating effectiveness of controls may also be impacted, for example requiring the use of technology to remotely perform procedures like walkthroughs and testing of controls via live screenshares and live videos.

Technology and digitization – are there additional and/or changed technology-related risks to consider? For example, whether:

- Remote or hybrid working is increasing reliance on technology to run operations, and if this needs to be reflected in formalized business continuity plans.
- There are increased cybersecurity and data transfer risks, including data protection compliance and security of information, cyberattacks on employees working from home, as well as other risks of data breaches through third parties and supply chains.

Other workforce considerations

- Ensuring health and safety of employees working from home.
- Talent attraction and retention in the finance function through flexible working arrangements.
- Whether management is monitoring the risk of employee frauds such as working for a third party remotely.

AUDIT COMMITTEE KNOWLEDGE, SKILLS, AND COMPETENCIES

It is easy to get overwhelmed with widening agendas, but it is important not to forget the basics – and crucial for an audit committee chair to consider is *competency*, including competency of the audit committee itself, the finance function and internal audit.

The size of an audit committee varies by jurisdiction, industry or company, but is often relatively small with only 3 – 5 members. Therefore, for audit committees to understand and effectively oversee a wider range of risks, considerations include:

Keeping up to date on the business – does the audit committee understand the business and how is it keeping up to date with any developments?

- In some circumstances, site visits may be appropriate to fully understand business operations in order to ask the right questions of management. At the same time, audit committee members need to be cautious not to overstep their oversight role.
- As well as updates from the CFO and chief internal auditor, audit committees may require updates during meetings from other department heads, such as the head of IT, head of human capital, and the chief sustainability officer.

Composition and collective expertise – does the audit committee as a whole have the collective experience and expertise to oversee a wider range of risks?

Considerations include whether:

- There is enough financial expertise. Often the requirement is for at least one member to have financial expertise, but this can create a risk of too much reliance on the professional accountant member, who often shoulders a bigger burden because of their professional responsibilities.
- Audit committee members are willing and able to continually learn new areas.
- The board can effectively rotate membership of committees to help increase knowledge of the business and broaden experience.
- There is a common member between audit and risk committees (where these are separate) to ensure connectivity of agendas.
- Appointing outside experts onto audit committees could help increase diversity, independence, and expertise. This approach is being used in jurisdictions such as Saudi Arabia.

Reliance on the expertise of others – does the audit committee need to bring in third party expertise to deal with certain risk areas?

- Subject matter specialists can be brought in to provide external perspectives.
- Set up advisory groups comprised of internal and external experts to support the audit committee on specific risk areas.

AUDIT COMMITTEE TRANSPARENCY

Given the broadening scope and complexities of audit committee agendas, audit committee reporting and transparency is increasingly more important to communicate to the board, investors and other stakeholders how the audit committee has discharged its responsibilities and to enable a more informed assessment of audit committee performance and effectiveness.

For audit committee reporting to be meaningful, there needs to be strong and candid disclosure of:

- The scope of the audit committee's work and key areas of its agenda and discussions.
- Significant issues the audit committee considered in relation to the financial statements and wider corporate reporting and how these issues were addressed.
- The audit committee's evaluation of the organization's internal controls.
- How the audit committee measures and monitors audit quality, including how the audit committee considered and assessed the performance of internal audit and the finance function, the work of external audit (including independence considerations), and whether any audit quality indicators are used.

In the US the CAQ 2021 **Audit Committee Transparency Barometer**, a review of audit committee disclosures by S&P 500 companies, revealed the highest rates of disclosure continue to be related to non-audit services and potential impact to independence.

KEY RECOMMENDATIONS FOR THE PROFESSION

PAOs can use this summary as a foundation to engage with their members who serve on audit committees to help:

- Understand the current priorities and challenges on audit committee agendas.
- Raise awareness of key trends that may impact the work of audit committees.
- Establish the support members need from PAOs to fulfil expanded roles and responsibilities.

Read more insights from IFAC's Professional Accountants in Business Advisory Group:
Global Priorities for Professional Accountants in Business and the Public Sector.