

To the Point

SEC – concept release

SEC seeks feedback on possible changes to audit committee disclosures

‘Effective audit committee oversight is essential to investor protection and the functioning of our capital markets.’

– SEC Chair Mary Jo White

What you need to know

- ▶ The SEC issued a concept release seeking public comment on whether there would be benefit from mandating more disclosures from audit committees about how they execute their existing audit oversight responsibilities.
- ▶ The concept release seeks comment on whether more audit committee disclosures would help close the expectation gap by providing investors with better insights into the responsibilities of the audit committee. It also asks whether new disclosures would inform their investment decisions and voting decisions about whether to ratify the selection of the auditor or re-elect members of the audit committee to the Board.
- ▶ Comments are due 60 days after the concept release is published in the Federal Register.

Overview

The Securities and Exchange Commission (SEC) issued a [concept release](#) on possible revisions to its audit committee disclosure rules that explores whether audit committees should provide more qualitative disclosures about how they execute existing responsibilities to oversee the audit. The audit committee report in the annual proxy statement currently must affirm only that the audit committee carried out certain specific responsibilities related to communications with the external auditor.¹

The SEC observed that while the Sarbanes-Oxley Act of 2002 (the Act) codified the role of the audit committee in overseeing a company’s financial reporting process and the audit, the SEC’s disclosure requirements for audit committee reporting to shareholders have not changed significantly since 1999. The Act required the audit committee to be independent from management and made the audit committee directly responsible for the retention, compensation

and oversight of the independent external auditor. The SEC noted that, in recent years, many audit committees have voluntarily provided more robust disclosures about their oversight of the external auditor. It also observed that investors have increased their focus on activities and transparency of audit committees.

The concept release is part of a broader effort by the SEC and the Public Company Accounting Oversight Board (PCAOB) to increase transparency of the audit process. The PCAOB has proposed that auditors name the engagement partner and other public accounting firms that participated in the audit in regulatory filings.² The PCAOB also issued a concept release on audit quality indicators it believes might be useful to various stakeholders, including audit committees, audit firms, investors, regulators and others.³ The comment period for all of these initiatives is now open so stakeholders have the opportunity to consider them holistically.

In its concept release, the SEC said it is seeking to understand whether mandating additional disclosure about the audit committee's oversight of the auditor would provide useful information that would help investors to make better investment decisions and voting decisions about whether to ratify the selection of the auditor or re-elect members of the audit committee to the Board. While the concept release discusses the views of certain investors and groups that have called for more audit committee reporting, it acknowledges that others have expressed concerns about the potential usefulness of additional audit committee disclosures.

Key considerations

The concept release requests public comment on 74 questions about possible disclosure changes primarily in the following areas:

- ▶ Oversight of the auditor
- ▶ Process for appointing or retaining the auditor
- ▶ Evaluation of the audit firm and engagement team qualifications

Oversight of the auditor

The concept release questions whether the SEC should require additional qualitative disclosures about the nature, timing and frequency of the communications between the audit committee and the auditor.⁴ For example, the SEC seeks input on whether the audit committee should report on its communications with the auditor about topics such as the overall audit strategy, significant risks, the nature and extent of specialized skills used in the audit and the use of a company's internal audit personnel.

The concept release also asks whether disclosure would be useful about how the audit committee assesses, promotes and reinforces the auditor's objectivity and professional skepticism. In addition, it seeks feedback on whether the audit committee should disclose how it considered the results of PCAOB inspection reports and the audit firm's internal quality control reviews.

Process for appointing or retaining the auditor

The concept release discusses possible disclosures about the process and criteria the audit committee used to assess the auditor and its rationale for selecting or retaining the auditor. It cites the PCAOB's concept release on possible indicators of audit quality and asks whether an audit committee that uses these or other indicators should disclose which indicators it used to evaluate the auditor.

The concept release also discusses possible disclosures about the number of firms that were asked to propose providing audit services and what information the audit committee considered in making its selection. And it requests feedback about disclosures of any policy on shareholder ratification of the auditor and how the results of these votes were considered in the audit committee's decision to retain the audit firm.

Evaluation of the audit firm and engagement team qualifications

The concept release asks whether the SEC should require disclosures about the length of the company's relationship with the auditor (which the PCAOB previously proposed requiring in the audit report) and how the audit committee considered the auditor's tenure in deciding to retain the auditor. It also asks whether the audit committees should name and report on the qualifications of certain individuals who perform the audit (e.g., the engagement partner, the engagement quality reviewer, additional individuals subject to PCAOB rotation requirements) and identify other public accounting firms that participated in the audit. As discussed above, the PCAOB has proposed requiring disclosure of the engagement partner and other participating public accounting firms, either in the auditor's report or a new form to be filed with the PCAOB.

Applicability and location of possible disclosures

The concept release also seeks input on whether new and existing audit committee disclosures should be required to appear in one location and whether the requirements should apply to smaller reporting companies and emerging growth companies. Disclosures required by existing SEC rules are included in proxy statements but they are not required in the prospectus delivered to investors for public offerings. The concept release asks whether investors would benefit from these disclosures being included in that prospectus.

The SEC is seeking input on whether and how additional reporting may be useful to investors.

How we see it

- ▶ Enhancing audit committee transparency can increase investors' confidence in financial reporting and their confidence in the role of the audit committee in overseeing the audit process and promoting audit quality in the interest of investors.
- ▶ Many audit committees have begun telling investors more about what they do in overseeing the audit and the independent auditor. Meaningful disclosure about what audit committees do and how they oversee auditors would provide a window into the work they perform, which could further the alignment among auditors, audit committees and investors, an outcome we strongly support. However, additional requirements that result in largely "boilerplate" disclosures would offer little value to investors.
- ▶ Commenters should consider the range of possible disclosures presented in the concept release to identify disclosures that would provide the most decision-useful information to investors.

Endnotes:

- ¹ The SEC's disclosure requirements are in Item 407 of Regulation S-K and Exchange Act Rule 10A-3.
- ² See [PCAOB Release No. 2015-004, Supplemental Request for Comment: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form](#).
- ³ See [PCAOB Release No. 2015-005, Concept Release on Audit Quality Indicators](#).
- ⁴ Audit committee and auditor communications required by PCAOB Auditing Standard No. 16, *Communications with Audit Committees*.

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