AN OFFERING FROM THE BDO CENTER FOR CORPORATE GOVERNANCE AND FINANCIAL REPORTING

2020 YEAR END AUDIT COMMITTEE AGENDA

BDO

Contents

Audit Committee Responsibilities on the Rise

2020 required companies to be adaptable and creative while addressing the challenges of COVID-19. 2021 promises further challenges for companies as they look to transition from perseverance to recovery. Directors have the opportunity to refocus and refine responsibilities in light of new risks and opportunities and to clearly communicate to stakeholders.

In the face of conditions resulting from the continued pandemic and economic uncertainties, audit committees are being asked to do more while remaining focused on the oversight areas required of them: risk management and financial reporting, independent and internal auditors, and compliance, ethics and controls. This publication provides directors with some insights into many of the evolving risk areas impacting year-end reporting that audit committees are to be mindful of as they perform their governance oversight duties.

Audit committee responsibilities may not be fully understood by the market. The **CAQ and Audit Analytics Annual 2020 Audit Committee Barometer** notes positive trends in audit committee disclosure within proxy statements about their supervision and evaluation of audit firms as well as expanding disclosure of risk oversight in emerging areas such as cybersecurity, COVID-19 and the discussion of critical audit matters (CAM). The Barometer also recommends areas for further consideration particularly including enhancing disclosures around significant areas of discussion that take place with the auditor.

The December **2020 AIPCA Conference on SEC and PCAOB Developments ("AICPA Conference")** further scored the overall goal of transparent and trusted financial reporting in light of the challenges presented by the pandemic. Leaders acknowledged the rate of change within the financial reporting landscape, the agile response by all stakeholders and the prediction for continued changes to navigate through 2021. Please refer to BDO's Conference Highlights **here**.

COVID-19 Impact on Risk and Financial Reporting

The global pandemic has created the emergence of new risks related to declining product demand and revenues; supply chain disruptions; talent retention and engagement; weakened internal controls in shifting to a virtual environment; and sophistication of cyber-attacks. Industry, business lifecycle and maturity will all contribute to a company's specific risk profile and tolerance. These considerations are coupled with economic uncertainties, regulatory developments, local regulations regarding business operations, and changes in the workforce that should be explored as the audit committee looks to oversee enterprise risk management. These risks are coupled with economic uncertainties, regulatory developments, local regulations regarding business operations, and changes in the workforce that should be explored as the audit committee looks to oversee risk management.

It is safe to say that frequent and timely communications between audit committees and external auditors should be expected and welcomed, as both have the same goal in mind…for management to produce trusted and relevant financial information. Reliance upon financial statements requires a commitment to rules, regulations, standards and responsibilities from all parties in the financial reporting ecosystem, including frequent and transparent communication and cooperation. The PCAOB has taken a particular interest in facilitating these discussions with its recent outreach to audit committee chairs culminating in two publications: **Conversations with Audit Committee Chairs: COVID-19 and the Audit** and **Conversations with Audit Committee Chairs: What We Heard & FAQs**. Difficult periods increasingly call for timely and relevant information about evolving risks that companies and audit committees can act upon and communicate to their stakeholders.

ACCOUNTING ESTIMATES AND USE OF SPECIALISTS

New or increasing risks resulting from uncertainty, volatility and continued changes in business operations, production, supply chains, revenue streams and customers are anticipated into 2021. These risks represent areas frequently leveraged as inputs when forecasting for revenue, expenses, capital needs and availability, consideration of asset impairments, going concern indicators and other areas relying on significant accounting estimation. Given increasing complexities in developing estimates, including those posed by COVID-19, companies and auditors often rely on specialists to aid in both the development of and the auditing of such measures. This has become an increasing area of focus of the PCAOB resulting in newly effective auditing standards: **AS 1210: Using the Work of an Auditor-Engaged Specialist** and **AS 2501: Auditing Accounting Estimates, Including Fair Value Measurements**. When reviewing these difficult judgment areas and the reliance placed on specialists, audit committees are reminded to exercise their own professional skepticism and may consider use of **BDO's Professional Judgment Framework** as well as a new **PCAOB Audit Committee Resource: New PCAOB Requirements Regarding Auditing Estimates and use of Specialists** to aid in this endeavor.

IMPLEMENTATION OF ACCOUNTING STANDARDS AND CLARIFICATIONS

Changes in the business environment have resulted in clarifications to recently implemented standards for revenue recognition and leases. Additionally, review of long-standing guidance regarding collectability of receivables, debt accounting and classification of obligations may be warranted as uncertainties arise. Contractual modifications and changes in terms, loss contingencies, computing of fair value and changes in compensatory arrangements are among other transactional areas that may further pose challenges in judgment and complexities in accounting, making for an interesting accounting and reporting season. BDO has maintained **guidance** over the past several quarters that may be helpful for audit committees related to accounting and disclosure considerations as part of year-end reporting. Additionally, we have issued a **resource** highlighting new accounting standards with upcoming effective dates. During the recent **AICPA Conference**, there was discussion of specific accounting matters regarding planning for reference rate reform, consideration received from a vendor, equity method investments, consolidation and segment reporting that may be of further interest.

Implementation of the new FASB guidance with respect to accounting for **Financial Instruments - Credit Losses** is drawing particular attention, given current economic considerations. Under the Current Expected Credit Losses ("CECL") model, entities will estimate credit losses over the entire contractual term of the instrument from the date of initial recognition of that instrument, as opposed to current U.S. GAAP that delays recognition of credit losses until it is probable the loss has been incurred. Accordingly, it is anticipated that credit losses will be recognized earlier under the CECL model than under the incurred loss model.

For those who have participated, and for potential participants, in a **government assistance program**, there are critical considerations including record keeping, reporting and oversight. Given the complexities, companies may benefit from leveraging internal or external audit procedures and attestation to validate that the initial application conformed to the program requirements, and that the recordkeeping is complete, accurate and compliant. Furthermore, it is helpful to note that these programs were enacted with necessary haste, and it's possible that some areas will be subject to ongoing reassessment or reinterpretation which make thorough documentation and transparent reporting even more critical.

We have compiled a list of resources providing further information on these complex topics below for your reference:

- 2020 AICPA SEC and PCAOB Conference Highlights
- 2020 SEC Reporting Insights
- New Accounting Standards Upcoming Effective Dates for Public and Private Companies
- COVID-19: Accounting, Reporting and Other Related Considerations
- Government Assistance Programs: Are You Ready for Scrutiny?
- FASB Topic 326, Financial Instruments – Credit Losses: Presentation and Disclosure
- FASB Topic 326, Financial Instruments – Credit Losses
- FASB Topic 842, Leases
- FASB Topic 842: Presentation and Disclosure
- Navigating Revenue Recognition
- FASB Topic 606, Revenue from Contracts with Customers

Continued Focus on Audit Quality

OVERSIGHT OF EXTERNAL AUDITOR

Oversight and trust of the external auditor by audit committees relies upon continued focus on audit quality. This begins with the appointment of the auditor, which involves a rigorous assessment of the auditor's expertise and experience, industry knowledge, project and relationship management, approach to the audit and engagement by the auditor with both management and the audit committee. Audit committees should also understand their auditor's system of quality control and ask the auditor about their own practices, as highlighted by the PCAOB in their recent **Spotlight: Staff Update and Preview of 2019 Inspection Observations** including use of audit milestones, early reviewer engagement, use of firm specialists, and quality control narratives tying quality objectives and controls to monitoring of engagement performance and enhancing effectiveness.

BDO has recently released our voluntary **2020 Audit Quality Report: Continuing to Build Trust** that explores how we invest in our system of quality management, leadership, professional practice resources and systems; define and measure audit quality indicators; and relentlessly execute our client audits by our firm's core values and our professional judgment.

OVERSIGHT OF INTERNAL AUDITOR

Internal audit is an extension of the audit function intended to provide independent assurance that an organization's risk management, control and governance processes are operating effectively; and recommend improvements if that is not the case. The Institute of Internal Auditors and the International Federation of Accountants issued **Six Recommendations for Audit Committees Operating in the "New Normal"** that urge audit committees to:

- Stay informed
- Communicate and collaborate
- Leverage available expertise
- Promote continuous improvement
- Think holistically
- Embrace technology

Internal audit may play a role in a number of these recommendations, in addition to assisting in the immediate needs of business continuity planning, crisis management, and operational risk management. Refer to **BDO's 2021 Internal Audit Webinar Series** for upcoming education in this area.

Evolving Reporting Considerations

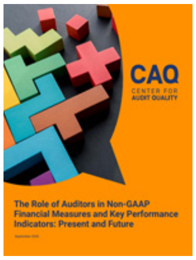
Stakeholders expect transparent financial reporting they can trust.

The SEC's continued focus on capital formation and its Disclosure Effectiveness Initiative, supported by several rulemaking activities, have resulted in significant changes to longstanding SEC rules and regulations. These rulemaking activities, among others, include final rules to amend:

- The definition of accelerated and large accelerated filers
- Regulation S-X financial disclosure requirements for registered debt offerings and acquired and disposed businesses
- Regulation S-K disclosure requirements for the description of a business, legal proceedings and risk factors
- Other aspects of Regulation S-K including the elimination of selected financial data and changes to modernize and simplify MD&A reporting.

Please refer to the **BDO Insight** for more details in applying these changes.

Many of the amendments emphasize a more principles-based, registrant-specific approach to disclosure, particularly outside of the financial statements. Some companies are including additional information (whether voluntarily or by "encouragement" from various stakeholders and regulatory bodies) regarding environmental, social and governance (ESG) risks, which we will discuss later in this publication.



There is also continued interest in use of non-GAAP reporting metrics, used by companies to better reflect how they are managing their business. The SEC continues to remind registrants to adhere to **SEC Non-GAAP Compliance and Disclosure Interpretations** issued in May 2016 when such measures are presented. Audit committees should particularly consider the appropriateness of management's use of non-GAAP measures to adjust for or explain impacts of COVID-19 or the CARES Act relief measures, and remember that the external auditor's responsibility for non-GAAP disclosures remains **limited**.

MERGER AND ACQUISITION ACTIVITY

BDO's fall **2020 Board Pulse Survey** indicates directors expect to see an uptick in merger and acquisition activity with 21% of directors reporting pursuit of M&A transactions as part of their corporate strategy and eight percent reporting plans for spinoff or divestiture; that number increased to 48% of directors reporting that their organizations are seeking or expanding an acquisition strategy in our soon-to-be-released winter board pulse survey results. While these business decisions may not fall directly under the purview of the audit committee, the committee will need to be highly involved in the accounting, financial reporting and tax implications of any such transaction. From the emerging popularity of **Special Purpose Acquisition Companies (SPACs)** to the revised disclosures related to **debt offerings** and the financial reporting implications for **divestitures**, there are a myriad of considerations for audit committees to be aware of in contemplation of such activities.

Changing Workplace

While the pandemic has affected industries differently, there is rarely a company that has not experienced significant changes to their workplace. It is recommended that the audit committee understand how changes such as efforts to physically and mentally protect the workforce; moves to a virtual digitized environment and increasing needs to re-skill employees are impacting the finance function; and recognize increased risks in areas such as internal control over financial reporting and the potential for fraud.

INTERNAL CONTROL OVER FINANCIAL REPORTING

ICFR continues to be an area of findings in **PCAOB inspections**. As it relates to the upcoming 2021 inspection cycle, the PCAOB staff **indicated** its intent to introduce more unpredictability into their selection and review process. It also intends to emphasize areas of recurring inspection findings, CAM determinations and communications, audit firms' system of quality control as well as custody and control of customer funds and securities in broker – dealer audits. Additionally, the staff will focus on industries and financial statement areas with increased risks during the pandemic – e.g., goodwill, intangibles and related impairment concerns; going concern considerations; inventory; and fraud assessments, including consideration of forecasts and management override of controls.

Specifically, the PCAOB reminds that permanent or temporary changes in the operations of the company may impact processes, flow of transactions and controls – e.g., reassignment of control owners or "workarounds" – which may in turn impact the auditor's approach to internal control testing.

Uncertainty continues to persist, making it difficult for organizations to evaluate impacts on their control environments. Each risk factor needs a thoughtful analysis to determine the impact, the action and solution, which may further highlight the need for investments in technology or additional staffing. Please take a moment to scan the following table to see if any of the conditions resonate with respect to the organizations for which you serve in a director capacity:

HOW HAS YOUR CONTROL ENVIRONMENT BEEN IMPACTED?

FACTOR	ACTION	SOLUTION
▶ Remote working / layoffs / hiring / furloughs ▶ Employees performing 'other duties' outside of their skill set ▶ Business unit / department reduction /slow-down / closure / expansion or growth	▶ Cross training of employees to cover reduction or increase in employees' tasks. ▶ Train new employees who are not fully knowledgeable of the position. ▶ Re-organization of business unit / department structure. ▶ Evidence of control performance (analysis / review) changes ▶ Control failure in design/ operating effectiveness	▶ Segregation of duties assessment & user provisioning and deprovisioning ▶ Restructuring / turnaround ▶ Business performance improvement ▶ Outsourced human capital management ▶ Risk and control matrix design assessment ▶ Implementation of new controls ▶ Documentation standards
▶ Growth or loss of revenue / customers	▶ In-scope processes, locations, or materiality due to financial results. ▶ Net operating loss (NOL) carryback / forward ▶ Possible liquidity issues ▶ Asset impairment or valuation concerns	▶ Risk Assessment and scoping update ▶ Implementation of new controls ▶ Tax assessment and implications ▶ Liquidity/cash flow management
▶ Data security	▶ Infrastructure does not have sufficient security for increased remote access.	▶ Cyber security assessment ▶ Implementation of new controls
▶ Federal financial assistance	▶ Compliance with regulations and guidelines for using the financial assistance ▶ Control gap in design ▶ CARES Act funding	▶ Risk and control matrix design assessment ▶ Implementation of new controls ▶ Payroll protection plan / payroll tax credits ▶ Implement new compliance processes, monitoring and controls

Source: Evolution of Control Environments During a Global Pandemic

Audit committees are encouraged to understand their auditors' assessment of management controls in planning their audit work, such as how auditors:

- Test control design and operating effectiveness, particularly management review controls (MRCs) and controls with a review component
- Test completeness and accuracy of reports used in management's control activities
- Evaluate whether management's controls are responsive to risks identified by both management and the auditor
- Audit management's estimates and judgments
- Test automated application controls, system/control configuration, report writers, and report parameters, etc.
- Evaluate control deficiencies under COSO 2013 Framework and identification of compensating controls
- Evaluate management's procedures around cybersecurity incidents

For a look back on interim and annual inspection observations by the PCAOB, refer to:

- PCAOB Spotlight: Staff Observations and Reminders During the COVID-19 Pandemic
- PCAOB Spotlight: Staff Update and Preview of 2019 Inspection Observations

FRAUD RISK CONSIDERATIONS

There is agreement that the pandemic has created increased risk relative to all three aspects of the fraud triangle – motive, opportunity and rationalization - and concerned parties from the Association of Certified Fraud Examiners to the SEC are weighing in on the issue. The Center for Audit Quality (CAQ) together with the Anti-Fraud Collaboration issued several resources discussing the impact of COVID-19 on fraud. Refer to these and additional resources below.

The pandemic-heightened risks lie where staffing and other changes may reduce segregation of duties, and where management may have opportunities or pressures to override existing controls and/or affect estimates and judgments. Increased awareness coupled with healthy skepticism and open communication should be utilized in mitigating these risks. Other key factors in risk mitigation include audit committee oversight in management activities designed to:

- Maintain well-designed and effective internal controls
- Perform continual risk (re)assessment of material areas
- Demonstrate professional skepticism
- Facilitate strong corporate culture
- Exercise leadership and set a strong tone at the top

Recent fraud publications for further consideration:

- ACFE Fraud in the Wake of COVID-19: Benchmarking Report
- CAQ Fraud and Emerging Tech: Cybercrime on the Rise during COVID-19
- SEC Fighting COVID-10 Related Financial Fraud
- Anti-Fraud Collaboration Resources
- NACD Blog: Why Audit Committees Are So Important During the COVID-19 Crisis

Recent fraud videos:

- Enhancing Skepticism to Fight Fraud
- The Fraud Risk Landscape of COVID-19
- Skepticism in Focus on Mitigating Fraud Risk
- A Focus on Ethical Culture and Diversity During Crisis

Technology Evolution

Although the COVID-19 pandemic has disrupted business operations and impacted revenue streams across all industries, the crisis has also highlighted the importance of optimizing processes and driving efficiencies through increased digital market channels. Strategic digital transformation is no less critical amid a pandemic or economic downturn. BDO's Fall 2020 Board Pulse Survey revealed that the number one priority of 49% of directors, once immediate safety issues of the pandemic are addressed, is prioritizing the improvement of their digital capabilities with stronger technology skillsets and revitalized digital transformation plans. Organizations that can harness digital capabilities have a much better chance to survive the crisis and thrive in the turbulence that lies ahead.

The current environment may cause organizations to focus more on operational efficiencies and cost savings in the short term. However, boards are urged to be mindful of business objectives for the longer term. Middle market executives revealed in the 2020 BDO Digital Transformation Survey that the top objectives for their digital strategy are diversifying revenues and modernizing information technology infrastructure over the next 18 months to three years. While each company's digital transformation will be unique, it will continue to significantly impact strategic corporate decision-making.

According to BDO's 2020 Digital Transformation Survey, middle market executives say that the top objectives for their digital strategy are to:

Next 18 Months to 3 Years

1. Diversify Revenues*

1. Modernize IT Infrastructure*

3. Increase Market Differentiation

4. Increase Operational Efficiencies*

4. Bolster Cyber*

**Represents a tie in ranking*

A crisis like the COVID-19 pandemic can lead some organizations to pause or de-emphasize innovation. But now more than ever, it's critical to continue developing digital capabilities that enable success for both the present and future. Deploying digital initiatives strategically can help protect revenues and identify unmet customer needs.

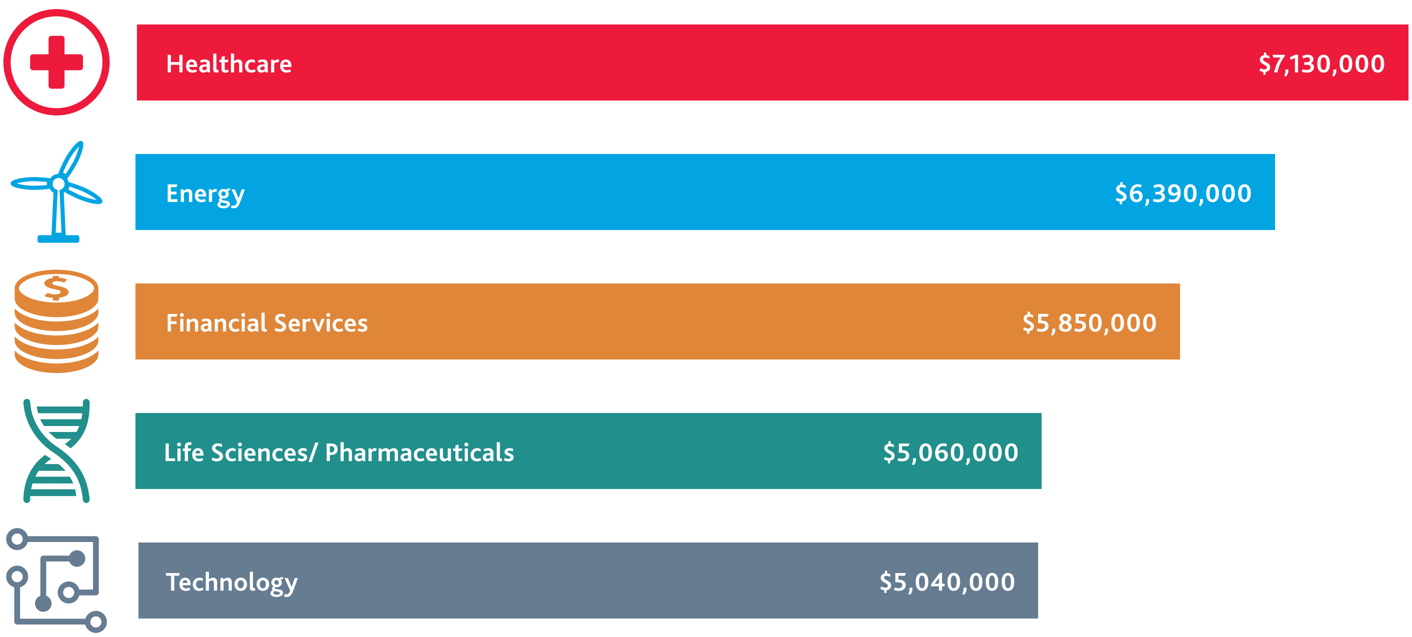
MALCOLM COHRON
National Digital Transformation Services Leader, BDO Digital

Cybersecurity & Data Privacy

CYBERSECURITY

Abrupt business interruptions for many industries, opened new opportunities for cyber-attackers. In BDO's 2020 BDO Digital Transformation Survey, 39% of C-Suite executives cited cyber-attacks as the biggest digital threat to their business; while 31% further described concerns about cybersecurity as the biggest challenge moving forward with a new digital initiative.

COST OF A DATA BREACH BY INDUSTRY



Source: IBM's 2020 Cost of a Data Breach Report

Specific cyber risk will vary among companies, driven by industry, life cycle and circumstantial vulnerabilities. Audit committees should remain educated about the current cyber risk landscape. According to BDO's Fall 2020 Cyber Threat Insight Report, these are the cybersecurity must-haves in 2020 and beyond:

Top Priorities for Cybersecurity in All Industries

1. **Use managed detection and response services:** Ensure you have security measures in place to continuously monitor, detect and respond to threats to the email system, network, software applications and all information system endpoints. Use advanced security information event management (SIEM) software, data visualization tools, artificial intelligence tools and security automation as needed to achieve 24/7/365 monitoring and instantaneous response.

2. **Confirm information system resilience on a continual basis:** Establish and periodically test the comprehensive incident response plan, business continuity plan and disaster recovery plan to minimize the potential damage from cyberattacks and protect operations.

3. **Conduct diagnostic assessments of technical architecture:** Regularly conduct penetration testing, network and endpoint assessments, vulnerability scanning assessments, email cyberattack assessments and more.

Directors further need to be informed of and consider exposure through third party transactions – e.g., customers and vendors, along with management's current detection and defense plans and long term strategy and proposals to continue to mitigate cyber risks. This can occur via frequent updates from the CISO, or appropriate individuals with insight into the cybersecurity function as well as **SOC for Cyber** assessments conducted by independent external advisors.

It is becoming more common for the board to utilize cyber experts, to assist in both the education and evaluation of cybersecurity updates. Further, the responsibility for cybersecurity should be well established within the board. Whether a cybersecurity committee is established, or certain responsibilities are delegated to another committee - such as the audit committee - the full board will generally be responsible for overall cybersecurity oversight.

It is also important to secure stakeholder confidence in a company's cybersecurity efforts. Robust cyber reporting includes timely discussion of threats, mitigation of risk and breaches when they occur. Cybersecurity risk reporting remains principles-based and falls under the guidance for reporting risks. **Harvard Law School Forum on Corporate Governance** released the results of proxy and 10-K reviews of 76 Fortune 100 Companies where it saw increases in voluntary cybersecurity disclosures including 100% reporting cybersecurity risk factor disclosures. Additionally, there continues to be an increase in disclosing cybersecurity management efforts and board oversight activity that includes overall board approach, board-level committee oversight, director skills and expertise as well as management reporting structure.

As a reminder to audit committees, all 50 states have security breach notification laws and the SEC maintains a Cyber Unit within its Division of Enforcement to protect investors. The SEC further has a **cyber resource page** with guidance for issuers. Best practices that provide for continuous threat monitoring and coordinated management of security tools help to guard against vulnerabilities, but there are always new risks emerging, and this has been especially true during the COVID-19 pandemic. Many organizations have also tightened budgets during the economic downturn, reducing resources for cybersecurity projects and protections. Boards are well served in prioritizing cyber risk and ensuring appropriate time, attention, continuing education and resources are allocated appropriately.

DATA PRIVACY

Data privacy regulations govern a company's responsible collection, maintenance and use of data. With the digital transformation of companies well underway, additional associated risks related to data is on the rise. The **Harvard Law School Forum on Corporate Governance** reports 99% of companies in their study reported data privacy within risk factor disclosures within their 10-Ks. The IIA, as part of a **series** on Fraud and Emerging Tech from the Anti-Fraud Collaboration, has released **Data Ethics and Governance with COVID-19 Considerations**, that explores the implications of data ethics and governance for mitigating fraud risk, protecting data privacy and navigating disruption during the COVID-19 crisis.

Data privacy is driven from operations: how data is collected, stored, used and shared; and comes with a number of compliance requirements from regulations including the **GDPR** to **CCPA**. This risk area requires operational and compliance expertise which will ultimately affect the financial statements, and for which the audit committee should remain involved.

ESG & Investor Priorities

Stakeholders are increasing their calls for, to quote the **Business Roundtable**, "an economy that serves all Americans" by redefining the purpose of a corporation to support all stakeholders including customers, employees, suppliers, communities and shareholders. This, coupled with a heavy focus on environmental, social and governance (ESG) activities, challenges boards to consider not only how to align these activities as priorities within sustainable long term value strategies but in how they are communicating such activities to the public.

The audit committee role, in particular, will vary across companies with the delegation of specific ESG risks and opportunities being assigned to one or often times various committees. At a minimum, the audit committee role continues to be defined with respect to corporate ESG/ sustainability reporting and includes understanding and evaluating the related materiality of the impacts of ESG on corporate reporting and disclosures. For example, human capital assets are becoming one of the most significant intangible assets driving a company's overall business performance. Deciphering what information to focus on, how such data is and can be gathered and shared as understandable metrics to be reported publicly is no easy task. Further, there needs to be an understanding of how the role of the audit committee, with regard to reporting metrics, fits within the often broader construct of the board's involvement with long term sustainable value creation and corporate purpose.

Stakeholder support for reporting on ESG initiatives are heavily influenced by calls from investors and policy makers, domestically and internationally. Following **Blackrock CEO Larry Fink's** letter from 2020, in early December the **Investment Company Institute** called on companies to enhance reporting on ESG matters.

Increased sustainability-based legislation and global industry adoption of strategies such as the **European Union Green Deal**, the **United Nations (UN) Principles of Responsible Investment** and the **UN Sustainable Development Goals** are powerful examples helping drive global adoption of ESG. Additionally, sustainability risk issues are increasingly being integrated into organizational risk frameworks such as **COSO's Enterprise Risk Management (ERM) framework**.

The reporting landscape with respect to ESG remains muddied by multiple international standard-setters that lack the "authority" of U.S. GAAP or IFRS standard-setting and provide varying means of reporting that can be broad, social-value driven methods within the GRI framework or more industry-centric and materiality driven metrics as within the SASB standards. A ray of hope lies in the September announcement by the five main organizations in this space – **GRI**, **SASB**, **IIRC**, **CDP** and **CDSB** – of a **shared vision** for collaborating to achieve a comprehensive reporting system. In November, the IIRC and SASB **announced** a merger to form "the Value Reporting Foundation" to provide a comprehensive corporate reporting framework focused on evidence-based, market-informed and transparent data to deliver long term value to shareholders while helping secure the future of people and our planet. They intend to work with international standards setters - including the IFRS Foundation, IOSCO, and EFRAG - toward global alignment.

The bad news is there is not a specific time frame or roadmap for how this might be achieved. Additionally, the IFRS Foundation had put forth a **Consultation Paper** seeking input into the need for a global set of internationally recognized sustainability reporting standards; whether the IFRS Foundation should play a role; and what the scope of that role could be (e.g., creating a Sustainability Standards Board to develop and maintain a global set of sustainability reporting standards initially focused on climate-related risks). Comments were due as of December 31, 2020.

In an effort to assist stakeholders supporting the sustainability movement, various ESG rating agencies (e.g., Sustainalytics, MSCI, ISS, etc.) have also arisen. However, these ratings are primarily based on retrospective reporting and vary significantly among raters. Inconsistent reporting methods—whether due to use of varying reporting frameworks, conflicting information from raters or simply just the non-uniform ways in which companies choose to share (or not share) information publicly— is heavily contributing to confusion in the market. There are also the considerations of cost associated with identifying, compiling and verifying requested data, creating the controls to ensure accurate reporting and potentially the need to obtain independent assurance on the integrity of reported information.

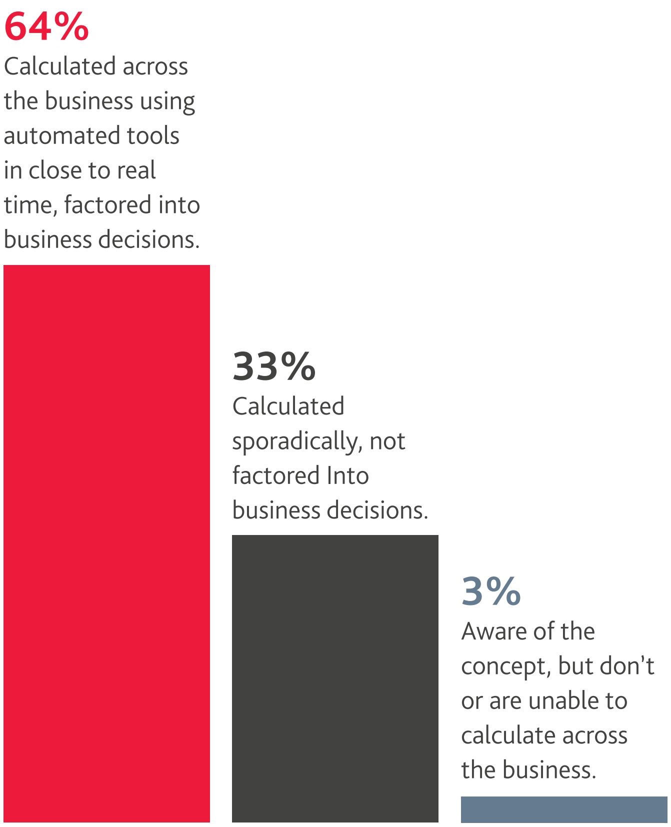
Mandated ESG reporting is currently not required in the U.S., although the SEC's recent **amendments to Regulation S-K** requiring human capital resource disclosures, including measures or objectives that management focuses on in managing the business (to the extent they are material to understanding of the business as a whole), could be interpreted as a step in that direction. In May, the SEC's **Investor Advisory Committee** recommended "the time has come for the SEC to address" incorporation of ESG disclosures into its integrated disclosure regime. With the incoming Biden Administration, who campaigned on a platform focused on climate change, we are anticipating renewed regulatory focus and potential rule-making attention in the coming months.

Finally, the audit committee will further need to understand the potential role of the external auditor in ESG reporting in attesting to certain ESG reporting metrics and analyses. The CAQ recently **shared** its views on the auditor's role when company-prepared ESG information is presented in reports that may or may not include the audited financial statements. In a **recent speech** by retiring PCAOB Board Member J. Robert Brown, he articulates his point of view on audit regulators placing priority on ESG.

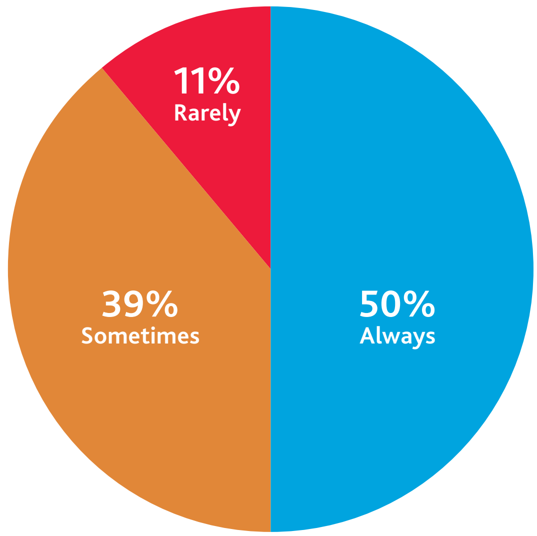
Total Tax Liability

The BDO 2020 Tax Outlook Survey revealed that only half of the tax professionals participating believe their board of directors have a high understanding of the company's total tax liability; and 45% have a moderate understanding. Directors often rely on tax leaders for insights and guidance on strategic planning and managing new developments, which includes frequent communication and collaboration. Boards are encouraged to receive frequent communication regarding total tax liability from their tax professionals including understanding how to consider tax impacts holistically across the business and assess their maturity in doing so and undertake transformation initiatives to better comprehend and ultimately optimize their total tax liability.

DESCRIBE YOUR TOTAL TAX LIABILITY MATURITY



HOW OFTEN DOES MANAGEMENT INCLUDE THE TAX DEPARTMENT IN PLANNING AND DECISION MAKING?



3 in 5
tax professionals say they are "very involved" in planning for an economic slowdown

Source: BDO 2020 Tax Outlook Survey

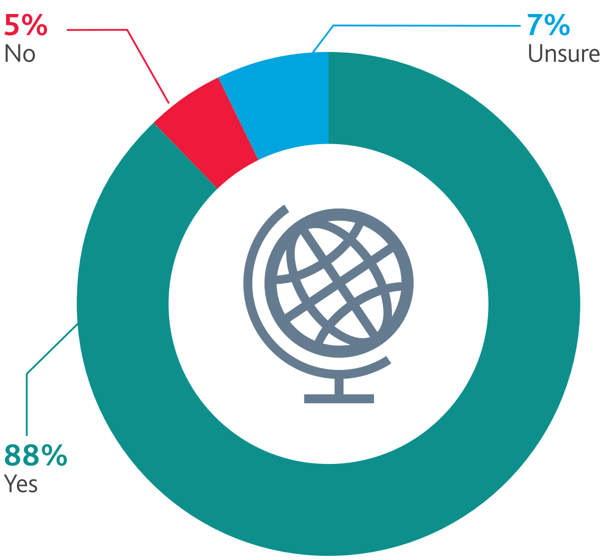
Tax complexity is accelerating at the international, federal, state and local levels driven by various risks including international trade tensions and tariffs, the growth of the digital economy, and the U.S. election results.

With the evolution of the digital economy, tax authorities around the world are scrambling to regulate a global economy no longer restricted by geographic borders.

#1 INTERNATIONAL TAX CONCERN:

Understanding the impact of the ongoing OECD work on digital taxation

DO YOU BELIEVE THERE SHOULD BE AN INTERNATIONAL FRAMEWORK FOR TAXING THE DIGITAL ECONOMY?



Source: BDO 2020 Tax Outlook Survey

Changes domestically are top of mind as the new administration takes office in January 2021. A third of directors responding to BDO's second Board Pulse Survey (to be released Winter 2021) indicated that anticipated U.S. tax changes are their organization's most significant concern in the post-2020 election period. In BDO's publication Year-End Tax Planning Under a Biden Presidency, it is stressed that despite all the uncertainty, significant tax law changes are probable and it is important for taxpayers to understand both current tax law and changes that may be on the horizon.

Tax Resources

- BDO Knows Tax Reform Resource Page, continually updated
- BDO COVID-19: Navigating the Pandemic Resource Page, continually updated
- Total-Tax Liability, continually updated
- BDO Income Tax Accounting Hot Topics: Year-end 2020, December 2020
- BDO Keys to Year-End Tax Savings for Businesses, December 2020
- BDO Year-End Tax Planning Under a Biden Presidency, November 2020
- BDO 600 – 2020 Study of CEO and CFO Compensation Practices, November 2020
- BDO 600 – 2020 Study of Board Compensation Practices, November 2020
- BDO 2020 Year-End Tax Planning for Individuals, October 2020
- BDO Year-End Tax Internal Controls – Virtual Close, September 2020
- BDO Tax Outlook Survey, February 2020

Adequacy of Insurance Coverage

One of the responsibilities that many audit committees assume is the review of adequacy of the Company's insurance coverage, including the Directors' and Officers' ("D&O") insurance coverage. Management should be conducting, on a recurring basis, an assessment of company insurance contracts that considers the perils covered, amounts of coverage and terms and limitations of the policies and identify any gaps that may need to be addressed. This includes consideration of the lifecycle phase of the company, plans for new/discontinuance of product and service offerings; expansion and M&A activity – domestic and international; emerging technology; employment practices as well as other specific risks, liabilities and exposures of the business operations – e.g., data privacy and cybersecurity. Audit committees need to be performing timely reviews of these coverage assessments and understand management's process and underlying assumptions used. Reviews incorporate applied business judgment based on a variety of factors that include current and potential risks as well as prior experience with claims and litigation. Note: COVID-19 may introduce new policy changes imposed by insurers and careful review of such changes in coverage is warranted.

D&O insurance protects the personal assets of corporate directors and officers, and their spouses, in the event they are personally sued by stakeholders. Directors and officers of public, private and nonprofit companies are often sued for a variety of reasons including[1]:

- Breach of fiduciary duty resulting in financial losses or bankruptcy
- Misrepresentation of company assets
- Misuse of company funds
- Fraud
- Failure to comply with workplace laws
- Theft of intellectual property and poaching of competitor's customers
- Lack of corporate governance

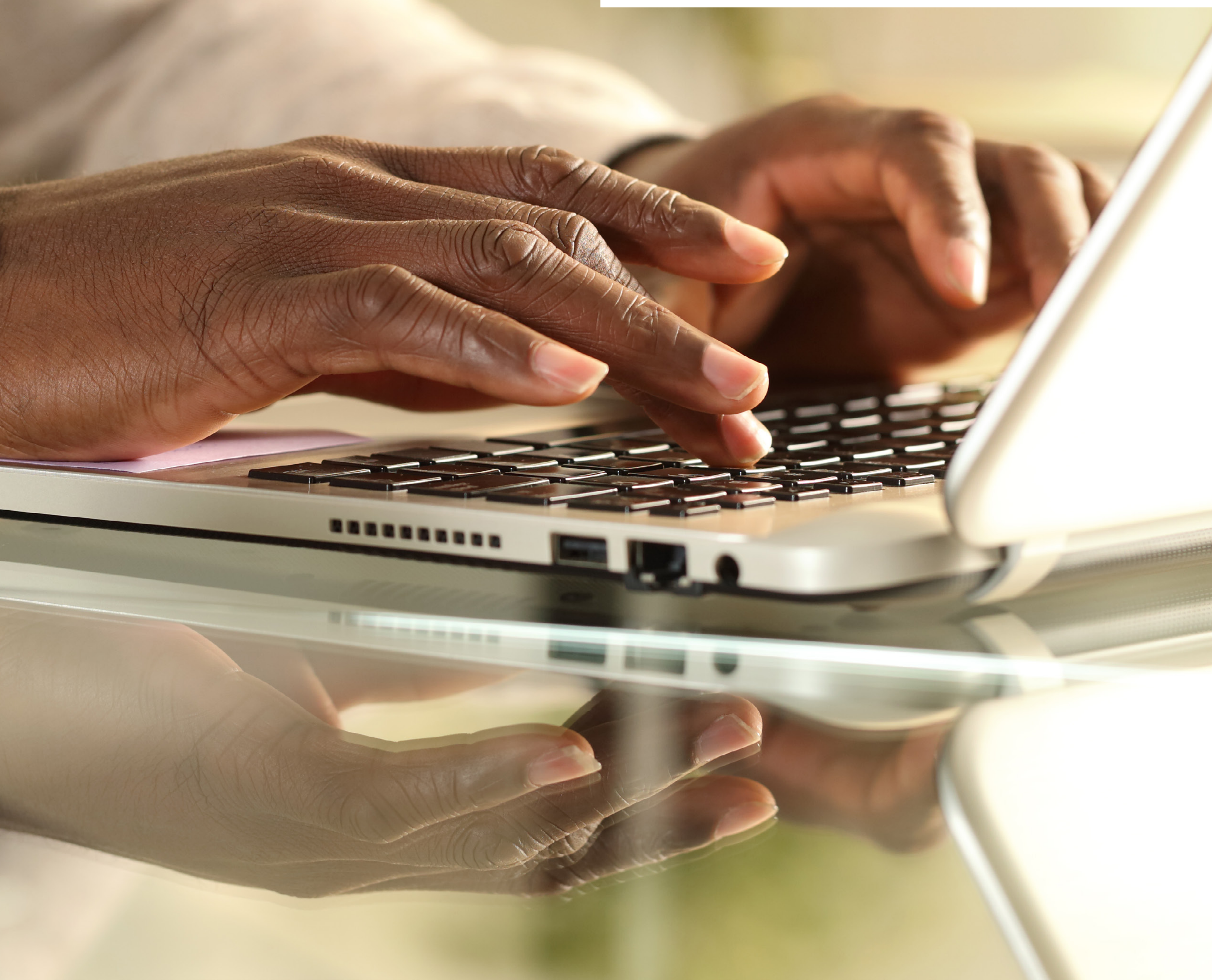
Note: Illegal acts or illegal profits are generally not covered under D&O insurance.

The NACD and Marsh have made available a **D&O insurance practice aid** for reference as you consider how your exposure may be evolving in the face of changing risks and how to respond to emerging issues.

1 Source: The Hartford – The Who, What & Why of Directors & Officers Insurance

Next Steps

These are just some of the many issues that audit committees are facing as they exercise their oversight responsibilities. We encourage audit committees to be thoughtful in their continued education and take advantage of the numerous opportunities available through **BDO's Center for Corporate Governance and Financial Reporting**. To begin receiving email notifications regarding BDO publications and event invitations (live and web-based), visit **www.bdo.com/member/registration** and create a user profile. Please reach out to your engagement teams with questions about content contained within this publication.



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