Audit committee reporting to shareholders in 2017
Executive summary

For the sixth consecutive year, the EY Center for Board Matters reviewed audit committee-related proxy disclosures by Fortune 100 companies to examine trends in voluntary reporting and finds a continued increase in voluntary audit committee disclosures to shareholders. Year-over-year growth in voluntary audit-related disclosures in 2017 filings was similar to that seen in 2015 and 2016, indicating that companies and audit committees continue to reflect upon and make changes to the information that they communicate to shareholders.

As discussed in our previous reports, audit committees have significant responsibilities related to oversight of financial reporting at public companies. These responsibilities were codified in the Sarbanes-Oxley Act of 2002 (SOX or the Act), now in its 15th year. For more information about the impact of SOX, see our Sarbanes-Oxley Act at 15 publication.

In recent years, investors, regulators and other stakeholders have taken a closer look at the important role of boards — and audit committees in particular — in supporting high-quality financial reporting and have sought greater transparency around the audit and oversight of financial reporting. This interest in transparency may be due in part to the fact that, even as the obligations of audit committees have expanded over the years, required audit committee disclosures have not; rather, disclosure obligations in this area pre-date SOX.

Companies and audit committees have responded to this interest by voluntarily providing enhanced audit-related disclosures, even without a change in regulatory requirements. While transparency has increased at a steady pace over the past three years, several recent and upcoming regulatory developments, such as the Public Company Accounting Oversight Board’s (PCAOB) revised standard on the auditor’s report and the U.S. Securities and Exchange Commission’s (SEC) ongoing disclosure effectiveness project, may contribute to further consideration of audit-related disclosures in the coming years.

This document examines key audit-related proxy disclosures from 2012 to 2017 in order to promote discussion regarding audit committee communications with stakeholders. Due to investor interest in board composition and activities, it also provides a snapshot of how certain characteristics of audit committees have changed from 2012 to today.
When SOX was signed into law 15 years ago, it expanded audit committee authority and responsibilities over financial reporting and the external auditor relationship at US-listed companies. SOX required the boards of companies listed on US stock exchanges to establish audit committees made up solely of board members that are independent from management. It also made audit committees, rather than management, directly responsible for the appointment, compensation and oversight of the work of external auditors.

In recent years, regulators, investors and other stakeholders in the US and abroad have focused attention on audit committees in light of their important role. Some have noted the limited nature of disclosure requirements regarding audit committee activities. Under US laws and regulations, while annual proxy materials must include an audit committee report, the required content of this report is quite limited. Additional information about the audit committee and auditor often can be found elsewhere in the proxy materials, annual reports and other materials, although these are not disclosures that audit committees are required to make.

Reconsideration of disclosure requirements

In recent years, regulators have sought public input about public company-related disclosures generally and specifically about audit committees and audits. Recent and ongoing activity at the PCAOB and SEC continue to be relevant to audit committee disclosure considerations.

The PCAOB is taking steps to require greater disclosures by the auditor, expanding publicly-available information relating to the audit.

- Since January 2017, audit firms have had to file Form AP to disclose the name of the lead engagement partner for each public company audit.
- Starting in July 2017, audit firms also must disclose the names, locations, and extent of participation of other accounting firms that took part in public company audits, if their work contributed 5% or more of the total audit hours.
- The PCAOB also approved a final standard to expand the auditor’s report to include items, such as the length of the auditor’s tenure and a statement that auditors are required to be independent. If approved by the SEC, this new information will be required for auditor’s reports relating to financial reporting periods ending on or after December 15, 2017. The standard will also phase in requirements for auditors to disclose critical audit matters (CAMs), starting with certain audits carried out in 2019. CAMs are matters that auditors communicated or were required to communicate to the audit committee that relate to material accounts or disclosures and involved especially challenging, subjective or complex auditor judgment.

These new PCAOB-required disclosures will not be located in the proxy materials, which is the focus of this research and where many investors seek audit-related information to make decisions about whether to ratify a company’s auditor.

Newly-appointed SEC Chairman Jay Clayton gave a speech in July indicating that improving disclosures for investors is on the SEC’s agenda and that the SEC has several current projects in this area. SEC disclosure-related actions in the past several years include:

- Starting in 2013, the SEC has engaged in a review of the overall effectiveness of current disclosure requirements. In addition to considering changes to disclosure requirements, the SEC staff has encouraged issuers to voluntarily review their disclosures to consider whether and how they can better provide investors with better information. This SEC initiative is ongoing.
- In 2015, the SEC issued a concept release, Possible Revisions to Audit Committee Disclosures, to solicit views on whether there would be a benefit from greater transparency around the work of audit committees, and if so, how best to achieve it. This action arose in part due to interest from investors in seeking greater disclosures by audit committees about their work. Although no regulatory action has been taken to date to change required audit committee-related disclosures, the SEC staff has continued to encourage audit committees to consider expanding disclosures voluntarily.
Findings

Our research into 2017 proxy materials showed similar increases in voluntary audit-related disclosure as in the past several years, with steady growth in certain areas. We conducted this analysis by looking at the proxy materials of 75 companies on the 2017 Fortune 100 list that filed proxy statements each year from 2012 to 2017 for annual meetings through August 15, 2017 (companies that have not yet held their 2017 annual meeting are excluded). Highlights from our findings include:

 Disclosure of audit oversight responsibilities
  ▪ The percentage of companies that explicitly stated that
    the audit committee is responsible for the appointment,
    compensation and oversight of the external auditor has
    nearly doubled since 2012, increasing to 87% in 2017, up
    from 81% in 2016 and 45% in 2012.

 Auditor assessment disclosures
  ▪ The percentage of companies disclosing the factors used in
    the audit committee's assessment of the external auditor's
    qualifications and work quality increased from 48% in 2016
to 56% in 2017. In 2012, 17% of companies made such
disclosures.

 Disclosure of interactions with auditor
  ▪ The level of disclosure about the topics discussed by the
    auditor and audit committee continues to be low, with only
    3%-4% of companies providing such information between
2012 and 2017. It will be interesting to observe whether
these numbers change in years ahead following the adoption
of the PCAOB's new auditor reporting standard (assuming
the SEC adopts the standard), which will require auditor
disclosures regarding critical audit matters discussed with the
audit committee.

 Disclosure regarding lead audit partner selection
  ▪ While in 2012, only 1% of companies disclosed that the audit
    committee was involved in the selection of the lead audit
    partner, this rose to 75% in 2017. In 2016, it was 69%.

 Independence-related disclosures
  ▪ The percentage of audit committees that explicitly stated in
    the audit committee report that they are independent from
management rose from 59% in 2016 to 64% in 2017.
  ▪ Since 2012, the percentage of companies that state that the
    audit committee considers non-audit fees and services when
assessing auditor independence rose dramatically, from 15% in
2012 to 84% in 2017.

 Fee-related disclosures
  ▪ Disclosures relating to audit fees have changed substantially
since 2012, when none of the Fortune 100 companies
disclosed that the audit committee is responsible for fee
negotiations with the auditor. In 2017, 32% of the companies
did so, compared to 27% in 2016.
  ▪ In 2017, 43% of companies provided an explanation for a
change in fees paid to the external auditor (including audit,
audit-related, tax and other fees), while 31% did so in 2016
and 11% in 2012. Breaking this figure down further:
    ▪ Our research shows that companies tend to provide
explatory disclosures more frequently when audit fees rise
and are less inclined to do so when they decline. In 2017, of
the companies that paid audit fees that were more than 5%
higher than in 2016, 29% provided an explanation for the fee
increase. For companies that paid audit fees that were more
than 5% lower than in 2016, only 9% provided explanatory
disclosures.

“Audit committees can help increase investor understanding of the reliability and quality of financial reporting when they provide additional insights into how the audit committee has fulfilled its responsibilities, particularly about the audit committee’s work in overseeing the independent auditor and the financial reporting process.”

Speech by SEC Chief Accountant Wesley R. Bricker
### Trends in audit committee disclosures

<table>
<thead>
<tr>
<th>Category</th>
<th>Topic</th>
<th>2017 % of total</th>
<th>2016 % of total</th>
<th>2015 % of total</th>
<th>2014 % of total</th>
<th>2013 % of total</th>
<th>2012 % of total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Disclosures in the audit committee report</strong></td>
<td>Statement that the audit committee is independent</td>
<td>64%</td>
<td>59%</td>
<td>60%</td>
<td>56%</td>
<td>52%</td>
<td>55%</td>
</tr>
<tr>
<td></td>
<td>Name of the audit firm is included in the audit committee report</td>
<td>77%</td>
<td>76%</td>
<td>75%</td>
<td>75%</td>
<td>76%</td>
<td>76%</td>
</tr>
<tr>
<td><strong>Audit committee composition</strong></td>
<td>Audit committee with one financial expert (FE)</td>
<td>17%</td>
<td>28%</td>
<td>27%</td>
<td>32%</td>
<td>29%</td>
<td>29%</td>
</tr>
<tr>
<td></td>
<td>Audit committee with two FEs</td>
<td>35%</td>
<td>21%</td>
<td>27%</td>
<td>29%</td>
<td>51%</td>
<td>37%</td>
</tr>
<tr>
<td></td>
<td>Audit committee with three or more FEs</td>
<td>48%</td>
<td>51%</td>
<td>47%</td>
<td>39%</td>
<td>20%</td>
<td>33%</td>
</tr>
<tr>
<td><strong>Audit committee responsibilities re: external auditor</strong></td>
<td>Explicit statement that the audit committee is responsible for appointment, compensation and oversight of external auditor</td>
<td>87%</td>
<td>81%</td>
<td>80%</td>
<td>69%</td>
<td>56%</td>
<td>45%</td>
</tr>
<tr>
<td><strong>Identification of topics discussed</strong></td>
<td>Topics discussed by the audit committee and external auditor</td>
<td>3%</td>
<td>3%</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td><strong>Fees paid to the external auditor</strong></td>
<td>Statement that the audit committee considers non-audit fees/services when assessing auditor independence</td>
<td>84%</td>
<td>81%</td>
<td>81%</td>
<td>77%</td>
<td>77%</td>
<td>15%</td>
</tr>
<tr>
<td></td>
<td>Statement that the audit committee is responsible for fee negotiations</td>
<td>32%</td>
<td>27%</td>
<td>24%</td>
<td>15%</td>
<td>7%</td>
<td>0%</td>
</tr>
<tr>
<td></td>
<td>Explanation provided for change in fees paid to external auditor</td>
<td>43%</td>
<td>31%</td>
<td>23%</td>
<td>21%</td>
<td>16%</td>
<td>11%</td>
</tr>
<tr>
<td><strong>Assessment of the external auditor</strong></td>
<td>Disclosure of factors used in the audit committee's assessment of the external auditor qualifications and work quality</td>
<td>56%</td>
<td>48%</td>
<td>40%</td>
<td>32%</td>
<td>20%</td>
<td>17%</td>
</tr>
<tr>
<td></td>
<td>Statement that audit committee involved in lead partner selection</td>
<td>75%</td>
<td>69%</td>
<td>65%</td>
<td>48%</td>
<td>15%</td>
<td>1%</td>
</tr>
<tr>
<td></td>
<td>Disclosure of the year the lead audit partner was appointed</td>
<td>16%</td>
<td>12%</td>
<td>11%</td>
<td>8%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td></td>
<td>Statement that choice of external auditor is in best interest of company and/or shareholders</td>
<td>73%</td>
<td>72%</td>
<td>63%</td>
<td>47%</td>
<td>20%</td>
<td>3%</td>
</tr>
<tr>
<td><strong>Tenure of the external auditor</strong></td>
<td>Disclosure of the length of the external auditor tenure</td>
<td>67%</td>
<td>65%</td>
<td>64%</td>
<td>56%</td>
<td>32%</td>
<td>27%</td>
</tr>
<tr>
<td></td>
<td>Statement that the audit committee considers the impact of changing auditors when assessing whether to retain the current external auditor</td>
<td>60%</td>
<td>55%</td>
<td>49%</td>
<td>33%</td>
<td>16%</td>
<td>3%</td>
</tr>
<tr>
<td><strong>Accessibility of audit committee charters from proxy statements</strong> (link in proxy statement goes directly to)</td>
<td>Audit committee and/or all committee charters</td>
<td>12%</td>
<td>12%</td>
<td>16%</td>
<td>16%</td>
<td>11%</td>
<td>8%</td>
</tr>
<tr>
<td></td>
<td>Company main website</td>
<td>39%</td>
<td>37%</td>
<td>39%</td>
<td>40%</td>
<td>41%</td>
<td>44%</td>
</tr>
<tr>
<td></td>
<td>Company site for investor relations</td>
<td>24%</td>
<td>24%</td>
<td>24%</td>
<td>27%</td>
<td>27%</td>
<td>25%</td>
</tr>
<tr>
<td></td>
<td>Company site for corporate governance</td>
<td>25%</td>
<td>27%</td>
<td>21%</td>
<td>17%</td>
<td>21%</td>
<td>23%</td>
</tr>
</tbody>
</table>

Notes: Percentages based on total disclosures for audit committees each year. Data based on the 75 companies on the 2017 Fortune 100 list that filed proxy statements each year during 2012-2017 and held annual meetings through 15 August 2017.
Topics discussed by the audit committee and external auditor

Companies making these disclosures indicated that the audit committee raised certain topics with their external auditors other than those required by regulations.

Sample language

“Management, the internal auditors and the independent auditors also made presentations to the audit committee throughout the year on specific topics of interest, including the company’s: (i) enterprise risk assessment process; (ii) information technology systems and controls; (iii) income tax strategy and risks; (iv) derivatives policy and usage; (v) benefit plan fund management; (vi) 20XX integrated audit plan; (vii) updates on completion of the audit plan; (viii) critical accounting policies; (ix) assessment of the impact of new accounting guidance; (x) compliance with the internal controls required under Section 404 of SOX; (xi) ethics and compliance program; (xii) risk management initiatives and controls for various acquisitions and business units; (xiii) strategy and management of the implementation of new systems; and (xiv) cyber security.”

Disclosure of factors used in the audit committee’s assessment of the external auditor qualifications and work quality

Companies that included this information provided examples of the criteria used in auditor assessments.

Sample language

“In evaluating and selecting the company’s independent registered public accounting firm, the Audit Committee considers, among other things, historical and recent performance of the current independent audit firm, an analysis of known significant legal or regulatory proceedings related to the firm, external data on audit quality and performance, including PCAOB reports, industry experience, audit fee revenues, firm capabilities and audit approach, and the independence and tenure of the audit firm.”

Explanation provided for change in fees paid to external auditor

Most companies provide an explanation for the types of services included within each fee category. The companies highlighted in this row explained the circumstances for the change.

Sample language

“... year-over-year increase largely driven by the ABC acquisition.”

Disclosure observations and sample language from Fortune 100 proxy statements

Characteristics of Fortune 100 audit committees – 2017 vs. 2012

The composition of boards is a current area of great interest to many institutional investors. Below is data regarding the composition and activities of audit committees in 2017 as compared to 2012. While the data in several areas did not change, notable exceptions included:

- Increases in the percentage of audit committee members that are identified as financial experts (66% in 2017 vs. 59% in 2012) and those that are women (26% in 2017 vs. 19% in 2012).
- Degree of turnover in audit committee chairs (41%), as well as the percentage of audit committees (85%) that gained new members between 2012 and 2017.

<table>
<thead>
<tr>
<th>Fortune 100 audit committees</th>
<th>2017</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Audit committee characteristics</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Independence</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Size (number of committee members)</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Financial experts</td>
<td>66%</td>
<td>59%</td>
</tr>
<tr>
<td>Women audit committee members</td>
<td>26%</td>
<td>19%</td>
</tr>
<tr>
<td>Meeting frequency (number of meetings per year)</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>Board tenure (average number of years on board)</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>Age</td>
<td>63</td>
<td>63</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Changes since 2012</th>
<th>2017</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit committees that experienced chair turnover</td>
<td>41%</td>
<td></td>
</tr>
<tr>
<td>Audit committees that added at least one new member</td>
<td>85%</td>
<td></td>
</tr>
<tr>
<td>Average percentage of new members on audit committees that added at least one new member</td>
<td>49%</td>
<td></td>
</tr>
</tbody>
</table>

Questions for audit committees to consider

1. To what extent does the audit committee already provide voluntary audit or audit-related disclosures?
2. Have investors expressed interest in greater transparency in the audit committee’s work in connection with broader company-investor engagement conversations?
3. How has the role of the audit committee evolved in recent years (e.g., oversight of the ERM process, cybersecurity risk) – and to what extent are these changes being communicated to stakeholders via the proxy statement?
4. What additional voluntary disclosures might be useful to shareholders related the audit committee’s time spent on certain activities such as company restructuring or financial statement reporting developments?
Endnotes

1 Item 407(d) of Regulation S-K (17 CFR §240.407(d)).


3 Ibid.


5 For large accelerated filers, the CAMS-related requirements will take effect for audits for fiscal years ending on or after June 30, 2019. For all other companies to which the requirements apply, these requirements will take effect for fiscal years ending on or after December 15, 2020.


9 For example, the pension fund of the United Brotherhood of Carpenters has engaged with certain companies over multiple years to seek enhanced disclosures regarding the audit committee’s ownership and oversight of the audit relationship.


12 In our previous publications on this topic, the data was based on the Fortune 100 list for that year (e.g., the 2016 Audit Committee Reporting to Shareholders had data based on the 2016 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.