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Setting the 2024 Audit Committee Agenda

Compared to prior years, our suggested 2024 audit committee agenda has taken a bit of a turn due to ongoing and recent market and regulatory developments. It includes important enterprise, governance, process, technology, and financial reporting and disclosure issues that merit consideration by the audit committee beyond its ongoing chartered activities.

In addition to discussing these agenda items, we offer assessment questions for audit committees to consider when evaluating 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 forums.

The 2024 Mandate for Audit Committees

Enterprise, Process and Technology Issues

1. Discuss the implications of the SEC's cyber disclosure enhancements
2. Determine the extent of any talent and skills shortages
3. Inquire as to external reporting implications of finance's use of generative AI
4. Review the substance and consistency of ESG reports and the underlying reporting process
5. Assess internal audit's commitment to relevance

Financial Reporting Issues

6. Assess the impacts of inflation, higher interest rates, economic uncertainty, tighter lending standards and other relevant factors on financial reporting assertions
7. Ascertain whether a "next generation" mindset is being deployed to combat rising SOX compliance costs
8. Monitor the impact of cost-optimisation measures and organisational changes on key internal controls

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

Enterprise, Process and Technology Issues

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

1. **Discuss the implications of the SEC's cyber disclosure enhancements —** The U.S. Securities and Exchange Commission (SEC) has adopted amendments[1] to its rules on cybersecurity risk management, strategy, governance and incident reporting. These rule amendments apply to public companies subject to the reporting requirements of the Securities Exchange Act of 1934. They warrant the audit committee's attention.

   Specifically, the committee should obtain an understanding of the SEC's requirements relative to when the rule goes into effect and the nature of the required disclosures, including the related materiality considerations. To that end, Protiviti has issued a Flash Report[2] summarising the Commission's amended rules and offering guidance to public companies that will need to comply as soon as December 2023. The thrust of the amended rules is not new, just more prescriptive.

   Armed with an understanding of the rules, the committee should inquire as to the following:

   — The game plan for monitoring whether a cyber incident has occurred

   — The materiality assessment framework for evaluating the significance of an incident or series of incidents within a reasonable time frame to determine whether it/they should be disclosed (note that once deemed material, a cyber incident or series of incidents must be disclosed within four business days)

   — The planned approach for describing the cybersecurity program and disclosing material incidents

   — The stakeholders at the table determining the adequacy of the disclosures (e.g., the general counsel, the chief financial officer (CFO), other members of the disclosure committee and the chief information security officer)

   In addition, the committee should obtain an understanding of the extent of changes in audit scope by the external auditor with respect to cybersecurity matters, formal reporting compliance and Sarbanes-Oxley (SOX) compliance.

[1] "Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure," SEC, July 31, 2023: www.sec.gov/files/rules/final/2023/33-11216.pdf.

[2] "SEC Cybersecurity Disclosure Enhancements: Efforts to Boost Investor Confidence," Protiviti, August 2, 2023: www.protiviti.com/us-en/flash-report/sec-cybersecurity-disclosure-enhancements-efforts-boost-investor-confidence#.

2. **Determine the extent of any talent and skills shortages —** According to a Protiviti survey of CFOs and finance teams, half of all CFOs consider the ability to recruit qualified candidates a key area of concern.[3] A similar issue falls just behind this challenge: replacing employees who leave the organisation. Understandably, there are notable year-over-year increases in plans to address individual career growth and upskilling as well as commitments to individual promotion tracks to achieve more versatility among the finance organisation team members.

   Why it matters: With executive leadership, including many CFOs and chief audit executives (CAEs), concerned about attracting, acquiring and retaining qualified candidates, an understanding of existing skills gaps, retention plans, and upskilling and development strategies is needed. To that end, following are suggested questions for audit committees:

   — 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?

   — Is the CFO function partnering with the human resources group to develop data-driven talent strategies that include redesigned job roles, enterprisewide skills inventories, rolling talent forecasts, skills modelling, and change management plans for quickly adapting work and jobs to new technologies — such as generative artificial intelligence (AI) — and other innovations?

   — Are we devoting more time to succession planning and related leadership development activities while practicing transparency with rising finance leaders and investing in their progression?

   — How is the CAE addressing skills development of team members and talent strategies for the internal audit function going forward?

According to a Protiviti survey of CFOs and finance teams, half of all CFOs consider the ability to recruit qualified candidates a key area of concern. A similar issue falls just behind this challenge: replacing employees who leave the organisation.

[3] *Accelerate: 2023 Global Finance Trends Survey*, Protiviti, October 2023: www.protiviti.com/us-en/survey/global-finance-trends-survey.

3. **Inquire as to external reporting implications of finance's use of generative AI —** The promise of generative AI is enormous, impacting sales and marketing, product research and development, customer operations, and software engineering as well as other business functions. Finance is no exception, as most finance organisations are diving into it.

   What they're saying: With risks relating to ownership rights, prejudice in text and images, deepfakes, hallucinations, and security and privacy issues, there are legitimate concerns regarding potential misinformation and disinformation issues. Fortunately, generative AI and technology companies are developing new partnerships designed to help organisations bring these models "inside their four walls" to deploy their own data sets in conjunction with an appropriate governance framework.

   Between the lines: The audit committee should inquire of management, the CFO and the CAE regarding the impact of this novel technology on compliance, regulatory and other required reporting, including forecasting and forward-looking guidance. The committee should also ensure that generative AI benefits are being achieved in a secure, reliable and unbiased manner. For example:

   — Are a cross-functional technology lens and expertise in data security, data privacy, risk management, and legal and compliance being deployed when spearheading generative AI solutions in the finance group?

   — Are we using controlled data sets in a closed source model and requiring attribution of model content to engender transparency and confidence? How are we managing the risk of unintentional bias on the part of those who define the data sets used and program the algorithms for creating content from the data?

   — How are we managing data from external sources (e.g., strategic suppliers, third-party providers and channel partners)?

   — Is appropriate supervision and review applied to generative AI content just as it would be to content generated by a finance function employee to ensure that it is factual and authentic?

   — What use cases are we envisioning in finance (e.g., financial planning and analysis, fraud prevention, capital allocation, investment planning, and scenario planning)? Will these and other applications across the company affect financial reporting and disclosures?

   — Do we have the skills needed to accomplish our objectives in implementing these models?

   — Has the CAE sufficiently considered the organisation's exploration and use of AI (or lack thereof) in the internal audit risk assessment and planning process, and are AI-related risks subject to assurance or advisory review?

Final word: The audit committee should ask management to keep it and the rest of the board informed of generative AI trends, risks, benefits and internal uses through periodic updates and ongoing communications.

Almost two-thirds of public organisations and just over 50% of private companies indicate a marked increase in the focus and frequency of their reporting related to ESG issues.

4. **Review the substance and consistency of ESG reports and the underlying reporting process** — While the term "ESG" is getting shopworn in the market, the underlying issues that impact the sustainability of the enterprise and its business model are not. Sustainability disclosures and reports, in one form or another, are being demanded by and provided to various stakeholders. Regulators in the European Union have set dates and deadlines for ESG disclosures with entity statutory reports.[4] The market continues to anticipate the SEC's release of its climate disclosure rules. Guidance has been issued on internal control over sustainability reporting.[5] Insurers' underwriting processes, banking partners' lending applications and customers' requests for proposals are asking for ESG-related documentation. So are third-party risk questionnaires and independent surveys. As these disclosures may be authored by different stakeholders in the organisation, they may or may not be consistent with the mandated reporting to investors.

   The aforementioned survey of CFOs and finance teams indicates that ESG stands out as the highest priority for the finance organisation to address over the next 12 months. Almost two-thirds of public organisations and just over 50% of private companies indicate a marked increase in the focus and frequency of their reporting related to ESG issues (on top of prior years, where increases were noted as well — a cumulative effect in increasing emphasis). There is also a notable jump in finance groups in which measuring and reporting on ESG risks and issues is becoming part of their role. Because the integrity and consistency of the company's sustainability reporting is of interest to the board, the audit committee should collaborate with the full board and various committee chairs to ensure that there is a "whole-board view" into the organisation's sustainability performance, reporting and disclosures. This governance role has reputational and brand image implications.

[4] "Corporate Sustainability Reporting Directive (CSRD) Approved by European Council; More Than 50,000 Organisations Affected," Protiviti, November 30, 2022: www.protiviti.com/us-en/flash-report/corporate-sustainability-reporting-directive-csrd-approved-european-council-more-50000.

[5] "Achieving Effective Internal Control Over Sustainability Reporting," Committee of Sponsoring Organisations (COSO), 2023: www.coso.org/_files/ugd/3059fc_a3a66be7a48c47e1a285cef0b1f64c92.pdf.

According to a market data report, 59% of "green" claims made by European and U.K. fashion brands are misleading, and two-thirds of executives worldwide questioned whether their company's sustainability efforts were genuine.

What to watch: Accusations of greenwashing are on the rise. According to a market data report, 59% of "green" claims made by European and U.K. fashion brands are misleading, and two-thirds of executives worldwide questioned whether their company's sustainability efforts were genuine.[6] As the prevalence of greenwashing in the business world negatively impacts customer loyalty and satisfaction, more brands are publicly reporting as little as possible on their sustainability efforts (i.e., "greenhushing").[7]

These developments are a result of many factors. With the current array of reporting frameworks, aggressive activists, the lack of rigorous disclosure processes and controls, the issuance of reports by parties unfamiliar with various regulatory and public reporting standards, and disjointed, uncoordinated efforts across the organisation, the audit committee should:

— Ascertain that the CFO function[8] is engaged in the review of sustainability reports issued across the company for consistency across all reporting channels.

— Inquire of management regarding (1) the rigour underpinning the processes, data and metrics feeding ESG-related disclosures and reports, (2) the means by which management's assertions regarding the effectiveness of disclosure controls and procedures relating to ESG metrics and reporting are supported, and (3) the processes for identifying and adapting to new or clarified sustainability reporting and disclosure demands and requirements applicable to the company's operations.

— Consider the implications of the company's human capital, climate and other ESG disclosures on the assumptions underlying financial reporting assertions.

— Ensure there is appropriate board oversight over assurance activities, if the company opts to obtain assurance, including the review of external auditor independence.

6 "Must-Know Greenwashing Statistics," by Lorena Castillo, Gitnux, October 15, 2023: https://blog.gitnux.com/greenwashing-statistics.

7 "The Rise of 'Greenhushing': Why Are Brands Going Silent About Their Sustainability Efforts?" by Josh Stephenson, *Marketing Week*, September 13, 2023: www.marketingweek.com/the-rise-of-greenhushing-why-are-brands-are-going-silent-about-their-sustainability-efforts/.

8 As certifying officers of public companies and the *de facto* purveyors of data at organisations of all kinds, many CFOs are charged with governing the environmental data and analyses in financial statements and ESG reports — including the oversight of reliability of data sources and reporting integrity, consistency and compliance.

Important takeaways: For many companies, it is expected that the audit committee discharge many, if not all of the above responsibilities. Market demand for and regulatory scrutiny of ESG reporting activities merits coordinated board oversight.

> ***Impactful communications, along with the methodologies, data and systems required to produce them, are the most important contributor to growing internal audit's relevance.***

5. **Assess internal audit's commitment to relevance —** According to Protiviti's research, top-performing internal audit groups focus on delivering streamlined, tailored, impactful communications and reporting.[9] They evolve and adapt routinely. They actively and persistently seek ways to integrate data and technology throughout the audit life cycle. They push themselves to find and build talent and resources from both within and outside their organisations.

   All of this is in the name of sustaining "relevance," meaning remaining connected and aligned with what's important and being insightful and providing value through quality communications and information sharing to management and the board. Impactful communications, along with the methodologies, data and systems required to produce them, are the most important contributor to growing internal audit's relevance. The efficacy of communications and reporting requires the optimisation of activities throughout the audit life cycle, including risk assessment, scoping and planning, project status, audit committee reporting, and issue follow-up and validation.

   The bottom line: The relevance and value orientation of internal audit is in everyone's interests.

   Competing priorities are the greatest barrier to internal audit innovation. Audit committees should be routinely asking internal audit leaders whether:

   — They have the resources, competencies and skills needed to transition to new value-adding capabilities.

   — There are any obstacles stopping them from focusing on priority items in the near or long term.

   Our point of view: The committee should expect internal audit leaders to be prepared to answer these questions directly and thoroughly, so they can evaluate how the office of the CAE is positioning the function to deliver against the goal of sustaining its relevance and value.

[9] *Achieving Audit Relevance*, Protiviti, March 2023: www.protiviti.com/gl-en/survey/next-gen-ia-2023.

Financial Reporting Issues

As financial reporting issues are fundamental to the audit committee's core mission, the 2024 suggested agenda includes three important items:

6. **Assess the impacts of inflation, higher interest rates, economic uncertainty, tighter lending standards and other relevant factors on financial reporting assertions —** Aggressive central bank monetary policies have commanded much attention in the market. The impact typically ripples through the economy as a whole. Higher interest rates increase borrowing costs for businesses, customers and consumers and affect present value calculations used in valuing leasing arrangements and financial instruments.

   Lending standards tighten. Demand for loans to firms of all sizes weakens. These and other trends put a damper on economic growth. If consumer spending declines significantly, the economy could drift toward recession. The effects vary in different sectors and companies. The reality is that changes in inflation, interest rates, supply chains and customer demand affect both the top and bottom lines of a company's customers and suppliers.

   These market developments can alter the assumptions and estimation processes underlying going concern, asset and deal valuations, loss contingencies, revenue and pricing projections, and other accounting, reporting and disclosure matters. They can affect forecasting and forward-looking guidance. The audit committee should inquire of their impact on the assumptions underpinning:

   - Valuation of existing, and calculation of new, 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
   - Customer and supplier viability
   - Other accounting and disclosure matters

   A key point: 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.

Protiviti's research indicates that more companies are embracing a new, "next generation" SOX compliance mindset, one that prioritises introducing tools and technology to support the company's internal controls systematically and efficiently.

7. **Ascertain whether a "next generation" mindset is being deployed to combat rising SOX compliance costs —** Protiviti's research indicates that more companies are embracing a new, "next generation" SOX compliance mindset, one that prioritises introducing tools and technology to support the company's internal controls systematically and efficiently.[10] Companies are attacking climbing compliance costs by taming the complexity of their control environment and exploring and pursuing options to further tech-enable controls and testing activities.

   The research also noted that a growing number of organisations are investing in automation and advanced technology tools to support their SOX compliance.

   — They use intelligent audit management and governance, risk and compliance (GRC) platforms, workflow automation, continuous monitoring, process mining, advanced analytics, and data visualisation tools to streamline gathering and extracting relevant data from documents and other control artifacts, controls testing, reporting, and other manual compliance activities.

   — With companies attacking climbing compliance costs in this manner, the audit committee should understand the extent to which automation and advanced technology tools are supporting the company's internal controls systematically and efficiently.

   — Importantly, Protiviti's survey results indicate that more compliance programs would benefit from moving in this direction, as there are efficiency, effectiveness and cost-saving benefits to be realised.

[10] "The Evolution of SOX: Tech Adoption and Cost Focus Amid Business Changes, Cyber and ESG Mandates," Protiviti, September 2023: www.protiviti.com/us-en/podcast-transcript/evolution-of-sox.

Between the lines: Automation and technology enablement, resourcing models that include outsourcing options and centres of excellence, and greater use of standardised controls across multiple locations and complex organisations are foundational elements of a next-generation SOX compliance program.

- The audit committee should inquire of management to understand whether the company is considering these elements.
- The committee should ascertain whether this next-generation mindset is driving a refresh of controls rationalisation, risk assessment and scoping, and the scope of the external auditor's work. For example: When was the SOX program risk assessment and scoping process last revisited, and did it include control rationalisation efforts to standardise controls and reduce complexity of the control environment?
- More importantly, is it having a positive impact in streamlining and strengthening business processes and IT controls?

Efforts to optimise costs or transform the organisational structure or business model may have an impact on the control structure and could result in ignoring certain critical controls or less diligence in their execution or timely remediation.

8. **Monitor the impact of cost-optimisation measures and organisational changes on key internal controls —** Referencing Protiviti's survey of CFOs and finance teams yet again, the impact of inflation, financial planning and analysis, and profitability reporting and analysis are among their highest-ranked 2024 priorities. These priorities reinforce efforts already underway throughout 2023 to optimise costs amid inflationary trends and an uncertain global economy. More than technology improvement or risk management, cost optimisation is viewed as a top priority for process improvement in organisations. And some companies are thinking about what the organisation's structure and business model should look like in the future.

   Why it matters: Efforts to optimise costs or transform the organisational structure or business model may have an impact on the control structure and could result in ignoring certain critical controls or less diligence in their execution or timely remediation. Combined with the effects of continued workplace developments, changes in personnel and processes can have subtle effects on internal control over financial reporting, cybersecurity risks, and exposure to compliance and fraud risk.

As the primary advocate for the control structure in the boardroom, the audit committee should consider engaging management on the following questions:

— Have we determined that changes in internal processes as a result of cost optimisation, business transformation efforts and workplace transitions have not affected the integrity of our internal control structure and execution of key financial controls? How do we know?

— Have recent and expected workplace changes, plans for reopening or shutting down 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 changes in our operating environment, have controls over general IT, user access (including privileged, sensitive access) and change management remained strong and intact?

— Have adjustments to the business model or to underlying business processes resulted in any significant changes in the internal control structure? How do we know?

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

In the context of the above matters, the committee should ascertain whether legal counsel has been consulted to ensure compliance with applicable laws and regulations.

Self-Assess Committee Effectiveness

Audit committees are encouraged to self-assess their performance periodically. 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's composition, charter and focus with consideration of the company's industry, circumstances, risks, financial reporting issues and current challenges.

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

Summary

The next 12 months will prove interesting for audit committees and the companies they serve. Giving consideration to cyber disclosure enhancements, talent and skills shortages, generative AI implementations, sustainability/ESG reporting, internal audit's relevance, the financial reporting implications of continued market developments, the emergence of a next-generation SOX compliance mindset, and the impact of cost-optimisation measures and organisational changes on key internal controls is a full plate on top of the committee's customary chartered responsibilities. But it is also an opportunity to provide value-added advice and counsel to management on various important matters that can impact financial and public reporting, directly or indirectly.

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As the global lead of Protiviti's Internal Audit and Financial Advisory practice, Andrew Struthers-Kennedy is privy to significant boardroom experience — his own as well as that of the managing directors he leads. His market focus is on increasing the relevance of and value delivered by internal audit both in the boardroom and across the company.

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