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AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

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This Update summarizes recent developments relating to public company audit committees and their oversight of financial reporting and of the company's relationship with its auditor.

In This Update:

Good News and Bad News: Audit Committee Members Think Audit Quality Held Steady During COVID, But Many See Fraud Risk Rising

Audit Fees Declined in 2020, But Don't Get Used to It

Audit Committees and ESG: The Journey in 2022

BlackRock and State Street Tell CEOs and Boards What They Expect from Them in 2022

On the Update Radar: Things in Brief

- The PCAOB Revives its Advisory Committees
- KPMG Survey Finds that Fraud, Cyber, and Compliance Threats are High and that Many Companies are Ill-Prepared
- What Should be on the Audit Committee's 2022 Agenda?
- SEC Wants to Hear More About Pay-For-Performance Metrics

The Audit Blog

Good News and Bad News: Audit Committee Members Think Audit Quality Held Steady During COVID, But Many See Fraud Risk Rising

The Center for Audit Quality and Deloitte's Center for Board Effectiveness have published the results of their survey of the oversight practices and current concerns of U.S. public company audit committees. Audit Committee Practices Report: Common Threads Across Audit Committees (Common Threads) reports on a 30-questions survey conducted during August and September of 246 audit committee

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members, mostly from large (i.e., greater than $700 million in market cap) public companies in the U.S. The survey focused on areas of audit committee oversight, key risks, and audit committee practices. Common Threads provides insight into changes in audit committee responsibilities, issues currently facing audit committees and how committees are responding.

While financial reporting and internal controls -- including fraud risk – are the most-cited audit committee priorities, many committee members also see cybersecurity (53 percent), data privacy security (48 percent), ethics and compliance (48 percent), third-party risk (47 percent) and enterprise risk management (42 percent) as top areas of focus. More than two-thirds of audit committee members (69 percent) anticipate spending more time on cybersecurity in 2022 than in 2021, and nearly three-quarters believe that ESG reporting will consume more of the committee's time this year. Forty-two percent of respondents believe that fraud risk has increased as a result of the impact of COVID-19 on the business environment.

Some of the key finds reported in Common Threads include:

- Audit Quality. Thirty-two percent of respondents said that audit quality increased last year, while 66 percent thought it remained the same; just 2 percent believe quality declined. As to what contributes to audit quality, 85 percent of respondents cited the competence of the engagement team and strong communication between the engagement partner and the audit committee as the most important factors. Only 37 percent identified engagement team independence.

- Financial Reporting and Internal Controls. Ninety-six percent of respondents said that the audit committee has responsibility for financial reporting and internal controls; 86 percent have fraud risk responsibility. Nearly a quarter (24 percent) of respondents believe they will spend more time on financial reporting and internal controls in 2022 than in 2021,while approximately three-quarters (73 percent) expect they will spend about the same amount of time. Just two percent predicted that the time devoted to reporting and controls will decline.

- Fraud Risk. As noted above, 42 percent of respondents think that fraud risk has increased because of covid-related changes in the business environment. Seventy-four percent said their company had updated internal controls to increase fraud deterrence and detection over the last 12 months, while 61 percent reported increasing internal audit's focus. Fifty-six percent said that the audit committee's focus on fraud deterrence and detection had increased.

- Enterprise Risk Management. When asked who was responsible for oversight of enterprise risk management (ERM) within their organizations, 42 percent of respondents said the audit committee, 33 percent said the board, and 20 percent said the risk committee. Thirty-two percent expect to spend more time on ERM oversight in 2022 compared to last year.

- Cybersecurity and Data Privacy Security. Fifty-three percent and 48 percent of respondents respectively said that the audit committee is responsible for overseeing cybersecurity and data privacy security. Sixty-nine percent of those with cybersecurity oversight responsibility anticipate spending more time on it in the coming year compared with the past year, and 16 percent see cybersecurity as the top risk their committee will focus on in 2022. Sixty percent of audit committees include cybersecurity on their agendas quarterly. Thirty-five percent of respondents stated their audit committee has cybersecurity expertise, but 41 percent thought that additional cybersecurity expertise would enhance the committee's effectiveness.

- Ethics and Compliance; Third-party Risk. About half of respondents said their audit committee is responsible for the oversight of ethics and compliance (48 percent), and 47 percent said they had responsibility for third-party risk. Seventy-four percent of audit committees include ethics and compliance on their agenda quarterly, second only to financial reporting and internal controls (89 percent) as a quarterly agenda topic. (Third-party risk was reported to be on quarterly agendas for 22 percent of respondents.)

- Audit Committee Engagement. Twenty-seven percent of respondents reported spending more than 250 hours on board or audit committee activities during the year. Almost as many – 24 percent -- spend between 50 and 100 hours. The remaining 49 percent said they devote between 101 and 250 hours to their board and committee duties.

Comments: The Common Threads survey results can serve as a benchmarking resource to aid audit committee members in understanding what their peers are doing and whether there are practices other audit committees employ that they may wish to copy. In addition, audit committees should be alert to the Common Threads finding that many audit committee members believe that fraud risk has increased – driven in large part by the impact of COVID-19 on the operation of controls and on the prevalence of remote work. A recent KPMG survey has a similar finding. Audit committees may want to consider KPMG's high-level recommendations as to how audit committees should respond to this elevated risk. See KPMG Survey Finds that Fraud, Cyber, and Compliance Threats are High and that Many Companies are Ill-Prepared, in this Update.

Audit Fees Declined in 2020, But Don't Get Used to It

Audit Analytics (AA) has released Nineteen Year Review of Audit Fee and Non-Audit Fee Trends, the 2022 edition of its annual analysis of fees paid to external auditors. Somewhat surprisingly, AA finds that, in 2020, both average and aggregate audit fees paid by public companies declined for the first time since 2010. Non-audit fees, as a share of total fees, also fell to a record low. In a blog post summarizing the study, AA observes: "Audit fee trends were impacted by several external events during fiscal year 2020. The COVID-19 pandemic necessitated modified audit procedures, subsequently lowering audit costs. Additionally, regulatory changes altered the composition of companies filing as accelerated filers. This resulted in the audit fee to revenue ratio falling for accelerated filers during the year." AA does not expect fees to continue to decline.

The Nineteen Year Review provides analysis and comparison of trends in audit and non-audit fees disclosed by public companies between 2002-2020. The executive summary highlights four findings:

1. In 2020, aggregate audit fees paid by public companies fell by about one percent, compared to 2019. AA notes that aggregate audit fees fell despite an increase in the number of public companies in 2020. (The rise in the public company population was rather slight – from 6,916 in 2019 to 6,972 in 2020. The long-term trend is downward – the number of companies peaked at 10,894 in 2006 and then declined each year until 2020.) AA suggests that several factors may account for the 2020 reduction in aggregate fees, "including pricing pressure due to uncertainty related to the pandemic, increased use of technology, and a lack of physical travel expenses."

2. Average audit fees also fell (by 2.1 percent) in 2020 for the first time in a decade. "Average fees were impacted by a wave of special purpose acquisition companies disclosing fees for the first time. SPACs pay relatively low fees due to their absence of operations."

3. Continuing a five-year trend, non-audit fees declined to a record low percentage (17.7 percent) of total fees paid to external audit firms. AA suggests that much of the decline is attributable to foreign companies, for which non-audit fees were 14.8 percent of total fees in 2020.

4. Audit fees per million dollars of client revenue declined 23.8 percent from 2019 to 2020 for companies classified as accelerated filers. In 2020, the SEC changed the definition of accelerated filer, causing many low revenue companies to be reclassified from accelerated filers to non-accelerated filers. See SEC Exempts More Small Companies from ICFR Audits, February-March 2020 Update. As AA notes, "This caused a significant decrease in audit fees per million dollars of revenue due to the removal of lower revenue companies."

   While not highlighted in the executive summary, AA also found that, for reporting companies of all types, audit fees per million dollars of revenue increased seven percent between 2019 and 2020.

> This increase was apparently driven by revenue declines, rather than fee increases, AA states that the increase "was largely due to 26% and 12% declines in revenue for mining (including oil and gas) and manufacturing companies, respectively."

In AA's view, the 2020 dip in audit fees is not the start of a trend. On the contrary, AA expects fees to resume their upward march in the future:

> "A decline in total audit fees is unlikely to continue. Some amount of audit work will return to in-person engagement. Physical counts of inventory and the existence of property, plant, and equipment are two examples of work that will likely return to in-person engagement. But other areas - such as observing the operation of internal controls - also have benefits to in-person engagement.
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> "Macro factors like inflation and talent competition will also impact fees going forward. The 'great resignation' has impacted most employers. But before this recent talent crunch, the audit profession was already seeing a talent deficit. A 2019 study by the AICPA found the number of CPA candidates that passed their fourth section of the CPA Exam has declined over the past decade. The talent competition is likely to increase the cost of an audit." (footnote omitted)

The view that audit fees are likely to rise in the future is consistent with the findings of a recent Gartner, Inc. survey. See Survey Finds that Audit Fees are Expected to Rise in 2021, May-June 2021 Update.

Comment: In addition to the headline findings summarized above, the Nineteen Year Review provides information concerning trends in audit and non-audit fee over the nineteen-year period based on location, company size, and industry. Audit committees may find it useful to compare changes in their company's fees against this information.

Audit committees might want to specifically focus on how their non-audit fees compare to broader measures. As noted, AA found that in 2020 non-audit fees reached their lowest level as a percentage of total fees paid in the 19 years of its study. AA observes that, from 2006-16, this metric was "between 20 and 23 percent each year, for 2017 and 2018 it was approximately 20 percent, and for 2019 it was 18 percent." AA describes non-audit fees as a percentage of total fees as "a way to evaluate how firms comply with auditor independence requirements in providing non-audit services to their public company clients." Regardless of whether one agrees with this statement insofar as it relates to legal compliance, it is certainly possible that investors may raise questions about auditor objectivity at companies where non-audit fees as a percentage of total fees are significantly above average.

Audit Committees and ESG: The Journey in 2022

In Navigating the ESG journey in 2022 and beyond, a January 2022 item in the "On the audit committee's agenda" series, Deloitte's Center for Board Effectiveness (CBE) discusses why governance structures around ESG (environmental, social, and governance) strategy and disclosure should be a priority for public companies and their boards. According to CBE, "In recognition of the important role ESG plays in driving long-term value creation, more and more boards are focused on and are disclosing how their governance structure is evolving to consider ESG more intentionally." While audit committees are not likely to have primary board level oversight responsibility for ESG, they have an important role to play. CBE offers some suggestions as to how audit committees fit into the board's approach to ESG governance and provides some questions committees should be asking.

As background, CBE summarizes recent ESG developments: Investor expectations regarding climate and other ESG issues are already high and continue to increase. The SEC is likely to propose ESG disclosure requirements in the areas of climate change, cyber risk governance, board diversity, and human capital management early in 2022. See The SEC's Agenda – ESG Tops the List, July 2021 Update. In addition, the IFRS Foundation has created the International Sustainability Standards Board. See IFRS Foundation Announces the International Sustainability Standards Board and Consolidation with CDSB and SASB, November-December 2021 Update. Other standard-setters are also enhancing their

involvement in ESG, including FASB and the Commodity Futures Trading Commission. See How Does ESG Affect Accounting and Financial Reporting? July 2021 Update. CBE concludes, “With the pace of the ESG developments expected to accelerate rapidly in 2022, company management and boards should be focused on enhancing governance structures and the control environment around managing, and overseeing, ESG risks and opportunities and delivering high quality disclosure.”

In light of these trends, CBE recommends that boards develop governance structures, policies, and practices for overseeing ESG accountability and strategy, including appropriate delegations to committees. This appears to be happening. According to CBE’s research, “there was a marked increase in 2021 in the percentage of S&P 500 companies disclosing in their proxies the primary committee(s) overseeing ESG relative to last year (from 72% to 86%).” These proxy disclosures reveal significant variation in the committees that oversee ESG. The data for 2020-2021 indicates that 53 percent of S&P 500 boards utilize the nominating and governance committee for primary oversight. (The CBE notes that some companies have changed the nominating and governance committee’s name in light of its “broader committee purview” -- e.g., to Nominating, Environmental, Social, and Governance Committee.) Thirteen 13 percent of the S&P 500 assign responsibility to an ESG/sustainability committee, while seven percent indicated that the full board has primary ESG responsibility, and an additional seven percent identified multiple committees. Only one percent of the S&P 500 reported that the audit committee had primary ESG oversight responsibility.

In CBE’s view, despite rarely having primary ESG responsibility, the audit committee has several important roles in ESG oversight, including:

- “Audit committees should understand whether there are appropriate internal and disclosure controls and procedures for the metrics disclosed, whether in an SEC filing or a separate sustainability report. This includes working closely with other committees to understand how ESG risks are identified and prioritized and how materiality is defined.

- “The audit committee should understand the companies’ ESG program— its interconnectedness across the pillars of “E”, “S”, and “G” and the related goals and metrics—and how management considers ESG strategies and the impact they may have on the financial statements.

- “As the development of companies’ integration of ESG into strategy and disclosure objectives continues to evolve and marketplace standards become more established and authoritative, the role of internal audit and the value of assurance as a tool to drive trust and confidence in ESG performance will become central. Assurance can provide a strong signal to investors and other stakeholders regarding the quality and reliability of disclosures. Audit committees should take the lead in overseeing the assurance engagement. The committee may consider inquiring with management about engaging with public company auditors on how to evolve and mature its ESG programs to meet the increasing demands of the market and regulators.”

Further, CBE suggests that the audit committee consider ten ESG questions:

1. Where does the primary ownership and oversight responsibility for ESG reside on the board, both overall and in terms of its various components (e.g., climate, diversity, talent, cyber)? Does the full board understand where and when these elements are being discussed at the board and committee level?

2. How does the company identify and assess ESG risks and opportunities and evaluate its materiality to the business?

3. For ESG risks that are material to the business, how are they integrated into enterprise risk management?

4. How is the company remaining informed of developments in ESG legislation and regulations in all the relevant jurisdictions for the business? And how is the company preparing for anticipated shifts in regulatory requirements (i.e., SEC rulemaking)?

5. How is progress against ESG commitments measured and monitored?

6. How confident are management and the board in the company's ability to anticipate disruptive environmental and societal trends?

7. What processes and controls are in place to address evolving ESG risks and related disclosures?

8. Has the audit committee reviewed the company's sustainability report prior to issuing and has management walked through the key assumptions made and the basis for the metrics and goals disclosed?

9. Have management and the audit committee considered the potential impacts of climate-related or other ESG events or conditions on the financial statements? If the company discloses climate-related information in the annual report that contains or accompanies the financial statements (such as in the MD&A) are those disclosures consistent with the audited financial statements?

10. Has management engaged with public-company auditors on how to evolve and mature its ESG program to meet the increasing requirements of the market and regulators?

Because of its ESG role, audit committees should "consider adding ESG matters as a standing agenda item in 2022, understand the company's disclosure process, and regularly assess the company's progress, risk oversight, financial statement implications, and the integration of ESG considerations into the core business strategy."

Comment: The CBE's perspective on the audit committee's role in board ESG oversight is consistent with other commentary on this issue. See, e.g., The Audit Committee's Role in ESG Disclosure: Part II, September-October 2021 Update. Audit committees that are not already doing so should focus on what ESG disclosures the company is making, how the information is collected, the applicable controls and procedures, and how these disclosures impact financial reporting. And, as CBE emphasizes, the audit committee's role needs to be considered in the broader context of the board's ESG oversight governance structure.

BlackRock and State Street Tell CEOs and Boards What They Expect from Them in 2022

The CEOs of two major asset managers have issued public letters outlining their expectations for portfolio company managements and boards during the coming year. The letters are likely to have a significant influence on public companies and their boards, particularly because of the ability of these two large institutions to use their voting power to enforce compliance with their views.

BlackRock

Each year, Laurence Fink, Chairman and CEO of BlackRock, the world's largest asset manager, sends an open letter to corporate CEOs. In his 2020 letter, Mr. Fink asserted that "[c]limate change has become a defining factor in companies' long-term prospects" and called on the companies that Blackrock invests in on behalf of clients to make disclosures in accordance the Sustainability Accounting Standards Board (SASB) standards for their industry and the recommendations of the Task Force on Climate-Related Disclosures (TCFD). See BlackRock's CEO Calls for Portfolio Companies to Make SASB and TCFD Disclosures, January 2020 Update. In 2021, Mr. Fink asked that companies "disclose a plan for how their business model will be compatible with a net-zero economy" by 2050." See BlackRock Calls for

Disclosure and Board Oversight of Company Plans for the Net-Zero Economy, January-February 2021 Update.

In his 2022 letter, Mr. Fink takes a somewhat different tack. While he reiterates the importance of addressing climate change, he also explains his view of stakeholder capitalism and how it is consistent with shareholder value creation. Among the points he makes:

- Capitalism, not politics. "Stakeholder capitalism is not about politics. It is not a social or ideological agenda. It is not 'woke.' *It is capitalism*, driven by mutually beneficial relationships between you and the employees, customers, suppliers, and communities your company relies on to prosper. This is the power of capitalism. * * * We focus on sustainability not because we're environmentalists, but because we are capitalists and fiduciaries to our clients. That requires understanding how companies are adjusting their businesses for the massive changes the economy is undergoing." (emphasis in original)

- The purpose-driven company. "Putting your company's purpose at the foundation of your relationships with your stakeholders is critical to long-term success. Employees need to understand and connect with your purpose; and when they do, they can be your staunchest advocates. Customers want to see and hear what you stand for as they increasingly look to do business with companies that share their values. And shareholders need to understand the guiding principle driving your vision and mission. They will be more likely to support you in difficult moments if they have a clear understanding of your strategy and what is behind it. * * * If you stay true to your company's purpose and focus on the long term, while adapting to this new world around us, you will deliver durable returns for shareholders and help realize the power of capitalism for all. "

- Human capital. "Workers demanding more from their employers is an essential feature of effective capitalism. It drives prosperity and creates a more competitive landscape for talent, pushing companies to create better, more innovative environments for their employees – actions that will help them achieve greater profits for their shareholders. Companies that deliver are reaping the rewards. Our research shows that companies who forged strong bonds with their employees have seen lower levels of turnover and higher returns through the pandemic."

- De-carbonization. "Most stakeholders – from shareholders, to employees, to customers, to communities, and regulators – now expect companies to play a role in decarbonizing the global economy. Few things will impact capital allocation decisions – and thereby the long-term value of your company – more than how effectively you navigate the global energy transition in the years ahead. * * * [W]e are asking companies to set short-, medium-, and long-term targets for greenhouse gas reductions. These targets, and the quality of plans to meet them, are critical to the long-term economic interests of your shareholders. It's also why we ask you to issue reports consistent with the Task Force on Climate-related Financial Disclosures (TCFD): because we believe these are essential tools for understanding a company's ability to adapt for the future."

State Street Global Advisors

Cyrus Taraporevala, President and CEO of State Street Global Advisors (SSGA), focuses on climate change and diversity in his annual letter to public company board members. He makes clear that SSGA intends to use its voting power against directors that do not conform to SSGA's views.

As to climate change, he states that "for the year ahead, our focus will be to drive both broad climate action in the market across sectors as well as more targeted action for companies with the most significant emissions." Accordingly:

- "We expect companies in major indices in the US, Canada, UK, Europe, and Australia to align with climate-related disclosures requested by TCFD, including whether the company discloses:

(1) board oversight of climate-related risks and opportunities; (2) total direct and indirect GHG emissions (Scope 1 and Scope 2 emissions); and (3) targets for reducing GHG emissions. * * * [W]e will start [during the 2022 proxy season] taking voting action against directors across applicable indices should companies not meet these disclosure expectations." (footnote omitted)

- "In the coming year, we will launch a targeted engagement campaign with the most significant emitters in our portfolio to encourage disclosure aligned with our expectations for climate transition plans, which covers 10 areas including decarbonization strategy, capital allocation, climate governance, and climate policy. In 2023, we will hold companies and directors accountable for failing to meet these expectations."

As to board and workforce diversity, SSGA is "prepared to vote against the Chair of the board's Nominating Committee or the board leader should a company fail to meet" the following expectations:

- "Beginning in the 2022 proxy season, we will expect all our holdings, across the globe, to have at least one woman on their boards. To-date, this policy has only applied to major indices in select markets around the world."

- "Additionally, beginning in the 2023 proxy season, we will expect boards to be comprised of at least 30% women directors for companies in major indices in the US, Canada, UK, Europe, and Australia. We expect this change to result in boards with 3 or 4 female directors on average and as many as 3,000-to-4,000 additional female directors across covered indices."

Further, as announced in Mr. Taraporevala's 2021 letter, SSGA will also vote against the "responsible directors" if (1) companies in the S&P 500 and FTSE 100 do not have a person of color on their board, (2) companies in the S&P 500 and FTSE 100 do not disclose the racial and ethnic diversity of their boards, and (3) companies in the S&P 500 do not disclose their EEO-1 reports.

Comment: BlackRock has nearly $7 trillion in assets under management, and Mr. Fink's annual letter attracts considerable attention because of BlackRock's leverage as a significant shareholder in many public companies. Mr. Fink's views on the relationship between stakeholder capitalism, company purpose, and shareholder value creation are provocative and thought-provoking. Of more practical significance, however, are his expectations that companies in which BlackRock holds shares establish explicit targets for greenhouse gas reductions, develop plans to meet those targets, and make public disclosures consistent with the recommendations of the TCFD. Similarly, SSGA's Mr. Taraporevala is very direct in committing to vote against directors of companies that do not comply with his very specific demands, including TCFD and detailed diversity disclosures.

For audit committees, these letters are yet another reminder of the importance of reviewing their company's ESG disclosures and discussing with management bringing the company's reporting into conformity with TCFD and SASB. They should also consider management's plans to implement procedures and controls to ensure the accuracy of these types of disclosures.

On the Update Radar: Things in Brief

The PCAOB Revives its Advisory Committees. The Public Company Accounting Oversight Board has announced the creation of two new advisory groups — the Investor Advisory Group (IAG) and the Standards and Emerging Issues Advisory Group (SEIAG) – and is seeking nominations for the membership in each. According to the Board's January 31 press release, the SEIAG will "advise the PCAOB on existing standards, proposed standards, potential new standards and, if requested by the Board, on matters other than standards that are of significance to the PCAOB, including emerging audit issues." The Investor Advisory Group will "advise the PCAOB on matters concerning the PCAOB's mission to oversee the audits of public companies, and related matters (such as the audits of broker-dealers), to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports, including providing investors'

perspectives on key areas of concern and potential emerging risks related to PCAOB oversight activities." The PCAOB has issued a Request for Public Comment that describes the SEIAG and IAG in more detail and invites views on draft governance frameworks for each, including purpose and role, membership selection, size, composition, member terms, leadership and agenda setting, meeting and overall structure, and observers.

The PCAOB previously maintained two similar advisory groups, but neither has met since 2018. The Board's announcement essentially revives these bodies, although with some differences in mission and composition. PCAOB Chair Erica Y. Williams stated: "Building on the success of the PCAOB's past advisory groups, the IAG and SEIAG will provide us with opportunities to obtain key views and insights from regular engagement with stakeholders."

The 24-member SEIAG is intended to include, along with other perspectives, audit committee members. The Request for Public Comment states that the Board will seek to include the following areas of expertise on the SEIAG: accounting (including financial reporting), auditing, corporate finance, corporate governance (including audit committees or boards of directors), investing in public companies, and other areas that the Board deems relevant. Regarding advisory group composition, Ms. Williams stated: "The effectiveness of our oversight depends on robust dialogue with key stakeholders, including the investor community, audit committee members, preparers and auditors of financial statements, and academics, among others."

The deadline for comments and for advisory group nominations is February 28. The PCAOB has released two forms for submitting nominations, the Nominator Form to nominate someone else to serve on the SEIAG, IAG, or both, and the Nominee Form to submit a self-nomination.

KPMG Survey Finds that Fraud, Cyber, and Compliance Threats are High and that Many Companies are Ill-Prepared. KPMG has issued A triple threat across the Americas: 2022 KPMG Fraud Outlook. The report, which is based on a survey of 642 senior executives and board members in the Americas from seven industries, presents a bleak picture. KPMG finds that "fraud, compliance concerns and cyber attacks are common, have increased in severity--and are expected to become more frequent." Specifically --

- The majority of companies across North and Latin America reported that they have suffered losses from fraud, compliance breaches, and/or cyber attacks. Eighty-three percent of companies represented in the survey were impacted by a cyber attack in the last 12 months, 71 percent experienced internal or external fraud (including 31 percent that suffered fraud perpetrated by an insider), and 55 percent incurred losses due to a regulatory fine or compliance breach.

- Large companies are more at risk of fraud. Only 15 percent of respondents from companies with at least US$10 billion in revenue said that they experienced no fraud losses in the past year. At smaller businesses, 29 percent report no fraud losses. Large companies lost 1.5 percent of their profits due to fraud and non-compliance.

- Fraud threats differ between North and Latin America. Seventy-six percent of North American company respondents experienced fraud losses involving external parties, compared with 42 percent in Latin America. However, respondents in Latin America were more than twice as likely to experience internal frauds; 49 percent of Latin American respondents reported such events, compared with 17 percent in North America. KPMG suggests that fraud risk management programs and other internal anti-fraud defenses may be less robust in Latin America.

- The COVID-19 pandemic has made things worse. Overall, 86 percent of respondents reported that remote work negatively affected at least one element of fraud prevention, compliance, or cybersecurity programs at their company. Half of respondents reported that working from home negatively impacted their company's ability to respond to fraud.

- Businesses expect fraud, compliance risk and cyber attacks to rise. Sixty-nine percent of respondents expect an increase in either external or internal fraud in the next year, while 29 percent project a rise in both. Seventy-seven percent thought that cybersecurity risk will increase in the next 12 months, and only seven percent foresee a decline. Six in ten expect compliance risk to grow, in part due an expected increase in regulation. Nearly every respondent expects more regulatory or compliance requirements related to data privacy, labor relations and the environment in the next five years.

- Not enough companies are completely on top of fraud controls, compliance, and cyber security. Only minorities of respondents said that their company reflected international best practice in anti-corruption compliance (18 percent), environmental compliance (21 percent), anti-money-laundering compliance (22 percent), anti-fraud controls (23 percent), and data-privacy controls (27 percent). Just 24 percent believed that their company is strong in half or more of the relevant cybersecurity protections, 17 percent in controls to prevent and detect fraud, and 13 percent in addressing compliance risks. Only 4 percent say that their company excels in all three areas.

KPMG outlines five steps that companies can take to mitigate fraud, compliance, and cyber risks: (1) Set the right tone from the top; (2) Carry out a risk review; (3) Communicate effectively; (4) Strengthen detection; (5) Create a culture of enforcement and accountability.

What Should be on the Audit Committee's 2022 Agenda? At the beginning of each year, many accounting and consulting firms present their views on the issues on which audit committees should focus at year-end and during the coming 12 months. Below is a list (with hyperlinks to the documents) of six of these 2021 year-end and 2022 agenda papers.

- BDO, Audit Committee Priorities for 2022

- Deloitte Center for Board Effectiveness, On the audit committee's agenda: What's on the horizon for 2022?

- EY Center for Board Matters, What audit committees need to know for year-end 2021 and beyond

- KPMG Board Leadership Center, On the 2022 audit committee agenda

- Protiviti, Setting the 2022 Audit Committee Agenda

- PwC Governance Insights Center, Approaching the 2021 year-end financial reporting season

The papers approach the topic of how audit committees should set their 2022 agendas at different levels of generality, and each firm has its own perspective on where audit committees should direct their time and attention. Not surprisingly, however, there are many common themes. Some frequently mentioned 2022 audit committee agenda topics include:

- Enterprise risk management; oversight of management's approach to identifying and addressing risk.

- Cyber risk, data privacy, and cybersecurity.

- Role of internal audit; maintaining IA's relevance and transforming its use of technology.

- ESG disclosure and the impact of ESG risks and opportunities on financial reporting.

- Impact of U.S. and global tax policy changes on financial reporting.

- Impact of COVID-19 on information systems, internal control, work environment, and culture.
- Changes in compliance risk and maintaining a positive compliance culture.
- Digital finance transformation; leveraging the use of technology in information management, reporting, and analytics.

A high-level review of these papers could be helpful to an audit committee as a check that it is not overlooking topics that should be on its agenda.

SEC Wants to Hear More About Pay-For-Performance Metrics. On January 27, the Securities and Exchange Commission issued a release reopening public comment on a seven-year-old proposal to require disclosure of the relationship between executive pay and company financial performance. The pay-for-performance rule was proposed in 2015 to implement Section 14(i) of the Securities Exchange Act, enacted by the Dodd-Frank Act of 2010, which directs the SEC to adopt rules relating to how executive compensation actually paid by a registrant relates to the financial performance of that registrant. The 2015 version would have required a table showing the relationship between compensation paid to named executive officers and company performance, as measured by the company's total shareholder return (TSR) and by peer group TSR. The comment period on this proposal closed in July 2015, but the Commission has never taken further action on it.

While the SEC has invited views on all aspects of the original proposal, the thrust of the new release is whether the metrics for company performance should be expanded beyond TSR. Additional performance measures the Commission is considering include pre-tax net income and reported net income; a "Company-Selected Measure" representing the metric that the company deems to be the most important performance measure used to link compensation to company performance; and a list of the five most important performance measures used to determine compensation actually paid.

The Commission's consideration of a broader range of performance measures and their impact on compensation potentially highlights the stakes involved in the selection and integrity of ESG metrics. In her statement supporting the reopening of comment, Commissioner Lee noted that additional metrics may help to illuminate the link between executive pay and corporate ESG goals:

> "The modern compensation landscape now encompasses enhanced reliance on performance metrics related to, for example, climate, diversity, and other company-specific ESG goals. It would be helpful to hear from commenters on how the increased flexibility contemplated in today's reopening release may facilitate investor analysis of the use of such metrics and targets in compensation plans * * *." (footnote omitted)

If publicly disclosed ESG metrics play a role in determining executive compensation, the audit committee may want to work with the compensation committee in considering the selection, disclosure, and control framework for the relevant ESG performance measures.

The Audit Blog

I am a co-founder of The Audit Blog and blog on developments in auditing and financial reporting, on auditor oversight and regulation, and on sustainability disclosure. Occasionally, items that appear in the Audit Committee and Auditor Oversight Update also appear on the blog.

The blog is available here. You can follow it @BlogAuditor on twitter or @the-audit-blog on medium.com.

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Email distribution of the Update is provided free of charge. If you would like to be added to the distribution, please email me at the address above. Readers are also free to recirculate the Update.

The Update seeks to provide general information of interest to audit committees, auditors, and their professional advisors, but it is not a comprehensive analysis of the matters discussed. The Update is not intended as, and should not be relied on as, legal or accounting advice.

Prior Updates issued between January 1, 2019, and May 31, 2020, are available here. Updates issued after June 1, 2020, are available here.