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Top Issues for Audit Committees in 2014

The demands on audit committees are expanding. At the same time, their primary responsibility to oversee management's activities, including financial reporting and compliance, remains fundamental to corporate governance. It can be challenging for audit committees to focus on their traditional core duties while staying up to date on emerging issues such as cybersecurity, proposed regulatory changes, and international developments. Following are several issues audit committees may wish to focus on in 2014 and questions to consider, excerpted from Deloitte's November-December 2013 *Audit Committee Brief*.

Updated COSO Framework

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) recently released an updated version of its Internal Control—Integrated Framework. The 2013 update will soon supersede the original framework, issued in 1992,.The transition period for implementation extends through December 15, 2014. Companies that provide their annual ICFR assessment in accordance with Sarbanes-Oxley Section 404 during the transition period should disclose which COSO framework was used in performing the assessment.

Questions for audit committees to consider:

- Is the company using the framework for internal control over financial reporting only, or for operations and regulatory compliance as well?
- Have company controls been mapped to the new framework?
- Has the new framework revealed any gaps in current processes, control activities, or documentation, and if so, how are these being addressed?
- Is the company educating leadership, risk management, and control owners regarding the content in the updated COSO framework?
- What policies are in place and who is responsible for communicating internal control considerations to external parties (e.g., third-party service providers)?
- Does the company use information technology and data analytics to help continuously monitor internal control systems?

Cybersecurity

Cybersecurity is often at the top of agendas for audit committees and management at companies of all sizes and industries, since the pervasiveness of cyber issues connects them to financial concerns and internal controls. The audit committee plays a vital role in monitoring management's preparation for and response to cyber threats.

Questions for audit committees to consider:

- What are the organization's critical assets to be secured, and how are vulnerabilities identified? How are risks disclosed?
- How are critical infrastructure and regulatory requirements met?
- What is the overall strategy and plan for protecting assets from cyber attacks? How robust are the organization's incident response and communications plans?

Proposed Auditor's Reporting Model

The PCAOB recently proposed auditing standards on the auditor's reporting model and the auditor's responsibility for other information in annual SEC filings. These standards, proposed in August 2013, could significantly change the external auditor's report and necessitate expanded audit procedures.

The significant proposed changes include:

- A new section in the auditor's report on critical audit matters specific to the audit:
  —Critical audit matters are defined as those matters the auditor addressed during the audit of the financial statements that (1) involved the most difficult, subjective, or complex auditor judgments; (2) posed the most difficulty to the auditor in obtaining sufficient appropriate audit evidence; or (3) posed the most difficulty to the auditor in forming an opinion on the financial statements
  —The PCAOB's proposal could potentially change the long-standing reporting model of management being responsible for the company's financial statements and disclosures and the auditor attesting to that information; some of the illustrative examples of reporting on critical audit matters provided in the proposal disclose what appears to be original information about the company that is not otherwise disclosed by management
- Enhanced language in the auditor's report on auditor responsibilities
- New statements in the auditor's report providing more information on areas such as auditor independence and tenure
- Increased auditor responsibility for other information in the company's annual report (including information incorporated by reference), and disclosure about this responsibility in the auditor's report.

The proposal containing the proposed standards and related conforming amendments indicates the effective date would be for audits of financial statements for fiscal years beginning on or after December 15, 2015; however, this date will depend on the nature and extent of revisions the PCAOB determines are necessary based on comments and other input on the proposal, as well as approval by the PCAOB and SEC of any final standards and related conforming amendments and the associated timing.

PCAOB Auditing Standard No. 16, Communications with Audit Committees

PCAOB Auditing Standard No. 16 (AS 16), Communications with Audit Committees, is effective for audits and quarterly reviews of fiscal years beginning on or after December 15, 2012. The PCAOB's primary objectives in issuing AS 16 are to (1) enhance communications between auditors and audit committees and (2) improve audits by fostering constructive dialogue between the auditor and the audit committee. The audit committee should keep the following auditor's responsibilities in mind with respect to year-end communications.

Foreign Corrupt Practices Act

Foreign Corrupt Practices Act (FCPA) enforcement actions have recently been increasing, and will likely continue to be a hot topic in 2014. Companies with strong anti-corruption compliance programs will likely be better positioned to prevent and detect potential violations, and to reduce or even avoid criminal and civil liability should a violation occur. The audit committee should consider assessing important components such as:

- The overall compliance structure
- The thoroughness of the anti-corruption risk assessment
- Policies and procedures covering riskier activities
- Training protocols
- Protocols for third-party and distributor due diligence
- The substance and frequency of senior management and regional compliance officer anti-corruption communications
- The whistleblower reporting systems for employees and third parties
- Monitoring and audit processes
- Disciplinary and incentive procedures for violations of anti-corruption policies and procedures
- Anti-corruption merger and acquisition due diligence procedures.

Questions for audit committees to consider:

- Are we conducting periodic anti-corruption risk assessments to continuously evaluate and manage our corruption risk profile?
- How does management communicate its continued commitment to compliance (i.e., the “tone at the top”)?
- Can we provide evidence that our compliance program is well designed, effectively overseen, and tailored to our size, structure, and risk profile?
- Do we provide country-by-country FCPA reinforcement training tailored to geography- and business-specific risks?
- Are we doing enough anti-corruption due diligence during pre-acquisition and postacquisition integration?

Tax Reform and Regulatory Authority Spotlight

Tax reform is expected to remain a priority in Congress for at least the next year as lawmakers struggle to agree on fundamental questions such as whether a tax code overhaul should be revenue-neutral or raise revenue for deficit reduction, and which corporate tax expenditures should be modified or eliminated to pay for a lower corporate tax rate. That ongoing debate, together with the inevitable transition issues that will arise as proposals move through the legislative process and are enacted into law, means that tax reform will likely be an important boardroom topic over the next several years.

In addition, base erosion and profit shifting continues to be a focus of the Organisation for Economic Co-operation and Development (OECD).

Regulatory authorities also continue to emphasize the importance of greater transparency in financial statement reporting, with a focus on income tax accounting and reporting. The SEC has increased scrutiny in areas such as the tax accounting for investments in foreign entities, including the indefinite reinvestment of foreign earnings, due to the significant judgment involved.

Questions for audit committees to consider:

- How does the tax department stay current on tax laws, regulations, and leading practices? How is the department assessing the potential effect of tax reform and OECD actions?

- What are the company's most significant risks related to tax positions, and what internal controls are in place to address those risks?
- What judgments are involved in the company's tax planning strategies and transfer pricing policies? What does the company rely on to support those positions?
- What key judgments are made in connection with assertions regarding the indefinite reinvestment of foreign earnings? What documentation does the company maintain to support those assertions?
- Do recent regulatory audits and actions raise concerns about how the tax function operates and evaluates the recognition and measurement of tax positions?

Risk Oversight

Risk oversight has taken on increased importance for boards and audit committees. Many boards are evaluating their risk governance structure and which committees have the skills and knowledge to oversee particular risks. The SEC considers risk oversight a key responsibility of the board and requires this role to be disclosed to improve investors' understanding of board activities.

Although it is the responsibility of senior management to assess and manage the company's risks, the audit committee should focus on areas of major financial risk and discuss the guidelines and policies for addressing them. Financial risks often arise from other sources of risk, such as strategy, operations, and compliance with environmental, health, safety, legal and regulatory requirements. Therefore, audit committees may want to consider widening the lens and adopting a more proactive approach to avoid reactive situations. They also should consider placing risk oversight high on the list of agenda items for their meetings. "The audit committee sets the tone for the meeting," notes Greg Weaver, CEO of Deloitte & Touche LLP, "and it should make clear that if there's something the committee needs to know, it's the responsibility of attendees to provide that information directly and concisely."

Related Resources

Audit Committee Brief – Top issues for audit committees in 2014
Taking a Proactive Approach to Today's Cyberthreats
COSO Update: Establishing and Assessing Effective Internal Control
COSO Enhances Its Internal Control—Integrated Framework
Navigating Anti-corruption Compliance: Tools for Audit Committees
The Board's Role in Overseeing Cybersecurity Risk
PCAOB's Proposed Changes to the Auditor's Reporting Model and Responsibilities for Other Information
Risk Oversight: Closing Gaps Between the Board and the CFO
