



EY Center for Board Matters Audit committee reporting to shareholders in 2016

September 2016

Executive summary

EY is pleased to present this fifth report on the topic of audit committee reporting based on the EY Center for Board Matters (CBM) review of audit committee-related proxy disclosures by Fortune 100 companies.¹ As in past years, our research shows that companies are continuing to supplement mandatory disclosures with additional voluntary information. Details on the continued adoption of enhanced disclosures by audit committees are provided later in this report. Through this publication, EY seeks to promote public discussion about audit committee communications with stakeholders, which has been the subject of investor and regulatory interest in recent years.

Audit committees have a key role in overseeing the integrity of financial reporting. Nevertheless, relatively little information is required to be disclosed by US public companies about the audit committee's important work. Since our first publication in this series, which covered 2012 audit committee-related proxy disclosures, we have described efforts by investors, regulators and other stakeholders to seek increased audit-related disclosures, as well as the resulting voluntary disclosures to respond to this interest.²

Over 2015-2016, US regulators have placed a spotlight on audit-related disclosures and financial reporting more generally. The US Securities and Exchange Commission (SEC) and the US Public

Company Accounting Oversight Board (PCAOB) have both taken action to consider the possibility of requiring new disclosures relating to the audit. SEC representatives also have used speeches to urge companies and audit committees to increase disclosures in this area voluntarily. While additional disclosure requirements for audit committees are not expected in the near term, regulators continue to monitor developments in this area. This report seeks to help shed light on the evolving audit-related disclosure landscape.

“Audit committees must ... take seriously their reporting to shareholders, a critical responsibility on which the SEC is closely focused ... [T]he audit committee report serves as a place for engaging with shareholders on important subjects, and the report must continue to meet the needs of investors as their interests and expectations evolve with the marketplace.”

SEC Chair, Mary Jo White; Keynote Address at the 2015 AICPA National Conference: [“Maintaining High-Quality, Reliable Financial Reporting: A Shared and Weighty Responsibility,”](#) December 9, 2015.

Context

Public company audit committees are responsible for overseeing financial reporting, including the external audit. Under US securities laws, audit committees are “directly responsible for the appointment, compensation, retention and oversight” of the external auditor,³ and must include a report in annual proxy statements about their work. This audit committee report, however, currently must affirm only that the committee carried out certain specific responsibilities related to communications with the external auditor, and this requirement has not changed since 1999.⁴ In recent years a variety of groups have brought attention to the relative lack of information available about the audit committee and the audit, including their view that this area of disclosure may not have kept up with the needs of investors and other proxy statement users. These groups include pension funds, asset managers, investors, corporate governance groups, and domestic and foreign regulators. As efforts to seek additional information have continued, there has been a steady increase in voluntary audit-related disclosures.⁵

Over the last year, the SEC has taken a series of actions to consider whether and how to improve transparency around audit committees, audits and financial reporting more generally. The combined effect of these activities has been to increase engagement by issuers, audit firms, investors and other stakeholders in discussions about the current state of financial reporting-related disclosure as well as how it should change.

SEC concept release

In July 2015, the SEC issued its Concept Release on Possible Revisions to Audit Committee Disclosures, which solicited views on whether there should be greater transparency around the work of audit committees, and if so, how best to achieve it. The concept release focused specifically on transparency relating to the audit committee’s oversight of the auditor.

Responses from commenters

The concept release drew comments from a variety of capital market participants, including audit committees, public company executives, investors, business and legal associations, academics and audit firms.⁶

- ▶ Commenters representing board members, corporate management and auditors generally advised against new, more prescriptive SEC-required disclosures. Many were supportive, however, of voluntary disclosures by issuers and audit committees, and provided views on the disclosures they thought would be most helpful to investors. These commenters suggested that companies would be more likely to provide more meaningful disclosures if allowed to disclose

information voluntarily in response to investor interest and the company’s particular circumstances. Mandatory requirements could result in boilerplate disclosures.

- ▶ A majority of the investors that provided comments took a different view, however, and supported mandatory disclosures. Among the reasons provided for preferring required disclosures was that investors typically do not have enough information with which to assess the audit committee under the current disclosure regime, which already allows voluntary disclosures. In addition, required disclosures would allow for greater comparability among companies.
- ▶ Commenters from multiple categories noted that one benefit of increased audit committee disclosures, whether required or voluntary, would be enhanced confidence in audit committees, as these disclosures would allow them to demonstrate their alignment with shareholders, as well as explain the breadth and depth of their activities, which currently may not be widely known or appreciated.

Since issuing the Concept Release, the SEC has not taken additional regulatory action on audit committee disclosures. SEC Chair Mary Jo White and SEC staff have said that voluntary disclosures will be monitored, however, and have urged audit committees to provide more such disclosures.

SEC focus on audit committee responsibilities

Over the past year, Chair White and SEC staff have used speeches to remind audit committees of their oversight responsibilities.⁷ They also have emphasized the responsibility of audit committees in particular areas, such as involvement in discussions between auditors and management on internal control over financial reporting, implementation of new accounting standards and use of non-GAAP measures.⁸

This year, amid heightened investor interest in director qualifications, we saw the emergence of enhanced disclosure around audit committee members. A few companies shared a committee-specific skills matrix, chair or committee photos, or disclosure of the skills and relevant experiences of financial experts.

In addition to the SEC focus, the PCAOB is exploring providing greater transparency around the audit to investors and other stakeholders. One of these initiatives is the repropoed standard to revise the auditor's report.⁹ Among other things, the reproposal would require auditors to provide information about critical audit matters, which would inform investors about areas of the financial statements that involved especially challenging, subjective or complex auditor judgment.¹⁰ In addition, the PCAOB finalized a standard in late 2015 to require auditors to disclose on a new Form AP the name of the lead engagement partner as well as the other audit firms that participated in an audit.¹¹

Findings

Our analysis of the 2016 proxy statements of Fortune 100 companies indicates that voluntary audit-related disclosures continue to trend upward in a number of areas.¹² Specifically, the CBM data for this review is based on the 78 companies on the 2016 Fortune 100 list that filed proxy statements each year from 2012 to 2016 for annual meetings through August 15, 2016 (i.e., excludes companies that have not yet held their 2016 annual meeting).¹³ Below are highlights from our research:

- ▶ The percentage of companies that disclosed factors considered by the audit committee when assessing the qualifications and work quality of the external auditor increased to 50%, up from 42% in 2015. In 2012, only 17% of audit committees disclosed this information.
- ▶ Another significant increase was in disclosures stating that the audit committee believed that the choice of external auditor was in the best interests of the company and/or the shareholders. In 2016, 73% of companies disclosed such information; in 2015, this percentage was 63%. In 2012, only 3% of companies made this disclosure.
- ▶ The audit committees of 82% of the companies explicitly stated that they are responsible for the appointment, compensation and oversight of the external auditor; in 2012, only 42% of audit committees provided such disclosures.
- ▶ 31% of companies provided information about the reasons for changes in fees paid to the external auditor compared to 21% the previous year. Reasons provided in these disclosures include one-time events, such as a merger or acquisition. Under current SEC rules, companies are required to disclose fees paid to the external auditor, divided into the following categories: audit, audit-related, tax and all other fees.¹⁴ They are not, however, required to discuss the reasons why these fees have increased or decreased. From 2012 to 2016, the percentage of companies disclosing information to explain changes in audit fees rose from 9% to 31%.
- ▶ Additional CBM research examined the disclosures of the subset of studied companies (43) that had changes in audit fees of +/- 5% or more compared to the previous year. Out of these 43 companies, roughly 20% provided explanatory disclosures regarding the change in audit fees. 29 of the 43 companies had fee increases of 5% or more, out of which 8 companies disclosed the reasons for the increases. 14 of the 43 companies had fee decreases of 5% or more, out of which only one company provided an explanatory disclosure.
- ▶ 53% of companies disclosed that the audit committee considered the impact of changing auditors when assessing whether to retain the current auditor. This was a 6 percentage point increase over 2015. In 2012, this disclosure was made by 3% of the Fortune 100 companies.
- ▶ Over the past five years, the number of companies disclosing that the audit committee was involved in the selection of the lead audit partner has grown dramatically, up to 73% in 2016. In 2015, 67% of companies disclosed this information, while in 2012, only 1% of companies did so.
- ▶ 51% of companies disclosed that they have three or more financial experts on their audit committees, up from 47% in 2015 and 36% in 2012.¹⁵

There also has been emerging disclosure about the key accomplishments of audit committees over the past year. Examples include work on acquisitions, cybersecurity and other information technology matters, environmental sustainability topics, disclosure effectiveness, and updating the committee charter.

Summary: trends in audit committee disclosure

Category	Topic	2016 % of total	2015 % of total	2014 % of total	2013 % of total	2012 % of total
Disclosures in the audit committee report	Statement that the audit committee is independent	58%	58%	55%	51%	54%
	Name of the audit firm is included in the audit committee report	76%	74%	74%	76%	76%
Audit committee composition	Audit committees with 1 financial expert (FE)	26%	24%	28%	26%	28%
	Audit committees with 2 FEs	23%	28%	31%	51%	36%
	Audit committees with 3 or more FEs	51%	47%	41%	23%	36%
Audit committee responsibilities re: external auditor	Explicit statement that the audit committee is responsible for appointment, compensation and oversight of external auditor	82%	81%	68%	55%	42%
Identification of topics discussed	Topics discussed by the audit committee and external auditor	6%	8%	6%	8%	8%
Fees paid to the external auditor	Statement that the audit committee considers non-audit fees/services when assessing auditor independence	81%	82%	79%	79%	14%
	Statement that the audit committee is responsible for fee negotiations	29%	26%	17%	9%	0%
	Explanation provided for change in audit fees paid to external auditor	31%	21%	19%	14%	9%
Assessment of the external auditor	Disclosure of factors used in the audit committee's assessment of the external auditor's qualifications and work quality	50%	42%	33%	19%	17%
	Statement that audit committee is involved in lead audit partner selection	73%	67%	49%	17%	1%
	Disclosure of the year the lead audit partner was appointed	13%	12%	8%	3%	3%
	Statement that choice of external auditor is in best interests of company and/or shareholders	73%	63%	49%	22%	3%
Tenure of the external auditor	Disclosure of the length of the external auditor tenure	63%	62%	51%	29%	24%
	Statement that the audit committee considers the impact of changing auditors when assessing whether to retain the current external auditor	53%	47%	33%	17%	3%
Accessibility of audit committee charters from proxy statements	Link goes directly to the charter	12%	15%	15%	10%	8%
	Company main website	37%	40%	40%	41%	45%
	Company site for investor relations	24%	24%	26%	26%	24%
	Company site for corporate governance matters	27%	21%	19%	23%	23%

Reviewed companies had an average of 2.9 financial experts.

Reviewed companies indicated that the audit committee raised certain topics with their external auditors other than those required by regulations; these included the testing and evaluation of internal controls, enterprise risk management, cybersecurity and other information technology matters, subsidiaries and accounts, tax and legal matters.

Most companies provide an explanation for the types of services included within each fee category. The companies highlighted here explain the circumstances for the change.

Reviewed companies indicated that audit committees based these assessments on criteria such as the independence and integrity of the external auditor and its controls and procedures; performance and qualifications, including expertise on the company and global reach relative to the company's business; quality and effectiveness of the external auditor's personnel and communications; appropriateness of fees; length of tenure and benefits of a longer tenure; and PCAOB reports on firm and peers.

Endnotes

- 1 See *Audit committee reporting to shareholders: going beyond the minimum* (February 2013), *Audit committee reporting to shareholders 2013 proxy season update* (September 2013), *Let's talk: governance – audit committee reporting to shareholders* (August 2014) and *Auditing committee reporting to shareholders in 2015* (September 2015).
- 2 EY also has several publications examining audit committee-related disclosure trends in other countries, most recently in *Enhancing audit committee transparency: EY's review of 2015 disclosures*.
- 3 17 CFR §240.10A-3(b)(2).
- 4 Item 407(d) of Regulation S-K (17 CFR §240.407(d)).
- 5 In addition to the EY publications in footnote 1, see also the Center for *Audit Quality's Audit Committee Transparency Barometer* (November 2015), which showed trends of enhanced, voluntary audit committee-related disclosures among companies in the Standard & Poor's Composite 1500 index.
- 6 See generally the [responses to the SEC's concept release](#).
- 7 See, e.g., Chair White's speech at the AICPA conference, *supra* note 4.
- 8 See, e.g., ["Remarks before the 12th Annual Life Sciences Accounting and Reporting Congress,"](#) James V. Schnurr, Chief Accountant, Office of the Chief Accountant, March 22, 2016.
- 9 PCAOB *Proposed Auditing Standard – The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, May 11, 2016.
- 10 The exact definition contained in the reproposal is: "A critical audit matter is any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment." (P. A1-7 of the reproposal.) *Supra* note 8.
- 11 PCAOB standard *Improving the Transparency of Audits: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form and Related Amendments to Auditing Standards*, December 15, 2015. This standard will take effect for auditor's reports issued after 31 January 2017 for the lead engagement partner name and 30 June 2017 for the names of other auditors that participated in the audit.
- 12 The data for this report was gathered through the Center for Board Matters' proprietary corporate governance database, which collects and analyzes data for more than 3,000 US public companies. See the [Center for Board Matters website](#).
- 13 In our previous publications on this topic, the data was based on the Fortune 100 list for that year (e.g., the 2015 Audit Committee Reporting to Shareholders had data based on the 2015 Fortune 100 companies). Since the Fortune 100 changes slightly from year to year, some of the percentages in this publication differ slightly from previous publications.
- 14 Item 9 of 17 CFR §240.14a-101 (Schedule 14A. Information required in a proxy statement).
- 15 Companies are not required to have financial experts on their audit committees, but must disclose whether they have one. There is no requirement to disclose whether additional audit committee members qualify as a financial expert. Item 407(d)(5) of Regulation S-K (17 CFR §240.407(d)(5)).

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