

the BULLETIN

Protiviti's Review of Corporate Governance

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Setting the 2022 Audit Committee Agenda

In prior years, there have been unique enterprise, process and technology risk issues and financial reporting issues for audit committees to consider in addition to the normal ongoing activities articulated within the committee's charter. These exciting, unprecedented times continue to evolve the committee's agenda. We discuss the agenda items for 2022 in this issue of *The Bulletin* and also offer questions for audit committees to consider when self-assessing their performance. In formulating these topics, we considered input from our interactions with client audit committees and insights from meetings with active directors in various virtual forums.

THE 2022 MANDATE FOR AUDIT COMMITTEES

Enterprise, Process and Technology Risk Issues

- 01 In collaboration with the board chair, evaluate the scope of the committee's responsibilities
- 02 Review the board's coverage of ESG reporting
- 03 Consider the reporting and disclosure implications inherent in the risk landscape
- 04 Pay attention to the demands on and resources available to the finance function
- 05 Understand the CAE's plans to sustain internal audit's relevance

Financial Reporting Issues

- 06 Assess the impacts of the emerging post-pandemic new normal on financial reporting assertions
- 07 Assess the impacts of the emerging post-pandemic new normal on internal controls
- 08 Consider the quality and effectiveness of whistleblower programmes

NOTE: The committee should continue to self-assess composition and focus.



ENTERPRISE, PROCESS AND TECHNOLOGY RISK ISSUES

Our suggested agenda includes five enterprise, process and technology risk issues:

01

In collaboration with the board chair, evaluate the scope of the committee's responsibilities

The audit committee is often the default recipient of new and emerging board responsibilities. Now may be a good time to take stock of committee workload, focus and composition.

Twelve years ago, in the aftermath of the financial crisis, the Securities and Exchange Commission (SEC) required disclosure in the proxy materials of the extent of the board's role in the risk oversight of the company. Research conducted by Protiviti shortly thereafter found that six in 10 public company audit committees had an expansive risk oversight role.¹

Later, the New York Stock Exchange required listed companies to include in their audit committee charters a responsibility for the committee to discuss with management the company's policies around risk assessment and risk management. In the years since, there has been a tendency in many companies to assign oversight responsibility to the audit committee when a new risk or regulation emerges, or a significant change occurs in the business. Many boards delegate their overall responsibility for risk oversight to the audit committee, a responsibility that presents challenges in an environment of rapid change in the marketplace and most industries — such as the one faced today.

Therefore, now may be a good time for the audit committee to pause and assess the scope of its activities and how it affects the committee's workload, focus and composition. It is paramount that responsibilities unrelated to financial reporting do not detract from the committee's primary role of overseeing the reliability of financial reporting. In collaboration with the board chair, there may be opportunities to assign responsibilities to other board committees or even to the full board. A review of the audit committee's responsibilities could also mean more frequent meetings and, if necessary, lengthening meetings to accommodate a crowded agenda.

It is paramount that responsibilities unrelated to financial reporting do not detract from the committee's primary role of overseeing the reliability of financial reporting.

¹ *Board Risk Oversight: A Progress Report*, Protiviti, commissioned by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), December 2010: www.coso.org/documents/Board-Risk-Oversight-Survey-COSO-Protiviti_000.pdf.

02

Review the board's coverage of ESG reporting

Collaborate with the board and committee chairs to ensure the board has sufficient input into ESG/sustainability performance, reporting and disclosures.

Several drivers have elevated the importance of environmental, social and governance (ESG) reporting. Sustainable investments driven by screening criteria of institutional investors and asset managers are on track to represent more than a third of the projected total assets under management by 2025.²

BlackRock and State Street are playing a strong hand as activists in leading the clarion call for companies to be active contributors to a sustainable, resilient future.³ State Street has asserted that a company's ESG score will soon be as important as its credit rating.⁴ As evolving consumer preferences and top talent trend to those companies committed to sustaining the environment, ESG performance is becoming a strategic imperative to operate in the marketplace.

In the United States, the SEC introduced last year new disclosure requirements intended to provide stakeholders insight into an issuer's management of human capital — a significant part of the "S" and "G" of ESG. The SEC is considering other disclosures that will likely require disclosures around climate issues and other matters.

To top it off, the International Sustainability Standards Board (ISSB) was formed recently. It will develop uniform sustainability disclosure standards for all companies to follow worldwide.

Smart boards are recognising the importance of a compelling strategy supported by targets and goals for the future that enables the companies they serve to convey a convincing sustainability commitment to the marketplace. Likewise, these boards recognise the importance of whether management's ESG storyline to the street is resonating with investors and impacting the company's valuation. Given the stakes, the audit committee should collaborate with the board chair and committee chairs to assess whether the present assignment of ESG oversight responsibilities sufficiently enhances the board's governance of ESG/sustainability strategy, performance, reporting and disclosures. Some directors are even considering a separate ESG committee.

Sustainable investments driven by screening criteria of institutional investors and asset managers are on track to represent more than a third of the projected total assets under management by 2025.

² "ESG assets may hit \$53 trillion by 2025, a third of global AUM," by Adeline Diab and Gina Martin Adams, Bloomberg Intelligence, February 23, 2021: www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/.

³ BlackRock expects the companies in which it invests to demonstrate sufficient progress on sustainability-related disclosures and plans underlying them, using guidelines from the Sustainability Accounting Standards Board (SASB) and recommendations from the Task Force on Climate-Related Financial Disclosures. State Street monitors for laggards on the sustainability front using its own scoring system based on the SASB and other frameworks and multiple data sources.

⁴ "State Street Vows to Turn Up the Heat on ESG Standards," by Robin Wigglesworth, *Financial Times*, January 28, 2020: www.ft.com/content/cb1e2684-4152-11ea-a047-eae9bd51ceba.

03

Consider the reporting and disclosure implications inherent in the risk landscape

Consider the implications of both current and long-term risk outlooks when evaluating the sufficiency of financial, sustainability and other public reporting and disclosures.

It's customary for management to conduct periodic risk assessments. Time horizon is a meaningful determinant of any organisation's risk outlook. As illustrated by our most recent

global risks survey, the top risks looking out one year and 10 years present markedly different views.⁵

2022 Top 10 Risks⁵

2031 Top 10 Risks⁵

| | | | |
|--|---|--|------------|
| Impact of government public health policies and pandemic-related regulations/protocols on the business | ↓ | Adoption of digital technologies may require new skills that are in short supply, requiring significant efforts to upskill/reskill existing employees | ↑ |
| Organisation's succession challenges and ability to attract and retain top talent in a tightening talent market may limit ability to achieve operational targets | ↑ | Organisation's succession challenges and ability to attract and retain top talent in a tightening talent market may limit ability to achieve operational targets | ↑ |
| Pandemic-influenced market conditions, including shifts in consumer behaviour, may affect customer demand | — | Rapid speed of disruptive innovations enabled by new and emerging technologies and/or other market forces may outpace the organisation's ability to compete without making significant changes to the business model | ↑ |
| Adoption of digital technologies may require new skills that are in short supply, requiring significant efforts to upskill/reskill existing employees | — | Substitute products and services may arise affecting the viability of current business model and strategy | ↑ |
| Economic conditions in markets we currently serve may significantly restrict growth opportunities for our organisation | ↓ | Economic conditions in markets we currently serve may significantly restrict growth opportunities for our organisation | ↑ |
| Anticipated increases in labour costs may affect ability to meet profitability targets | ↑ | Ease of entrance of new competitors into the market or other significant changes in the competitive environment may threaten the company's market share | ↑ |
| Resistance to change may restrict the organisation from making necessary adjustments to the business model and core operations | — | Regulatory changes and regulatory scrutiny may heighten, noticeably affecting how products or services will be produced or delivered | ↑ |
| Inability to utilise data analytics and "big data" to achieve market intelligence and increase productivity and efficiency | ↑ | Resistance to change may restrict the organisation from making necessary adjustments to the business model and core operations | ↑ |
| Organisation may not be sufficiently prepared to manage cyber threats that have the potential to significantly disrupt core operations and/or damage the brand | ↓ | Changes in the overall work environment (e.g., shifts to a hybrid environment, evolving labour markets, changes in nature of work) may lead to challenges to sustaining organisational culture and the conduct of the business | New |
| Shifts in perspectives and expectations about diversity, equity and inclusion may be occurring at a faster pace than the organisation can manage effectively | ↑ | Inability to utilise data analytics and "big data" to achieve market intelligence and increase productivity and efficiency | ↑ |

⁵ Executive Perspectives on Top Risks for 2022 and 2031, Protiviti and NC State University's ERM Initiative, December 2021, available at www.protiviti.com/toprisks.

The comparative tables above report the top 10 risks, both short term and long term, based on the input from 1,453 executives and directors across the world. The arrows in the tables note whether the reported risks are increasing or decreasing based on comparing the mean average of ratings this year and last year using a 10-point scale. The absence of an arrow means relatively no change between years.

The rapid speed of disruptive innovation, the threat of substitute products and services, fleeting customer loyalty, and the ease of entrance of new competitors into the industry are all top risks looking out 10 years. It's interesting that most of these risks were ranked much higher over the next decade than for 2022. Combined with other risks related to talent, the workplace and organisational culture, these risks portend a disruptive post-pandemic decade ahead.

Near term, risk priorities are shifting. Many of the same risks remain top of mind this year and last year; however, the way organisations are prioritising risks is changing. Looking out 12 months, three risks fell out of last year's top 10 — concerns pertaining to regulatory matters, competition with “born digital” companies and data privacy. New to the top 10 risks list for 2022 are anticipated increases in labour costs, the inability to utilise data analytics and “big data,” and adjusting to shifts in perspectives and expectations pertaining to diversity, equity and inclusion, which respondents ranked as 23, 11 and 16, respectively, in last year's survey.

Also, there are shifts within the top 10 risks, the most notable being talent management and succession. That risk jumped from the eighth spot on last year's list to second place for 2022. This change reflects how the mobility of the workforce has increased

significantly. The war for talent is real, and the employees, contractors and other resources emerging from the pandemic are increasingly selective about *who* they want to work for, *where* they want to work (e.g., home, office or hybrid arrangement) and *when* they want to work (e.g., flexible schedules). It's very likely that the company the audit committee serves is feeling the heat on this front.

The audit committee should understand changes in both the current and long-term enterprise risk outlooks and consider their implications when evaluating the sufficiency of financial, sustainability and other public reporting and disclosures. An understanding of the company's risks helps to:

- Inform the committee's consideration of risks from a financial statement accounting and disclosure perspective (e.g., cybersecurity and privacy incidents, litigation developments, and changes in market and other key risks).
- Enable the committee to put into proper context the various representations and assertions received from management, newly reportable critical audit matters and audit scope changes raised by the external auditor, and internal control concerns, errors and irregularities and other findings presented by internal audit.
- Facilitate the contribution of quality input on ESG reporting (e.g., compliance with the SEC's requirements of human capital disclosures, the ISSB's sustainability reporting requirements and expectations from institutional investors) and the adequacy of the company's risk factor disclosures in public filings.
- Provide insight as to workplace disruptions and the competition for talent that can impact the internal control environment.

04

Pay attention to the demands on and resources available to the finance function

Take note that data security and privacy, enhanced data analytics and changing expectations of internal customers and regulatory challenges are placing increased demands on finance leaders as they cope with retaining talent.

CFOs have a mandate that extends beyond the scope of traditional finance to more strategic matters that include data security and privacy, enhanced data analytics, ESG strategies and reporting, supply chain management, changing expectations of internal customers, and regulatory challenges. Their success in addressing these expansive responsibilities augments their ability to add value to all who seek their help, including the audit committee.

Protiviti's most recent finance trends survey offers insights on how CFOs and finance leaders worldwide are informing and shaping the business on a wide variety of fronts.⁶ Our global survey findings offer context for relevant questions audit committees should consider directing to finance leaders:

- Are we protected, spending enough and investing wisely in the right cybersecurity and data privacy areas? How does finance quantify our organisation's information security risks and the returns on cybersecurity and data privacy investments?
- How does the company ensure that it accurately discloses material ESG information and measures the return on investment (ROI) on sustainability investments? How does finance use ESG data collection, reporting and monitoring activities to increase business value by enabling efficient access to capital, driving higher profitability and attracting better talent?

- How is the CFO optimising talent investments to increase flexibility as well as gain and sustain access to cutting-edge skills and innovative thinking? Is finance balancing the use of a highly skilled core of full-time staff, interim professionals, contractors, managed services providers and outsourcers? Are these talent investments sufficiently supported by related investment in cloud-based collaboration and workflow technologies?
- To what extent are the finance organisation's planning, forecasting and related processes integrating new data inputs to help generate increasingly real-time insights for finance customers? To what extent are finance teams supplementing key performance indicators with data from suppliers and external nonfinancial sources to fuel real-time decision-making support?
- Are the finance organisation's investments in technology and talent sufficient to support the data and governance, analytics, workflows, and collaboration required to thrive as a next-generation function?

These questions are of interest to the audit committee because the success and effectiveness of finance impacts the quality of the function's input into topics germane to the committee's oversight responsibilities. They may be appropriate for an executive session with the CFO.

⁶ "2021 Finance Trends Survey," Protiviti, September 2021: www.protiviti.com/US-en/insights/finance-trends-survey.

05

Understand the CAE's plans to sustain internal audit's relevance

Inquire about the function's approach to achieving an appropriate level of engagement with the business and risk management, data and controls through the necessary skill sets and more agile and technology-enabled audit practices.

CAEs and internal audit functions are facing unprecedented challenges today. Demands are increasing, and expectations are rising as companies face increased business complexity and competition. Interestingly, the results from Protiviti's 2021 Next-Generation Internal Audit Survey⁷ reveal relatively low maturity levels in the governance, methodologies and enabling technology internal audit is deploying. The journey to next-generation capabilities is just beginning as most CAEs report that transformation and innovation initiatives are underway. Meanwhile, digital leaders stand out as they forge the way ahead.

If internal audit is not raising its game, its value will inevitably decline in a rapidly changing environment. "Analog auditing" doesn't mix well in the digital age. Accordingly, the audit committee should consider inquiries around the capabilities the CAE needs to maximise the internal audit function's value to the organisation. For example, should internal audit:

- Deploy robotic process automation (RPA) to take on tedious, time-consuming data-gathering and other highly repetitive manual tasks?
- Use advances in automation and data science technologies to monitor transactional data to identify process or policy deviations?

- Incorporate data analytics and near-real-time risk analysis and dashboards with drill-down capabilities to help focus audit selection, scoping and testing?
- Deploy agile methods to incorporate new and emerging risks timely in the audit plan and provide faster, deeper and more valuable insights?

Next-generation capabilities enable internal audit to keep pace with the company's overall digital transformation strategy, embrace change, improve continuously and maintain relevance. They pave pathways to efficiencies, adaptability, increased engagement and deeper, more valuable insights. That's why the audit committee should ask the CAE to articulate the function's next-generation vision and strategy and whether it's aligned with change taking place across the company. Importantly, internal audit should possess the requisite competencies and skills to facilitate its transition to new value-adding capabilities.

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⁷ "Protiviti's 2021 Next-Generation Internal Audit Survey," May 2021: www.protiviti.com/US-en/insights/whitepaper-next-gen-internal-audit-survey.

Financial reporting issues are fundamental to the audit committee’s core mission. Our suggested agenda includes three such issues:

06 **Assess the impacts of the emerging post-pandemic new normal on financial reporting assertions**
Inquire about the impact of reopening and recovery on assumptions and estimation processes underlying asset impairments, valuation, net realisable value, loss contingencies, and other accounting and disclosure matters.

This particular agenda item was included on last year’s recommended agenda for audit committees. It remains relevant to next year’s agenda as the evolution to the post-pandemic new normal continues. The audit committee should inquire about the impact of reopening and recovery on assumptions and estimation processes underlying impairments of goodwill, long-lived assets, and receivables, loans and investments; valuation and net realisable value determinations associated with inventories and various fair value measurements; revenue

recognition; loss contingencies; and other accounting and disclosure matters.

Given the complexity of these matters, companies must also consider information that becomes available after the balance sheet date but before the issuance of financial statements. If significant subsequent events occur, companies are required to disclose their nature and either an estimate of the financial statement impact or a declaration that an impact assessment cannot be made.

07 **Assess the impacts of the emerging post-pandemic new normal on internal controls**
Continued developments in reimagining the workplace and reopening physical locations may also affect internal control over financial reporting, cybersecurity risks, and exposure to compliance and fraud risk.

The workplace continues to evolve as the pandemic has empowered many employees — particularly those whose physical presence in interacting with people and machines isn’t required at a specific location or in a specified environment — by giving them a desire for a voice and choice as to where and when they work. As a result, many organisations are transitioning to various forms of a hybrid work environment. That said, there’s uncertainty as to what the post-pandemic norm will look like, particularly as the number of companies implementing permanent work-from-anywhere

policies continues to grow. It’s the race to the “new nimble.”

For the audit committee, the question arises as to the effects of these continued workplace developments on internal control over financial reporting, cybersecurity risks, and exposure to compliance and fraud risk. Committee members should consider the following questions:

- What changes in internal controls have been implemented as a result of adjustments to the workplace?

- How have we determined that changes in internal processes during the pandemic and with the planned reentry and expectations of the evolving new nimble have not affected the integrity of our internal control structure and the execution of key internal controls over financial transactions and financial reporting?
- Are we satisfied there aren't any segregation of duties issues in sensitive areas?
- Are the resulting changes in our control environment and the pandemic's effects material enough to warrant disclosure?
- How are recent and expected workplace changes and plans for reopening physical locations affecting the company's cyber-threat landscape and exposure to compliance and fraud risk? Have IT general and change management controls remained strong?
- Have we consulted with legal counsel to ensure the company remains in compliance with applicable laws and regulations, including privacy rules, and is exercising appropriate due diligence to reduce litigation risk over safety issues?



Consider the quality and effectiveness of whistleblower programmes

It is customary to review online complaints and code of conduct violations as they arise. It may be worthwhile to pause and assess the efficacy of the processes designed to support the reporting of these matters.

Internal audit, general counsel or an outside consultant can assess the whistleblower programme against best practices, including user-friendly, multiple reporting channels, available 24/7; multilingual capabilities; a zero-tolerance retaliation policy; accurate, intelligent tracking, reporting and analytics for decision-making; secure and scalable infrastructure; periodic user training, at least annually, on the scope and use of whistleblower channels; use of third parties to engender confidence in programme independence and credibility; effective protocols around handling and investigating reported incidents; and clear reports to decision-makers and the audit committee.

Integrity of complaint reporting channels is also a priority to consider. A review might consider the risk of misinformation or disinformation about financial reporting and internal accounting controls communicated via hotlines and web reporting tools. It should also consider the myriad cyber concerns, including, but not limited to, the underlying security practices of third-party platforms and the potential for documentation provided by ill-intentioned reporters (e.g., document-based malware and links to malicious websites).

Integrity of complaint reporting channels is also a priority to consider.



SELF-ASSESS COMMITTEE EFFECTIVENESS

As it self-assesses its performance periodically, the audit committee might consider the illustrative questions we have made available at www.protiviti.com/US-en/insights/bulletin-assessment-questions-audit-committees. Committee members should periodically assess the committee's composition, charter and agenda focus in view of the current challenges the company faces.

In *Assessment Questions for Audit Committees to Consider*, we cover the following topics:

- Committee composition and dynamics
- Committee charter and agenda
- Oversight of internal controls and financial reporting
- Oversight of the external auditor
- Risk oversight
- Business context
- Corporate culture
- Executive sessions
- ESG reporting
- Oversight of the finance organisation
- Oversight of internal audit
- Committee effectiveness
- Member orientation and education



SUMMARY

Hopefully, 2022 will put the COVID-19 pandemic squarely in the rearview mirror. Indeed, 2022 can be a year in which the audit committee, along with the board, recalibrates its focus in helping management prepare for a disruptive decade ahead.

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