

Audit Committee Brief

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SEC issues concept release concerning audit committee reporting requirements



Following an increased focus on audit committee disclosure, the SEC issued a concept release on July 1, 2015, titled *Possible Revisions to Audit Committee Disclosures*. The concept release seeks comment on the audit committee's responsibility for overseeing the independent auditor, among other related topics.

The SEC has said that investors have been vocal in advocating for more information on how the audit committee executes its duties. For example, the United Brotherhood of Carpenters Pension Funds has sent letters asking companies to include in their proxies additional information regarding the audit committee's oversight of auditor independence. Similarly, the Council of Institutional Investors expanded its [corporate governance policies](#) in 2013 to advocate for "meaningful information to investors about how the committee carries out its responsibilities" in audit committee reports.

Governance groups also have supported improved disclosure by audit committees on a voluntary basis, and indications are that a number of companies have heeded these calls.¹

Strengthening Audit Committee Disclosures

The Audit Committee Collaboration's 2013 guide, entitled *Enhancing the Audit Committee Report: A Call to Action*, encourages the proactive strengthening of public disclosures to more effectively convey to investors and others the critical aspects of the important work that audit committees perform. The group was formed in 2012 by the Center for Audit Quality and several leading governance organizations.

"As auditors, we value active audit committees and believe that meaningful disclosures that increase awareness of the audit committee's responsibilities, and how individual committees carry them out, can be important. We look forward to participating in the public dialogue that the SEC concept release has started, and we encourage audit committee members to share their perspectives as well."



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¹ See, e.g., the Center for Audit Quality and Audit Analytics report, *Audit Committee Transparency Barometer*, which assesses audit committee disclosures in the proxy statements of 1,500 companies in the S&P composite indices.

Why now?

The SEC's concept release notes that the disclosure requirements for audit committees have been largely unchanged since 1999. Since then, the roles and responsibilities of audit committees have increased significantly due to the Sarbanes-Oxley Act; changes in listing requirements; and enhanced requirements for communications with the external auditor, as required by the PCAOB.² The concept release seeks input on whether the SEC should consider adding, removing, or modifying certain current audit committee disclosure requirements in consideration of these changes.

The concept release cites differing views about whether additional disclosure requirements would be useful to investors, as well as a divergence in practice regarding voluntary disclosures. The SEC seeks input on whether enhanced requirements could help investors better assess the audit committee's performance, and thus make more informed investing and voting decisions, including voting on the ratification of the external auditor and the directors who are members of the audit committee.

Although the concept release is primarily focused on the relationship between the audit committee and the independent auditor, the SEC also encourages comment on other aspects of disclosures related to the audit committee, including roles and responsibilities, qualifications of audit committee members, and oversight of financial reporting and internal controls.

[Comments on the SEC's concept release](#) are due by September 8.

"The audit committee plays a critical role in financial reporting oversight, and investors have expressed interest in increased transparency into the audit committee's activities. The audit committee reporting requirements have not changed significantly in a number of years and I think it is time to take a look at whether improvements can be made." Mary Jo White, SEC Chair, *Remarks at the Financial Accounting Foundation Trustees Dinner*, May 2014

Specific requests for comment

The concept release seeks public input on some general issues regarding audit committee disclosure, such as whether regulatory change is needed, and the ideal location of disclosure about the audit committee in SEC filings. It also contains 74 specific questions, grouped primarily into three areas: (1) the audit committee's oversight of the external auditor, (2) the audit committee's selection of the external auditor, and (3) the audit committee's consideration of the audit firm's and engagement team's qualifications.

Oversight of the external auditor. The SEC seeks input on the potential utility of additional disclosure about the audit committee's oversight of the external auditor, including:

- Additional information regarding the communications between the audit committee and the external auditor
- The frequency with which the audit committee met with the external auditor
- Review of, and discussion about, the external auditor's internal quality review and most recent PCAOB inspection report
- Whether the audit committee assesses, promotes, and reinforces the external auditor's objectivity and professional skepticism and, if so, how

² January 4, 2013 *Heads Up: SEC Approves PCAOB Auditing Standard on Communications with Audit Committees*

Selection of the external auditor. The SEC requests comment on potential disclosures that could provide information on how the audit committee reached a decision about selecting the external auditor for the upcoming fiscal year, including:

- How the audit committee assessed the external auditor, including its independence, objectivity, and audit quality, as well as the audit committee’s rationale for selecting the auditor
- Whether the audit committee sought requests for proposal for the external audit and, if so, the process the committee undertook to seek such proposals and the factors it considered in making its selection
- The board’s policy, if any, for an annual shareholder vote on the selection of the external auditor, and the audit committee’s consideration of the voting results in its evaluation and selection of the external auditor

Consideration of the audit firm’s and engagement team’s qualifications. The SEC seeks input on certain potential disclosures relevant to the audit committee’s consideration of the qualifications of the firm and the engagement team, including:

- Disclosures of certain individuals on the engagement team
- Audit committee input in selecting the engagement partner
- The number of years the auditor has audited the company
- Other firms involved in the audit

Additional requests for comment. The SEC requests comment on additional areas, including:

- Whether additional disclosures beyond current requirements should be required or voluntary
- The location of audit committee disclosures in commission filings
- The application of the current and potential audit committee disclosure requirements to different types of companies, including smaller companies or foreign private issuers
- Certain potential collateral effects of additional disclosure requirements, such as whether they would change how the audit committee oversees the auditor, promote audit quality, or result in boilerplate disclosure, as well as the potential economic impact of additional disclosures

The audit committee perspective

Typically, only a small percentage of feedback on proposed financial reporting and audit regulations and standards comes from audit committees, although regulators and standard setters have emphasized the importance of hearing perspectives from audit committees, in their capacity as representatives of the interests of investors. A concept release is a step before formal rulemaking, making this an early, but important, stage in the process. We encourage audit committees to consider commenting on the proposal. Taking the time to comment, individually or through a group letter, can substantively affect the development of any future requirements in this area.

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PCAOB requests comments on audit firm transparency and quality indicators

The SEC acknowledges that some proposed topics of discussion in the SEC concept release, such as disclosure of the name of the engagement partner and audit tenure, overlap with proposals the PCAOB is considering. These include the PCAOB’s August 13, 2013, [proposed changes to the auditor’s reporting model](#)³, which its latest standard-setting agenda indicates may be re-proposed for public comment in the fourth quarter of 2015.

Moreover, on June 30, 2015, the PCAOB released two documents that are intended to, at least in part, increase audit-firm transparency and enhance audit committee oversight of auditors:

Concept Release on Audit Quality Indicators (AQIs) and Notice of Roundtable⁴ The PCAOB is seeking input on a portfolio of 28 potential AQIs, including uses for and reporting of such AQIs; whether AQI usage should be mandatory or voluntary; the scope of the potential requirements; and the value of such indicators to audit committees, audit firms, investors, and regulators. Comments on this concept release are due by September 29, 2015.

Supplemental Request for Comment: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form⁵ The PCAOB is seeking input on a proposed requirement for registered public accounting firms to disclose certain information to be included in a searchable database on the PCAOB’s website including the following:

- The name of the engagement partner on the current audit
- The names, country location of headquarters, and extent of participation of other public accounting firms involved in the audit (above a 5 percent threshold based on total audit hours)

Comments on the supplemental request for comment are due by August 31, 2015.

For additional information on these documents see [Heads Up: SEC and PCAOB Take Steps Toward Enhancing Audit Committee and Auditor Disclosures](#).

3 PCAOB Release No. 2013-005, *Proposed Auditing Standards—The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion; The Auditor’s Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor’s Report; and Related Amendments to PCAOB Standards*.

4 PCAOB Release No. 2015-005, *Concept Release on Audit Quality Indicators and Notice of Roundtable*.

5 PCAOB Release No. 2015-004, *Supplemental Request for Comment: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form*.

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