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Current trends in audit committee reporting

Disclosure of audit committee composition and performance has received increased focus during the past several years. Some governance groups and a few investors have been vocal in advocating for more information on how the audit committee executes its duties, especially related to the oversight of the independent auditor.¹ Audit committee reporting has also been the topic of discussion and legislation in other jurisdictions, including the United Kingdom and the European Union. The SEC sought public comment on this topic in a July 2015 concept release titled *Possible Revisions to Audit Committee Disclosures*.²

Deloitte believes that transparency into the audit committee's activities and performance can increase investors' confidence in the audit committee. In preparation for our response to the SEC's concept release, we analyzed the most recent proxy statements of the companies included in the S&P 100 index³ to identify trends in audit committee reporting that may be relevant to the SEC's consideration of any future regulatory action in this area. After noting that the S&P 100 companies uniformly comply with required disclosure requirements related to the audit committee, which are summarized in the appendix, we focused our review on disclosures that either expanded on or exceeded these required elements.

¹For example, in 2013, the Center for Audit Quality and several governance organizations formed the Audit Committee Collaboration, which released a report titled *Enhancing the Audit Committee Report: A Call to Action* to encourage enhanced audit committee disclosures. For the past several proxy seasons, the United Brotherhood of Carpenters Pension Funds has made public its requests of select companies to provide specific disclosures related to the audit committee.

²For further details regarding the concept release, refer to the [July 2015 Special Edition Audit Committee Brief](#).

³Our review included the most recent annual proxy statements filed as of August 1, 2015, for the companies that were included in the S&P 100 index as of January 31, 2015.

Deloitte's analysis shows that many companies have voluntarily increased proxy disclosures related to the audit committee, including the committee's role, its composition, and how it works with the independent auditor and the internal audit function. Commenters on the SEC's proposal⁴ expressed varying points of view on whether SEC rule changes are necessary in these areas, but most supported meaningful transparency into the audit committee's oversight of the independent auditor, whether required or voluntary. Even as the SEC considers its next steps, it appears that audit committee disclosures will remain an area of focus.

Composition of the audit committee

Since 2009, when the SEC required companies to enhance disclosures about the qualifications of director nominees, many companies have increased their focus on providing information on board qualifications and skills. There is an added complexity when considering which board members to include on the audit committee because of listing requirements that audit committee members be independent and possess financial expertise or financial literacy.⁵

While the SEC does not require companies to have a designated financial expert, it does require disclosure of whether or not a company has at least one financial expert on the audit committee. Additional details on audit committee composition may help investors understand the qualifications of audit committee members to fulfill their responsibilities.

Every company covered by our analysis disclosed that it had at least one financial expert, and 76 percent have more than one financial expert. Almost 60 percent of the companies in our analysis included disclosure relevant to the financial literacy of their audit committee members. Those companies that did not explicitly disclose this information often referred to the audit committee being compliant with applicable listing standards on board composition, which for the NYSE includes that each member of the audit committee be financially literate.⁶

In the portions of the proxy that contained director biographies and board qualifications, many companies included expanded disclosure of why each board member was selected for the audit committee and/or disclosed information on industry background, credentials, and prior positions held by the candidates that may be relevant to their qualifications for audit committee service. Such disclosures included attributes such as:

- Management and operations experience
- Risk management experience
- Knowledge of financial statements and audit matters
- Experience as a director and audit committee member of a public company.

With respect to the NYSE requirement that companies disclose if an audit committee member sits on the audit committee of more than three public companies, some companies disclosed that they had a cap on the number of other boards and audit committees to which board members could belong.



⁴See comment letters received on SEC Concept Release No. 33-9862; 34-75344 File No. S7-13-1, *Possible Revisions to Audit Committee Disclosures* at <https://www.sec.gov/comments/s7-13-15/s71315.shtml>.

⁵See, e.g., *Commentary to NYSE Listed Company Manual* Section 303A.07(a) and NASDAQ Equity Rule 5605(c)(2)(A); NASDAQ IM-5605-4, setting out requirements for audit committee composition and independence.

⁶NYSE Listed Company Manual Section 303A.07(a).

Role of the audit committee

Every company in the S&P 100 included some disclosure regarding the roles and responsibilities of the audit committee. Although there were varying levels of detail provided by companies, the specific responsibilities most commonly noted — often by noting that they were included in the charter⁷ — were the audit committee’s oversight of:

- The company’s financial statements
- The company’s accounting and financial reporting processes, including internal control over financial reporting and relevant reports
- The independent auditor’s qualifications, performance, and independence
- The risk management process
- The performance of the company’s internal audit function
- Compliance with the company’s ethical standards
- Compliance with legal and regulatory requirements
- The ratification of related-party transactions
- Procedures to receive, retain, and address complaints regarding accounting, internal accounting controls, or auditing matters.

More than 75 percent of the S&P 100 disclosed more than just the existence of their audit committee charter, including information such as how often the charter is reviewed or additional detail on the provisions of the charter.

We most often found disclosures related to the audit committee’s responsibilities in the section of the proxy describing the board committees, but we also found disclosures related to the responsibilities of the audit committee in other areas of the proxy statement, including:

- The audit committee report
- Disclosure related to the ratification of the selection of the independent auditor⁸
- Policy on pre-approval of audit and permissible nonaudit services of the independent auditor
- Discussion of policies on related-party transactions
- Disclosure of the board’s role in risk oversight.

All of the S&P 100 companies disclosed at least some topics of discussion between the audit committee and management, the independent auditor, the internal audit function, and others. Most companies limited this disclosure to the four items required by Item 407 of the SEC’s Regulation S-K. Those companies that identified additional topics of discussion generally limited their disclosures to the topics covered and did not provide detail of the discussions. The topics listed most commonly were:

- Risk management process
- Quality of financial reporting
- Quality of compliance programs
- Selection, application, and disclosure of critical accounting policies
- New accounting developments and accounting-related disclosures
- Key assumptions and accounting judgments made in preparing the financial statements
- Results of internal audit and/or independent audit examinations and management’s response to the findings.

⁷For additional information about audit committee charter trends and requirements see Deloitte’s [Audit Committee Resource Guide](#).

⁸Although companies are not required to obtain shareholder ratification of the appointment of the independent auditor, all of the S&P 100 companies did seek ratification.

Oversight of the financial reporting process

While some companies merely noted that one of the audit committees' roles was oversight of the financial reporting process, many others provided at least some additional detail. For example, 47 percent of the companies in our analysis disclosed that the audit committee reviews significant accounting policies. More than half of those (or 28 companies) included further detail on this review, such as the quality of the significant accounting policies, or on discussions with management and the independent auditor. The same number disclosed discussion of management judgments and accounting estimates.

Twenty of the companies in the S&P 100 disclosed that the audit committee reviews the earnings or annual report press release with either management or the independent auditor. Slightly fewer disclosed that audit committee discussions about the financial statements took place before earnings announcements were released.

Oversight of the independent auditor

Sarbanes-Oxley requirements made clear that the audit committee has a responsibility to select, compensate, and oversee the work of the independent auditor. The law explicitly states that the auditors "shall report directly to the audit committee" and thus interposed the audit committee between management and the independent auditor. Sixty-eight percent of the S&P 100 disclosed that the audit committee had separate meetings with the auditor. There is a range of other disclosure practices by companies related to the audit committee's oversight of the independent auditor.

"Disclosures that emphasize the direct reporting relationship between the audit committee and the external auditor, and give insight into the audit committee's assessment of audit quality and independence, could be valuable to investors in assessing an audit committee's performance of its Sarbanes-Oxley duties. These could include disclosures that give a clearer picture of the level and extent of communication between the external auditor and the audit committee, beyond the fact that communications required by PCAOB auditing standards and listing requirements occurred, such as the audit committee's practices with regard to:

- Meeting privately, or otherwise fostering the direct reporting relationship, with the external auditor;
- Meeting with key members of the audit team, including subject matter experts, industry experts, other specialists; and
- The assessment of the audit firm's performance and its system of quality control."

Deloitte's September 2 Comment Letter to the SEC

Appointment and evaluation of the independent auditor

Sixty-one of the S&P 100 companies explicitly disclosed that the audit committee evaluates the independent auditor, often specifying the criteria it used for those evaluations (e.g., independence, qualifications, or performance). Over half of these 61 companies included additional disclosures about why the audit committee decided to reappoint the independent auditor. The criteria most often mentioned as considerations for reappointment were the talent and experience of the auditor, the appropriateness of fees, and the quality and candor of the auditor's communications with the audit committee.

Approximately 70 percent of the companies in our analysis disclosed that the audit committee or its chair are directly involved in the selection of the auditor's new lead engagement partner when rotation is required by SEC rules. A small number of companies that included such disclosure supplemented it with additional information, such as:

- Assessment of the lead partner candidates' independence, objectivity, and qualifications (e.g., business judgement, multinational and industry experience)
- The role of management in the lead partner selection process
- Discussions with the full audit committee, if the selection process is led by the chair.

Companies commonly provided information relevant to the appointment of the independent auditor. Almost three-quarters of the S&P 100 stated explicitly that the members of the audit committee and/or the board believed that the continued appointment of the incumbent independent auditor was in the best interest of the company and its investors. Approximately the same number of companies disclosed that the audit committee periodically considers whether to change or regularly rotate the independent auditor. Just under two-thirds of companies disclosed the tenure of the incumbent auditor or noted that the company had had the same auditor for many years.

These disclosures were most often found in the disclosure related to the ratification of the independent auditor, and 80 percent of the companies disclosed what they would do if the majority of shareholders voted against ratification (e.g., consider whether to select another independent accounting firm).

"Disclosures that give insight into the audit committee's process and rationale for appointing the external auditor can provide important insight not only into the auditor's qualifications but also the audit committee's level of engagement and oversight."

Deloitte's September 2 Comment Letter to the SEC

Compensation of the independent auditor

The SEC requires disclosure of the audit committee's policies and procedures regarding pre-approval of fees paid to the independent auditor, and all companies in our analysis provided this information, along with the required disclosure related to the fees paid.

Some companies provided additional disclosures related to the auditor's compensation in other areas of the proxy, such as in the audit committee report or in the disclosure supporting ratification of the independent auditor. Just over three-quarters of companies explicitly stated that the audit committee compensates the independent auditor. Three other common articulations of the audit committee's role were that the audit committee approves audit engagement fees (40 percent); that the audit committee is responsible for the audit fee negotiations (23 percent); and that the audit committee sets the compensation for the independent auditor (7 percent).

Responsibility of the independent auditor

More than two-thirds of the S&P 100 included disclosures regarding the responsibilities of the independent auditor. For those companies that included this disclosure, specific responsibilities mentioned were:

- Audit the company's annual consolidated financial statements
- Express opinions on the conformity of the company's audited financial statements with generally accepted accounting principles
- Audit management's assessment of the effectiveness of internal control over financial reporting
- Review the company's quarterly financial statements.

Additionally, 62 percent of the S&P 100 disclosed that the audit committee discussed the overall scope of and plans for the audit with the independent auditor. Seven companies noted that they discussed issues encountered during the audit.

Based on our review, it appears that many companies and their audit committees currently provide disclosures that go well beyond those currently required. As audit committee disclosure continues to be a focus of regulators and investors, all audit committees should consider whether additional transparency, beyond required disclosures, would be beneficial. Although it is not possible to disclose everything an audit committee does each year in fulfilling its duties, providing additional insight into its structure and activities can help increase investors' confidence in the audit committee's performance and the independent audit process.

Appendix

Required disclosure related to the audit committee

SEC rules and regulations require that certain information about the audit committee be disclosed. Most companies include all of the required disclosures in their annual proxy statement. The following is an overview of those disclosure requirements.

Item 407 of Regulation S-K requires:

- Disclosure of whether the audit committee is governed by a charter and if so, whether a current copy of the audit committee’s charter is available on the registrant’s website or included as an appendix to the proxy statement or information statement that it is provided to security holders at least once every three fiscal years (or sooner if the charter has been materially amended).
- Disclosure of whether the audit committee members are independent as defined in the applicable listing standards⁵ and circumstances surrounding the appointment of any director who is not independent.
- Disclosure of whether the company has an audit committee, and if it does, the names of the members, the number of times the committee met in the past year, certain information about member attendance at these meetings, and a brief description of the functions performed.
- Disclosure of whether the audit committee has at least one “financial expert” and the name (and in some cases attributes) of the expert(s).
- An audit committee report that states whether the audit committee has:
 1. Reviewed and discussed the audited financial statements with management
 2. Discussed the required communication matters under applicable auditing standards with the independent auditor
 3. Received the required written independence communications from the independent auditor as required by the rules of the PCAOB and discussed with the independent auditor his or her independence
 4. Recommended to the board of directors that the audited financial statements be included in the company’s annual report on Form 10-K.

The name of each member of the audit committee must appear below these required disclosures.

The SEC’s regulations pertaining to preparation of a company’s annual proxy statement (Schedule 14A, Item 9) also require that the company disclose the audit committee’s policies and procedures regarding pre-approval of fees paid to the independent auditor.

In addition to the disclosures required by the SEC, the New York Stock Exchange Corporate Governance Listing Standards, Item 303A.06, require that public companies disclose whether any audit committee member serves on the audit committees of more than three public companies, and if so, why the board determined this was appropriate.

⁵Director independence disclosures are also required under NYSE *Listed Company Manual* Section 303A.02(a) and NASDAQ Listing Rule 5605(b)(1).

Summary Results of Analysis

Disclosure Related to the Composition of the Audit Committee

1. Audit committee has more than one financial expert	76%
2. Financial literacy of audit committee members	59%

Disclosure Related to the Role of the Audit Committee

3. Roles and responsibilities of the audit committee	100%
4. Information about the charter beyond its existence	77%
5. Topics of discussion by the audit committee	100%

Disclosure Related to the Oversight of the Financial Reporting Process

6. Audit committee review of significant accounting policies	47%
7. Additional disclosure about significant accounting policies	28%
8. Discussion of management judgments and/or accounting estimates	28%
9. Audit committee review of earnings/annual report press release with management and the independent auditor	20%
10. Audit committee discussions about the financial statements before earnings announcements	18%

Disclosure Related to the Oversight of the Independent Audit

11. Audit committee evaluates the independent auditor	61%
12. Why the audit committee decided to reappoint the independent auditor	35%
13. Audit committee or its chair involved in the selection of the auditor's new lead engagement partner	71%
14. Tenure of the independent auditor	64%
15. Retention of the incumbent independent auditor is in the best interest of the company and its investors	73%
16. Audit committee consideration of changing or regularly rotating the independent auditor	74%
17. Steps to be taken if majority of shareholders do not ratify the independent auditor	80%
18. Audit committee compensates the independent auditor	77%
19. Audit committee approves the audit engagement fees	40%
20. Audit committee is responsible for audit fee negotiations	23%
21. Audit committee sets the compensation for the independent auditor	7%
22. Responsibilities of the independent auditor	68%
23. Audit committee discussion with the independent auditor regarding the scope of and plans for the audit	62%
24. Discussion of issues encountered during the audit	7%
25. Separate meetings between the audit committee and the independent auditor	68%

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