



Board of Trustees

Audit Committee Meeting

May 18, 2021

Table of Contents

1. Agenda
2. Approval of Minutes Memo
 - a. September 2, 2020
3. Presentation: FY21 Audit Plan and Strategy
4. Financial Report
5. Audit Committee Self-Assessment
6. Memo: KPMG On the Audit Committee Agenda

Audit Committee Meeting**May 18, 2021****2:30 - 4:30 p.m.****Michael J. Burns Building -- David Rose Board Room (3rd Floor)
801 W 10th St. Juneau, AK 99801****Webinar Access (click link to join webinar)***Join via WebEx and enjoy the ability to listen on your computer and follow presentations:*<https://apfc.webex.com/apfc/onstage/g.php?MTID=e2fbe8fc91a7d685dc3449e4cc8a1394b>*Password: audit***Teleconference Option***If you are unable to join in-person or via webinar, please contact us at
(907) 796-1500 to receive a teleconference number***AGENDA****Tuesday, May 18, 2021**

- 2:30 p.m. CALL TO ORDER
- ROLL CALL (Action)
- APPROVAL OF AGENDA (Action)
- APPROVAL OF MINUTES (Action)
- Audit Committee Meeting – September 02, 2020
- SCHEDULED APPEARANCES AND PUBLIC PARTICIPATION
- 2:35 p.m. FY 21 KPMG AUDIT PREVIEW AND RISK ASSESSMENT REVIEW (Information)
 Mike Hayhurst, Engagement Partner, KPMG
 Melissa Beedle, Engagement Manager, KPMG
- 3:00 p.m. FY21 YEAR-TO-DATE FINANCIAL STATEMENT REVIEW (Information)
 Valerie Mertz, Chief Financial Officer
 Jacki Mallinger, Portfolio Accountant II
- 3:30 p.m. AUDIT COMMITTEE SELF-ASSESSMENT (Information)
 Corri Feige, Committee Chair
 Valerie Mertz, Chief Financial Officer
- OTHER MATTERS / FUTURE AGENDA ITEMS
- 3:45 p.m. ADJOURNMENT

NOTE: TIMES MAY VARY AND THE CHAIR MAY REORDER AGENDA ITEMS
(Please telephone Jennifer Thorsteinson at 907.796.1519 with agenda questions.)

ALASKA PERMANENT FUND CORPORATION

AUDIT COMMITTEE

September 2, 2020

1:30 p.m.

WebEx/Teleconference

Originating at:

**David Rose Board Room
Michael J. Burns Building
801 West 10th Street, Suite B
Juneau, Alaska 99801**

SUMMARY MINUTES

Trustees Present:

William Moran, Chair
Ethan Schutt
Craig Richards
Lucinda Mahoney
Steve Rieger

Staff Present:

Angela Rodell, CEO
Valerie Mertz, CFO
Chris Poag, General Counsel
Pauly Swanson
Jennifer Thorsteinson
Larissa Murray
Jackie Mallinger
Nellie Metcalfe

Also participating:

Mike Hayhurst, KPMG
Melissa Beedle, KPMG

PROCEEDINGS

CALL TO ORDER

TRUSTEE MORAN called the meeting to order and asked for a roll call.

ROLL CALL

TRUSTEES SCHUTT and MORAN formed the quorum. Also present were TRUSTEES RICHARDS and RIEGER.

APPROVAL OF AGENDA

TRUSTEE MORAN moved to approval of the agenda.

MOTION: A motion to approve the agenda was made by TRUSTEE SCHUTT.

The MOTION was APPROVED.

SCHEDULED APPEARANCES AND PUBLIC PARTICIPATION

TRUSTEE MORAN asked for any scheduled appearances and public participation going online.

MS. THORSTEINSON replied that there was no one online for public testimony

TRUSTEE MORAN moved to the KPMG audit.

KPMG AUDIT

MR. HAYHURST began with a brief introduction and a quick status update. He stated that the procedures are substantially complete, and they expect to be in a position to issue their opinion on the Alaska Permanent Fund as well as the financials for the Alaska Mental Health Trust Authority tomorrow.

MS. BEEDLE began the presentation with the lists of the required communications as set out by the AICPA. She stated that there are no matters to report related to subsequent events that have occurred, any illegal acts, any fraud. There was nothing identified related to those. She continued that a copy of the management representation letter that is requested of management to be signed prior to issuing the opinion will be provided. Through the discussions surrounding key processes with management, there were no material weaknesses or significant deficiencies identified in those internal controls. She added that an opinion on the management discussion and analysis was not expressed but was read for consistency and comparability with the financial statements that the opinion is issued on.

CHAIR RICHARDS asked if the State's unclean audit would go back on the Permanent Fund.

MR. HAYHURST replied that it did not go back on the Permanent Fund as it related to the issued opinion because it is being done in accordance with Generally Accepted Accounting Principles for the financial statements, and they do not have to qualify the opinion for that.

MS. BEEDLE continued that one of the biggest significant accounting policies related to the classification of fund balance which was looked at very closely to make sure that it is presented in accordance with GASB. As part of the audit, no significant elements of management bias were identified when selecting or applying the policies to the financial statements.

TRUSTEE RIEGER asked if there is an obligation to do their own environment analysis on any of this or if no bias is found is it let go.

MS. BEEDLE replied that they did not do an impairment analysis but tested the valuations the fund managers recorded or reported to the Permanent Fund through a variety of procedures. She continued her presentation, explaining the different slides as she went along. She added that their firm put out a lot of guidance with the Audit Committee Institute, the board leadership

related to COVID-19 and the effects it had and is having in different areas and industries.

MR. HAYHURST stated that the audit was essentially 100 percent remote and the teams worked well together with the upfront communication process. He appreciated the Permanent Fund team for being available and for having the information uploaded timely.

MS. BEEDLE finished her presentation with the audit quality transparency report that is issued every year and provided the links to it.

TRUSTEE MORAN moved on to Valerie Mertz and her review.

MS. MERTZ welcomed Trustee Schutt to the committee. She went through a detailed review of the fiscal '20 financial statements. She agreed with everything said by Mr. Hayhurst and Ms. Beedle that the audit went smoothly even being remote. She introduced Jackie Mallinger who has been with the Fund about four years and has recently taken on a new role doing portfolio accounting and will be at future meetings. She continued with her review, answering questions as she went along.

CHAIR RICHARDS asked if a rolling day-to-day sort of recorded number could be done. Periodic reports are not on a rolling basis.

MS. MERTZ stated that a full close is done every month, and this balance would be available at the end of each month; usually two to three weeks after the end of the month.

CEO RODELL stated that two weeks is aggressive on closing of the end of the month. It has been really difficult to get it in two weeks.

CHAIR RICHARDS asked how the earnings reserve performed in terms of volatility during the COVID situation.

MS. MERTZ replied that the earnings reserve was not affected as much by the movement in the market. The portion of the earnings reserve that was most directly impacted by the volatility in the market was that allocation of unrealized gains.

CHAIR RICHARDS asked if there was any way a month-by-month reporting of the last year was possible for the annual meeting and also a breakdown performance of statutory net income.

MS. MERTZ replied yes and asked to get together to figure out what was wanted. She moved on to the statement of revenue expenditures and changes in fund balance and then talked about statutory net income feeding into the earnings reserve.

TRUSTEE MORAN asked for a motion to adjourn.

MOTION: A motion to adjourn the Audit Committee meeting was made by TRUSTEE SCHUTT; seconded by TRUSTEE MORAN.

(Audit Committee meeting adjourned at 2:38 p.m.)



Alaska Permanent Fund Corporation

Discussion with Those Charged with Governance

Audit plan and strategy for the year ending June 30, 2021

May 18, 2021



Our commitment to you

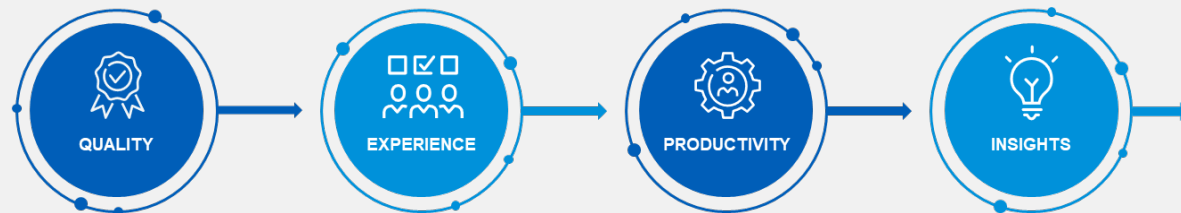


Delivering a better audit experience drives us.

With KPMG you can expect an experience that's better for your team, organizations and the capital markets. An experience that's built for a world that demands agility and integrity.

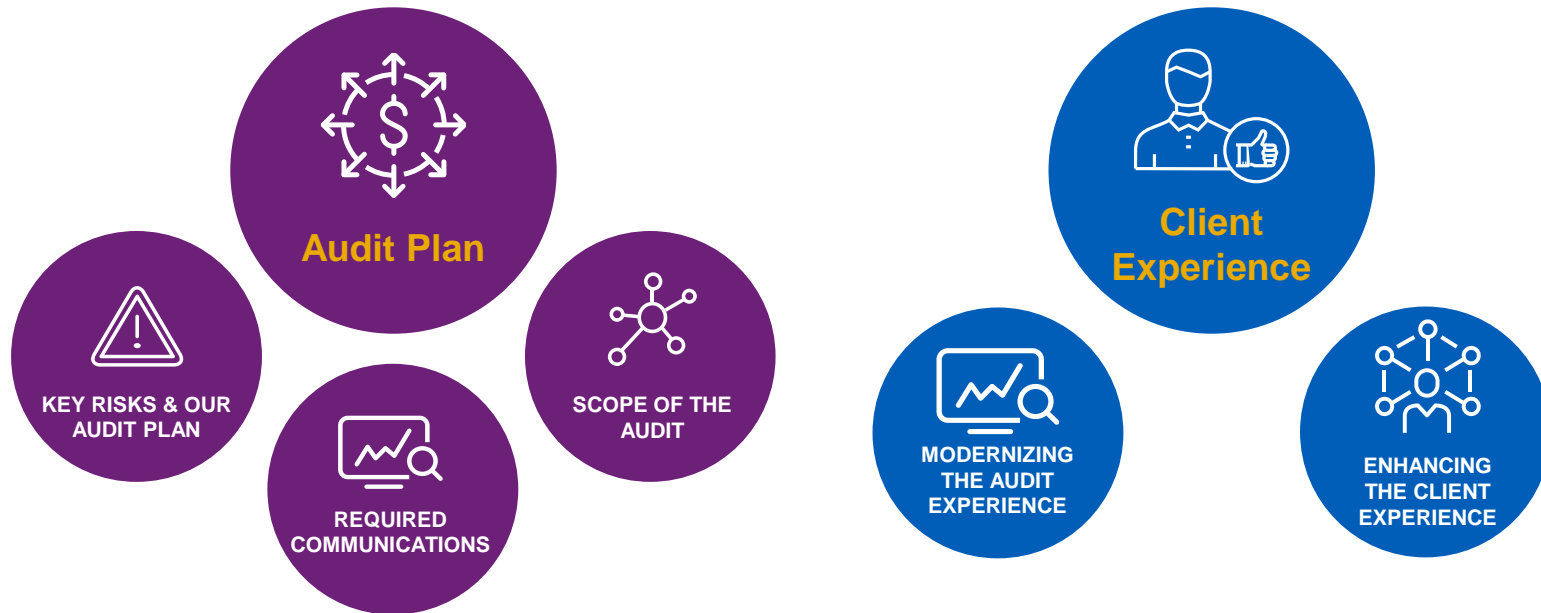
See patterns in what has passed. See where risks may emerge. See opportunities emerge. See opportunities to optimize processes. And see ahead to new possibilities.

We aim to deliver an exceptional client experience for the Permanent Fund by focusing on:



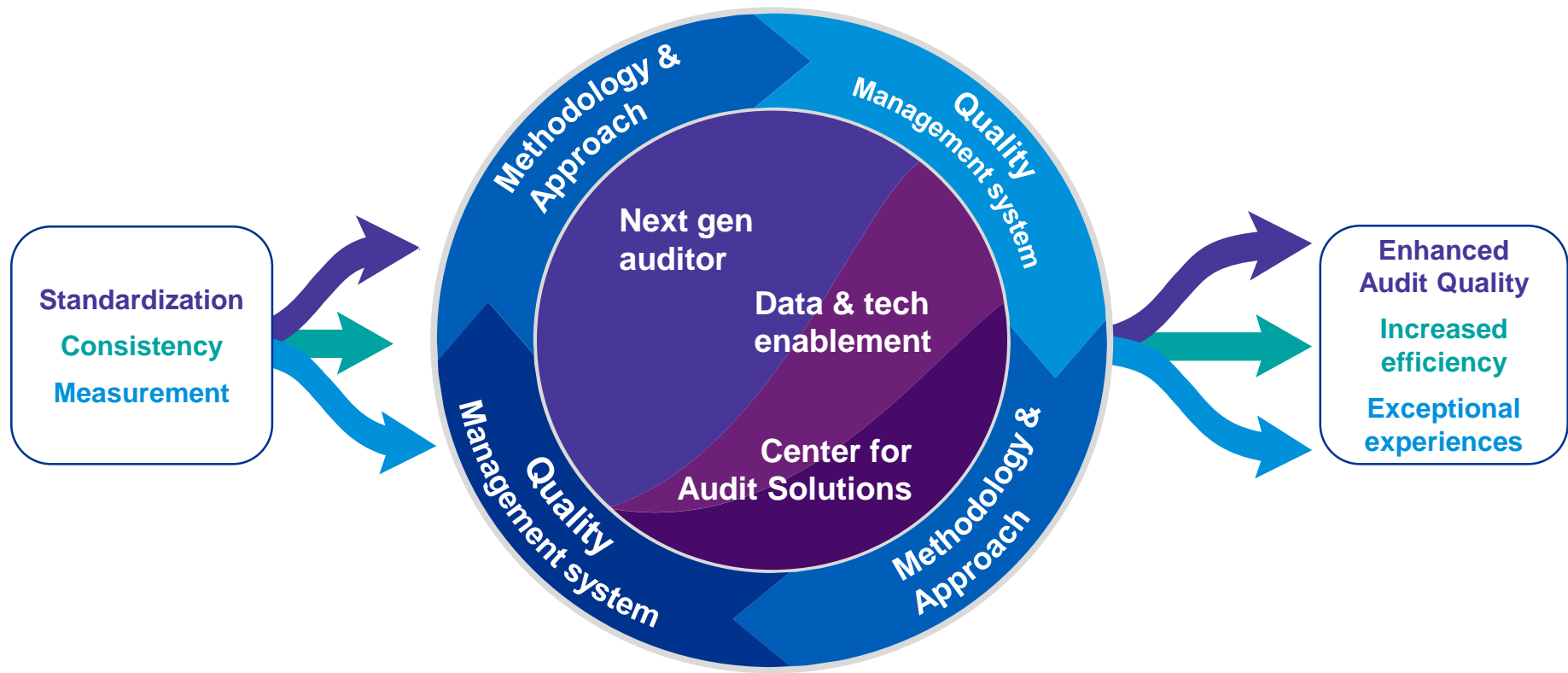
Executive summary

2021 AUDIT PLAN HOW WE'LL DELIVER AN EXCEPTIONAL AUDIT EXPERIENCE TO YOU



Modernization: Driving quality, efficiency, and experience

We are modernizing the audit experience. Our continuous transformation effort will enhance quality and efficiency, while delivering an exceptional experience marked by a responsive team and enriched with audit insights.



Cybersecurity considerations

Factors and forces elevating cybersecurity risks:

- Shifts to remote work, online customer engagement, digital finance – “remote everything”
- Acceleration of digital strategies/transformation
- Surge and sophistication of cyber attacks
- Risks, vulnerabilities posed by third-party vendors

Considerations for robust oversight:

- Focus on internal controls, access, and security protocols
- Increase diligence around third-party vendors
- Insist on a robust data governance framework
- Clarify responsibilities for data governance across the enterprise
- Reassess how the board—through its committee structure—assigns and coordinates oversight responsibility for cybersecurity and data governance frameworks, including data privacy, ethics, and hygiene

Audit considerations:

- Evaluate risks of material misstatement resulting from, among other things, unauthorized access to financial reporting systems (e.g., IT applications, databases, operating systems)
- Determine whether there is a related risk of fraud
- Develop audit approach based on risk assessment
- If a cybersecurity incident occurs, we understand and evaluate its effect on our audit approach, as well as evaluate management’s assessment of the effect on the financial statements and disclosures

Summary: Audit approach required communications and other matters

		Response
Planning & risk assessment	Role and identity of engagement partner	The lead audit engagement partner is: Mike Hayhurst.
	Significant findings or issues discussed with management	No matters to report.
	Scope of audit	Our audit of the financial statements of The Permanent Fund (the Fund) as of and for the year ended June 30, 2021, will be performed in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards. Performing an audit of financial statements includes consideration of internal control over financial reporting (ICFR) as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's ICFR.
	Materiality in the context of an audit	See slide 6
	Our timeline	See slide 7
	Our approach to fraud risk	See slide 8
	Risk assessment: Significant risks	See slide 9
	Risk assessment: Additional risks identified	See slide 10
	Involvement of others	See slide 11
	Independence	See slide 12
Responsibilities	See slide 13	
Inquiries	See slide 14	

Materiality in the context of an audit

We will apply materiality in the context of the preparation and fair presentation of the financial statements, considering the following factors:

Misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

Judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a misstatement, or a combination of both.

Judgments about materiality involve both qualitative and quantitative considerations.

Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

Determining materiality is a matter of professional judgment and is affected by the auditor's perception of the financial information needs of users of the financial statements.

Judgments about the size of misstatements that will be considered material provide a basis for

- a) Determining the nature and extent of risk assessment procedures;
- b) Identifying and assessing the risks of material misstatement; and
- c) Determining the nature, timing, and extent of further audit procedures.

Our timeline

Mar 1 – June 30

Planning and risk assessment

- Planning and initial risk assessment procedures, including:
 - Involvement of others
 - Identification and assessment of risks of misstatements and planned audit response for certain processes
- Obtain and update an understanding of the Fund and its environment
- Inquire of those charged with governance, management and others within the Fund about risks of material misstatement
- Coordinate with Specialists
- Evaluate design and implementation (D&I) of entity level controls and process level controls for certain processes
- Perform process walkthroughs and identification of process risk points for certain processes

Interim

- Ongoing risk assessment procedures, including:
 - Identification and assessment of risks of misstatements and planned audit response for remaining processes
- Communicate audit plan
- Identify IT applications and environments
- Evaluate D&I of process level controls for remaining processes
- Perform interim substantive procedures

July 1 – September 30

Year-end

- Complete control testing for remaining process level, general IT, and entity-level controls, where applicable
- Perform remaining substantive audit procedures
- Evaluate results of audit procedures, including control deficiencies and audit misstatements identified
- Review financial statement disclosures
- Obtain written representations from management
- Present audit results to those charged with governance and perform required communications

September 3: Issue audit reports on financial statements.

Our approach to fraud risk

Quality in all that we do

- Audit quality remains our highest priority and is critical to fulfilling our role in the capital markets.
- To deliver on our audit quality commitment, we are focused on consistently planning and executing our audits, in line with the requirements of applicable professional standards within a strong system of quality control.
- Core to actions to drive quality are a culture of integrity, innovation, including our smart audit platform KPMG Clara, and nurturing and supporting our talented professionals.

- Financial fraud can be complex and sophisticated and it is essential that businesses, those charged with governance, and their auditors assess the risk of financial fraud and respond accordingly.
- The auditors' responsibility is to plan and perform an audit to provide reasonable assurance that material misstatements are detected, whether caused by error or fraud.
- At KPMG, we are focused on exercising professional skepticism, and executing fundamental audit procedures and collating evidence, aligned with the professional standards, to seek to detect material misstatement as a result of fraud.
 - We share our planned audit approach and responses with those charged with governance every year.
 - We perform risk assessments, including conducting interviews within the Fund, assessing management's fraud risk, and running analytical procedures, as appropriate under the standards.
 - And when fraud risk is identified, we perform incremental procedures at the highest level of risk.
- As part of our commitment to sustaining audit quality, we recognize nothing remains static. We are committed to continually improving the quality, consistency, and efficiency of our audits, enabled by our technology, including our approach to fraud risk.

Risk assessment: Significant risks

Significant risks

Management override of controls

Management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk nevertheless is present in all entities.

Susceptibility to:

Error

Fraud

Yes

Significant risk – Valuation of alternative investments

Market values for these funds are recorded based on monthly statements provided by the external investment managers. The market value recorded by the Fund is subject to significant estimation risk

Susceptibility to:

Error

Fraud

Specifically, the following elements included within the fair value estimate give rise to a significant risk:

- Due to the timing lag, significant fluctuations in value could occur that result in material errors.

Yes

Relevant factors affecting our risk assessment

- Size of the portfolio
- Potential exposure to losses
- Measurement uncertainty

Risk assessment: Additional risks identified

Additional risks identified	Relevant factors affecting our risk assessment and planned response
Valuation of real estate	<ul style="list-style-type: none">- Complexity of real estate valuations- Size of the directly owned real estate portfolio

Involvement of others

Audit of financial statements	Extent of planned involvement
Service Organization: Bank of New York Mellon	<ul style="list-style-type: none"> - Obtain service auditors' report - Test user controls identified in the report
KPMG professionals with specialized skill or knowledge who are involved in performance of audit procedures	<ul style="list-style-type: none"> - Provide guidance on risks related to alternative investments, including current economic environment - Review audit team's procedures over alternative investments - Review third party real estate appraisals for selected real estate investments - Assist in portfolio risk assessment and scoping of non-public portfolio

Shared responsibilities: Independence

Auditor independence is a shared responsibility and most effective when management, those charged with governance and audit firms work together in considering compliance with the independence rules. In order for KPMG to fulfill its professional responsibility to maintain and monitor independence, management, those charged with governance, and KPMG each play an important role.

System of independence quality control

The firm maintains a system of quality control over compliance with independence rules and firm policies. Timely information regarding upcoming transactions or other business changes is necessary to effectively maintain the firm's independence in relation to:

- New affiliates (which may include subsidiaries, equity method investees/investments, sister companies, and other entities that meet the definition of an affiliate under AICPA independence rules)
- New directors, officers, and persons in key positions with respect to the preparation or oversight of the financial statements

Certain relationships with KPMG

Independence rules prohibit:

- Certain employment relationships involving directors, officers, or others in an accounting or financial reporting oversight role and KPMG and KPMG covered persons.
- The Fund or its directors, officers, from having certain types of business relationships with KPMG or KPMG professionals.

Responsibilities

Management responsibilities



- Communicating matters of governance interest to those charged with governance.
- The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

KPMG responsibilities – Objectives



- Communicating clearly with those charged with governance the responsibilities of the auditor regarding the financial statement audit and an overview of the planned scope and timing of the audit.
- Obtaining from those charged with governance information relevant to the audit.
- Providing those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process.
- Promoting effective two-way communication between the auditor and those charged with governance.
- Communicating effectively with management and third parties.

KPMG responsibilities – Other



- If we conclude that no reasonable justification for a change of the terms of the audit engagement exists and we are not permitted by management to continue the original audit engagement, we should:
 - Withdraw from the audit engagement when possible under applicable law or regulation,
 - Communicate the circumstances to those charged with governance, and
 - Determine whether any obligation, either legal contractual, or otherwise, exists to report the circumstances to other parties, such as owners, or regulators.
- Forming and expressing an opinion about whether the financial statements that have been prepared by management, with the oversight of those charged with governance, are prepared, in all material respects, in accordance with the applicable financial reporting framework.
- Establishing the overall audit strategy and the audit plan, including the nature, timing, and extent of procedures necessary to obtain sufficient appropriate audit evidence.
- Communicating any procedures performed relating to other information, and the results of those procedures.

Inquiries

The following inquiries are in accordance with AU-C 260

Are those charged with governance aware of:

- Matters relevant to the audit, including, but not limited to, significant related party transactions, fraud, violations or possible violations of laws or regulations?
- Any significant communications with regulators?
- Any developments in financial reporting, laws, accounting standards, corporate governance, and other related matters, and the effect of such developments on, for example, the overall presentation, structure, and content of the financial statements, including the following:
 - The relevance, reliability, comparability, and understandability of the information presented in the financial statements
 - Whether all required information has been included in the financial statements, and whether such information has been appropriately classified, aggregated or disaggregated, and presented?

Do those charged with governance have knowledge of:

- Fraud, alleged fraud, or suspected fraud affecting the Fund?
 - If so, have the instances been appropriately addressed and how have they been addressed?

Questions?

For additional information and audit committee resources, including National Audit Committee Peer Exchange series, a Quarterly webcast, and suggested publications, visit the KPMG Audit Committee Institute (ACI) at www.kpmg.com/ACI

This presentation to those charged with governance is intended solely for the information and use of those charged with governance and management and is not intended to be and should not be used by anyone other than these specified parties. This presentation is not intended for general use, circulation or publication and should not be published, circulated, reproduced or used for any purpose without our prior written permission in each specific instance.

Reference Slides



Audit committee resources

Board Leadership Center

Engaging with directors and business leaders. Articulating boardroom challenges. Delivering practical thought leadership – on risk and strategy, talent and technology, globalization and compliance, financial reporting, and more – all through a board lens.

<https://boardleadership.kpmg.us>

Audit Committee Institute

Provides audit committee and board members with practical insights, resources, and peer-exchange opportunities focused on strengthening oversight of financial reporting and audit quality, and the array of challenges facing boards and businesses today – from risk management and emerging technologies to strategy, talent, and global compliance.

<https://boardleadership.kpmg.us/audit-committee.html>

Government Institute

KPMG Institute Network provides executives, senior management, board members, industry leaders, government officials, academics, and other stakeholders with knowledge they can use to make informed decisions and meet their marketplace challenges.

<https://institutes.kpmg.us/government.html>

Diversity, Equity and Inclusion

Accelerate 2025: Driving Meaningful Change



**Chair and CEO
Paul Knopp**

“Diversity, Equity and Inclusion are foundational to KPMG’s purpose, values and strategy. I have witnessed incredible change and significant progress throughout my 37-year career, but it has not been nearly enough—as a society, as a profession and as a firm.”



**Chief DEI Officer
Elena Richards**

“We believe we have a responsibility to make KPMG a place where all of our people can grow and thrive, and are committed to that vision. Our vision.”

Our 2025 Goals



- › 50 percent of our Partners and Managing Directors from under-represented groups, including a doubling of Black representation
- › 50 percent increase of Black and Hispanic/Latinx representation in our workforce
- › Significant increase in representation from under-represented groups in client and firmwide leadership roles

Read our first U.S. Diversity, Equity & Inclusion Transparency Report: read.kpmg.us/diversity

ESG reporting considerations

Our definition

ESG refers to strategic and operational environmental, social and governance risks and opportunities with the potential to have material impact on a company's long-term financial sustainability and value creation.

Why ESG



Environmental criteria consider how a company acts in its role as a steward of nature, such as energy use, recycling practices, pollution, and natural resource conservation.



Social criteria examine how well a company manages relationships with employees, suppliers, customers, and the community, including diversity and inclusion metrics.



Governance criteria are concerned with a company's leadership, internal controls, executive pay, audits, and shareholder rights. An example is ethnic diversity in the board of directors.

Five questions for those charged with governance to consider:

1. Which ESG topics are you measuring and reporting, and why?
2. Where are you currently publishing your ESG reporting?
3. What processes and controls exist over the data being collected and reported?
4. Are you getting assurance on ESG metrics?
5. How should those charged with governance think about value creation when engaging on ESG?

Boards and executives increasingly see ESG topics as important to long-term value creation and the need to meet investor demand for ESG information in a way that drives value for the organization.

Source: *Audit committees and corporate ESG commitment: 'Prove it'*, *Accounting Today*, October 15, 2020

ESG services

Example assurance services for audit clients

- Corporate social responsibility (sustainability) report assurance
 - Full report
 - Specific indicators
- Greenhouse gas attestation
- Green bonds assurance (use of proceeds)
- Private equity impact fund reporting



Level of assurance (AICPA)

- Examination engagement (reasonable assurance – AT-C 205)
- Review engagement (limited assurance – AT-C 210)
- Agreed-upon procedures (specific procedures – restricted use – AT-C 215)



Example ESG non-audit services for audit clients

- Readiness assessment
- Gap analysis
- Materiality assessment
- Benchmarking



Audit quality and transparency

2020 Audit quality report

- Highlights the steps we have taken in 2020 to evolve and enhance our audit practice and our firm
- Provides an overview of how we are strengthening our culture, continuing to invest in our people, and the new technologies that will enable our workforce



2020 Transparency report

- Provides more granular detail on our commitment to continually enhance audit quality
- Outlines KPMG LLP's structure, governance and approach to audit quality
- Discusses how the firm aligns with the requirements and intent of applicable professional standards



Reports and supplements available at:
read.kpmg.us/auditquality

New auditor reporting standards

SAS 134*, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*, aligns the content of the auditors' report under US GAAS with the equivalent ISAs. The revised auditors report will:

- Present the opinion section first, followed by the basis for opinion section.
- Include a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities relating to the audit.
- Expand the statement of management's responsibility to include assessing the entity's ability to continue as a going concern.
- Expand the description of auditor responsibilities to include exercising and maintaining professional judgment throughout the audit, concluding on whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern, and communicating with those charged with governance regarding, among other matters:
 - The planned scope and timing of the audit,
 - Significant audit findings, and
 - Certain internal control-related matters that are identified during the audit
- When engaged by the entity, key audit matters are communicated within the auditors' report.

SAS 137*, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, amends the definition of an annual report and clarifies the auditor's responsibilities for other information included in the annual report, including when auditors reporting is required. The revised auditors report will:

- Include a separate 'Other Information' section when the annual report is available before the date of our auditors' report.

Effective for years ending on or after December 15, 2021.

* Conforming changes were made to AU-C 800, 805, and 810 to incorporate Auditor Reporting Changes from SAS 134. Conforming changes were made to AU-C Sections 725, 730, 930, 935, and 940 to incorporate auditor reporting changes from SAS 134 and 137.

New auditor reporting standards

Basic Elements of a US GAAS Auditors' Report Comparison

Revised auditors' report

- Title
- Addressee
- Auditors' opinion
- Basis of opinion
- Going concern (when applicable)
- Key audit matters
- Responsibilities of management for the financial statements
- Auditors' responsibilities for the audit of the financial statements
- Other information (when applicable)
- Other reporting responsibilities (when applicable)
- Signature of the auditor
- Auditors' address
- Date of the auditors' report

Current report under reporting standards

- Title
- Addressee
- Introductory paragraph
- Management's responsibilities for the financial statements
- Auditors' responsibilities
- Auditors' opinion
- Other reporting responsibilities (when applicable)
- Signature of the auditor
- Auditors' address
- Date of the auditors' report



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ALASKA PERMANENT
FUND CORPORATION

FY21 Year-to-Date Financial Statement Review

May 18, 2021

Highlights as of March 31st

- Accounting net income: \$13.9b
- Statutory net income: \$5.3b
- Mineral revenues deposited to corpus: \$207m
- POMV transfers to General Fund: \$2.3b
- Total return 22.69%

Total Assets (millions)

Assets		FY21 as of 3/31	FY20
	Cash	\$5,616.8	\$4,815.9
	Receivables	670.0	2,194.7
	Investments	<u>73,099.2</u>	<u>60,894.0</u>
	Total Assets	\$79,386.0	\$67,904.6

Investments (millions)

Investments at Fair Value		FY21 as of 3/31	FY20
	Marketable debt securities	\$15,648.2	\$13,595.5
	Preferred and common stock	29,527.4	25,109.8
	Real estate	5,374.5	4,303.6
	Absolute return	5,026.1	4,288.5
	Private equity	13,222.6	9,803.9
	Infrastructure	2,237.2	1,902.3
	Private credit	<u>2,063.2</u>	<u>1,890.4</u>
	Total Investments	\$73,099.2	\$60,894.0

Investments One Year Ago (millions)

Investments at Fair Value		FY21 as of 3/31	FY20 as of 3/31
	Marketable debt securities	\$15,648.2	\$11,398.2
	Preferred and common stock	29,527.4	21,137.7
	Real estate	5,374.5	5,480.2
	Absolute return	5,026.1	4,695.8
	Private equity	13,222.6	9,468.4
	Infrastructure	2,237.2	3,320.8
	Private credit	<u>2,063.2</u>	<u>1,903.3</u>
	Total Investments	\$73,099.2	\$57,404.4

Liabilities (millions)

Liabilities		FY21 as of 3/31	FY20
	Accounts Payable	\$2,273.9	\$2,581.9
	Income Distributable	<u>791.5</u>	<u>20.5</u>
	Total Liabilities	\$3,065.4	\$2,602.4

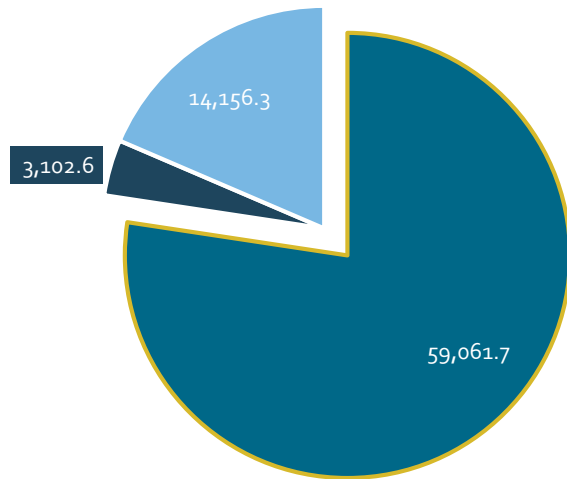
Fund Balances (millions)

Fund balances		FY21 as of 3/31	FY20
	Nonspendable	\$59,061.7	\$52,408.1
	Committed	3,102.6	3,091.5
	Assigned	<u>14,156.3</u>	<u>9,802.6</u>
	Total fund balances	<u>\$76,320.6</u>	<u>\$65,302.2</u>
	Total liabilities and fund balances	\$79,386.0	\$67,904.6

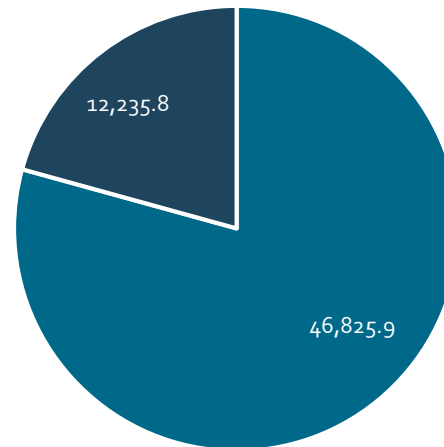
Fund Balances One Year Ago (millions)

Fund Balances		FY21 as of 3/31	FY20 as of 3/31
	Contributions & Appropriations	\$46,825.9	\$41,822.1
	Unrealized Appreciation	<u>12,235.8</u>	<u>1,792.4</u>
	Total Nonspendable	\$59,061.7	\$43,614.5
	Total Committed	\$3,102.6	\$7,865.3
	Realized Earnings	\$10,580.8	\$7,850.6
	Unrealized Appreciation	<u>3,575.5</u>	<u>673.5</u>
	Total Assigned	\$14,156.3	\$8,524.1
	TOTAL FUND BALANCES	\$76,320.6	\$60,003.9

Nonspendable

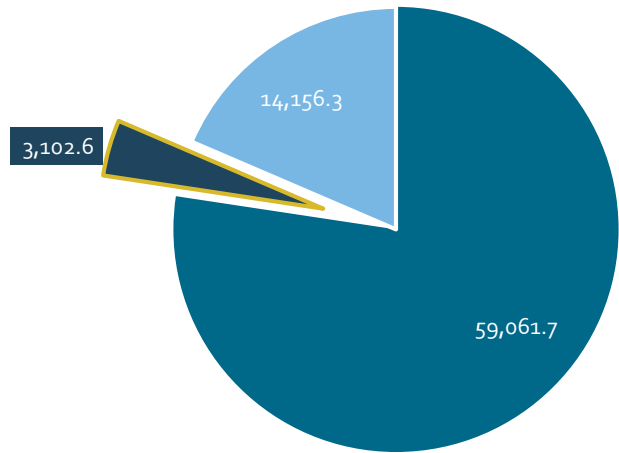


■ Nonspendable ■ Committed ■ Assigned

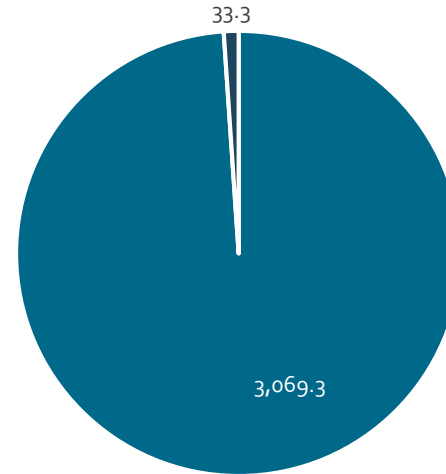


■ Deposits ■ Unrealized Appreciation

Committed



■ Nonspendable ■ Committed ■ Assigned

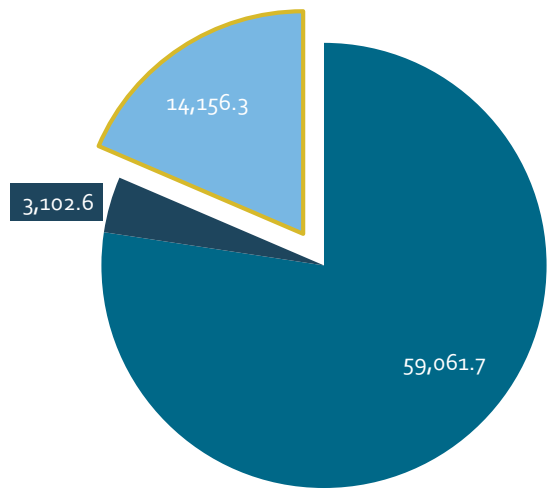


■ General Fund ■ ACIF

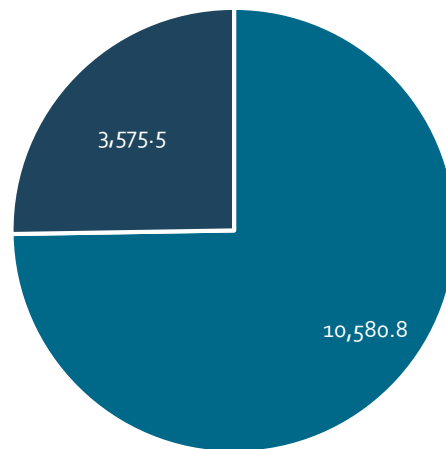
General Fund Transfer Calculation

ALASKA PERMANENT FUND GENERAL FUND COMMITMENT FISCAL YEAR ENDING JUNE 30, 2021 (millions)			
FISCAL YEAR	GAAP MARKET VALUE	STATE vs AMERADA HESS	APFC MARKET VALUE
2016	52,770	424	52,345
2017	59,785	424	59,361
2018	64,894	424	64,470
2019	66,300	424	65,876
2020	65,302	424	64,878
Average market value			61,386
PERCENTAGE from AS 37.13.140(b)			5.00%
Amount available for appropriation per AS 37.13.140(b)			3,069

Assigned



■ Nonspendable ■ Committed ■ Assigned



■ Realized Earnings ■ Unrealized Appreciation

Revenues (millions)

Revenues		FY21 ytd	FY20
	Interest	\$323.4	\$492.9
	Dividends	380.1	515.3
	Real estate and other income	<u>349.0</u>	<u>394.7</u>
	Total interest, dividends & other income	\$1,052.5	\$1,402.9
	Total increase in fair value of investments	<u>12,989.7</u>	<u>361.8</u>
	Total Revenues	\$14,042.2	\$1,764.7

Net Change in Investments Value (millions)

Net increase (decrease) in fair value	FY21 ytd	FY20
Marketable debt securities	\$(122.5)	\$433.9
Preferred and common stock	9,450.1	40.7
Real estate	(2.7)	(456.4)
Absolute return	553.1	44.4
Private equity	3,446.7	886.0
Infrastructure	247.8	(347.9)
Private credit	118.6	(5.1)
Derivatives & Currency	<u>(701.4)</u>	<u>(233.8)</u>
Total net increase	\$12,989.7	\$361.8

Expenditures (millions)

Expenditures		FY21 ytd	FY20
	Operating expenditures	\$(131.0)	\$(120.4)
	Other legislative appropriations	<u>(8.4)</u>	<u>(7.8)</u>
	Total expenditures	<u>\$(139.4)</u>	<u>\$(128.2)</u>
	Excess of revenues over expenditures	\$13,902.8	\$1,636.5

Statutory Net Income (millions)

	FY21 ytd	FY20
Accounting (GAAP) net income	\$13,902.8	\$1,636.5
Unrealized (gains) losses	(8,597.8)	1,490.0
ACIF realized income	<u>\$(33.3)</u>	<u>\$(20.5)</u>
Statutory net income	\$5,271.7	\$3,106.0

Changes in fund balances (millions)

Other financing sources (uses)		FY21 ytd	FY20
	Transfers in	\$207.1	\$319.0
	Transfers out	<u>(3,091.5)</u>	<u>(2,953.6)</u>
	Net change in fund balances	\$11,018.4	\$(998.1)
Fund balances	Beginning of period	\$65,302.2	\$66,300.3
	End of period	\$76,320.6	\$65,302.2

A teal-colored background featuring a close-up, slightly blurred image of a pine branch with several clusters of small, developing pine cones. The word "Questions?" is centered in white text.

Questions?

SUBJECT: FY21 Year-to-Date Financial Update ACTION: _____

DATE: May 18, 2021 INFORMATION: _____ X _____

KEY TAKEAWAYS:

- Total return for the first three quarters of FY21 of 22.69%; 5.95% for the quarter ended March 31, mostly fueled by private (18.77%) and public equity (8.49%) returns
- Accounting net income year-to-date of \$13.9 billion, with \$4.5 billion earned in the third quarter, well ahead of Callan’s high forecast of \$8.7 billion for the year
- Realized (statutory) net income year-to-date of \$5.3 billion, \$2.4 billion generated in the quarter ended March 31
- Fund value as of March 31 of \$76.3 billion, an \$11 billion increase from the \$65.3 billion at the end of the prior year
- \$750 million transferred to the General Fund during the third quarter in accordance with SB26; \$450 million in January and \$300 million in March for a total of \$2,300 million through the third quarter
- \$89 million of mineral deposits transferred in during the quarter ended March 31 for a total of \$207 million year-to-date
- Committed Earnings Reserve balance of \$3.1 billion for FY22 General Fund transfers (\$3.069 billion) and the transfer to ACIF (\$33 million)

Financial results for the third quarter of FY21 continued to reflect the unusually strong performance in the public and private equity markets, giving rise to earnings at unprecedented levels. Overall, the fund recorded unrealized gains of \$2.1 billion between the end of December and the end of March, for a total of \$8.6 billion for the first three quarters of the fiscal year. The largest gains by far were experienced in the public equity portfolio which gained nearly \$1 billion in value during the quarter. In addition, \$2 billion in gains were realized during the quarter ended March 31st, primarily through rebalancing the overweight to public equities resulting from strong market performance.

Net assets increased by \$11 billion year-to-date through March. This is a result of net income of \$13,903 million and \$207 million received in mineral royalty deposits offset by the FY21 POMV transfer to the State of Alaska General Fund in the amount of \$3,092 million. Corporate operating expenses and other appropriations for the first three quarters totaled \$139 million.

Two transfers to the General Fund were made during the third quarter of FY21 totaling \$750 million, bringing total transfers for the year to \$2,300 million. Staff is in communication with the cash managers at the Department of Revenue to ensure that amounts designated for the General Fund remain invested in the Fund as long as possible, while being available to meet the liquidity needs of the State.



**Financial Report
March 31, 2021**

Fiscal Year 2021 Net Assets

Balances through March 31, 2021

(in millions)

Total assets	\$ 79,386.0
Less liabilities	(3,065.4)
Net assets	<u>76,320.6</u>
Fund Balances:	
Non-spendable	
Permanent Fund corpus—contributions and appropriations	46,825.9
Not in spendable form—unrealized appreciation on invested assets	12,235.8
Total non-spendable fund balance	<u>59,061.7</u>
Committed	
General Fund Commitment	3,069.3
Current FY AK Capital Income Fund	33.3
Committed fund balance	<u>3,102.6</u>
Assigned for future appropriations	
Realized earnings	10,580.8
Unrealized appreciation on invested assets	3,575.5
Total assigned fund balance	<u>14,156.3</u>
Total fund balances	<u>\$ 76,320.6</u>

Fiscal Year 2021 Income

For the nine months ending March 31, 2021

(in millions)

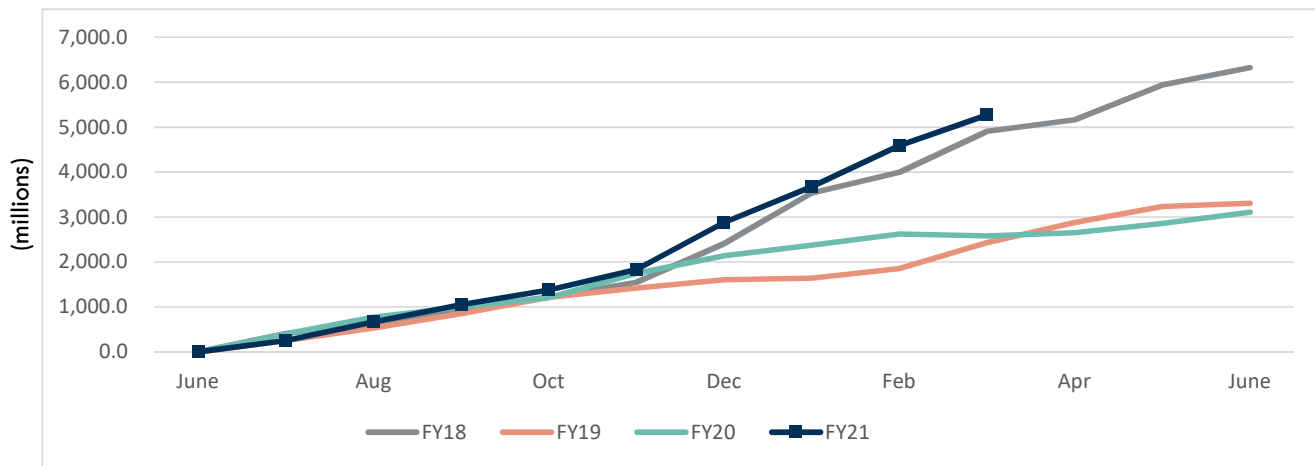
Statutory (Realized) Net Income

Interest, dividends, real estate, and other income	\$ 1,052.5
Realized gains on the sale of invested assets	4,391.9
Less operating expenses/legislative appropriations	(139.4)
Less Alaska Capital Income Fund committed realized earnings	(33.3)
Statutory net income	<u>5,271.7</u>

GAAP (Accounting) Net Income

Statutory net income	5,271.7
Unrealized gain on invested assets	8,597.8
Alaska Capital Income Fund committed realized earnings	33.3
Accounting net income	<u>\$ 13,902.8</u>

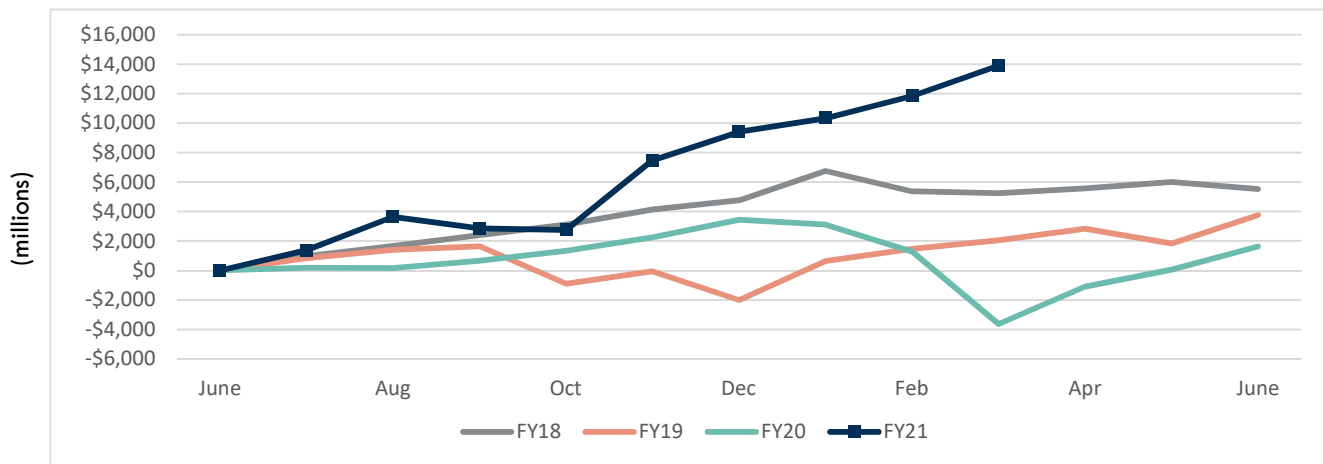
Statutory Net Income, Fiscal Years 2018 - 2021



- Comprised of receipts from interest on fixed income, real estate rentals, stock dividends, and all realized gains and losses on the sales of invested assets, less AK Capital Income Fund committed amounts and operating expenses.

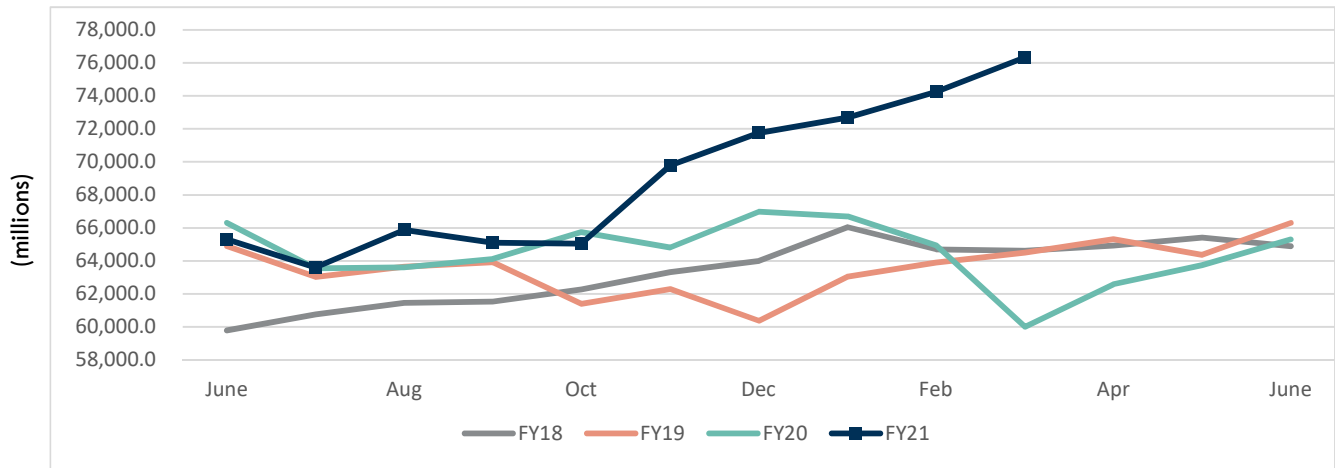
- FY18 statutory net income was \$6,324.4 million.
- FY19 statutory net income was \$3,305.1 million.
- FY20 statutory net income was \$3,106.0 million.
- FY21 statutory net income through March 31st was \$5,271.7 million.

GAAP Accounting Net Income (Loss), Fiscal Years 2018 - 2021



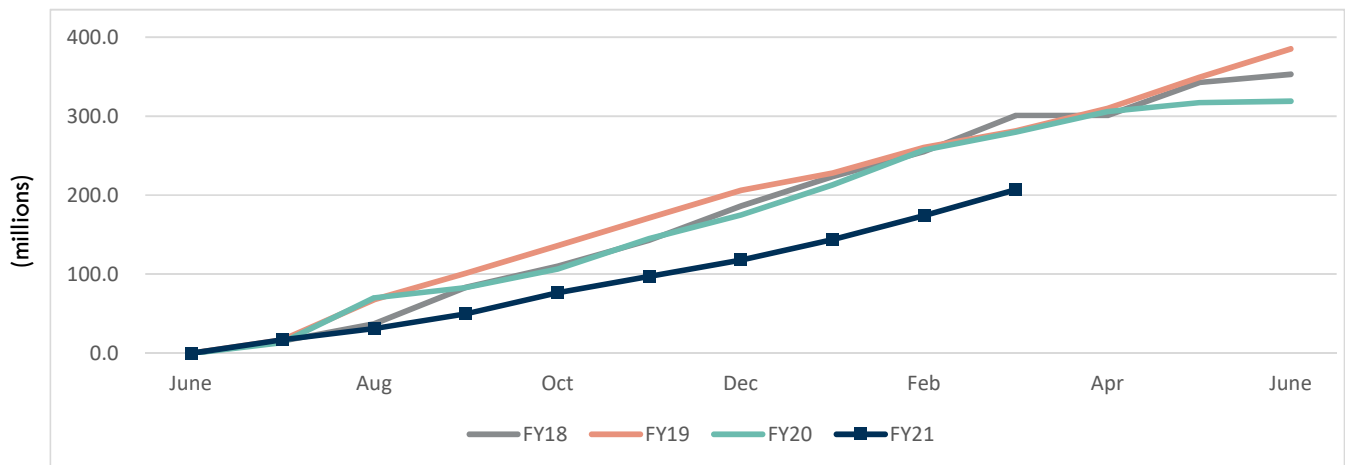
- Accounting net income is the same as statutory net income, except it includes unrealized gains and losses.
- Accounting net income for FY18 was \$5,525.5 million.
- Accounting net income for FY19 was \$3,765.8 million.
- Accounting net income for FY20 was \$1,636.5 million.
- Accounting net income for FY21 through March 31st was \$13,902.8 million.

Market Value of Fund Net Assets, Fiscal Years 2018 - 2021



- FY18 net assets as of June 2018 were \$64.9 billion, an increase of \$5.1 billion over the FY17 ending balance.
- FY19 net assets as of June 2019 were \$66.3 billion, an increase of \$1.4 billion over the FY18 ending balance.
- FY20 net assets as of June 2020 were \$65.3 billion, a decrease of \$1.0 billion from the FY19 ending balance.
- FY21 net assets as of March 31st were \$76.3 billion, an increase of \$11.0 billion from the FY20 ending balance.

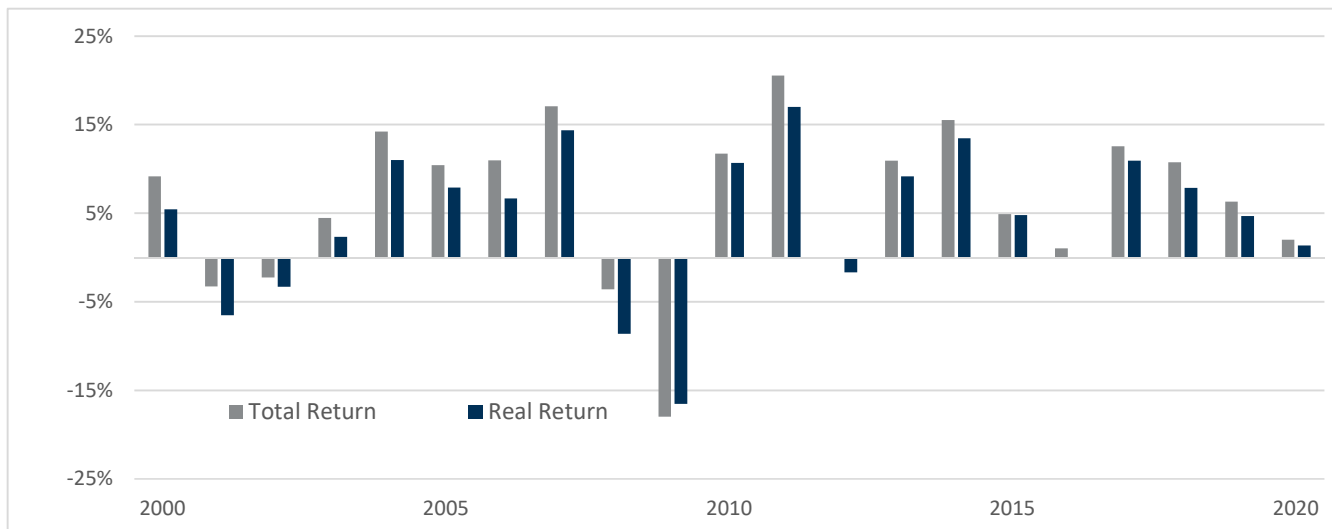
Dedicated Mineral Revenues, Fiscal Years 2018 - 2021



- FY18 mineral revenue was \$353.1 million.
- FY19 mineral revenue was \$385.2 million.
- FY20 mineral revenue was \$319.0 million.
- FY21 mineral revenue as of March 31st was \$207.1 million.

Alaska Permanent Fund Historical Returns, Fiscal Years 2000 - 2020

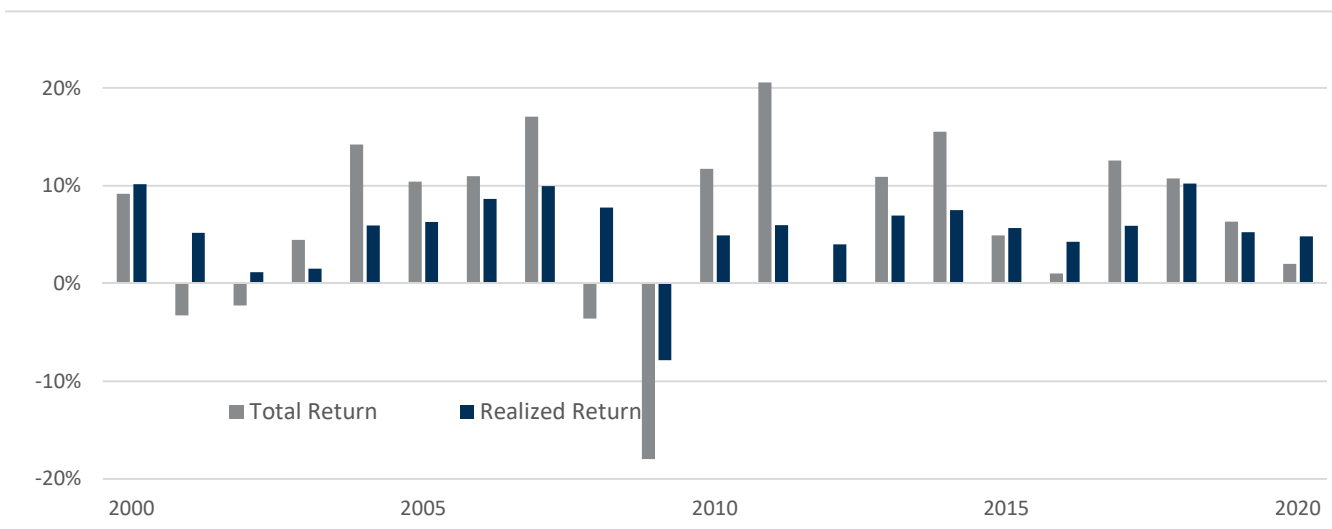
Total return minus inflation equals real return



- Total return annualized over 36 years is 8.68%
- Real return annualized over 36 years is 6.14%

Alaska Permanent Fund Historical Returns, Fiscal Year 2000 - 2020

Total return minus unrealized gains/losses equals realized return



- Total return annualized over 36 years is 8.68%
- Realized return annualized over 36 years is 7.43%

**Audit Committee of the Board of Trustees
2021 Annual Self-assessment**

Per the AICPA, the self-assessment should aid the audit committee in assessing its strengths and weaknesses and lay a foundation for future improvement.

General Questions (some may not apply):

1.	Is the level of independence of the audit committee acceptable?
2.	Has the audit committee developed a continuing education program to enhance its members' understanding of relevant auditing, accounting, regulatory, and industry issues?
3.	Are new audit committee members provided with an orientation program to educate them on the company and their responsibilities?
4.	Does the audit committee consider the pressures on management that may impact the quality of financial reporting (e.g. earnings targets, resource limitations, and performance measures)?
5.	Does the audit committee dedicate appropriate time and resources to execute its responsibilities?
6.	Does the audit committee help to establish the right "tone at the top" promoting organization-wide awareness of corporate ethics, quality financial reporting, and strong internal controls?
7.	Does the audit committee make inquiries of the appropriate parties (external auditor, management, etc.) on the depth of experience and sufficiency of staff?
8.	Does the audit committee review the management recommendation letters written by the auditor to ensure that all significant matters raised are addressed?
9.	Are the audit committee's meeting packages complete and received with enough lead time? Do they include the right information to allow meaningful discussion?
10.	Is there appropriate consideration in the audit committee's discussions of the company's financial reporting risks and the related internal controls?
11.	Is there active consideration of the audit plan and results of the independent audit?
12.	Do executive sessions held with the independent auditor result in candid discussion of relevant issues?
13.	Are adjustments to the financial statements that resulted from the audit process reviewed by the audit committee, regardless of whether they were recorded by management?
14.	Is the audit committee charter used as a document to guide the committee in its efforts, and to help guide the committee's agenda?

APFC Charter Specific Questions:

15.	Has the audit committee reviewed the adequacy of the charter within the last three years?
16.	Have significant changes to accounting principles been discussed?
17.	Have any legal matters that could impact the Fund's financial statements been discussed with legal counsel?
18.	Has APFC financial and accounting personnel succession planning been reviewed?
19.	Has the audit committee overseen the role of the external auditors from selection to termination?
20.	Has the independence and performance of the auditors been reviewed?
21.	Has the appropriateness and quality of accounting principles applied to the financial statements, including estimates and disclosures, been discussed?



On the 2021 audit committee agenda

KPMG Board Leadership Center

The events and crises of 2020—COVID-19, recession, extreme weather events, deep-seated social unrest, and an increasingly polarized America—paint a picture of a daunting and opaque business and risk environment for the coming year. Global volatility—driven by trade and geopolitical tensions, resurging debt, technology and business model disruption, elevated cyber risk, regulatory scrutiny, and political gridlock in the U.S. and elsewhere—will add to the challenge. The pressure on employees, management, the board, and governance will be significant.

Prioritizing a heavy audit committee agenda will be particularly challenging. Along with the business and the full board, the audit committee will continue to operate against a backdrop of tremendous uncertainty and an uneven economic recovery. Drawing on insights from our latest survey work and interactions with audit committees and business leaders, we highlight seven issues for audit committees to keep in mind as they consider and carry out their 2021 agendas:



Take a fresh look at the audit committee's agenda and workload.

It is little surprise that more than 60 percent of audit committee members we surveyed report that COVID-19 has prompted the committee to reassess the scope of its agenda and risk oversight responsibilities.¹ Beyond financial reporting and related control risks, many audit committees indicate they have substantial oversight responsibility for a range of other risks, including financial risks such as liquidity and access to capital; legal/regulatory compliance; cybersecurity and data privacy; reporting of environmental, social, and governance (ESG) metrics; supply chain and other third-party risks; health and safety; and other operational risks posed by the COVID-19 environment.

Keeping the audit committee's agenda focused will require vigilance. Virtually all companies will continue to deal with significant disruption and uncertainty, and will grapple with reopening the business and managing a remote workforce, accelerating digital transformation,

building more resilient supply chains, and strengthening connections with customers—all while attempting to innovate and take advantage of opportunities arising from this disruption. To address the ongoing disruption, audit committees are asking management to update and stress test risk assessments, scenario planning, and crisis protocols. Does the audit committee have the time and expertise to oversee the major risks now on its plate? Does cyber risk require more attention at the full-board level—or perhaps a different board committee? Is there a need for a compliance or risk committee? Where does oversight of ESG metrics and reporting belong? Many boards are reluctant to create an additional committee, but considering whether a finance, technology, risk, sustainability, or other committee would improve the board's effectiveness can be a healthy part of the risk oversight discussion. Also consider reallocating risk oversight duties among the board's existing committees.



Monitor the financial reporting and disclosure impacts of COVID-19 on the company's filings.

The financial reporting, accounting, and disclosure impacts of COVID-19 are far-reaching and will continue to unfold in 2021. Among the key areas of audit committee focus for the company's 2020 Form 10-K and 2021 filings:

— **Forecasting and disclosures.** The uncertain trajectory of COVID-19 and the economy—coupled with the extensive use of forward-looking

¹ KPMG Audit Committee Institute, [Challenges presented by COVID-19](#), October 5, 2020.

information in financial statements and SEC filings—have made disclosures regarding the current and potential effects of COVID-19 (e.g., risk factors, Management Discussion & Analysis (MD&A), liquidity, results of operations, and known trends and uncertainties) a top area of focus. As identified in our [survey](#), other prominent areas of audit committee attention include preparation of forward-looking cash-flow estimates; impairment of nonfinancial assets, including goodwill and other intangible assets; accounting for financial assets, including fair value; going concern; and use of non-GAAP metrics. [CF Disclosure Guidance Topic No. 9A](#), issued by the staff of the Securities and Exchange Commission's Division of Corporation Finance, provides companies affected by COVID-19 additional guidance on disclosure considerations for the financial statements and MD&A. The SEC wants companies to provide disclosure that allows investors to evaluate the impact of COVID-19 through the eyes of management and to revise and update that disclosure as circumstances change.

— **Accounting for government assistance.**

Assistance under the Coronavirus Aid, Relief, and Economic Security (CARES) Act may take different forms, including favorable loans (some or all of which may be forgiven) and loan guarantees, grants, credits, payroll and payroll tax support, and reimbursement of healthcare-related expenses and/or lost revenue. Loans and grants obtained under these programs generally impose significant restrictions on the recipient and some require the issuance to the U.S. Treasury of stock warrants or other equity interests. Companies receiving government assistance need to determine the appropriate revenue recognition model.

— **Internal control over financial reporting (ICFR).**

Companies are reassessing, enhancing, or establishing new internal controls due to COVID-19-related disruptions to business operations, including IT system access and authentication to enable a remote/virtual workforce, cybersecurity, entity-level controls (communication and assignment of authority, segregation of duties, access review controls), return-to-work plans, and data privacy. In the event of material changes in ICFR, disclosure is required.



Reinforce audit quality and understand the impact of COVID-19 on the external audit process.

Audit committees should understand what changes to the audit process auditors are making in light of COVID-19 and why. As a starting point, the external auditor needs to conduct incremental risk assessment procedures that are sufficient to provide a reasonable basis for identifying and assessing the risks of material misstatement (whether due to error or fraud), and design further audit procedures. What changes in audit scope and revisions to the audit approach are necessary? The Center for Audit Quality's *Focus on the Auditor's Risk Assessment* identifies new or different risks the auditor may need to consider, including:

- Liquidity, access to capital, debt covenant compliance
- Ability to continue as a going concern
- Cybersecurity, including data security in a virtual environment
- Changes in ICFR due to working in a virtual environment including information technology general controls
- Asset and goodwill impairment
- Fair-value estimates
- Third-party vendor considerations
- Industry-specific regulatory and economic considerations, including concentration risk
- Geographic-specific regulatory and economic considerations, including concentration risk
- Business interruption
- Heightened risk of fraud due to COVID-19.

The internal control environment is a critical area of focus. With the shift to remote working and financial reporting processes moving from in-person to virtual, there is an increased risk of internal control breakdowns. In evaluating the design and implementation of controls relevant to the audit, an important area of auditor focus will be on how controls may have changed during COVID-19 to accommodate remote workforces and process flows. What new controls or changes to controls have been required as a result of risks posed by, among other things, the work-from-home environment, change in reporting lines or new people responsible for controls, and increased fraud risk due to employee financial hardship as well as management pressure to meet financial targets?

The PCAOB has highlighted the importance of frequent communication with the auditor as a result of COVID-19, and offered the following considerations:²

- Engage with the auditor and management to discuss potential challenges to a timely completion of the audit. Review and discuss the timeline for the phases of work.
- Determine a good cadence for communications that include both the auditor and management so that the audit committee receives the information it needs in a timely manner, while also considering the additional demands on auditors and management during the pandemic.
- Discuss any changes to the audit plan with the auditor, including changes to areas of focus and how the auditor plans to address new or modified areas of risk. Discuss if there are changes to how the auditor will identify and test internal controls plans.
- Discuss which disclosures may need to change as a result of COVID-19.

Finally, as the PCAOB noted, audit committees should discuss with the auditor the challenges and risks of conducting the audit remotely. For example, what alternative methods are available for conducting physical inventory counts? Will additional time be needed to get the audit work done remotely? What complexity does working remotely add to the audit?



Work with management to reassess and oversee the scope and quality of the company's ESG/sustainability reports and disclosures.

For several years, companies have faced increasing demands—from investors, research and ratings firms, activists, employees, customers, and others—for more transparent and higher-quality information about ESG issues and risks. How does the company define its corporate purpose, and how does it consider the interests of stakeholders—employees, customers, suppliers, and communities—in addition to shareholders? These demands increasingly have teeth, particularly from investors exerting pressure during shareholder engagement and director elections. For example, Institutional Shareholder Services (ISS) stated that, for annual meetings held on or after February 1, 2021, “demonstrably poor risk oversight of environmental and social issues, including climate change” may trigger a vote against or withhold from directors.³ Boards also risk potential lawsuits and

exposure if the company discusses these issues (such as a commitment to diversity) in a manner that does not align with what is happening on the ground. We expect the 2021 proxy season to feature a significant number of ESG proposals.

The events of the past year—COVID-19, its disproportionate impacts on employees and communities of color, and the social unrest triggered after the death of George Floyd and others—have focused companies on the “S” in ESG. For example, how a company addresses employee issues such as diversity and racial inequality, health and safety, sick leave, and work-from-home arrangements and communicates with suppliers and customers regarding their COVID-19-related challenges highlights the importance of the “S” issues. How the company considers its stakeholders in creating sustainable long-term value may have a major impact on reputation. And stakeholder demands are not limited to social issues. Disclosure on climate issues continues to be a high priority for many institutional investors. More than 90 percent of respondents to Morrow Sodali’s Institutional Investor Survey 2020 expect companies to demonstrate a link between financial risks, opportunities, and outcomes with climate-related disclosure.⁴

Stakeholder demands for more detailed sustainability/ESG reporting include requests for comparable and consistent information that is actionable from an investment perspective (and an explanation of how it links to strategy and performance). Audit committees should encourage their management teams to reassess the scope and quality of the company’s sustainability/ESG reports and disclosures—including benchmarking against peers, consideration of the methodologies and standards of ESG raters (which may vary widely), and ESG reporting frameworks.

Whether on a website, sustainability report, or in an SEC filing, the audit committee should ask, what controls are in place to ensure the quality of the ESG information being disclosed? Is it reviewed with the same rigor as financial information? Does (or should) the company obtain third-party assurance on the ESG information to provide investors with a greater level of comfort? Does the audit committee understand and receive reports on the basis for and processes used to generate the disclosures? Beyond ratings, this is about how ESG risks and opportunities are handled and their impact on the creation of long-term value, whether investors elect to invest (or not) based upon a company’s ESG profile, and cost of capital. Stating its

² PCAOB—Conversations with Audit Committee Chairs: COVID-19 and the Audit, July 2020.

³ Institutional Shareholder Services, Inc., “Americas Proxy Voting Guidelines Updates for 2021,” published November 12, 2020.

⁴ Kiran Vasantham and David Shammai, Institutional Investor Survey 2020, Morrow Sodali, March 2020

view that “a company’s ESG score will soon effectively be as important as its credit rating,” State Street Global Advisors said it would take voting action against directors at companies that were laggards based on their ESG scores (as determined by State Street) and that could not articulate how they planned to improve their score.⁵ Similarly, BlackRock has indicated that it will also vote against directors for a lack of progress on ESG.⁶

Investors want to understand which ESG issues are of strategic significance to the company. How is the company addressing ESG as a long-term strategic issue and embedding it into the company’s core business activities (strategy, operations, risk management, incentives, and corporate culture) to drive long-term performance and value creation? Is there a clear commitment and strong leadership from the top as well as enterprise-wide buy-in? As one director commented, “Real transparency is not easy, and it’s usually uncomfortable. But to make real progress and be accountable as a company today, you have to ‘show your work.’ What targets have you set and what are you doing to reach those targets?”

In light of the social justice protests and “S” commitments that business leaders have made to various stakeholders, expectations will continue to grow for companies to “show their work,” shortcomings and all. The company’s progress on these ESG issues—from employee well-being to addressing social justice issues and climate risk—will be front and center for stakeholders as we head into a challenging recovery and a new reality.



Understand how technology is impacting the finance organization’s talent, efficiency, and value-add.

With COVID-19, we have seen an acceleration of companies’ digital transformation efforts. Technology changes also present important opportunities for finance to reinvent itself and add greater value to the business. As audit committees monitor and help guide finance’s progress in this area, we suggest three areas of focus:

- Recognizing that much of finance’s work involves data gathering, what are the organization’s plans to leverage robotics and cloud technologies to automate as many manual activities as possible, reduce costs, and improve efficiencies?

- Understand how the finance function is using data analytics and artificial intelligence to develop sharper predictive insights and better deployment of capital. The finance function is well-positioned to guide the company’s data and analytics agenda and to consider the implications, opportunities, and risks of new transaction-related technologies, from blockchain to crypto-currencies. As historical analysis becomes fully automated, the organization’s analytics capabilities should evolve to include predictive analytics, an important opportunity to add value.
- As the finance function combines strong analytics and strategic capabilities with traditional financial reporting, accounting, and auditing skills, its talent and skill-set requirements must change accordingly. Is finance attracting, developing, and retaining the talent and skills necessary to match its evolving needs? In this environment, it is essential that the audit committee devote adequate time to understand finance’s transformation strategy.



Help ensure that internal audit remains focused on the most critical risks, including risks posed by COVID-19.

Is our internal audit plan risk-based and flexible and does it adjust to changing business and risk conditions? This is an increasingly common question that chief audit executives are asked by the audit committee. While a global pandemic was perhaps not on internal audit’s list of likely risk events as we headed into 2020, audit committee members responding to our survey by and large said that their internal auditor successfully shifted its focus to the critical risks posed by COVID-19—identifying emerging risks, reviewing management’s assessment of those risks as well as management’s remediation plans and controls for those risks, and assessing incremental fraud risks, as well as return-to-work plans and related risks.⁷

The audit committee should work with the chief audit executive and chief risk officer to help identify the COVID-19-related risks and other risks that pose the greatest threat to the company’s reputation, strategy, and operations—such as tone at the top and culture, legal/regulatory compliance, incentive structures, cybersecurity and data privacy, ESG risks, and global supply chain and outsourcing risks. Ask again whether the audit plan is risk-based, flexible, and can adjust to changing COVID-19 and other business and risk conditions. What’s changed in the operating

⁵ State Street Global Advisors, “CEO’s letter on our 2020 Proxy Voting Agenda,” January 28, 2020. State Street employs a proprietary rating system called R-Factor™ that leverages the SASB framework and draws on data from four providers.

⁶ A Fundamental Reshaping of Finance, Larry Fink’s letter to CEOs, BlackRock, January 2020.

⁷ KPMG Audit Committee Institute, [Challenges presented by COVID-19](#), October 5, 2020.

environment? What risks are posed by the company's digital transformation and the company's extended organization—sourcing, outsourcing, sales, and distribution channels? Is the company sensitive to early warning signs regarding safety, product quality, and compliance? What role should internal audit play in auditing the culture of the company? Set clear expectations and help ensure that internal audit has the resources, skills, and expertise to succeed—and help the chief audit executive think through the impact of digital technologies on internal audit.



Sharpen the focus on the company's ethics, compliance, and whistle-blower programs, recognizing the increased pressure on employees.

The reputational costs of an ethics or compliance failure are higher than ever, and COVID-19 has increased the risk of such a failure, particularly given the changed control environment, increased fraud risk due to employee financial hardship, and the pressure on management to meet financial targets. Fundamental to an effective compliance program is the right tone at the top and culture throughout the organization, which supports the company's strategy, including its commitment to its stated values, ethics, and legal/regulatory compliance. This is particularly true in a business environment made more complex by COVID-19, and as companies move quickly to innovate and capitalize on opportunities in new markets, leverage new technologies and data, and engage with more vendors and third parties across increasingly complex supply chains. Coupled with the challenging global regulatory environment—the array

of data privacy, environmental, healthcare, financial services, and consumer protection regulations, as well as the Foreign Corrupt Practices Act and the U.K. Bribery Act—compliance risks and vulnerabilities will require vigilance.

Closely monitor the tone at the top and culture throughout the organization with a sharp focus on behaviors (not just results) and yellow flags. Is senior management sensitive to the human resource issues stemming from COVID-19, particularly the pressures on employees (in the office and at home), employee health and safety, employee productivity, engagement and morale, and normalizing work-from-home arrangements? In a crisis of this magnitude, leadership and communications are key, and understanding, transparency, and compassion are more important than ever. Does the company's culture make it safe for people to do the right thing? Help ensure that the company's regulatory compliance and monitoring programs are up to date, cover all vendors in the global supply chain, and clearly communicate the company's expectations for high ethical standards. Focus on the effectiveness of the company's whistle-blower reporting channels and investigation processes. Does the audit committee see all whistle-blower complaints and receive reports on how they are handled? If not, what is the process to filter complaints that are ultimately reported to the audit committee? As a result of the radical transparency enabled by social media, the company's culture and values, commitment to integrity and legal compliance, and its brand reputation are on full display.

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The KPMG Board Leadership Center (BLC) champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programs and perspectives—including the KPMG Audit Committee Institute, the WomenCorporateDirectors Foundation, and more—the BLC engages with directors and business leaders to help articulate their challenges and promote continuous improvement of public- and private-company governance. Drawing on insights from KPMG professionals and governance experts worldwide, the BLC delivers practical thought leadership—on risk and strategy, talent and technology, globalization and compliance, financial reporting and audit quality, and more—all through a board lens. Learn more at kpmg.com/us/blc.

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As part of the KPMG Board Leadership Center, the ACI provides audit committee and board members with practical insights, resources, and peer-exchange opportunities focused on strengthening oversight of financial reporting and audit quality, and the array of challenges facing boards and businesses today—from risk management and emerging technologies to strategy, talent, and global compliance. Learn more about ACI at kpmg.com/us/aci.

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