
OUR VIEW ON CORPORATE GOVERNANCE MATTERS

VOLUME 8, ISSUE 3

# Setting the 2023 Audit Committee Agenda

**As in prior years, our suggested 2023 audit committee agenda includes important enterprise, process and technology issues and financial reporting and disclosure issues. In addition to discussing these agenda items, we have offered questions for audit committees to consider when self-assessing their own performance with respect to executing the normal ongoing activities articulated in the committee charter. In formulating the eight agenda topics, we considered input from our interactions with client audit committees and insights from meetings with active directors in various forums.**

### *The 2023 Mandate for Audit Committees*

**Enterprise, Process and Technology Risk Issues**

1. Understand the critical enterprise risks that could affect the company's financial and public reporting and disclosures
2. Draw insights from the CFO's efforts to leverage traditional finance skill sets to contribute value to the organisation
3. Continue to review the board's coverage of ESG reporting
4. Keep a watchful eye on red and yellow flags warning of possible dysfunction in the company's culture
5. Determine whether the internal audit function is undertaking transformation or innovation initiatives

**Financial Reporting Issues**

6. Inquire as to whether the steps the company is taking to address new SEC requirements are sufficient
7. Assess the impacts of inflation, rising interest rates, supply chain issues and other market developments on financial reporting assertions
8. Monitor developments affecting the workplace to ensure no substantive change in key internal controls

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:

1. **Understand the critical enterprise risks that could affect the company's financial and public reporting and disclosures —** Audit committees should understand the company's current and long-term risks when evaluating the sufficiency of financial, sustainability and other public reporting and disclosures. This imperative is especially important in these disruptive times as companies undertake transformation initiatives through modernising technology and implementing enterprise systems. The committee's understanding of company risks:

   — Informs its view of risks from a financial accounting, reporting and disclosure perspective (e.g., cyber and privacy incidents, litigation developments, and changes in market and other risks).

   — Enables its members to put into proper context financial reporting representations and assertions made by management, newly reportable critical audit matters and audit scope changes raised by the external auditor, and internal control concerns, errors, irregularities and other findings presented by internal audit.

   — Facilitates its input on environmental, social and governance (ESG) reporting, management discussion and analysis (MD&A), and risk factor disclosures in public filings.

*Understanding risks is especially important in these disruptive times as companies undertake transformation initiatives through modernising technology and implementing enterprise systems.*

As illustrated by our most recent global risks survey, the top risks (shown on the next page) looking out one year and 10 years present markedly different perspectives.[1]

[1] "Executive Perspectives on Top Risks for 2023 and 2032," Protiviti and NC State ERM Initiative, December 2022: www.protiviti.com/us-en/survey/executive-perspectives-top-risks-2023-and-2032.

| 2023 Top 10 Risks[1] | 2032 Top 10 Risks[1] |
|---|---|
| 1. Organisation’s succession challenges and ability to attract and retain top talent in a tightening talent market may limit ability to achieve operational targets | 1. Organisation’s succession challenges and ability to attract and retain top talent in a tightening talent market may limit ability to achieve operational targets |
| 2. Economic conditions in markets we currently serve may significantly restrict growth opportunities | 2. Adoption of digital technologies may require new skills in short supply, requiring significant efforts to reskill/upskill employees |
| 3. Anticipated increases in labour costs may affect ability to meet profitability targets | 3. Rapid speed of disruptive innovations enabled by new and emerging technologies and/or other market forces may outpace ability to compete |
| 4. Resistance to change may restrict the organisation from making necessary adjustments to the business model and core operations | 4. Resistance to change may restrict the organisation from making necessary adjustments to the business model and core operations |
| 5. Uncertainty surrounding core supply chain ecosystem | 5. Ensuring privacy and compliance with growing identity protection expectations may require significant resources |
| 6. Changes in the overall work environment may lead to challenges in sustaining culture and the conduct of the business | 6. Existing operations and legacy IT infrastructure may not be able to meet performance expectations as well as “born digital” competitors |
| 7. Adoption of digital technologies may require new skills in short supply, requiring significant efforts to reskill/upskill employees | 7. Inability to utilise data analytics and “big data” to achieve market intelligence and increase productivity and efficiency |
| 8. Organisation’s culture may not sufficiently encourage the timely identification and escalation of risk issues | 8. Economic conditions in markets we currently serve may significantly restrict growth opportunities |
| 9. Approach to managing demands on or expectations of a significant portion of workforce to work remotely or as part of a hybrid work environment | 9. Regulatory changes and regulatory scrutiny may heighten, noticeably affecting how products or services will be produced or delivered |
| 10. Organisation may not be sufficiently resilient and/or agile to manage an unexpected crisis | 10. Anticipated increases in labour costs may affect ability to meet profitability targets |

The comparative tables above report the top 10 risks, both short-term and long-term, based on the input from 1,304 executives and directors across the world. The arrows in the tables note that the reported risks have increased year-over-year based on comparing the average of ratings this year and last year using a 10-point scale. As reported in our survey results, there are also shifts in the top risks lists for 2023 and 2032. Amid the opportunities and challenges companies face is the need to closely examine organisational readiness and resilience in the face of inevitable disruptive change and the potential for unwelcome surprises. The ability to adjust and pivot to market developments could become the key differentiator between winners and losers. These results illustrate the kind of insights — near-term and long-term — the audit committee can glean from an up-to-date risk assessment by management.

> ***The audit committee should gain useful insights from the CFO's unique blend of financial management fundamentals and data-driven insights.***

2. **Draw insights from the CFO's efforts to leverage traditional finance skill sets to contribute value to the organisation —** The CFO's role in reliable financial reporting has always been a key focal point for audit committees. Protiviti's most recent Global Finance Trends Survey[2] offers insights on the expanding influence of CFOs and finance leaders worldwide as they position themselves as key contributors to the enterprise's strategy and related dialogue in the C-suite and boardroom. CFOs are making important contributions to channelling the organisation's talent and technology investments, supporting the design and implementation of supply chain transformation, guiding ESG strategy and reporting, fortifying cybersecurity, and helping the enterprise contend with soaring inflation and rising interest rates. Much of this activity enhances the value the CFO can contribute to the audit committee's fulfilment of its mission.

   The audit committee should gain useful insights from the CFO's unique blend of financial management fundamentals and data-driven insights related to the company's strategy, investments and innovations as they drive financial reporting activities, ESG, talent management, supply chains, cybersecurity and more. The CFO can contribute to many of the committee's conversations.

   Following are relevant questions derived from the aforementioned research that audit committees should consider directing to finance leaders on a variety of topics, whether in discussion with them directly or in conjunction with conversations with other C-suite executives:

[2] "2022 Global Finance Trends Survey Report," Protiviti, September 2022: www.protiviti.com/us-en/survey/2022-global-finance-trends-survey.

**DATA SECURITY AND PRIVACY**

- Are our processes for identifying material cybersecurity incidents and reporting cyberattacks and related remediation efforts effective?
- How do we quantify information security risks and the returns on cybersecurity and data privacy investments?
- How are we evaluating the cost, coverage and value of cyber insurance policies as premiums continue to rise and coverage limits decline?
- Are we protected, spending enough and investing wisely in the right cybersecurity and data privacy areas as we shift the focus to resilience?
- How do we know we're complying with privacy regulations and our breach notification processes?
- How is finance contributing to the investment decision-making process?

**ESG REPORTING**

- How do we ensure that material ESG information is appropriate, relevant, subject to internal and potential external validation, and accurately disclosed?
- How do we measure ROI on sustainability investments?
- How are we leveraging ESG data collection, reporting and monitoring activities to increase long-term business value (e.g., enabling efficient access to capital, driving higher profitability and attracting better talent)?

**TALENT AND WORKPLACE MANAGEMENT**

- How are we evaluating the impact of flexible labour models, ESG, well-being, and diversity and inclusion on ROI in the employee experience?
- How are we evaluating the true value our physical office and other facilities provide to the company, its employees and its customers?

**SUPPLY CHAIN RESILIENCE**

- How are we addressing supply chain reliability and responsiveness? Are supply chain risks evaluated in a sufficiently expansive manner?
- How are we measuring "total costs" of the supply chain?

**INFLATION MANAGEMENT**

- Have we identified the key factors that are most sensitive to inflationary pressures and leveraged them in forecasting activities, scenario planning and stress-testing (e.g., projecting customer breaking points where price increases reduce demand)?
- Have we improved the forecasting process for financial managers by clearly identifying cash flow drivers while integrating information from supply chain, financial planning and analysis, and other sources?
- How is finance coordinating with sales and supply chain leaders and procurement groups to optimise sales and preserve margins?
- What have we done to equip treasury teams with reliable business plans and forecasts to help assess liquidity and evaluate investment options?

*Continued ...*

**FINANCE CAPABILITIES**

- To what extent are finance's planning and forecasting processes integrating new data inputs to help generate real-time insights for finance customers? For example, are key performance indicators supplemented with data from external nonfinancial sources to enable real-time decision-making?
- How is the CFO optimising finance talent investments to increase flexibility as well as sustain access to cutting-edge skills and innovative thinking? For example, is finance balancing the use of full-time staff, interim professionals, contractors, managed services providers and outsourcers, as well as seeking ways to blend upskilling, reskilling and retention activities in managing the group? Has consideration been given to the impact of the Great Attrition and evolving talent availability?
- Are talent investments sufficiently supported by related investments in cloud-based collaboration, data collection, automation and workflow technologies?
- 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?
- Is the finance organisation prepared to tackle potentially disruptive non-routine challenges and transactions associated with the company's strategies?

As these questions illustrate, the broadening role of finance impacts the CFO's ability to offer useful perspectives on topics germane to the committee's oversight responsibilities.

3. **Continue to review the board's coverage of ESG reporting —** In last year's suggested agenda, we recommended that the committee chair work with the board chair and other committee chairs to assess whether the board's assignment of oversight responsibilities sufficiently enhances its ESG governance. With evolving consumer preferences, top talent trending to sustainability-committed companies, regulators broadening ESG disclosure requirements, and the influence of institutional investor and asset manager screening criteria on investing decisions, smart boards are ensuring that there is a "whole board view" of the organisation's sustainability strategy, performance, reporting and narrative to the street (and other stakeholders looking to that reporting).

   However the board chooses to organise its oversight of ESG strategy and reporting, the audit committee has a role to play in engaging with management on the effectiveness of the disclosure controls and procedures relating to ESG metrics and reporting. If the company seeks to obtain external assurance, the committee should ensure that there is appropriate board oversight over such activities, including continuing to ensure external auditor independence.

4. **Keep a watchful eye on red and yellow flags warning of possible dysfunction in the company's culture —** As a keystone provides integrity to an arch structure, organisational culture infuses the shared values and attitudes that frame how an organisation thinks and behaves. It gives the company its particular character. Corporate culture is a potent source of strength or dysfunction for an organisation and is often the root of reputational and financial performance outcomes.

Culture is never static. As organisations initiate significant changes in the workplace, they often alter how people interact and collaborate. Market pressures and performance expectations further influence behaviour and incentives. Even subcultures are common in large organisations. The fluid nature of culture is why the audit committee should pay attention to warning signs of dysfunction that could affect the quality of public and financial reporting and the effectiveness of the internal control structure. Illustrative examples of such warning signs are provided below.

### *12 Examples of Warning Signs*

1. Return-to-office and virtual hybrid workplace policies reduce peer-to-peer collaboration and seasoned mentorship, create performance evaluation inequities, and/or spawn behaviours inconsistent with stated core and ethical values.
2. There is poor positioning of and executive support for independent risk management/compliance functions within the organisation.
3. There is undue pressure to achieve unrealistic targets, executive resistance to bad news and/or internal competition fostering a warrior culture.
4. Unacceptable risk-taking is encouraged, rewarded or tolerated, e.g., “star performers” are making a lot of money, and no one understands why or how.
5. A “speak-up” culture and formalised escalation processes enabling people to do and say the right things without fear of retribution are not in place.
6. A dominant, cognitively dissonant senior executive ignores the warning signs posted by risk management or resists facts suggesting the strategy is not working.
7. Risk is not considered explicitly by management when evaluating whether to enter new markets, introduce new products, or consummate a complex acquisition, investment or other transformational event.
8. Management only informs the board after the fact when significant risks are undertaken or does not involve the board timely regarding strategic issues and significant policy matters.
9. The company’s enterprise risk management process is neither enterprisewide in scope nor strategic in focus; periodic risk assessments rarely impact business plans and decision-making.
10. Risk management responsibility is not linked to the reward system to set accountability for results or, worse, the incentive compensation programme rewards unbridled risk-taking.
11. Surprises occur from time to time as a result of previously unknown risks, e.g., risk management silos allow significant risk issues to go unnoticed.
12. There is a tolerance for and acceptance of obvious conflicts of interest.

An important challenge with company culture is the tendency of directors to limit their focus to the top. While “tone at the top” is important and a vital foundation to corporate culture, the real driver of behaviour on the front lines is what employees see and hear every day from the managers to whom they report. If the behaviour of unit and middle managers contradicts the messaging conveyed from the top regarding the organisation’s vision, mission and core values, it won't take long for lower-level employees to notice. This lack of alignment with the "tone in the middle" may be exacerbated by increased attrition as well as increased hiring, resulting in a higher percentage of new personnel versus those who are established ambassadors of company culture. As most organisations have undergone significant change over recent years, the warning signs provided on the previous page illustrate the manner in which cultural issues can manifest themselves in the organisation.

5. **Determine whether the internal audit function is undertaking transformation or innovation initiatives —** The past two years have seen unprecedented levels of transformation and innovation among organisations worldwide as they have pivoted and adapted in response to the COVID-19 pandemic. Many companies are operating in a significantly different manner than just a few years ago. They are engaging with customers in new and different ways, improving the overall customer experience, enhancing strategic and operational resilience, and making better use of data as a competitive differentiator. This mindset is one that chief audit executives (CAEs) and their internal audit teams must adopt to remain relevant and attract and retain talent.

   According to the results of a recent Protiviti survey,[3] two in three internal audit functions worldwide have completed or are currently undertaking one or more transformation or innovation initiatives. Three in four CAEs report that not only are these initiatives happening, but many audit committees are also highly engaged in their innovation and transformation efforts. However, there are still numerous internal audit groups that have yet to take any steps toward innovation and transformation.

*The fluid nature of culture is why the audit committee should pay attention to warning signs of dysfunction that could affect the quality of public and financial reporting and the effectiveness of the internal control structure.*

   There are three important takeaways from this research:

   — If the internal audit function has yet to undertake any form of innovation or transformation activities, it is missing opportunities to position itself to provide insight on forward-looking risks and remain relevant on critical and emerging matters. Thus, it may be in danger of lagging behind the competition and is likely building barriers to accessing and developing talent.

[3] "Next-Generation Internal Audit Survey: Innovation and Transformation Are Driving the Future of Internal Auditing," Protiviti, March 15, 2022: blog.protiviti.com/2022/03/15/new-protiviti-research-innovation-and-transformation-are-driving-the-future-of-internal-auditing/.

- Even small steps toward beginning the innovation and transformation journey are effective and can lead to long-term value. Incremental improvement over time and micro-innovations (incremental versus monumental) need not be complicated and are legitimate paths to progress. So, the key is getting started.
- Next-generation capabilities, including wider use of technology, enable internal audit to embrace change, improve continuously and maintain its relevance. They offer a pathway to efficiency, adaptability, increased engagement and deeper, more valuable insights.

*If internal audit has not yet undertaken any innovation or transformation initiatives, the committee should understand the reasons why.*

Audit committees should discuss with the CAE whether there is a next-generation (or transformation) vision and strategy for the function that is aligned with change taking place across the company. If internal audit has not yet undertaken any innovation or transformation initiatives, the committee should understand the reasons why.

In developing a plan for innovation or transformation initiatives, the aforementioned survey noted the following:

- Increased use of data analytics solutions and other technology is by far the most significant priority for a majority of CAEs, especially those from midsize organisations.
- Other often-cited priorities are improvements in the risk assessment approach and pursuit of continuous monitoring and auditing.
- Larger companies are focused on evolving how internal audit coordinates and aligns with other assurance functions across the organisation.

There are other areas of focus for internal audit organisations. They include improving the ways the function communicates with and reports to various stakeholders (including making reporting more impactful). In addition, CAEs should focus on skills development of team members and talent strategies for the function going forward to ensure it has the necessary breadth, depth and combination of experience and skills for both current and expected future needs.

Whatever plan is in place, the audit committee should inquire whether internal audit possesses the requisite competencies and skills to facilitate its transition to new value-adding capabilities.

## Financial Reporting Issues

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

6. **Inquire as to whether the steps the company is taking to address new SEC requirements are sufficient —** Before the Securities and Exchange Commission (SEC) finalises its rules in a number of areas (e.g., cyber and climate change disclosures) and clarifies existing rules in other areas (e.g., human capital disclosures), audit committees serving registrants listed on U.S. exchanges should ascertain that the company is prepared to respond. Of particular importance is understanding the application of the new or clarified requirements to the company's circumstances, the source of the necessary data and metrics needed to comply, the processes to put in place for vetting the output and preparing for attestation, and the appropriate disclosure controls and procedures necessary to ensure timely, consistent preparation and reliable and transparent disclosure. Companies should be focused on these matters sooner than later.

7. **Assess the impacts of inflation, rising interest rates, supply chain issues and other market developments on financial reporting assertions —** There is a lot happening in the global economy, in different sectors and with companies themselves. Changes in inflation, interest rates, supply chains and customer demand, for example, affect both the top and bottom lines of customers and suppliers. Such changes can alter the assumptions underlying financial statement estimation processes. Audit committees should inquire about the impact of changes in market factors on the assumptions underpinning:

   - Valuation of financial instruments (including customer accounts and notes receivable), investments, long-lived fixed and intangible assets, and goodwill
   - Valuation and net realisable value determinations associated with inventories and various fair value measurements
   - Revenue recognition and pricing projections
   - Loss contingencies
   - Debt service issues and going concern assessments
   - Other accounting and disclosure matters

   With respect to these matters, companies should consider information that becomes available after the balance sheet date but before the issuance of the 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.

8. **Monitor developments affecting the workplace to ensure no substantive change in key internal controls —** For the audit committee, there are important questions around such market developments as the Great Attrition; management's efforts to reimagine where, how and why work is performed; company initiatives to automate and/or outsource financial-reporting-related process activities; and other organisational changes. For example, have such developments affected internal control over financial reporting, spawned fresh cybersecurity risks, or increased exposure to compliance and fraud risk? Accordingly, committee members should consider the following questions:

   — Have we determined that changes in internal processes during the pandemic and with our transition to a virtual, hybrid or return-to-office workplace have not affected the integrity of our internal control structure and the execution of key internal controls over financial transactions and financial reporting? How do we know?

   — Have recent and expected workplace changes, plans for reopening physical locations, and shifts in the company's talent model affected the company's cyber-threat landscape and exposure to compliance and fraud risk? Are we satisfied there aren't any segregation of duties issues in sensitive areas exposing our organisation to errors or irregularities?

   — Amid this changing environment, have general, user access (including privileged and sensitive access), and change management controls in IT remained strong?

   — Have adjustments to the business model or in underlying business processes resulted in changes in the internal control structure?

   — Are there changes in our control environment that are material enough to warrant disclosure?

   — Have we consulted with legal counsel to ensure the company remains in compliance with applicable laws, including privacy rules, and is exercising appropriate due diligence to reduce litigation risk over workplace safety issues?

*One thing is certain: The audit committee will need to continue its focus on advising management in the face of continued change in the marketplace.*

## Self-Assess Committee Effectiveness

Audit committees are encouraged to self-assess their performance periodically, in coordination with the board's overall self-assessment process. To that end, we have made available illustrative questions at www.protiviti.com/us-en/newsletter/bulletin-assessment-questions-audit-committees. Committee members should periodically assess the committee composition, charter and agenda focus in the context of the current challenges the company faces.

### *Topics Covered by "Assessment Questions for Audit Committees to Consider"*

- 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 finance organisation
- Oversight of internal audit
- Committee effectiveness
- Member orientation and education

## Summary

Amid unprecedented uncertainty, 2023 will be an interesting year. How will the workplace evolve? Will there be a recession and, if there is, will it culminate with a so-called "soft landing" or will it be sharp, severe and persistent? How high will interest rates go? Will Russia finally cease or lose its war against Ukraine? How will the talent market evolve? Will continued shifts in environmental and social responsibility expectations influence company business strategies and reporting activities? What new developments in digital transformation are likely to affect the customer experience and workplace design? What new reporting requirements will regulators require? These and other questions linger.

One thing is certain: The audit committee will need to continue its focus on advising management in the face of continued change in the marketplace. And, of course, committee members should keep a watchful eye on the effects of change on financial and public reporting.



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