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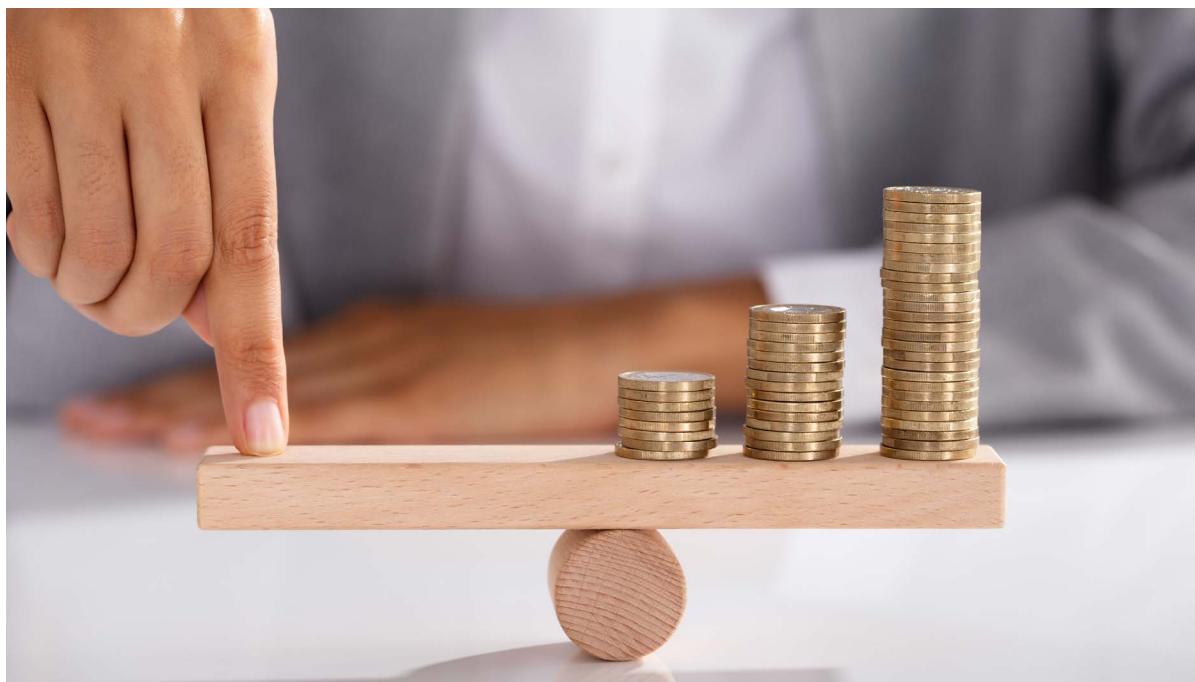
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Audit fees level off in 2018, study shows

Public company audit fees remained virtually unchanged in 2018, according to the latest annual study by Audit Analytics.

Maria L. Murphy has more.

In the newest installment of its annual analysis of audit and non-audit fees, Audit Analytics reports public companies paid an average of \$511 in audit fees for every \$1 million in revenue. That is the same average amount as in 2017, but it represents a decrease from \$537 in 2016 and \$515 in 2015.

When audit fees are combined with non-audit fees paid to the principal auditor, the trend year over year is consistent. The study shows companies paid an average of \$575 in fees per million in revenue in 2018 compared with \$574 per million in 2017.

This stability in fees in relation to revenues is not surprising and reflects that the economy has settled down in 2018 after the downturn in 2015 and some rebound in 2017, says Don Whalen, general counsel and director of research at Audit Analytics. Revenue and audit fees both tend to rise together with corporate growth and inflation.

The study also examines non-audit fees paid over time, as a way to evaluate how firms are complying with auditor independence requirements relating to the provision of non-audit services to their public company clients. In 2018, non-audit fees totaled 19.9 percent of the total fees paid to auditors, which

was the second-lowest amount during the 17 years under review and generally consistent with 19.7 percent paid in 2017. From 2005-2018, these percentages have stayed very close to 20 percent, which is a significant drop from the 51.1 percent outcome in the 2002 study.

This report is in its 17th year. It is based on fees paid as disclosed in SEC filings by accelerated and large accelerated filers.

Their analysis shows audit costs were at their highest in 2004, when Sarbanes-Oxley reporting began. Audit fees were increasing during the period from 2012-2016 due in part to increased Public Company Accounting Oversight Board (PCAOB) oversight of public company auditors.

In a separate analysis of audit fees, the Financial Education & Research Foundation's 10th annual audit fee survey reported growth in average audit fees remains strong. Overall, average audit fees increased 4.25 percent from 2017 to 2018, based on an examination of total fees paid for 2018 auditing and related services. This is up from 2.5 percent in 2017. Adoption of new accounting standards by public companies, particularly revenue recognition, leases, and current expected credit losses (CECL), continues to be reported as the leading cause of audit fee movement, along with high levels of merger and acquisition activity. The study notes audit fees relating to new accounting standards include both time spent assisting clients with transition and increased audit hours to audit new controls and ensure correct implementation.

Over the 10-year period, average hourly audit fees were reported to have increased from \$216 per hour in 2009 to \$283 in 2019. The report notes there have been significant changes in the audit process over the past decade, and the results reflect the challenges faced by companies and their auditors in containing audit costs.

While larger firms reported an increase in total audit fees, smaller firms reported stable to decreasing fees. This is consistent with the study's public company respondents reporting more change in the amount of annual audit work carried out by external

auditors in providing an audit opinion on the financial statements, while the private company and non-profit respondents reported less.

“This stability in fees in relation to revenues is not surprising and reflects that the economy has settled down in 2018 after the downturn in 2015 and some rebound in 2017.”

Don Whalen, General Counsel & Director of Research, Audit Analytics

According to Dr. Robert Knechel, an expert in audit fee research from the Warrington College of Business who was interviewed for the survey, the biggest driver of audit fee movement is size, with large companies requiring more work to audit than small companies. In addition, he notes complexity at the company being audited makes the audit more complex, and with complexity comes more hours and higher fees. Third, he attributes higher public company audit fees to audit committees expecting more robust and higher quality audits, especially in recent years as a result of Sarbanes-Oxley and PCAOB oversight.

The FERF report is based on responses from financial executives at public companies, private companies, and nonprofit organizations, and audit fees reported by a sample of SEC filers.

It will be interesting to see the results in these annual surveys next year, after a number of years of relatively stable fees and percentages. New accounting standards, like revenue recognition, leases, and credit losses, among others, will have been adopted by more of the companies included in these studies and will likely continue to drive audit and audit-related hours and fees up. ■



PCAOB: Best practices in improving audit quality

The PCAOB has published a document that offers insights from audit committee chairs on what procedures have worked best for them in improving audit quality. **Jaclyn Jaeger** explores.

The Public Company Accounting Oversight Board has published a document highlighting talks it has had with audit committee chairs on what has worked best in improving audit quality.

"Continuous dialogue with audit committees on areas of mutual importance helps us to advance our mission and may assist audit committees in fulfilling their duties," the PCAOB said. "To that end, our conversations focused broadly on audit quality, with specific discussions around such topics as audit committee perspectives of the auditor, new auditing and account-

ing standards, and technology and innovation."

According to the PCAOB, among the measures audit committee chairs said are working well for improving audit quality include:

- » Asking the auditor if the audit firm has an annual audit quality, transparency report, or other document outlining how it measures audit quality;
- » Understanding and discussing the processes the auditor has in place to address the previous year's PCAOB inspections report;

- » Reviewing other audit firms' inspections reports to see if there are any lessons learned or questions about potentially similar issues that could be discussed with your auditor;
- » Selecting relevant AQIs to discuss with the engagement team and use as part of an annual evaluation; and
- » Discussing at least annually the audit procedures performed at shared service centers (when used), what controls are in place, the impact on the quality of the work product, and whether the audit firm is considering additional shared service centers.

Auditor relationships

Relevant to their relationship and communication with auditors, "most audit committee chairs were satisfied with their relationship with their auditors, the service from the audit firm and engagement teams, and the team's skepticism and judgment," the PCAOB said. What works especially well, the PCAOB noted, is:

- » Holding a pre-call or meeting with the audit committee chair and lead engagement partner prior to an audit committee meeting to review and refine the meeting agenda and materials;
- » Conducting an assessment, at least annually, of the engagement team and audit, including discussions around what went well and what could be improved;
- » Asking the audit firm about any matters that arose during a PCAOB inspection;
- » Having the audit committee chair visit the component location(s) for multilocation audits; and
- » Dedicating some audit committee meetings to deep dives on specific topics—like governance processes or cyber-security—and having the auditor provide feedback on best practices or other trends they are seeing in those areas

New accounting standards

Not surprisingly, audit committee chairs "spent significant time discussing new accounting and auditing standards with their auditors and most felt like their auditors were proactive and timely in address-

ing new requirements," the PCAOB said. One thing that has worked well, however, is "discussing new accounting and auditing standards with the auditor as early as possible, at least a year in advance of implementation deadlines," the document states.

Other measures that have worked well included "creating a timeline to make sure the appropriate processes are in place and milestones are met for implementation of new standards, including the auditing of the implementation," as well as "using outside consultants or experts to educate the audit committee on new or complex accounting standards."

Technological advances

Most audit committee chairs the PCAOB said it spoke with "indicated that the audit committee is primarily responsible for cyber-security and it is a top priority for the committee and board. Many indicated that they are committing significant resources to cyber-security detection and prevention, including by hiring third-party consultants or dedicated internal resources or teams."

From audit committee chairs' perspective, the PCAOB said the following works well:

- » Using project management software or a site where the audit committee, auditor, and management can track the status of the audit plan;
- » Discussing with the audit firm the technology and software tools being used and how they're being used; and
- » Learning more about technology and scheduling time on the audit committee agenda to do deep dives on new and emerging technologies.

The PCAOB's comprehensive document goes on to provide an overview of its inspections process and staff responses to frequently asked questions in their conversations with audit committee chairs, including questions about how the PCAOB selects audits to inspect and what those inspections entail; what happens when deficiencies are identified in the inspection process; and more. ■



Developing a Tech-Aware Audit Function

BY MATT KELLY
EDITOR & CEO, RADICAL COMPLIANCE

How, exactly, do you build a more agile and risk-aware audit function? What new technologies are necessary? How will these technologies change audit plans and activities? And what about the governance of this brave new risk assurance world?

Audit leaders must understand that better analytics, robotic process automation (RPA), and artificial intelligence (AI) are essential technologies. The technology revolution now rolling over the horizon is transformative: audit functions will be able to do new things.

On the far side of that revolution, audit leaders will be at the helm of more agile, responsive audit functions that can provide the sharper risk assurance boards and the C-suite demand. Internal audit functions really will be able to add value to the whole enterprise.

Still, what's the roadmap to get there?

TECHNOLOGY CHANGES THAT MUST HAPPEN

First, audit functions need to move away from time-consuming manual approaches to SOX compliance and controls testing and toward automated monitoring.

But research shows that's not easy. A Protiviti survey¹ of more than 1,100 audit executives found that the hours devoted to SOX compliance in 2017 increased more than 10%.

Part of this increase is due to specific financial reporting challenges, like the accounting standard for revenue recognition. Another part is due to organizational complexities like merger integration or outsourced business processes.

Audit firms, under pressure to be more skeptical and demand more data, are another cause.

Audit firms must embrace new technology to break that logjam: more automated, preventive controls, embedded in business processes, which will lead to less time spent testing and more time on analytics.

The technologies to achieve that—RPA, advanced analytics that use visualization tools, machine learning—definitely aren't secrets. But they're still relatively low on the adoption

curve. In the Protiviti survey, 11% of respondents said they use RPA now; 8% use advanced analytics and visualization; and only 2% have implemented machine learning.

That means there is tremendous future potential for internal audit functions to transform their risk assurance capabilities—but we still have lots of groundwork to do today to build the foundation.

For example, if we want to build a world of diverse data analytics, then robust data governance becomes crucial.

Audit leaders will need to work with business process owners in the first and second lines of defense to define the data that gets created in a digital business process.

Audit leaders will also need to work with business units on how to automate the extraction and migration of that data from the business software into whatever analytics or RPA tools you want to use.



FORWARD-THINKING AUDIT FUNCTIONS ARE INVESTIGATING OR ADOPTING EMERGING TECHNOLOGIES.

- + Robotic process automation.
- + Visualization tools.
- + Advanced data analytics.
- + Machine learning.

TEAM CHANGES THAT MUST HAPPEN

Adoption of these new technologies is so low because audit teams don't quite know what to do with them. The technologies are dazzling—but how can an audit team of real people, monitoring real risks, take full advantage of them?

That's going to require thoughtful planning and incremental change. Audit leaders will need to bring together people with the right expertise: data analysts, business process users, and cybersecurity professionals. These skills must then be converted into reliable audit practices that will deliver the assurance the board wants.

Rush headlong into that effort, and all sorts of mistakes could arise. A business risk might be misunderstood, for example, leading to an automated process that doesn't generate the right data for continuous monitoring. That's the fundamental challenge for audit in this new world: RPA, machine learning, and related technologies will operate at tremendous speed, from whatever starting point you place them.

So, identifying the correct risks and objectives, and developing the best audit procedures using those technologies will be the primary mission of the audit function.



AUDIT LEADERS WILL NEED TO BUILD TEAMS THAT ARE EQUIPPED WITH THE RIGHT EXPERTISE AND SKILLS.

+ Data analysts.

+ Business process users.

+ Cybersecurity professionals.

GOVERNANCE CHANGES THAT MUST HAPPEN

Those issues of bringing together the right talent and technology, to develop the best audit procedures for a more agile risk assurance function, bring us to the next challenge audit leaders need to contemplate here.

Who runs all this? Who is going to declare these new risk assurance capabilities reliable? Right now, nobody knows. For example, data analytics, RPA, and machine learning deliver numerous benefits to GRC professionals. And these technologies are starting to slowly be adopted. But no standards exist yet for how to gain assurance over the technologies themselves. We know how to build a better audit function, but we haven't defined how much trust other stakeholders can put in the results. For example, when an internal audit team uses data visualization to get a better perception of a risk (e.g., processing an invoice before the

organization receives a purchase order), the audit team can then leave that visualization tool with the accounting department, so the accounting team immediately knows when a transaction like that comes along.

So how would an external auditor gain comfort with the effectiveness of that monitoring control, for example? Audit the source code? Perform its own testing at the client's expense? Use its own AI and visualization? But what if its AI and your AI reach different results?

The audit profession has no clear answers to those questions yet. The Public Company Accounting Oversight Board (PCAOB)² is researching whether an audit standard for this subject is necessary, but when any standard might arrive isn't clear.

² National Association of State Boards of Accountancy, 2019, PCAOB still studying use of technology

Meanwhile, boards will continue to pressure audit firms to deliver better risk assurance—and telling the board you’re waiting on PCAOB audit standards is not a viable answer.

So, audit leaders will need to consider how they negotiate this terrain with external auditors, the C-suite approving new audit technology investment, and colleagues in the business units who will wind up working more intimately with the risk assurance mechanisms you create.

This is no theoretical discussion, either. Consider two statistics from PwC³. First, 53% of audit executives say they use

dashboarding or reporting tools within internal audit today; and 33% share those tools across other business functions. Second, those same survey respondents also say those numbers will jump to 85% and 71%, respectively, in 2020.

In other words, internal audit functions already are embracing next-generation technology and spreading its advantages across the enterprise. There is no scenario where better risk assurance becomes less necessary in the future. We simply need a clear-eyed understanding of what this transformation will entail.

“There is no scenario where better risk assurance becomes less necessary in the future.”

WHAT SUCCESS WILL LOOK LIKE

Above all else, a board of directors wants to preserve the organization’s ability to create value. The implicit assumption there, however, is that the organization can recognize what a threat to that ability looks like and respond accordingly.

That’s risk awareness. Boards—and senior managers and business operations leaders, for that matter—don’t just want confirmation that business activity is efficient or in compliance with the law. They want to know that the organization can respond to changing business conditions quickly, if not immediately.

The technology exists for internal audit leaders to build that risk-aware capability, and the audit function itself is supremely well-suited to the job. That task will require new collaborations with talent both inside and outside the enterprise, and a thoughtful strategy for taking all those resources and forging them into a next-generation audit function. It will take competency and deliberation, magnified by technology. Regardless, this future is coming. That’s one fact we’re all already aware of.



Accounting and audit regulators' 2020 priorities

Maria L. Murphy highlights some focus areas of accounting and audit that regulators—SEC, PCAOB, and FASB—say should be top of mind for boards of directors.

The regulatory priorities of the Securities and Exchange Commission, Public Company Accounting Oversight Board, and Financial Accounting Standards Board for 2020 and beyond impacting financial reporting and related governance should be top of mind for boards of directors and their committees as they perform their oversight, according to a recent publication of the National Association of Corporate Directors and Contributing Partners: “2020 Governance Outlook, Projections on Emerging Board Matters.”

In the section on “Governing Through Regulatory Change: A Focus on Financial Reporting, Accounting, Auditing, and Related Governance Matters,”

boards are encouraged to remain vigilant to ensure management has policies and practices in place to keep directors informed of regulatory developments on a timely basis and to assess and report on the impact of regulatory changes.

Audit committees have a leading role in financial reporting oversight and compliance, which includes the implementation of new accounting standards. But all board members must be aware of these regulatory changes.

What follows are highlights of some of the current priorities and focus areas of accounting and audit regulators that boards should be thinking about this year.

SEC

Capital formation: The SEC proposed amendments to the rules for which companies qualify as nonaccelerated filers, which would increase the number of them and would result in those companies no longer being required to have their auditors report on their internal control over financial reporting.

Disclosure effectiveness: Proposed rules to amend Regulation S-K are being finalized that would amend the required disclosures for description of business, legal proceedings, and risk factors to make them more modern and principles-based. There are also proposed new human-capital resource measures and objective disclosures going beyond the current requirement to disclose the number of employees. Additionally, there is a new proposed mandatory summary of risk factors

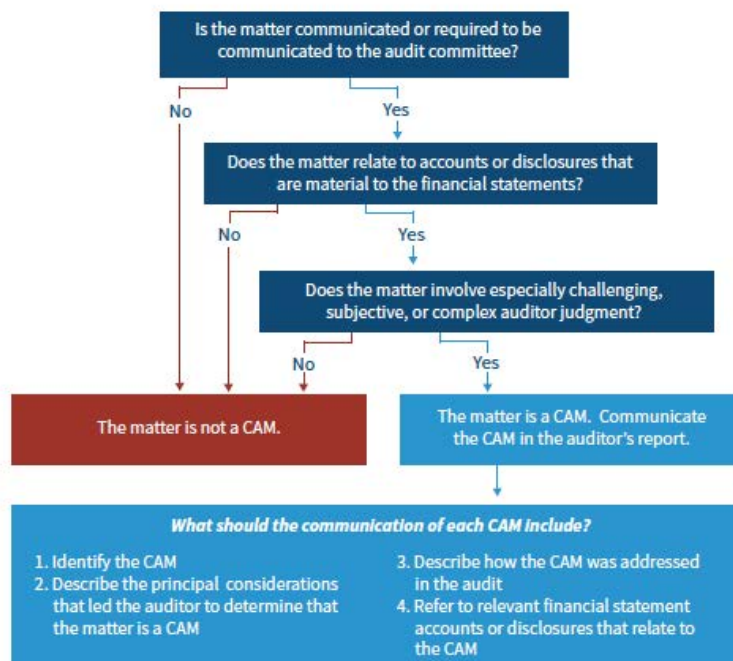
if the risk factor disclosures exceed 15 pages.

The SEC is also finalizing proposed rules to improve investor information about acquired or disposed businesses, including simplified disclosure requirements for registered debt securities and amended financial reporting for significant acquisitions and dispositions to reduce the complexity and cost.

Risk disclosures: The SEC is continuing its focus on companies' risk disclosures and their boards' oversight of risks in the areas of cyber-security, transition from LIBOR, and Brexit.

Cyber-security includes both the prevention and detection of cyber-breaches and controls over identifying and escalating any incidents that do occur. Any material cyber-security risks should be disclosed to investors on a timely basis. The SEC has a resource

When is a matter arising from the audit of financial statements a Critical Audit Matter (CAM)?



page on its Website related to cyber-security.

As companies and markets transition away from LIBOR and alternate reference rates replace it, the SEC expects companies to disclose their risk exposure from contracts indexed to LIBOR. In July 2019, the SEC staff issued a statement advising companies to monitor matters such as their identification of LIBOR exposure, how they are analyzing their existing and alternative rates and working with counter parties, and any hedging implications. Companies should disclose material qualitative and quantitative information about where they are in their assessment process for the transition from LIBOR.

Management should be considering the uncertainties relating to the potential effects of Brexit. Chairman Jay Clayton included Brexit in a December 2018 speech about the SEC's 2019 agenda and initiatives. The SEC expects companies to review their risk disclosures about Brexit and update them to reflect their current risk assessment.

The SEC is also actively involved in potential rulemaking and requests for clarification of disclosure guidance relating to environmental matters, including climate change. Environmental, social, and governance (ESG) matters are a very hot topic now, and there could be additional required disclosures in this area in the near-term.

PCAOB

Reporting of Critical Audit Matters (CAMs): As audit reports in 2019 and 2020 begin to include the reporting of CAMs, the PCAOB intends to focus on this new reporting requirement. This will include both their inspections of auditors and post-implementation review of the new standard, to consider the need for additional guidance or changes to the requirements. The PCAOB has issued guidance on CAMs, including a July 2019 report for audit committees to use as they engage with their auditors.

Quality-control (QC) standards: In December 2019, the PCAOB issued a concept release on quality-control standards. Responses to the release may result in potential changes in the QC standards that

boards and audit committees need to be aware of as they work with and monitor their auditors. These include firm governance and organizational structure, assessing and monitoring quality-control risks, continuous improvement, and transparency.

Auditors' use of data and technology: As technology continues to change the way auditors conduct their audits, the PCAOB is actively looking at whether existing standards are adequate or need to be changed. They have a task force involved, and this is a topic on its current research agenda.

Auditors' supervision of other auditors: The PCAOB proposed amendments to audit standards in this area in 2016. It is concerned with how lead auditors evaluate and ensure quality work of other auditors involved in the issuance of their audit report. The PCAOB issued a request for additional comments on their proposal in 2017 and is in the process of determining next steps, which could happen in 2020.

FASB

New accounting standards—education and implementation assistance: FASB's focus includes continuing to monitor significant new accounting and amended standards, such as revenue, leases, credit losses, and hedge accounting. They are providing assistance and education on implementation issues. They are obtaining feedback through their post-effective-date review and monitoring program to identify areas in which preparers need guidance or where standards may need amendment in the future.

Future standard setting: Current FASB Chair Russ Golden will complete his term on June 30, 2020, and a new chair, Richard Jones of EY, will take over. FASB is continuing to work on the accounting for convertible instruments and contracts on an entity's own equity, along with potential changes from the transition from LIBOR. They are also looking at potential improvements to financial reporting, including segment reporting and income statement presentation. It has a number of other projects on its agenda that are narrower in scope, relating to both accounting and disclosures. ■

New auditor reporting standards: What's changed?

A closer look at new standards issued in May by the Auditing Standards Board will aid auditors in conferring with clients before 2020 reports arrive. **Maria L. Murphy** has more.

It's time for auditors to scrutinize new standards issued in May by the Auditing Standards Board (ASB) that will significantly impact auditor reports issued under Generally Accepted Auditing Standards (GAAS) for nonpublic companies. A closer look now will help auditors prepare for client discussions, as 2020 reports are quickly approaching.

Although much of the information included in the report is the same, there are significant changes to the format and some new required information.

Statement on Auditing Standards No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*, contains guidance about auditor responsibilities in forming an opinion and the form and content of the audit report.

The intent is to provide greater value to users of audit reports by making the auditor's opinion and basis for opinion more visible and transparent. In addition, changes to language in the report are intended to provide more useful information and to more clearly define the responsibilities of both the auditor and management.

One of the ASB's objectives was to converge GAAS with audit reporting standards of the International Auditing and Assurance Standards Board (IAASB) and improve consistency with the auditor reporting model of the Public Company Accounting Oversight Board (PCAOB).

The ASB issued an additional standard in May. Statement on Auditing Standards No. 135, *Omni-bus Statement on Auditing Standards - 2019*, deals with audit performance and reporting. It aligns ASB guidance for auditor communications, related parties, and consideration of fraud more closely

with PCAOB guidance in these areas. The intent of the Auditing Standards Board was to eliminate unnecessary differences between ASB guidance and PCAOB standards, to increase consistency, and improve the audit quality of auditors who perform audits under both standards.

SAS 134 and SAS 135 are effective for audits for periods ending on or after Dec. 15, 2020. Early implementation is not permitted.

What has changed?

SAS 134 changes the positioning of the information within the report and some of the language of the audit opinion. The intent of the ASB was to address concerns of users of audits that wanted a better understanding and clearer communication about the conduct of the audit and conclusions reached.

As such, the audit opinion will now appear at the beginning of the report and will have the heading, "Opinion."

It will be immediately followed by the "Basis for Opinion" section, which is intended to provide additional context about the opinion and must include a statement about auditor independence and compliance with other ethical requirements. The Basis for Opinion section is now required for all audit reports, not only those with modified opinions as in prior guidance.

Next is a section that includes expanded discussion of the responsibilities of management for the financial statements. This section contains additional disclosure about management's evaluation of going concern matters, even if there is not any doubt about the entity's ability to continue as a going concern.

Following management's responsibilities is an expanded discussion of the auditor's responsibilities for the audit. This section includes the auditor's procedures relating to use of judgment and professional skepticism in areas like risk assessment, internal controls, accounting estimates, evaluating going concern, and communication with those charged with governance.

How SAS 134 is organized

SAS 134 amends a number of other auditing standards and includes new requirements relating to understanding the entity, assessing risk, and performing procedures in response. It also includes illustrations of audit reports under typical audit situations that auditors can use for reference. It contains the following sections, which supersede existing Sections 700, 705, and 706 and add the new Section 701:

Section 700, *Forming an Opinion and Reporting on Financial Statements*, is the core section that covers the auditor's responsibility when opining on financial statements. It provides the form and content of an unmodified opinion, when the auditor's conclusion is that the financial statements are presented fairly in all material respects and in accordance with the applicable financial reporting framework. This section has an appendix of amendments to the various auditing standard sections that deal with auditor reporting and related disclosures.

Section 705 of SAS 134, *Modifications to the Opinion in the Independent Auditor's Report*, provides the form and content of a qualified, adverse, and disclaimer of opinion. This section does not change existing audit guidance about when an auditor should modify the opinion, because the auditor has concluded that the financial statements are materially misstated or the auditor is unable to form a conclusion or the type of report modifications to be made.

Section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's*

Report, covers the form and content of these types of additional communications in an audit report. The revised standard requires that an auditor include the conclusion about doubt related to an entity's continuing as a going concern under a separate section headed, "Substantial Doubt About The Entity's Ability to Continue as a Going Concern," rather than in an emphasis of matter paragraph under the prior guidance.

Section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, provides guidance about what an auditor should communicate and how it should be presented and only applies when the auditor is engaged to communicate key audit matters (KAMs).

KAMs are matters that, in the auditor's judgment, are most significant in the audit and are selected from matters the auditor communicates to those charged with governance. KAMs were added by the IAASB, and they are not the same as critical audit matters (CAMs) that are required to be communicated under PCAOB standards. SAS 134 does not require communication of KAMs, but this section provides guidance if the auditor is reporting on KAMs.

What should auditors do now?

Although 2019 year-end audit reports will not change, 2020 reports are certainly not far off. That's why auditors should be thinking about these changes now and helping their clients prepare for discussions with users of their financial statements and audit reports.

It should be noted that audits of employee benefit plans subject to the Employee Retirement Income Security Act (ERISA) are scoped out of these standards, and they are the subject of a separate statement, SAS No.136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, issued in July 2019. SAS 136 is effective for audits for periods ending on or after Dec. 15, 2020, and early implementation is not permitted. ■

Report: Investor confidence in audit committees high

The CAQ says confidence in audit committee effectiveness has soared, but there's a lack of transparency. **Maria L. Murphy** explores.

The 2019 Audit Committee Transparency Barometer—issued annually by the Center for Audit Quality (CAQ) and Audit Analytics—indicated investor confidence in audit committee effectiveness was strong and had increased 10 percentage points since the first Barometer report was issued in 2014. The CAQ believes greater transparency about audit committee responsibilities will strengthen this confidence even further.

The Barometer, published in November, evaluates how public company audit committees communicate their oversight activities over their external auditors to the public. It also measures the percentage of certain categories of proxy disclosures by companies in the S&P Composite 1500 (S&P 1500) and provides examples of effective proxy disclosures based on filings from July 1, 2018, through June 30, 2019. It includes results for S&P 500, MidCap, and SmallCap companies. What follows is a summary of the results of the 2019 report:

Positive findings: Improvements in disclosures

Audit committees are providing the following disclosures most frequently: non-audit services and independence; how long auditors have been engaged; criteria used to evaluate the audit firm; and involvement in selecting the audit partner.

There are significantly more disclosures than in prior years about cyber-security. These include the audit committee's responsibility and process for cyber-security risk oversight and controls, how the audit committee works with management to monitor risk exposures, whether there is a cyber-security expert on the board, and on which committee.

Areas of concern

There are many categories of disclosures that are

at the same level or have decreased as a percentage from 2018. The Barometer encourages audit committees to continue to increase disclosures and transparency into their role and process to increase investor confidence.

The Barometer notes there is little or no disclosure about how the audit committee addressed significant areas with the auditor, considered auditor compensation, or discussed the connection of audit fees to audit quality.

Opportunities for more transparency

Audit committees are encouraged to consider the following opportunities for future additional disclosures:

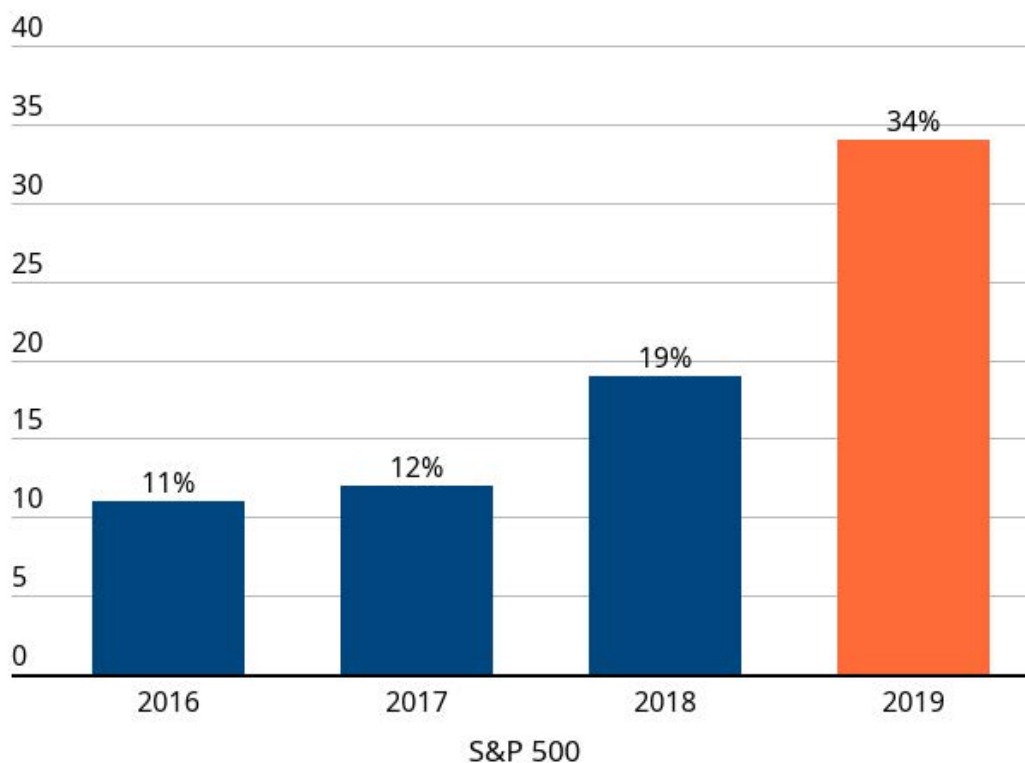
- » Significant areas under the auditing standards are those areas the auditor considers to be most significant and relevant to the responsibilities of those charged with overseeing the financial reporting process. Disclosures about how the audit committee addresses these areas with the auditors, along with the determination of Critical Audit Matters (CAMs) that are beginning to be required disclosures in audit reports, can provide useful information about a company's financial statements and internal controls.
- » How the audit committee evaluates its auditors (how often, who is involved, and key criteria) and its process for selecting engagement partners upon partner rotation are critical to understanding each company's specific policies and procedures around audit quality. Disclosures about auditor evaluation criteria can include the firm's expertise in the industry, knowledge of the company, resources and capabilities, historical performance, length of time as auditors, independence, quality of communications with the committee

and management, and any legal proceedings or PCAOB inspection reports.

- » Disclosures about the audit committee's role in evaluating audit firm compensation may include how the committee evaluates the appropriateness of and negotiates the audit fee. Their evaluation could include the number of hours spent, dollar amount, comparison of fees to peers, and reasons for changes in fees year over year (such as new accounting standards, company-specific changes, technology, and fees for non-audit services).

- » Another important related disclosure area is how the audit committee balances the fee and budgeted hours assessment with the need for a quality audit. Their assessment of audit quality may be based on the auditor's tenure with the company and its institutional knowledge of the company's business, accounting, and internal controls over financial reporting. They may also have considered external data relating to audit quality and performance, including any PCAOB reports issued on the auditor or its peer firms. ■

Percentage of S&P 500 stating audit committee responsible for Cyber-security risk oversight



Chartered IIA publishes new Internal Audit Code

The Chartered IIA's new Internal Audit Code of Practice aims to increase the status, scope, and skills of internal audit and offers 38 recommendations. **Jaclyn Jaeger** has more.

The Chartered Institute of Internal Auditors (Chartered IIA) announced in January the publication of new guidance, intended to serve as an industry benchmark to improve the effectiveness of internal audit functions and raise the bar across the profession within organizations operating in the United Kingdom and Ireland.

Publication of the Chartered IIA's "Internal Audit Code of Practice" follows a series of high-profile collapses linked to governance deficiencies, most notably the fall of Carillion in 2018. The principles-based code was developed by an independent steering committee set up by the Chartered IIA and is chaired by Brendan Nelson, audit committee chair of BP.

"High-profile corporate collapses linked to governance deficiencies have led to a wide-ranging review of the audit and corporate governance framework," Nelson said. "Strong, effective, and well-resourced internal audit functions have a central role to play in supporting boards to better manage and mitigate the risks they face."

Nelson said he urges boards, and particularly audit committees, "to apply appropriately the Internal Audit Code of Practice to increase the effectiveness of their internal-audit functions, in the pursuit of stronger corporate governance and risk management."

The new code aims to increase the status, scope, and skills of internal audit and makes 38 recommendations to companies, including:

- » Unrestricted access for internal audit so it is not restricted from looking at any part of the organization it serves and key management information.
- » The right to attend and observe executive committee meetings.

- » A direct line to the CEO and a direct report to the audit committee chair to increase the authority and status of internal audit.
- » The direct employment of chief internal auditors in every business, even when the internal audit function is outsourced in order to ensure chief internal auditors have sufficient and timely access to key management information and decisions.
- » Regular communication and sharing of information by the chief internal auditor and the partner responsible for external audit to ensure both assurance functions carry out their duties effectively.

"High-profile corporate collapses linked to governance deficiencies have led to a wide-ranging review of the audit and corporate governance framework."

Brendan Nelson, Audit Committee Chair, BP

The final version of the code follows a 12-week public consultation exercise in which over 100 stakeholders participated in November 2019. Meetings were held with senior stakeholders, and chief internal auditors from some of the U.K.'s largest companies took part in online discussions about the draft code.

The final Code was welcomed in Sir Donald Brydon's 2019 independent review into the quality and effectiveness of audit. Chartered IIA's Code complements the recommendations in the Brydon review. ■



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