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Considering the audit committee's disclosures

Amid increasing focus by investors, regulators, and other stakeholders on the role and responsibilities of the audit committee, and potential regulatory action to expand mandatory disclosure requirement, audit committee reporting is evolving. In particular, there is a movement toward voluntary, enhanced disclosure around external auditor oversight, an important facet of the audit committee's broader financial reporting oversight role. As a result, companies may wish to take a fresh look at their audit committee reports and consider whether any enhancements could help investors better understand the processes and work that the committee does in carrying out its oversight responsibilities.

The heightened focus on audit committee disclosure culminated in the July 2015 publication of a 55-page SEC Concept Release seeking comment on possible revisions to audit committee disclosures. The concept release focuses on the audit committee's reporting of its responsibilities with respect to its oversight of the independent auditor, the audit committee's process for auditor selection, and its consideration of the qualifications of the audit firm and certain engagement team members when selecting the audit firm. Many of the current disclosure requirements—which exist principally in Item 407 of Regulation S-K—were adopted in 1999, prior to the passage of the Sarbanes-Oxley Act, which significantly changed the audit committee's role and responsibilities.

Some issuers already go beyond the reporting requirements. The Center for Audit Quality's *2015 Audit Committee Transparency Barometer* provided examples of enhanced disclosures from the proxies of companies in Standard & Poor's Composite 1,500.

The SEC received almost 100 comment letters on the concept release, many of which supported a voluntary framework to enhance disclosures. But concerns have been raised that mandatory disclosures can become boilerplate, which could have a chilling effect. "The message in most of the comment letters was, 'there's been some pretty good movement with voluntary disclosures…but if you put this into the rules, you'll get boilerplate,'" said Dennis T. Whalen, head of KPMG's Board Leadership Center.

The Commission's consideration of this topic comes as the PCAOB is engaged in its in own standard-setting initiatives, which could also result in additional disclosure about auditors and their work—the Board's transparency rules, which if approved by the SEC, would require, among other things, disclosure of the name of the engagement partner for each issuer audit[1]; proposed changes to the auditor reporting model, and the potential use of audit quality indicators.

In a survey by KPMG's Audit Committee Institute, 8 percent of those polled said their board/audit committee has expanded the audit committee report, and 16 percent said they were considering doing so in light of SEC interest. As some comment letters responding to the SEC's Concept Release observed, improving transparency does not necessarily mean additional disclosure, but rather better communication—for example, to explain the robustness and effectiveness of the audit committee process. Others suggested that as part of the committee's consideration of whether to add any additional information to their disclosures, it may be helpful to engage with the company's largest shareholders to determine whether the information would be useful.

1 See *PCAOB Adopts Rules Requiring Disclosure of the Engagement Partner and Other Accounting Firms Participating in an Audit,* from KPMG's Financial Reporting Network, published Dec. 18, 2015.

Areas for potential enhanced voluntary disclosures:

Audit firm selection/ratification, including discussion of the audit committee's considerations in recommending the appointment of the external audit firm as well as the length of time the audit firm has been engaged.

Audit firm compensation, including discussion of how non audit services may impact independence, a statement that the audit committee is responsible for fee negotiations, an explanation provided for a change in fees paid to the external auditor, and a discussion of audit fees and their connection to audit quality.

External auditor evaluation/supervision, including a discussion of criteria considered when evaluating the audit firm, and disclosure of significant areas addressed with the external auditor.

Audit partner selection, including a statement about engagement partner rotation and a statement that the audit committee is involved in selection of the audit engagement partner.

About the KPMG Board Leadership Center

The KPMG Board Leadership Center champions outstanding governance to help drive long-term corporate value and enhance investor confidence. Through an array of programs and perspectives—including KPMG's Audit Committee Institute and Private Markets Group, the WomenCorporateDirectors Foundation, and more—the Center engages with directors and business leaders to help articulate their challenges and promote continuous improvement. Drawing on insights from KPMG professionals and governance experts worldwide, the Center delivers actionable thought leadership—on risk and strategy, talent and technology, globalization and compliance, financial reporting and audit quality, and more—all through a board lens. Learn more at kpmg.com/blc.

Audit Committee Institute

Part of the Board Leadership Center, KPMG's Audit Committee Institute focuses on oversight of financial reporting and audit quality and other issues of interest to audit committee members, including risk oversight, internal controls, and compliance. Learn more at kpmg.com/aci.

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