



EY Center for Board Matters

Audit committee reporting to shareholders in 2021

EY

Building a better working world

For the 10th consecutive year, the EY Center for Board Matters has reviewed voluntary proxy statement disclosures by Fortune 100 companies relating to audit committees, including their oversight of the audit.

Audit committees of listed companies have the critical role in the US capital markets in promoting high-quality and reliable financial reporting, which includes overseeing the external auditor and the internal audit function. Investors and other stakeholders are able to gain valuable insight into these important audit committee governance activities through disclosures provided by companies in proxy statements. The role of the audit committee (as well as transparency around that role) helps strengthen investor confidence in financial reporting and US capital markets.

The EY Center for Board Matters (CBM) has tracked audit committee-related disclosures over 10 years to provide a spotlight on the information available about audit committees' critical duties. Our research shows that companies recognize the value of this reporting to investors and other stakeholders.

Since 2013, many companies have significantly enhanced voluntary communications about how audit committees are executing their core responsibilities. This publication presents data on the types of audit committee-related disclosures that some of the largest public companies are providing, as well as examples of disclosures.

The establishment of independent audit committees as overseers of the audit was one of the key features of the Sarbanes-Oxley Act of 2002 (SOX) – now approaching its 20th anniversary – to help restore confidence in the US capital market after a series of corporate financial reporting scandals. In addition to providing information about today's audit committee-related disclosures, this document highlights the enduring importance of audit committees' governance responsibilities over financial reporting.

In brief

- ▶ Since 2012, there has been a significant increase in the percentage of companies making audit committee-related disclosures around key topics.
- ▶ Companies continue to enhance transparency around the audit committee's role and its oversight responsibilities.
- ▶ Companies are increasingly discussing the audit committee's role in overseeing climate change risks and other environmental, health and safety-related matters.

Understanding the context

The role of audit committees

Audit committee oversight of financial reporting is a vital element of the US capital market regulatory framework. Audit committees of listed companies are responsible for overseeing financial reporting, including the external audit. US securities laws state that audit committees are “directly responsible for the appointment, compensation, retention and oversight” of the external auditor.¹ These audit committee members also must be independent, meaning they may not be affiliated with the company or any subsidiaries, and they cannot directly or

indirectly receive any compensation from the company other than in their capacity as members of the board. Audit committees also have responsibilities around auditor independence. These include preapproving all audit and non-audit services provided by the external auditor and resolving disagreements between the auditor and management about financial reporting. This positions audit committees to be objective overseers of the external audit and financial reporting on behalf of shareholders – a key pillar supporting the integrity of financial reporting.

Audit committees over time

Audit committee composition data – S&P 500 companies

Audit committee attribute	2021	2017	2012
Size	4.3	4.2	4.0
Number of meetings per year	8.4	8.6	8.9
Age	63.0	63.0	62.7
Years served on board	7.3	8.0	8.4
% of designated financial experts	66%	64%	58%
% of female committee members	35%	25%	18%

Certain aspects of the composition of boards and audit committees has changed since CBM began tracking audit committee-related disclosures. We are seeing an expansion in the percentage of financial experts (increase from 58% to 66% between 2012 and 2021, respectively) along with greater diversity (as evidenced by the increase in female representation since 2012) in the audit committee composition.

Audit committee disclosures

Our examination of proxy disclosure data for 2021 demonstrates that companies continue to provide voluntary disclosures in audit-related areas of interest to investors and other stakeholders, typically going beyond the specific areas of required disclosures. These required disclosures include information about the functions, policies and procedures of audit committees. In response to investor and other stakeholder interests, many companies add on to these mandatory disclosures to help shed more light on the type and degree of oversight exercised by audit committees. Examples of voluntary disclosures include the factors audit committees use when assessing the external auditor and identification of financial experts on the committee.

Voluntary audit committee-related disclosures have grown significantly over the past 10 years that Ernst & Young LLP has been tracking them, although the pace of change has slowed in recent years. While the COVID-19 pandemic has had a great deal of impact on publicly traded companies, it does not appear to have altered the upward trend in voluntary disclosures about audit committees, albeit incremental. 2021 disclosures also indicate that some audit committees are expanding their remit to include issues increasingly relevant to today’s investors, such as environmental, social and governance (ESG) matters, cybersecurity and more.

¹ Section 10A(m)(2) of the Securities and Exchange Act of 1934 (15 US Code Section 78j-1(m)(2)), Securities and Exchange Commission website, accessed 14 September 2021, <https://www.govinfo.gov/content/pkg/COMPS-1885/pdf/COMPS-1885.pdf>

What we see in 2021

While the year-over-year change in the percentage of companies included in our review that provide these voluntary disclosures is relatively minor, there has been a dramatic increase in disclosures in most categories since we began examining these disclosures in 2012. For example:

- ▶ This year, 71% of reviewed companies disclosed factors used in the audit committee's assessment of the external auditor qualifications and work quality, up from 64% last year. Only 15% of these companies made that disclosure in 2012.
- ▶ Nearly 92% of reviewed companies disclosed that the audit committee considers non-audit fees and services when assessing auditor independence vs. just 16% in 2012.
- ▶ Nearly 70% of reviewed companies stated that they consider the impact of changing auditors when assessing whether to retain the current external auditor, and 79% disclose the tenure of the current auditor. That's up from just 3% and 23%, respectively, in 2012.

Additional observations

- ▶ **Expansion of audit committee role:** Consistent with the trends of voluntary audit committee disclosures, we continue to see companies bolster their description of audit committee oversight and the roles and responsibilities of the committee. This year, we reviewed the key committee responsibility-related disclosures to assess if there were disclosures around additional risks or issues falling under the audit committee's purview beyond financial reporting, compliance and legal matters. We noted that approximately 76% of the reviewed companies included additional disclosures around risks beyond financial reporting that were being overseen by the audit committee. Some of these top risks being overseen by audit committees include cybersecurity, data privacy, enterprise risk management and ESG. Leading companies are also adding additional specificity by highlighting changes to oversight activities and key focus areas for the audit committee for the year.
 - ▶ Nearly 70% of reviewed companies disclosed that the audit committee oversees cybersecurity matters.
 - ▶ Notably, 10% of reviewed companies discussed the audit committee's role in ESG matters, up from 6% last year. These matters include oversight of climate change risks as they relate to financial and operational risk exposures and other environmental, health and safety-related matters.
- ▶ **Critical audit matters (CAMs):** We specifically tracked whether any of the audit committee disclosures this year referenced critical audit matters, which are matters communicated or required to be communicated by the external auditor to the audit committee relating to material accounts or disclosures and involving especially challenging, subjective or complex auditor judgment.² We noted 16 examples of company disclosures (out of 72 companies) regarding CAMs.
 - ▶ These disclosures noted that the audit committee reviewed and discussed with the external auditor CAMs that arose during the current period audit. Only one company noted the number of CAMs identified.
 - ▶ **Auditor ratification support:** In terms of voting results for proposals to ratify the external auditor, support is still very strong. As of Q2 2021, average support is 99% for the Russell 3000, 98% for the S&P 1500 and 97% for the S&P 500, which is in line with recent years. Fewer than 1% of the auditor ratification proposals voted so far this year have received less than 90%.



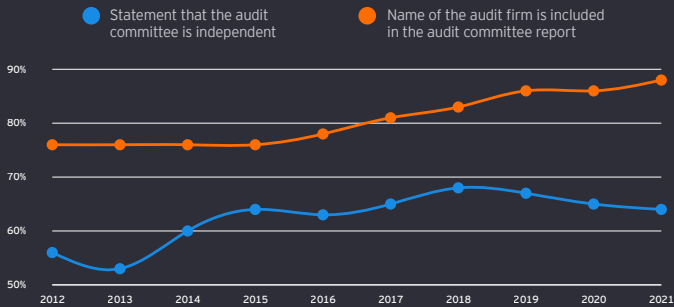
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² Public Company Accounting Oversight Board (PCAOB) standard, AS 3101: The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, PCAOB website, accessed 13 September 2021, <https://pcaobus.org/oversight/standards/auditing-standards/details/AS3101>

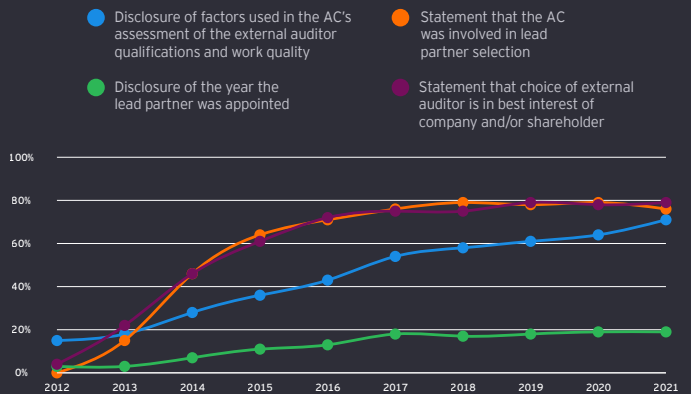
Trends in audit committee disclosures

Percentages based on total disclosures for audit committees each year. Data based on the 72 companies on the 2021 Fortune 100 list that filed proxy statements each year during 2012-21 and held annual meetings through July 2021.

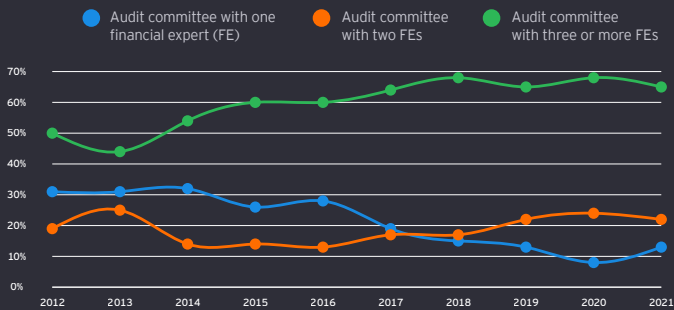
Disclosures in the audit committee report



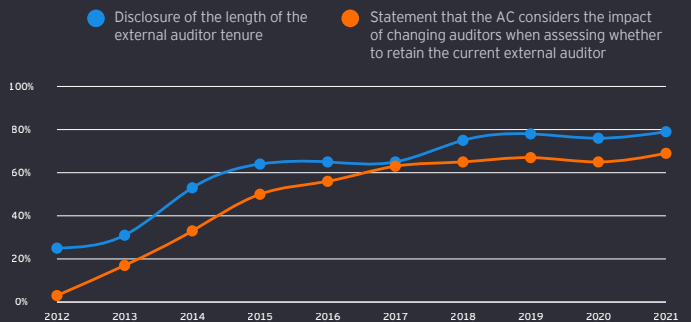
Assessment of the external auditor



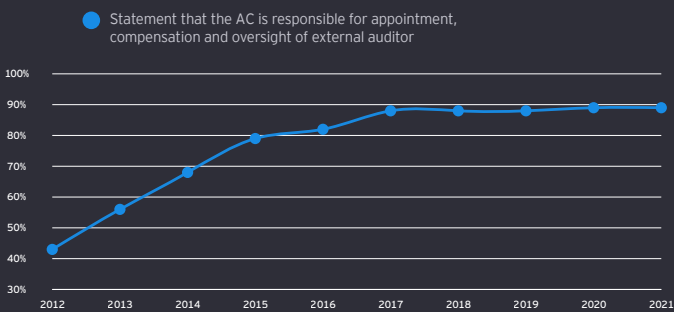
Audit committee composition



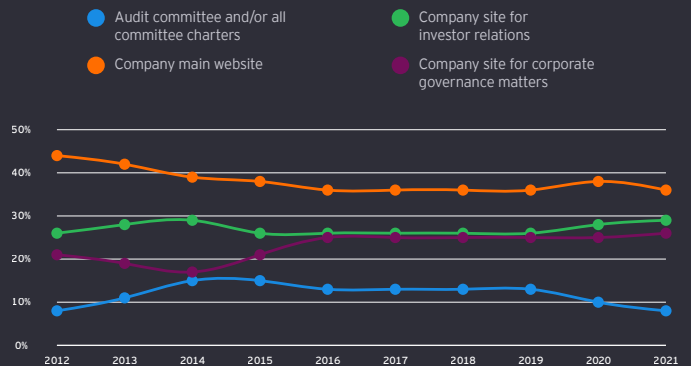
Tenure of the external auditor



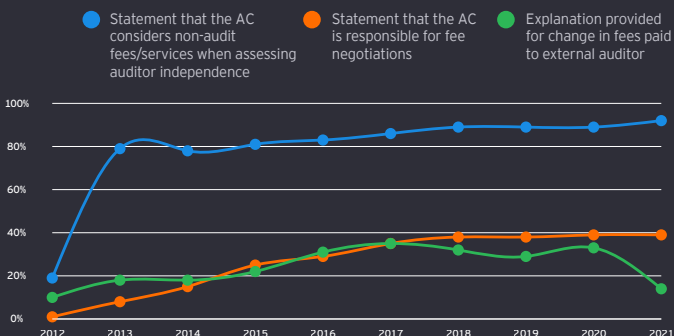
Audit committee responsibilities re: external auditor



Accessibility of audit committee charters from proxy statements



Fees paid to the external auditor



Disclosure observations and sample language from 2021 Fortune 100 proxy statements

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. Reviewed companies explained the circumstances for changes to those fees, for example:

“Audit fees were principally for audit work performed on the consolidated financial statements and internal control over financial reporting, as well as statutory audits. The decrease in audit fees in 2020 vs. 2019 is primarily due to a decrease in audit work as a result of the [XXX spin-off] and a reduction in nonrecurring strategic projects.”

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

Reviewed companies provided examples of criteria used in auditor assessments.

“The Audit Committee regularly considers the independence, qualifications, compensation and performance of its independent auditor. In [Year X], the Committee approved an evaluation framework developed by management to assist with the Committee's annual assessment of the independent audit firm, which includes the solicitation of feedback from members of management and the Audit Committee. Results of the full assessment were provided to the Committee for its annual review and determination of whether to retain [Audit Firm] as the Company's independent auditor for 2021. Using the framework, the Audit Committee assessed the following four areas in addition to a consideration of the firm's independence:

Quality of the independent audit firm and audit process

- ▶ *The number of restatements, material weaknesses and significant deficiencies to determine if any items should have been reasonably identified by the independent audit firm.*
- ▶ *Results of the 20XX PCAOB Inspection report issued in [Month] 20XX.*
- ▶ *The risk associated with the audit firm based on their financial stability, compliance with applicable laws and professional standards, pending litigation or judgments against the firm, and results of applicable firm inspections.*

Level of service provided by the independent audit firm

- ▶ *Results of annual satisfaction surveys distributed to the Committee and management with high interactions with the independent audit firm.*

Alignment with [Company X's] core values

- ▶ *Whether the audit firm's onsite team demonstrates a commitment to diversity, equity, and inclusion (DE&I) aligned with [Company X's] core values.*
- ▶ *Annual DE&I assessment of third-party finance vendors by management led to firm's appointment to DE&I honor roll for the 9th consecutive year.*

Good faith negotiation of fees

- ▶ *Robust biennial fee negotiations process.*
- ▶ *Review of fees incurred for reasonableness against the annually approved fees and reported current fee estimates provided to the Committee quarterly.*

Statement that the audit committee considers the impact of changing auditors when assessing whether to retain the current external auditor

Reviewed companies indicated that the audit committee considered alternatives to retaining the external auditor.

"The Audit Committee considers a number of factors in deciding whether to re-engage Audit Firm as the independent registered public accounting firm, including the length of time the firm has served in this role and an assessment of the firm's professional qualifications and resources. In this regard, the Audit Committee considered that [Company X] requires global, standardized and well coordinated services, not only for audit purposes, but for other nonaudit services items, such as valuation support, IT consulting and payroll services. Many of these services are provided to [Company X] by other multinational audit and accounting firms. A change in our independent auditor would require us to replace one or more of the multinational service providers that perform nonaudit services for [Company X] and could significantly disrupt our business due to loss of cumulative knowledge in the service providers' areas of expertise."

Disclosure of audit committee's involvement in lead audit partner selection

Reviewed companies provided a statement noting the audit committee's involvement – some additionally provided a description of the lead partner selection process.

"The Audit Committee is involved in the selection of, and reviews and evaluates, the lead audit partner as part of its oversight activities. The Audit Committee bases its selection of the lead audit partner on the Audit Committee's interactions with prospective candidates, assessment of their professional experiences, and input received from Audit Firm and management."

Disclosure relating to the year the lead partner was selected

"In selecting and approving the lead audit partner from Audit Firm, Company management and the Audit Committee interviewed proposed candidates, and, after discussing the desired qualifications of the lead audit partner, the Audit Committee approved the selection of the current lead audit partner of the Company beginning with the 2021 audit who is expected to serve in this capacity through the end of the 2025 audit."

Disclosure of audit committee's discussion of CAMs with its external auditor

"We reviewed and discussed with management, the Chief Audit Officer and Audit Firm: Audit Firm's opinion on the consolidated financial statements, including (i) the critical audit matters addressed during the audit and (ii) the effectiveness of the Company's internal control over financial reporting, including the impact of the COVID-19 pandemic and the [Company X] acquisition."

Questions for the board to consider

- ▶ Does the company's proxy statement effectively communicate how the audit committee is overseeing and engaging with the independent auditor? Does it address areas of investor interest, such as the independence and performance of the auditor and the audit committee's key areas of focus?
- ▶ How has the role of the audit committee evolved in recent years (e.g., oversight of enterprise risk management, cybersecurity risk), and to what extent are these changes being communicated to stakeholders?
- ▶ In light of the changing environment, what additional voluntary disclosures might be useful to shareholders related to the audit committee's time spent on certain activities, such as cybersecurity, data privacy, business continuity, corporate culture and financial statement reporting developments?
- ▶ Has the audit committee considered how changes in the auditor reporting requirements may impact audit committee disclosures?
- ▶ How do director qualifications and board composition-related disclosures highlight the diversity considerations, expertise, experiences and backgrounds of audit committee members?

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About the EY Center for Board Matters

Effective corporate governance is an important element in building a better working world. The EY Center for Board Matters supports boards, committees and directors in their oversight role by providing content, insights and education to help them address complex boardroom issues. Using our professional competencies, relationships and proprietary corporate governance database, we are able to identify trends and emerging governance issues. This allows us to deliver timely and balanced insights, data-rich content, and practical tools and analysis for directors, institutional investors and other governance stakeholders.

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