EY Center for Board Matters

What audit committees should prioritize in 2024

Building a better working world

Presented by the EY Audit Committee Forum

Audit committees must work with management to understand how economic uncertainty, geopolitical volatility and other matters will impact the business in 2024.

In brief

- Understanding the risks and opportunities around AI and other disruptive technologies will continue to be an area of focus for boards.
- Global tax changes could have profound implications for multinational entities and their global tax obligations in 2024.
- SEC rulemaking and other actions could meaningfully shift regulatory requirements in the months ahead.

With the changing risk landscape, the audit committee's role continues to grow more demanding and complex amid the uncertain and dynamic business environment. This report will assist audit committees to proactively address developments in risk management, financial reporting, tax and the regulatory landscape.

1. Risk management

Boards face sharper challenges in navigating a risk environment that has become more expansive, complex and interconnected. A recent EY Board Risk survey indicates an escalating level of concern among boards that a risk will severely impact their business. In an increasingly complex risk environment that is likely to both persist and evolve, boards need to support their organizations in anticipating and adapting to key and other emerging risks, rather than reacting to them. Leading boards are continuing to add value by supporting management in horizon scanning and scenario planning to identify and capitalize on changes in the business environment before they materialize into significant risks.

Top risks and expectations for 2024

The ongoing economic uncertainty, growing geopolitical turmoil, cybersecurity, artificial intelligence and other disruptive technologies, labor shortages, cost-of-living crisis and extreme weather events continue to be areas of focus for organizations. These risks are also challenging organizations' ability to navigate simultaneous or intersecting crises or the occurrence of multiple risk events. A recent EY survey[1] shows that organizations are closely monitoring continued high cost of capital while expecting higher growth in revenue and profitability in 2024 compared with 2023. While geopolitical uncertainty could dampen profit expectations, we're hearing that the top two barriers to maximizing revenue growth and profitability in 2024 are increasing investment costs and slowing economic growth in key markets.

We expect that companies will need to be able to understand how the dynamics for their business have evolved and to anticipate future shifts, including their competitive position within their target markets. Audit committees may want to consider whether finance teams have adeptly adjusted to this environment by integrating economic considerations, customer demand projections, and dynamic pricing strategies to alleviate these challenges. In a slower-growth environment with greater costs of doing business and a higher external cost of capital for investment, funding ongoing and future transformation will likely hinge on internal operational rationalization and cost takeout initiatives. Accordingly, we expect that this may be one area where leading organizations leverage artificial intelligence (AI) to make better use of their own data, supplemented with external sources, to have a clearer view of their addressable markets.

Internal audit areas of focus

To help internal auditors and their stakeholders, including audit committees, better understand the risk environment and prepare audit plans for the upcoming year, the Internal Audit Foundation recently issued its survey report *2024: Risk in Focus*. We've excerpted some notable highlights from this survey:

- The three areas of highest risk for organizations were cybersecurity, human capital and business continuity. For most regions, regulatory change also ranks as a top-five highest risk, with the exception of Africa and the Middle East, where financial liquidity is more of a concern.
- In terms of future risk, there is consensus worldwide that risk levels will rise in the next three years for digital disruption and climate change.
- Although risk levels may vary from region to region, the areas of highest effort for internal audit are generally similar. The top areas of audit effort, worldwide, were as follows: 1) cybersecurity, 2) governance/corporate reporting, 3) business continuity, 4) regulatory change, 5) financial liquidity, and 6) fraud.
- For North America, governance/corporate reporting is low risk for organizations but high effort for internal audit. Steep rises in audit efforts are expected to deal with digital disruption and climate change. These increases are expected to be offset by reductions for audit efforts relating to financial liquidity and governance/corporate reporting.
- As it relates to mitigating cybersecurity related risks, most North American chief audit executives (CAEs) noted efforts to strengthen training and awareness to combat continuous developments and social engineering hacks. Organizations are also expected to run through extensive hacking, defense and recovery scenarios to ensure the executive team and board are ready for strategic decision-making if a ransomware attack occurs. This is combined with the use of ethical hackers to test online and operational defense controls.
- As it relates to human capital, the report notes that few companies have fully redefined their work processes in the post-pandemic era. CAEs can help boards with awareness about differences in work practices across business units so that boards are more in tune with culture realities within the organization.
- Securing the right talent and skill sets for internal audit is a continuing challenge. Evolving technologies such as AI, the growing complexity of new and changing regulations and the dynamic nature of risks all require new skills and capabilities within internal audit. Increasing the use of guest auditors for specific assignments and boosting rotations from within the business are becoming a strategy that organizations are deploying to raise the bench strength and capabilities of the internal audit function.

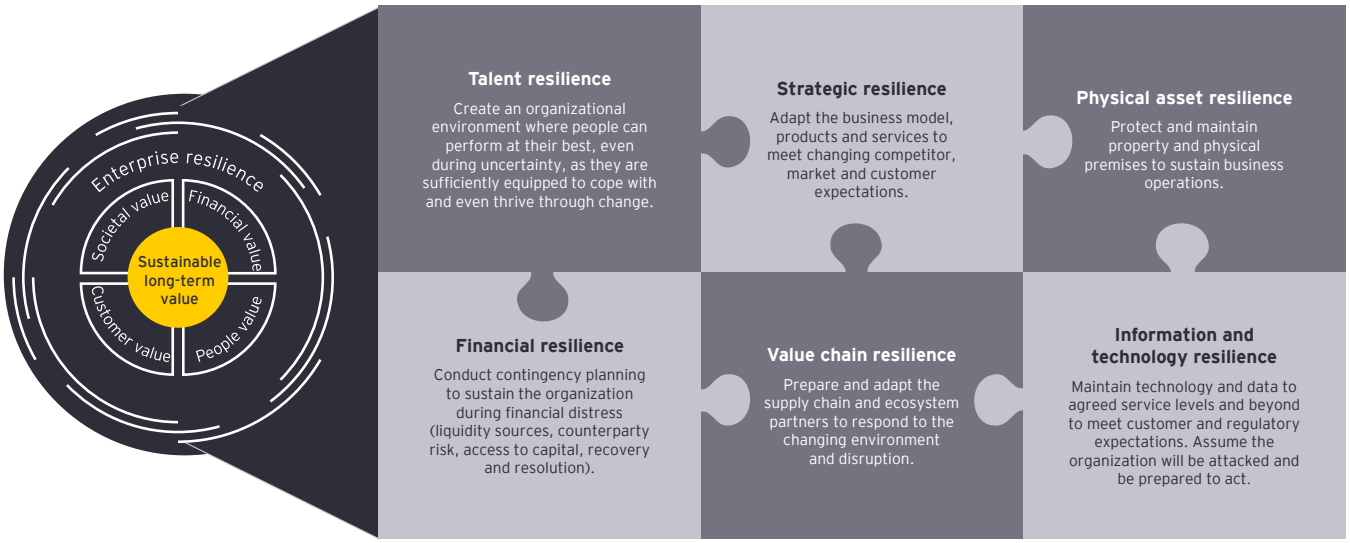
Internal audit functions and audit committees may want to review this report to benchmark their own internal audit risk areas and planned audit efforts.

[1] US execs focus on GenAI strategy to accelerate growth," EY CEO Outlook Survey, EY, October 2023, https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/ceo/ey-ceo-outlook-survey-us-edition-october-2023.pdf.

Ongoing focus on enterprise resiliency

Research shows that companies currently remain in the S&P 500 index for an average of just 18 years, down from 61 years in 1958. At the current churn rate, 75% of the S&P 500 today will have been replaced by 2027. Boards and audit committees are revisiting risk management practices to see that risks are managed effectively across the organization. They're also building more resiliency toward low-likelihood and high-impact risks, including the ability to rapidly restore business operations. Given the likely continued waves of disruption ahead, leading organizations are making investments to drive resiliency into their long-term strategies and operating models.

We're seeing leading organizations reassess their enterprise resiliency capabilities and seek ways to increase their maturity on this front. Critical components of enterprise resiliency that leading companies are focused on:



Below are key considerations to assess the company's resiliency capabilities across these key components:

Strategic resilience

- Does the organization deploy future-scenario planning to inform its long-term planning process to enable rapid adaptation during changing circumstances?
- How confident is the organization in its abilities to sense and respond to changing consumer trends?
- Does the organization have clarity on where its product and services portfolio sits on the S curve?
- How effective is the organization's capability to leverage consumer data, analytics and insights to inform product innovation and development?

Financial resilience:

- Is the organization equipped to sustain its financial stability and remain resilient against any financial threat or crisis?
- Does the organization perform stress tests to confirm that the financial reserves of the company can absorb distress in the economy?
- Does the organization have confidence in the financial strength of its counterparties?
- Are fraud control mechanisms strong enough to provide stakeholders a reasonable assurance against fraud scenarios?

Information and technology resilience:

- Is the organization able to protect its information (data)?
- Does the organization consistently monitor technological advances, adopting those that it thinks could be valuable for the business?
- Does the organization have a clearly defined policy and framework for data governance and protection, in line with regulations, including GDPR?

Value chain resilience:

- Has the organization deployed simulation and risk monitoring across the value chain to enable end-to-end visibility?
- Has the organization secured alternative sources of supply to ensure continuity during disruptions to the supply chain?
- How satisfied is the organization with its third-party risk management capabilities?

Talent resilience:

- Is the organization adequately prepared to remain resilient against any talent risk or crisis scenario?
- Has the organization established a program to develop key and emerging competencies among key employees?

Physical asset resilience:

- Has the organization identified its critical assets?
- Is there an appropriate level of robustness and redundancy provided for each to minimize service disruption?
- Does the organization understand the interdependence of the core assets of the other service providers?

Cybersecurity trends and related governance

The cybersecurity threat landscape continues to evolve — in addition to long-standing threats such as intellectual property (IP) theft and ransomware, new technologies (e.g., generative AI) are dramatically affecting the cybersecurity landscape. Meanwhile, more guidance on cyber oversight and disclosure is here with the SEC finalizing its cybersecurity rules earlier in 2023.

In our latest analyses of disclosures in the proxy statements and Form 10-K filings of Fortune 100 companies, we have seen steady and significant increases in the percentage of certain categories of cybersecurity risk and oversight disclosures. The SEC's rules on cybersecurity will have an impact on future disclosures — accordingly, audit committees should closely monitor this area and encourage management to proactively strengthen its disclosures.

Additionally, Ideagen Audit Analytics recently published its report *Trends in cybersecurity breach disclosures: a 12-year review*. Below are notable excerpts from that report:

- The number of cybersecurity breaches disclosed in 2022 decreased by 36%. The SEC's new reporting requirements around cybersecurity are expected to have an impact on the number of public company cybersecurity disclosures and alter disclosure trends in the years to come. Fewer than half of cybersecurity breaches were initially disclosed in an SEC filing.
- On average, companies took 96 days and 78.9 days in 2022 and 2021, respectively, to disclose a breach after it was discovered. This represents a longer disclosure window by 2.5 weeks in 2022 compared with the prior year.
- Since 2011, the most common cybersecurity attack methods were unauthorized access, malware and phishing.
- The top types of disclosed attacks in 2022 were as follows:

2022		
Type of attack	% of disclosed breaches	# of breaches
Unauthorized access	69%	77
Ransomware	17%	19
Phishing	9%	10
Misconfiguration	5%	6
Malware	3%	3

Given the dynamic cybersecurity landscape, audit committees should stay attuned to evolving oversight practices, disclosures, reporting structures and metrics and understand implications for how the company is staying in compliance with requirements.

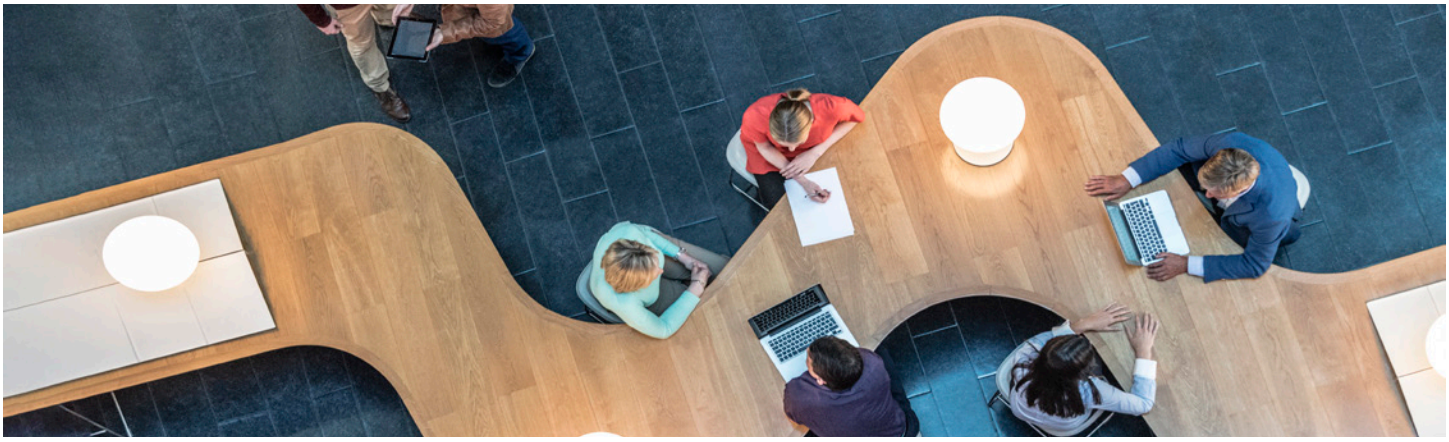
Artificial intelligence

Artificial intelligence and machine learning (AI/ML) have climbed to the top of the strategic agenda for many boards in recent times. The emergence of generative AI (GenAI) tools capable of producing rich prompt-based content and code has further fueled this focus.

Fraud detection, automating operational tasks, identifying possible cyber attacks, and regulatory compliance are some of the use cases that organizations are exploring to enhance their risk management and compliance-related efforts. However, AI/ML early adopters may face increased risks, such as lawsuits arising from the use of web-based copyrighted material in AI outputs, concerns about bias, lack of traceability due to the "black box" nature of AI applications, reliability of the output, and threats to data privacy and cybersecurity. As a result, many organizations are opting for a cautious approach to AI/ML.

Organizations are initially implementing applications in non-customer-facing processes or to aid customer-facing employees where the primary goals are improving operational efficiency and augmenting employee intelligence by offering insights, recommendations and decision-making support. In the future, we expect to see risk teams using AI to scan and review regulations and for process, risk and control diagnostics. Over time, AI-enabled scenario modeling is expected to be used for market simulation and portfolio optimization.

With AI usage increasingly democratized, robust and agile governance has become an urgent board priority. Audit committees should inquire with management and internal audit regarding risk assessments around AI and related AI governance, including how risks around the ethical use of AI, accuracy of outputs, plagiarism, copyright, trademark violations, and protections of company IP were considered. Additionally, audit committees should ask management whether and how AI is used within the financial reporting processes, including related internal control impacts.



AI-related US policy development for boards to consider

US policymakers, alongside C-suites and boards, are considering what AI could mean for capital markets, the economy and society. The Biden administration recently issued an executive order (EO) on AI with the goal of promoting the "safe, secure, and trustworthy development and use of artificial intelligence." This EO represents a significant development on the subject of accountability in how AI is developed and deployed across organizations.

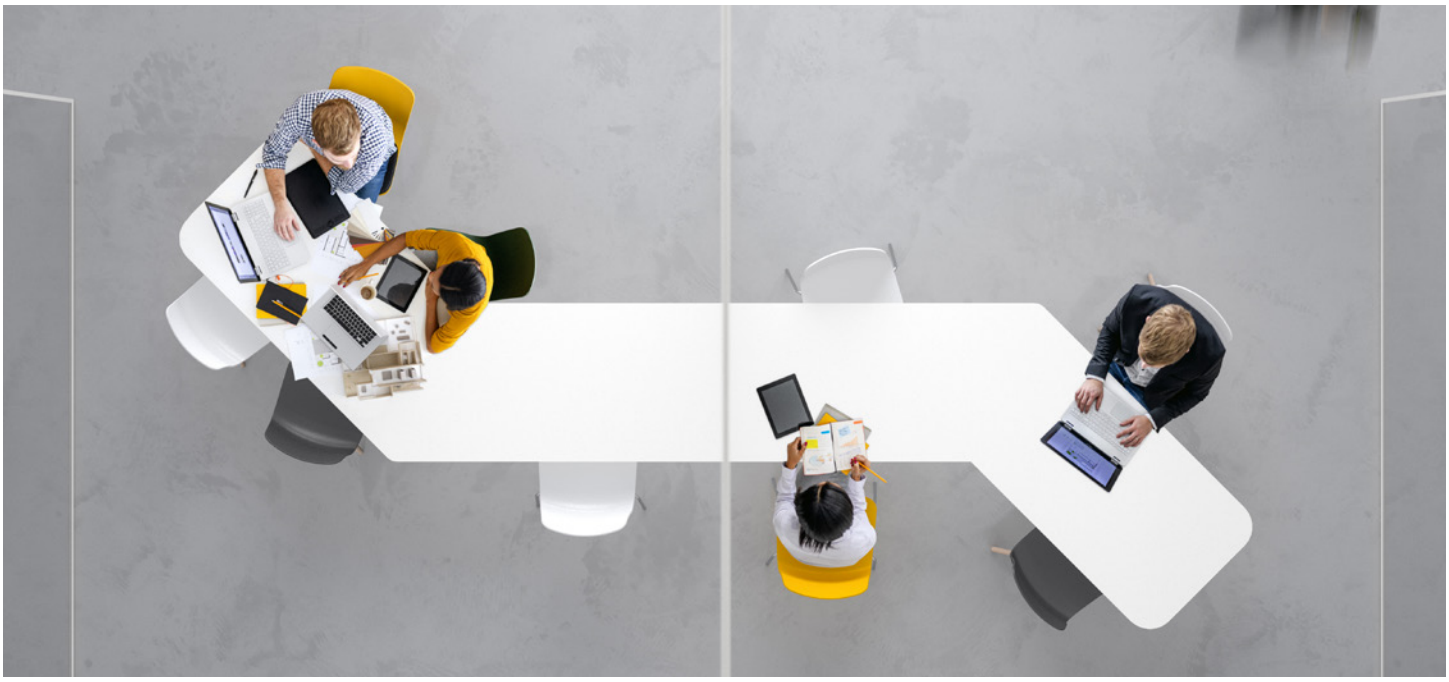
Given the breadth of recommendations and actions provided, it is likely to have an effect on organizations of varying stages and across all sectors of the economy, from the most mature AI implementers to first-time adopters. The EO's definition of AI systems is also broad; it is not limited to generative AI or systems leveraging neural networks but is inclusive of systems that have been built over the last several years.

Determining the extent to which the EO affects an organization will involve careful assessment of not only an entity's own use of AI, but also the extent to which its products and services incorporate or are reliant on third-party vendors' AI-enabled capabilities.

Some of the ways in which the EO may impact issuers include:

- The National Institute of Standards and Technology (NIST) is tasked with developing guidelines and best practices for "developing and deploying safe, secure and trustworthy AI systems," which companies may want to consider for internal use.
- Government agencies must develop guidelines, incorporating the existing NIST AI Risk Management Framework as appropriate, related to the deployment of AI systems in the critical infrastructure sector; agencies must also take steps to mandate the adoption of such guidelines. "Critical infrastructure" is broadly defined, including systems and assets that, if harmed, could have a "debilitating impact on security, national economic security, national public health and safety." Among others, it includes financial services and energy.
  - Companies may want to evaluate their existing AI risk management frameworks against the NIST AI Risk Management Framework to develop a baseline and prepare for additional guidance to be released from relevant agencies and regulatory bodies.
- Federal procurement policy relating to AI will be revised to address the "effective and appropriate use of AI, advance AI innovation and manage risks from AI." As the largest customer in the US economy, the federal government's purchasing requirements often become industry standard — making procurement policy a very strong tool for promoting policy goals.

A White House fact sheet on the order can be found here. Refer also to this EY Biden administration news alert along with this summary of key AI-related policy issues.



2. Financial reporting developments

Companies are continuing to re-evaluate their disclosures as stakeholders seek to understand the impact of various external developments on the business. This includes the continued global economic uncertainty; climate and other environmental, social and governance (ESG) factors; and evolving geopolitical developments. We've highlighted some key financial reporting developments and trends to assist audit committees in overseeing audit quality and encouraging an environment and a culture that support the integrity of the financial reporting process.

Accounting update

- **FASB expands income tax disclosure requirements**

  The Financial Accounting Standards Board (FASB) issued guidance requiring public business entities (PBEs) to disclose in their rate reconciliation table additional categories of information about federal, state and foreign income taxes and provide more details about the reconciling items in some categories if items meet a quantitative threshold.

  Entities that aren't PBEs have to provide qualitative disclosures about the new categories. The guidance requires all entities to disclose income taxes paid, net of refunds, disaggregated by federal (national), state and foreign taxes for annual periods, and to disaggregate the information by jurisdiction based on a quantitative threshold.

  All entities are required to apply the guidance prospectively, with the option to apply it retrospectively. The guidance is effective for PBEs for fiscal years beginning after 15 December 2024, and interim periods within fiscal years beginning after 15 December 2025. It is effective for other entities for fiscal years beginning after 15 December 2025, and interim periods within fiscal years beginning after 15 December 2026. Early adoption is permitted.

- **FASB requires disclosure of significant segment expenses and allows reporting on more than one segment measure of profitability**

  The FASB amended the guidance in Accounting Standards Codification (ASC) 280, Segment Reporting, to require a public entity to disclose significant segment expenses and other segment items on an annual and interim basis and to provide in interim periods all disclosures that are currently required annually about a reportable segment's profit or loss and assets. Public entities with a single reportable segment are required to provide the new disclosures and all the disclosures required under ASC 280, including the significant segment expense disclosures.

  Entities are also permitted to disclose more than one measure of a segment's profit or loss, as long as at least one of those measures is determined in the way that is most consistent with the measurement principles used to measure the corresponding amounts in the consolidated financial statements. Entities will also have to consider the SEC rules around non-GAAP before presenting another measure of a segment's profit or loss.

  The US GAAP guidance applies to all public entities and is effective for fiscal years beginning after 15 December 2023 and for interim periods beginning after 15 December 2024. The guidance is applied retrospectively to all periods presented in financial statements unless it is impracticable. Early adoption is permitted.

What we're seeing in SEC comment letter trends

In our review of SEC staff comment letters on periodic reports, we found that the SEC staff issued nearly 60% more comment letters on periodic reports in the year ended 30 June 2023 than in the previous year, continuing the upward trend that began in 2022. This reverses multiple years of decline in the number of letters issued by the staff, with the volume of comment letters exceeding that of each of the past four years. With the SEC staff now issuing significantly more comment letters to many more registrants, it is important that audit committees and management understand the process and ways to effectively respond to the staff's comments.

The following chart summarizes the most frequent comment areas in periodic SEC filings in the year ended 30 June 2023:

Comment area	Ranking 12 months ended June 30*	Comment area received as a percentage of registrants receiving comment letters	Average letters per registrant***
	2023	2023	2023
Management's discussion and analysis (MD&A)**	1	39%	1.2
Non-GAAP financial measures	2	39%	1.3
Segment reporting	3	14%	1.2
Revenue recognition	4	10%	1.2
Climate-related disclosures	5	6%	1.9

*These rankings are based on topics assigned by research firm Audit Analytics for SEC comment letters issued to registrants with a market capitalization of $75 million or more on Forms 10-K and 10-Q from 1 July 2022 through 30 June 2023, excluding comment letters issued to special purpose acquisition companies (SPACs) and other blank check entities. In some cases, individual SEC staff comments are assigned to multiple topics.
**For the year ended 30 June 2023, this category includes comments on MD&A topics, excluding climate-related disclosure matters, in order of frequency: (1) results of operations (58%), (2) liquidity matters (23%), and (3) various other matters, including key performance indicators and critical accounting estimates (19%). Many registrants received MD&A comments on more than one MD&A topic.
***This represents the average number of comment letters (or rounds of comments) the SEC staff issued for each topic to resolve its concerns.

MD&A and non-GAAP financial measures again took the top two spots on our list of topics the SEC staff addressed most frequently in comment letters in the year ended 30 June 2023. The SEC staff's increased focus on MD&A and non-GAAP measures was a key reason for the overall increase in comment letters. For the second year in a row, comments on climate-related disclosures made our list of frequent topics addressed by the SEC staff, and we expect the SEC staff to continue to scrutinize these disclosures, even as the SEC is expected to finalize a new rule to require more extensive disclosures. On average, the comments on climate-related disclosures also continued to require more rounds of comments to resolve than comments on other topics on our list.

The SEC staff has also been asking registrants about the effects of macroeconomic factors such as inflation, rising interest rates and supply chain issues on their results of operations. Given the persistence of inflation, the expectation that interest rates may remain elevated, and uncertainly in the geopolitical environment, registrants should carefully evaluate how such conditions may affect their business and provide disclosures related to these matters in sufficient detail.

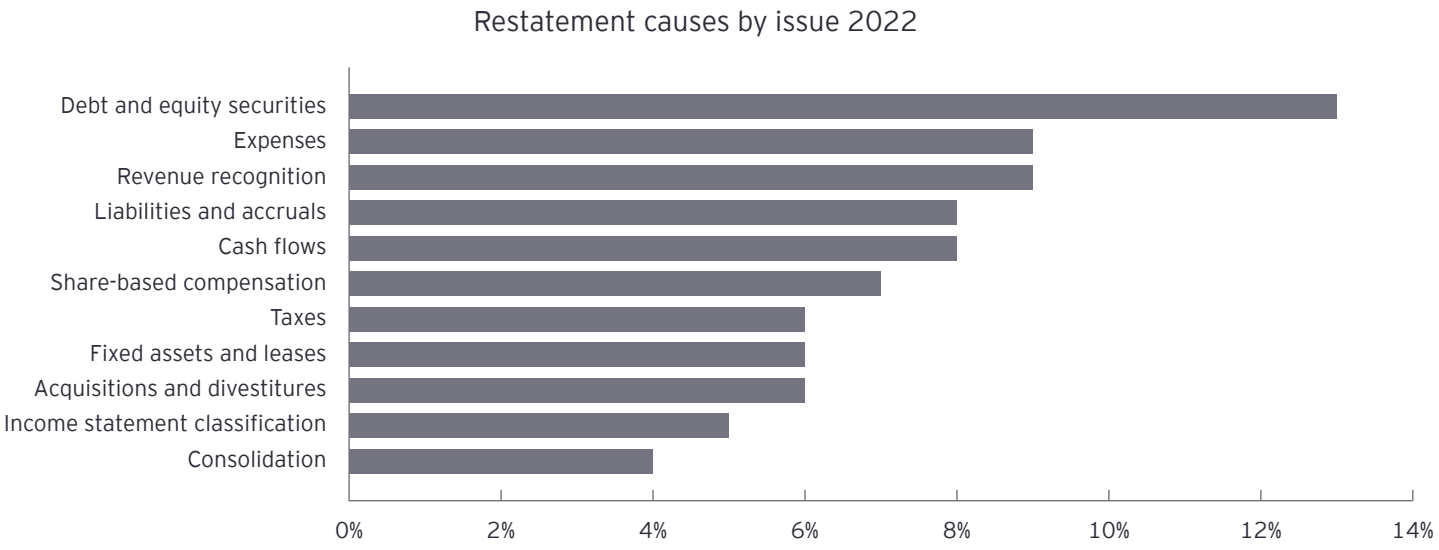
Looking ahead, we expect the SEC staff to continue to focus on the topics discussed above in the upcoming year. The SEC staff may also expand its comments related to pay-vs.-performance disclosures, cybersecurity-related disclosures and other disclosures made in response to recently issued or amended SEC rules.

Audit committees should continue to understand SEC comment letter trends to be better informed and identify disclosure improvements for the management team to consider.

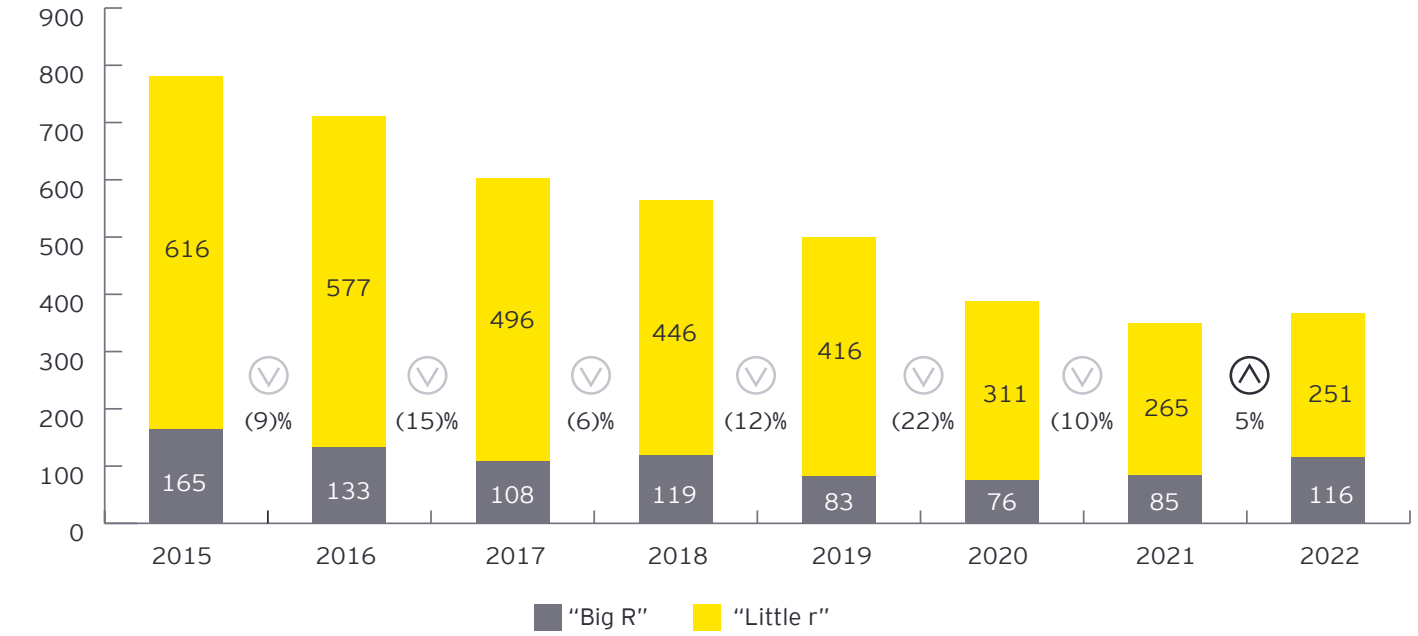
Restatement trends

Audit Analytics (AA) monitors specialized accounting and reporting data, including restatements. Leveraging that data, we've highlighted and extracted some of the notable trends and issues around financial restatements:

- We continue to see consistency in the categories causing restatements among recent years. For most companies, debt/equity accounting, expenses and revenue recognition continue to be top restatement issues. Historically, restatements involving revenue are more likely to lead to SEC investigations and shareholder litigation.
- While misapplication of accounting rules continues to be the main cause of restatements, fraud has led to more restatements since the pandemic. Our analysis found that fraud has historically caused larger and longer restatement periods, including triple the average restated value and 2 to 3 times longer restatement periods.



- Ignoring the surge of SPAC-related restatements in 2021, the aggregate number of restatements and revisions showed a 5% increase in restatement volume in 2022. This is the first annual increase in total restatements filed in recent years.



SOX 404 trends

AA released its annual report on Sarbanes-Oxley Act (SOX) Section 404 reporting, *SOX 404 Disclosures: A 19-year review*, which summarizes the trends in SOX 404 disclosures. Per the report, there was an increase in adverse internal control over financial reporting (ICFR) reports in 2022 — adverse auditor assessments of ICFR increased by 21%, while adverse management reports increased by 4% compared with 2021. We've highlighted some of the notable trends and issues included in the report below:

Top 5 internal control issues in adverse ICFR auditor assessments
(Rank based on percentage of total adverse disclosures referencing issues)

Rank	Issue	2022
1	Information technology	54.5%
2	Accounting personnel resources	53.7%
3	Inadequate disclosure controls	39.7%
4	Segregation of duties	39.3 %
5	Non-routine transactions	14.4%

Top 5 internal control issues in adverse ICFR management-only reports
(Rank based on percentage of total adverse disclosures referencing issues)

Rank	Issue	2022
1	Accounting personnel resources	70%
2	Segregation of duties	61.1%
3	Inadequate disclosure controls	35%
4	Insufficient audit committee	17.1%
5	Non-routine transactions	17.1%

Top 5 accounting issues in adverse ICFR auditor assessments
(Rank based on percentage of total adverse disclosures referencing issues)

Rank	Issue	2022
1	Revenue recognition	9%
2	Debt and equity	8.3%
3	Accounts receivable, investments and cash	6.8%
4	Subisidary/affiliate issues	5.5%
5	Liabilities	5.4%

Top 5 accounting issues in adverse ICFR management-only reports
(Rank based on percentage of total adverse disclosures referencing issues)

Rank	Issue	2022
1	Debt and equity	9%
2	Revenue recognition	6.6%
3	Accounts receivable, investments and cash	5.9%
4	Subidiary/affiliate issues	5.3%
5	Liabilities	4.7%

The overall uptick in the number of adverse management and auditor ICFR reports appears to be driven by two main causes: the difficulties associated with hiring and retaining qualified accounting personnel, coupled with the related challenge of maintaining adequate segregation of duties resulting from staffing shortages. Audit committees should query whether any of the above frequently cited control weaknesses described in the AA report could be present in the company's control environment.

Monitoring these and other financial reporting-related trends may assist audit committees in focusing on the top accounting issues and maintaining high-quality financial reporting.

3. Tax and other policy-related developments

In today's volatile environment, companies will need to carefully monitor geopolitical, macroeconomic and global tax developments to make sound tax decisions for 2024 and beyond.

US tax policy outlook

The political dynamics and unpredictability of the current Congress have so far yielded little in terms of tax legislation, but it is still possible that a tax bill could advance in late 2023 if a must-pass legislative vehicle, such as Federal Aviation Administration authorization or the fiscal 2024 National Defense Authorization Act, emerges. Among the items that might be included are modifications of some expired provisions from the Tax Cuts and Jobs Act (TCJA). These include addressing a change to Section 174 that requires five-year or 15-year research and development (R&D) amortization, depending on the location of the activity, rather than expensing; changes to the interest deduction limitation calculations under Section 163(j); and 100% expensing.

So far, however, these priorities have remained mired in a partisan standoff, which makes the path forward unclear. Congressional Democrats wish to expand the Child Tax Credit, while Republicans would aim to partially offset a tax package's revenue losses by rolling back clean energy tax provisions from last year's Inflation Reduction Act (IRA). Some members of both political parties in high-tax states would also like to enact some form of relief from the TCJA's $10,000 cap on deductions for state and local taxes (SALT).

Filling in the blanks — insights from administrative guidance

While tax legislation has been slow to move, the Treasury Department and IRS continue to issue administrative guidance on a range of issues that may affect companies' tax positions.

Topics of recent guidance have included the IRA's corporate alternative minimum tax (CAMT), the 1% excise tax on certain corporate stock repurchases, and different aspects of clean energy incentives included in the IRA legislation.

Additionally, in a July 2023 notice (Notice 2023-55), the U.S. Treasury Department announced temporary relief for taxpayers seeking foreign tax credits (FTCs). For tax years ending on or before 31 December 2023, the notice generally allows taxpayers to claim certain FTCs that otherwise may not have been available. Further relief, and additional changes to the FTC regulations, might be considered in the future. Companies should evaluate the notice's impact on their tax returns, financial statements and FTC profile.

The IRS also issued highly anticipated proposed digital asset rules (REG-1122793-19) that would define key terms and introduce new standards that would apply uniquely to digital assets. The package adopts many of the long-standing concepts and terms that apply to sales of securities, including the reporting of a customer's tax basis and gross proceeds from a sale.

More regulatory guidance on a variety of topics is expected from Treasury and the IRS before year-end. Audit committees should ask how management is tracking relevant tax guidance and determining the potential impact on their organization's reporting and compliance obligations, supply chains and effective tax rate (ETR). Depending on the topic, such guidance can affect future decisions and provide opportunities for engagement with tax policymakers.

State outlook

State tax policy often flows from federal tax policy changes and their impact on state fiscal conditions. Having reported record revenues over the last few years, many states experienced a decline in tax revenue collections this year.

Current revenue declines — in combination with inflation, the ending of pandemic-related federal aid, and migration of businesses and individuals — could lead to future business tax increases in some states. Businesses in states with stronger fiscal conditions may consider tax rate reductions and other business tax relief in the coming year.

2024 elections will also influence state tax policy decisions; lawmakers up for re-election are typically not keen on enacting tax increases or major tax reform. Among state tax trends to monitor in the upcoming year are:

- Reforms modifying the sources and mix of state tax revenues
- Taxing and regulating the digital economy
- Shifting from graduated to flat income tax rates
- Changing the taxation of foreign-source income, especially global intangible low-taxed income, and worldwide taxation
- Decoupling from TCJA-related provisions, including IRC Sections 163(j) and 174
- State credits and incentives focused on sustainability, climate change, semiconductors and job creation — including the onshoring of manufacturing, production and R&D — especially in response to the IRA and Infrastructure Investment and Jobs Act

Global tax — unprecedented cross-border cooperation

Globally, it is a time of fundamental tax change and cross-border coordination that may have profound implications for multinational entities (MNEs) and their global tax obligations. In October 2021, agreement was reached on new global minimum tax rules that establish a minimum tax rate of 15% and give priority of rights to impose a "top-up tax" to the local country, the headquarters country or other countries where an MNE group has taxable presence. Known as Pillar 2 of the OECD/G20 project on addressing the tax challenges arising from the digitalization of the economy (commonly referred to as the BEPS 2.0 project), it applies to companies with global revenue of at least €750m (roughly $825m) and is being implemented through changes to country tax laws.

[2] "The Fiscal Survey of States," National Association of State Budget Officers, spring 2023; "Monthly State Revenue Highlights," Urban Institute & Brookings Institution Tax Policy Center, July 2023; "Fiscal 50: State Trends and Analysis," The Pew Charitable Trusts, September 27, 2023.

Among the potential implications of Pillar 2 for MNEs:

- Increases in cash taxes and ETR
- Substantive changes to tax provision and compliance processes, controls, systems and governance
- Re-evaluation of legal structures
- Increased costs for mergers and acquisitions

The EU adopted a Pillar 2 directive at the end of 2022 requiring most Member States to implement the global minimum tax rules by the end of 2023. Many countries in Europe and Asia are already beginning to implement Pillar 2, and global minimum tax rules will begin to take effect in countries in 2024. Given the variations in implementation within different countries, careful consideration and monitoring of country legislative activity will be important.

The United States, meanwhile, currently has no pending legislation on Pillar 2 implementation. In fact, legislation has been proposed in the House of Representatives to counter the implementation of the undertaxed profits rules (UTPRs) that are part of Pillar 2. As discussed in a recent EY Quantitative Economics and Statistics Practice report, however, even if the United States does not adopt the Pillar 2 rules, widespread adoption by other jurisdictions could significantly increase the corporate income tax liability of in-scope US MNEs, so companies that may be impacted must still plan for these changes.

To prepare for Pillar 2, potentially affected companies will want to make sure they have the appropriate processes and controls in place, and audit committees should review management's plans as soon as possible. There will be substantial new data requirements and a need for complex calculations. Companies may also need to consider disclosures if Pillar 2 is expected to materially impact their tax exposures.

The other part of the OECD/G20 BEPS 2.0 project, Pillar 1 on new rules for allocating taxing rights to global business profits among countries, is moving forward more slowly. Significant new documents on Pillar 1 were released on 11 October 2023, and global negotiations are expected to continue into 2024.

Trade

Ongoing geopolitical challenges, a focus on supply chain resiliency and outgrowths from the IRA's green energy incentives are among the forces driving US trade policy this year. Both the executive and the legislative branch have expressed an interest in limiting outbound technology investments to China, and the Biden administration has been working to put together limited trade deals focused on critical minerals as a follow-up to the IRA's electric vehicle (EV) tax credits.

But forward momentum on trade agreements has been hampered somewhat by growing congressional dissatisfaction with the administration's pursuit of limited trade deals negotiated without congressional involvement. While the executive branch does not have the authority to unilaterally enter into free trade agreements, the administration has taken the position that it can negotiate more limited trade agreements, including one it reached with Japan in March focusing on critical minerals.

Tax compliance and controversy — driven by data

The evolving and globally connected tax landscape is also prompting a re-examination of companies' tax governance and data needs, and the focus on tax controversy is growing. Greater transparency and cross-border cooperation, coupled with expanded access to technology, have increased tax authorities' expectations for access to company data.

In response, companies need to find ways to make sure their data is "audit-ready." They should be thinking about how they can transform their approach to tax and financial data management to facilitate accurate and timely responses to new reporting obligations that may arise from BEPS 2.0, emerging ESG concerns and country-by-country reporting requirements.

Boards and audit committees also need to be mindful of shifts in tax controversy areas of focus. The IRS has indicated that it intends to use funding received under the IRA to improve its technology and use of AI to identify compliance risks, with a particular focus on high-income earners, large partnerships and large corporations.

4. Regulatory developments

Market participants should continue to expect regulatory changes in 2024 as the SEC works through its rulemaking agenda. As has been widely observed, the SEC under Chair Gary Gensler has issued more rule proposals at this stage of his tenure than it had under most other recent SEC chairs at the same point in their tenure. The SEC is now in the process of finalizing some rules as well as planning new proposals. Chair Gensler also remains focused on a vigorous enforcement program. The Public Company Accounting Oversight Board (PCAOB) also has a number of standard setting initiatives planned for 2024. Outside the U.S., regulators are likely to continue to be similarly active, as, for that matter, are certain state authorities. Audit committees and SEC registrants and other companies should keep abreast of these areas to be able to meet regulatory expectations.

SEC's regulatory agenda

In 2023, the SEC issued a number of final rules that impact public companies. These include final rules on cybersecurity risk management, strategy, governance and incident governance; share repurchase disclosure modernization; and recovery of erroneously awarded compensation (clawbacks). Still pending is action on climate-related and several other ESG disclosure matters (e.g., board diversity, human capital) as reflected on the SEC's rulemaking agenda, which is updated semiannually.

Climate-related disclosures: One of the major areas of expected activity in 2024 relates to climate-related disclosures. The SEC continues to consider the public's feedback on its proposal to enhance and standardize disclosures that public companies make about climate-related risks, their climate-related targets and goals, their greenhouse gas (GHG) emissions, and how the board of directors and management oversee climate-related risks. The proposal would also require registrants to quantify the effects of certain climate-related events and transition activities in their audited financial statements. There is no clear indication of when a final rule may be issued, although Chair Gensler has indicated that it remains high on the SEC's agenda.

In the meantime, US companies should also consider whether they will fall within the scope of climate disclosure requirements that have been finalized by California and the European Union (EU) and that will begin to take effect in the next several years. The EU Corporate Sustainability Reporting Directive (CSRD) includes a mandate to disclose sustainability information that applies to a wide range of entities operating in the EU, including subsidiaries of non-EU entities and non-EU subsidiaries of EU holding companies. Refer to the EY Technical Line for additional information on the CSRD.

California enacted the Climate Corporate Data Accountability Act and the "Greenhouse gases: climate-related financial risk" law that will require public and private entities doing business in the state that exceed certain revenue thresholds to disclose greenhouse gas emissions, information recommended by the Task Force on Climate-related Financial Disclosures and measures adopted to reduce and adapt to identified climate-related risks. Refer to the EY Technical Line for additional information on the California climate-related reporting developments.

Newly adopted SEC rules taking effect in the next 12 months:

- **Cybersecurity disclosure rule:** The SEC issued final rules requiring registrants to disclose information about material cybersecurity incidents on Form 8-K within four business days of determining that an incident is material, with a delay only when the U.S. attorney general concludes that disclosure would pose a substantial risk to national security or public safety. The rules also require disclosures about cybersecurity risk management, strategy and governance in annual reports (e.g., Form 10-K, Form 20-F). The rules apply to nearly all registrants that are required to file periodic reports with the SEC, including smaller reporting companies (SRCs) and foreign private issuers (FPIs), except for Canadian FPIs under the multijurisdictional disclosure system. All issuers other than SRCs must begin to report cybersecurity incidents as of 18 December 2023 and provide the other information in 2023 annual reports. Refer to the EY To the Point and Technical Line for additional information.
- **"Clawback" listing standards:** The SEC approved listing standards for the New York Stock Exchange (NYSE) and Nasdaq that require listed companies to recover or "claw back" incentive-based compensation erroneously received by current and former executive officers in the event of a required accounting restatement. The standards became effective as of 2 October 2023, and registrants listed on those exchanges were required to have adopted compliant clawback policies by 1 December 2023. The NYSE and Nasdaq were required to establish these listing standards under the SEC's clawback rules adopted in October 2022. Refer to the EY To the Point for further information.

SEC enforcement and auditor independence

The SEC Division of Enforcement also continues to be active. SEC Chair Gensler has discussed five themes that capture his priorities for the enforcement program, including holding individuals and entities accountable for securities law violations as well as prioritizing high-impact cases. This approach has meant that the SEC regularly imposes high fines and mandates corrective actions via its enforcement actions. Gensler also has focused on accountability for gatekeepers, including lawyers, auditors, underwriters and others, on whom he says trust in the markets depends. Division of Enforcement Director Gurbir Grewal also has highlighted the SEC's expectations for compliance personnel, including that they will create a culture of proactive compliance.

Audit committees should consider how their companies are preparing for regulatory changes that could impact reporting requirements, disclosures, and policies and procedures.

Key actions for the audit committee may include:

- Evaluate the implications arising from SEC rulemaking related to cybersecurity risk and whether the company has adequate disclosure controls and procedures.
- Evaluate the potential impact of the SEC's proposed rule on climate-related disclosures, as well as whether the company falls under the scope of the EU CSRD and the California climate bills. This includes whether the company has adequate disclosure controls and procedures over the company's existing climate-related disclosures (including any potential need for third-party assurance).
- Continue to monitor how the company is addressing existing requirements for disclosures about human capital resources as well as how those disclosures may evolve. Additionally, inquire as to ways management can enhance data and information-gathering practices to further enhance the overall quality of these disclosures.

Role of the audit committee in overseeing audits

Both the SEC and the PCAOB have highlighted the important role of the audit committee in overseeing the audit and financial reporting. SEC Chief Accountant Paul Munter has urged audit committees to have an investor-focused mindset and to remind auditors to do the same. The PCAOB conducts ongoing outreach to audit committees and provides various resources to assist in their auditor oversight. These include a publication highlighting questions that audit committees may want to ask their auditors, including about potential risks due to the economic environment that could impact financial reporting and the audit.

Transparency and audit quality also are ongoing themes in PCAOB communications with audit committees. Earlier this year, the PCAOB widely publicized worsening trends in findings from its inspections of audit firms and encouraged audit committees to ask related questions to help hold auditors accountable for the quality of their work.

PCAOB standard setting

The PCAOB significantly expanded its standard setting agenda in 2023 and is expected to continue advancing on it through 2024. The PCAOB currently plans to propose or finalize 10 standards and rules in 2024. Audit committees, external auditors and SEC registrants should keep abreast of related developments and the impact they can have on the execution of audits and overall audit quality.

Planned standard setting for 2024 includes:

- Finalizing a new quality control standard
  - If adopted, the proposal would replace the current quality control (QC) standards in their entirety and provide a framework for a firm's QC system based on proactive identification and management of risks to quality as well as ongoing monitoring and remediation of any deficiencies.
- Finalizing a new standard on noncompliance with laws and regulations (NOCLAR)
  - If adopted, the proposal would expand auditor requirements to identify, evaluate and communicate possible or actual noncompliance with laws and regulations. In issuing it, the PCAOB stated that the proposal would facilitate auditors' finding instances of noncompliance earlier, which would help protect investors. Many commenters on the proposal, including business groups and issuers, have raised concerns about the expanded scope and cost of the audit that would result from the proposal.
- Proposing a new standard on firm and engagement performance metrics
  - The PCAOB plans to propose a standard to enhance information provided to investors, audit committees and other stakeholders at both the firm and engagement level.

Questions for audit committees to consider:

Risk management:

- How strong are the organization's capabilities to be highly informed about the internal and external environment, and risks, events and opportunities that may influence or compromise enterprise resilience?
- How effective is the board's oversight of emerging risks and other evolving external risks such as geopolitical developments, uncertain economic conditions and climate risk? Does it have the information, expertise and professional skepticism it needs to challenge management in these areas?
- Has the board participated with management in one of its cyber breach simulations in the last year? How rigorous was the testing?
- How does management stay informed about regulatory and legislative developments related to AI, machine learning, data privacy and emerging technologies in relevant jurisdictions? How is it monitoring whether the company is staying in compliance and assessing potential impacts to strategy?
- Do the organization and the board have a complete inventory/database of AI applications, models, deployments, embedded capabilities, use cases, etc., within the organization to better understand the associated risks and related impacts?

- How is the company assessing and mitigating the risks of generative AI? Is it using an external framework such as the NIST AI Risk Management Framework? How does management establish that these applications are performing as intended to mitigate ethical and compliance risks?
- How is the company using generative AI to challenge the existing business model and key strategic assumptions?

Financial reporting:

- Has management considered which financial reporting items and disclosures may pose heightened restatement risk, such as through the company's regular risk assessment activities?
- Is management confident in the effectiveness of its whistle-blowing process and that known or suspected issues in financial reporting would be appropriately reported and addressed? How does management evaluate the effectiveness of its whistle-blowing process?

Tax and other policy-related developments:

- Has there been an assessment of whether the organization might be in scope of Pillar 2, and if so, have constituent entities been identified in countries that have enacted, or will enact, the Pillar 2 rules by year-end? Is there a plan in place for determining what may be owed under the new rules in relevant countries?
- Has the organization begun making the necessary changes to its data and systems that will be needed to do the Pillar 2 computations required to establish its estimated annual effective tax rate for its fiscal year ending in 2024 and its other provision, compliance and reporting obligations?
- What resources and processes are in place for monitoring federal and state legislative and regulatory developments, and does the audit committee have a line of sight into these activities?
- Is management prepared to address any potential financial or reputational risks that may accompany expanded reporting requirements and calls for greater transparency?
- Has the organization adopted, or does it plan to adopt, dedicated technology in response to new and evolving data and reporting requirements and to help assess tax risks and manage tax controls?

Regulatory developments

- What process does the committee have in place for assessing the impact of regulatory updates and is the committee sufficiently engaged in dialogue providing views and input as needed on the related impacts?
- Does the company have sufficient controls and procedures over nonfinancial data? Is internal audit providing any type of audit coverage on ESG-related data or is the company obtaining any external assurance?
- If ESG-related matters are being discussed in more than one place (e.g., SEC filings, earnings releases, analyst communications, annual report and shareholder letter, sustainability report), is there consistency in the disclosures? Has the company evaluated controls related to such disclosures?
- How is the organization proactively assessing opportunities to enhance stakeholder communications, including corporate reporting, to address changes in operations and strategies as well as changing stakeholder expectations?
- In light of the changing environment, what additional voluntary proxy disclosures might be useful to shareholders related to the audit committee's time spent on certain activities, such as data privacy, business continuity, corporate culture and financial statement reporting developments?

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