

Audit committee reporting to shareholders

2013 proxy season update



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Building on February's Audit committee reporting to shareholders: going beyond the minimum

This 2013 proxy season update builds on EY's prior work in the area of audit committee reporting. To facilitate consideration and discussion of enhanced audit committee disclosures for investors, regulators and other stakeholders, in February 2013, EY issued *Audit committee reporting to shareholders: going beyond the minimum*. That document reviewed the 2012 audit committee-related disclosures of Fortune 100 companies to determine whether companies already provide information over and above what is required under current disclosure laws and rules. It also compared the companies' voluntary disclosures to the additional information sought by some investor groups and policymakers. Our review of 2012 disclosures showed that many companies provided information beyond the minimum required by current law or stock exchange rules. The review also showed that there is significant variation in the type and location of these voluntary disclosures.

Audit committee reporting to shareholders: 2013 proxy season update

During the 2013 proxy season, the majority of Fortune 100 companies disclosed more information about their audit committees and external auditors than is required - and in many instances they also increased their disclosures in this area as compared to 2012. This conclusion was reached following a review of proxy data in the EY Corporate Governance Center's proprietary database. This review examined Fortune 100 companies that filed proxy statements for 2013 and 2012 and had an annual meeting by 30 June 2013 (78 companies in total). Companies that did not have an annual meeting in 2012 are not included in the data set, nor are companies that had their annual meetings after 30 June 2013.¹

Context

This enhanced audit committee-related disclosure coincides with several recent initiatives by investors and policymakers in which greater audit committee transparency is a theme.² Currently, US companies, boards and audit committees are required to provide certain disclosures relating to the external audit and the audit committee's oversight of the external auditor. Some suggest that greater insight into the work of the audit committee, including its auditor oversight role, would be beneficial to investors and other stakeholders. EY supports effective audit committees and believes that greater audit committee transparency can help increase investor confidence in financial reporting.

Investors, regulators and other stakeholders have continued to demonstrate interest in greater access to information about the audit and role of audit committees in the 2013 proxy season. For example, in April 2013, the Council of Institutional Investors (CII) revised its policies to support enhanced oversight of external audits and auditors by the audit committee, including additional reporting by audit committees.³

Investor groups also engaged with companies during the 2013 proxy season to request more information about auditors and audit committees.⁴

Outside of the United States, various developments support enhanced audit committee reporting as well, such as the final recommendations of Canada's *Enhancing Audit Quality* initiative.⁵ One of these recommendations was to enhance audit committee transparency about the audit committee's oversight of the auditor. In addition, the UK's Competition Commission recently recommended an advisory shareholder vote on the sufficiency of the audit committee's disclosures in annual reports as one of its proposed recommendations for addressing audit market concentration in the UK.⁶

Highlights of findings from the 2013 disclosures

Our review of 2013 proxy data examined whether companies are changing their voluntary audit committee-related disclosures from year to year in response to this environment. To this end, EY compared the audit committee-related disclosures of Fortune 100 companies from the 2012 and 2013 proxy seasons. While many companies' disclosures remained the same, there were some notable changes in 2013, particularly in areas where specific requests for additional information had been made by investors.

Voluntary proxy statement disclosures responding to shareholder requests	% of reviewed companies disclosing this in 2012	% of reviewed companies disclosing this in 2013
The audit committee is responsible for audit fee negotiations	1%	9%
The selection of the auditor is in the best interests of the company/ shareholders	4%	23%
The audit committee was involved in the selection of the lead audit partner	1%	17%
The audit committee is responsible for the appointment, oversight and compensation of the audit firm ⁷	37%	50%
The audit committee considers the impact of changing auditors when assessing whether to retain the current external auditor	3%	15%

Companies are responding to shareholder requests for more information: While many of the companies included in our review maintained the same level of audit committee-related disclosures from 2012 to 2013, there were certain noteworthy areas where the number of companies providing certain disclosures increased significantly. These areas corresponded to investor requests for specific categories of information.⁸ The chart above lists some of these categories of investor-requested information.

Some companies are innovating with respect to audit committee-related information: There were several types of informative disclosures provided by a few companies; these disclosures may signal practices that could become more widespread in coming years. For example:

- ▶ Four companies provided an explanation of why audit fees changed from 2012 to 2013. In 2012, only one company provided such disclosure.
- ▶ Six companies disclosed the topics that audit committees discussed with the external auditor in 2013, up from five in 2012.
- ▶ Two companies noted the year in which the current lead audit partner was appointed, rather than disclosing only the general policy that lead partners must rotate every five years.

Location, location, location: In our February publication we noted that audit committee-related disclosures can be found in different places in the proxy statement and the company website, which can make it difficult for readers to synthesize all available information.

Audit committees are required to provide in the proxy statement an audit committee report, which must contain certain information.⁹ While the audit committee report often is identified in the proxy statement's table of contents, making it easy for readers to find, other audit committee-related disclosures can often be found throughout the proxy, such as in the overall corporate governance section or the proposal to ratify the auditor. Many companies' audit committee charters are located on their company websites rather than attached to proxy materials.¹⁰ Companies generally do not provide a direct link to the charters in proxy statements, and navigation to the charter is not always intuitive.

This dispersal of audit committee-related information throughout disclosure documents continued in 2013. Where companies provided new disclosures in 2013, most were located in places other than the audit committee report.¹¹

What to expect in the 2014 proxy season: The focus on audit committee-related disclosures will continue into the 2014 proxy season. Investors are likely to continue or increase engagement with companies on the topic through letter-writing campaigns and direct dialogue. As investor groups, regulators and other stakeholders continue to focus on this topic, companies may decide that increased communication and transparency about audit and audit committee matters is in their self-interest as well as the public interest.

2013 findings

Below is a table showing voluntary audit committee-related disclosures by the reviewed Fortune 100 companies in 2012 and 2013 proxy statements. For information on disclosures required under federal statutes and stock exchange listing rules, please see our February publication of [Audit committee reporting to shareholders: going beyond the minimum](#).

Category	Disclosure	2012	2013
		% of total	% of total
Disclosures in the audit committee report	Statement that the audit committee is independent	56%	54%
	Name of the audit firm is included in the audit committee report	72%	72%
Audit committee composition	Audit committees with one financial expert (FE) ¹²	32%	31%
	Audit committees with two FEs	17%	23%
	Audit committees with three or more FEs	51%	46%
Audit committee responsibilities with respect to the external auditor	Statement that the audit committee is responsible for appointment, compensation and oversight of the external auditor ¹³	37%	50%
Identification of topics discussed with auditor	Topics discussed by the audit committee and external auditor ¹⁴	6%	8%
Fees paid to the external auditor	Statement that the audit committee considers non-audit fees and services when assessing the independence of the external auditor	79%	79%
	Statement that the audit committee is responsible for fee negotiations	1%	9%
	Explanation provided for a change in the fees paid to the external auditor	1%	5%
Assessment of the external auditor	Disclosure of the factors used in the audit committee's assessment of the external auditor's qualifications and work quality	18%	21%
	Statement that the audit committee was involved in lead partner selection	1%	17%
	Disclosure of the year the lead audit partner was appointed	3%	3%
	Statement that the choice of external auditor is in best interests of company and/or shareholders	4%	23%
	Tenure of the external auditor	27%	31%
Accessibility of audit committee charters from proxy statements	Disclosure of the length of the external auditor's tenure	3%	15%
	Statement that the audit committee considers the impact of changing auditors when assessing whether to retain the current external auditor	3%	15%
	Company provides a direct link to the audit committee charter	6%	9%
	Link to the audit committee charter goes to the company's main website	44%	40%
	Link to the audit committee charter goes to the company site for investor relations	26%	28%
	Link to the audit committee charter goes to the company site for corporate governance matters	24%	23%
	Link to the audit committee charter is located in the audit committee report	41%	41%
Link to the audit committee charter is located elsewhere in the proxy statement	59%	59%	

The reviewed companies had an average of 2.7 financial experts on their audit committees both 2012 and 2013.

In 2012 and 2013, a statement that the audit committee is responsible for the appointment, compensation and oversight of the auditor was disclosed by 10% of companies in the audit committee report. Twenty-seven percent and 40% of companies disclosed this information elsewhere in the proxy statement in 2012 and 2013, respectively.

A statement that the audit committee considers non-audit fees and services when assessing the independence of the auditor was disclosed by 47% of companies in the audit committee report, while 32% made it elsewhere in the proxy.

Reviewed companies' audit committees that disclosed information about their assessment of the external auditor stated that the assessments were based on criteria such as the independence and integrity of the external auditor; expertise of the external auditor; performance and qualifications of the auditor; and the quality of the external auditor's personnel and communications.

The average tenure of the external auditor was 27 years in 2012 and 2013 for those reviewed companies that disclosed this information.

End notes

¹ To enhance comparability of 2012 and 2013 data, some of the companies that had been included in the February 2013 *Audit committee reporting to shareholders: going beyond the minimum* were excluded if their annual shareholder meeting took place after June or if they were no longer in the Fortune 100.

² These initiatives include *Audit Committee Annual Evaluation of the External Auditor*, produced by a collaboration among the Association of Audit Committee Members, Inc., Center for Audit Quality, Corporate Board Member/NYSE Euronext, Independent Directors Council, Mutual Fund Directors Forum, National Association of Corporate Directors, and Tapestry Networks (available at <http://www.thecaq.org/resources/pdfs/AuditorAssessment.pdf>). They also include the *UK Corporate Governance Code*, which states that audit committees should report to shareholders about how they have assessed the effectiveness of the external audit and the approach taken to the appointment or reappointment of the auditor, among other topics. See §C.3.8 of the Code, which was issued by the UK Financial Reporting Council (September 2012) (available at www.frc.org.uk). This Code is implemented on a comply-or-explain basis.

³ *CII Policy on Corporate Governance*, §2.13a, available at www.cii.org.

⁴ For example, the pension funds of the United Brotherhood of Carpenters sent letters to a number of companies seeking additional disclosures relating to the audit and audit committee.

⁵ *Conclusions and recommendations of the Enhancing Audit Quality: Canadian Perspectives* project of the Chartered Professional Accountants of Canada and the Canadian Public Accountability Board (May 2013) (available at <http://www.cica.ca/enhancing-audit-quality-canadian-perspective/item74564.pdf>). Among other things, this report also recommended that audit committees conduct a comprehensive evaluation of the auditor every five years.

⁶ *Summary of provisional decisions on remedies*, UK Competition Commission Statutory Audit Services Market Investigation, 22 July 2013 (available at http://www.competition-commission.org.uk/assets/competitioncommission/docs/2011/statutory-audit-services/130719_summary_of_provisional_decision_on_remedies.pdf).

⁷ This percentage refers to companies that voluntarily disclose this information in the proxy statement. This information must be disclosed in audit committee charters. Many companies provide access to audit committee charters on their websites rather than as an attachment to the proxy itself.

⁸ For example, the pension funds of the United Brotherhood of Carpenters sent letters to certain companies requesting the information identified in the chart on p. 2.

⁹ The audit committee report must state whether the audit committee has a charter and if so, where it can be found. The audit committee report also must include a statement by the audit committee regarding whether it has discussed with the auditor matters required to be discussed by US auditing standards, received the written disclosures and letter from the auditor relating to independence, and based on this review and discussions, recommended to the board that the audited financial statements be included in the annual report. 17 CFR §229.407(d).

¹⁰ According to federal statutes and rules, public companies must disclose whether they have an audit committee charter. 17 CFR §229.407(d). Audit committees are required to have charters if they are listed on the New York Stock Exchange. New York Stock Exchange Rule 303A.07(b).

¹¹ Most companies that provided more audit- and audit committee-related disclosures in 2013 than in 2012 did so in the section of the proxy statement relating to the ratification of the auditor.

¹² Under SEC rules, companies must disclose whether there is a “financial expert” on the audit committee or explain why they do not have a financial expert. If there is more than one person that qualifies as a financial expert on the board, the company can choose whether to identify the additional members. 17 CFR §229.407(d)(5).

¹³ See end note 7 above.

¹⁴ Management and the internal audit unit may also be included in the discussion.

For more information

To obtain more information regarding EY's insights in this area, please contact Ruby Sharma, Americas Leader, Audit Committee Center of Excellence, EY at ruby.sharma@ey.com; +1 212 773 0078; or Allie Monaco Rutherford, Americas Leader, Corporate Governance Center, EY at allie.rutherford@ey.com or +1 202 327 7026.

Additional resources

- ▶ *Audit committee reporting to shareholders: going beyond the minimum*
- ▶ *EY's Point of view: enhancing transparency of the audit committee auditor oversight process*, available on www.ey.com

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