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Boards Voluntarily Disclose More Audit Info in Proxies

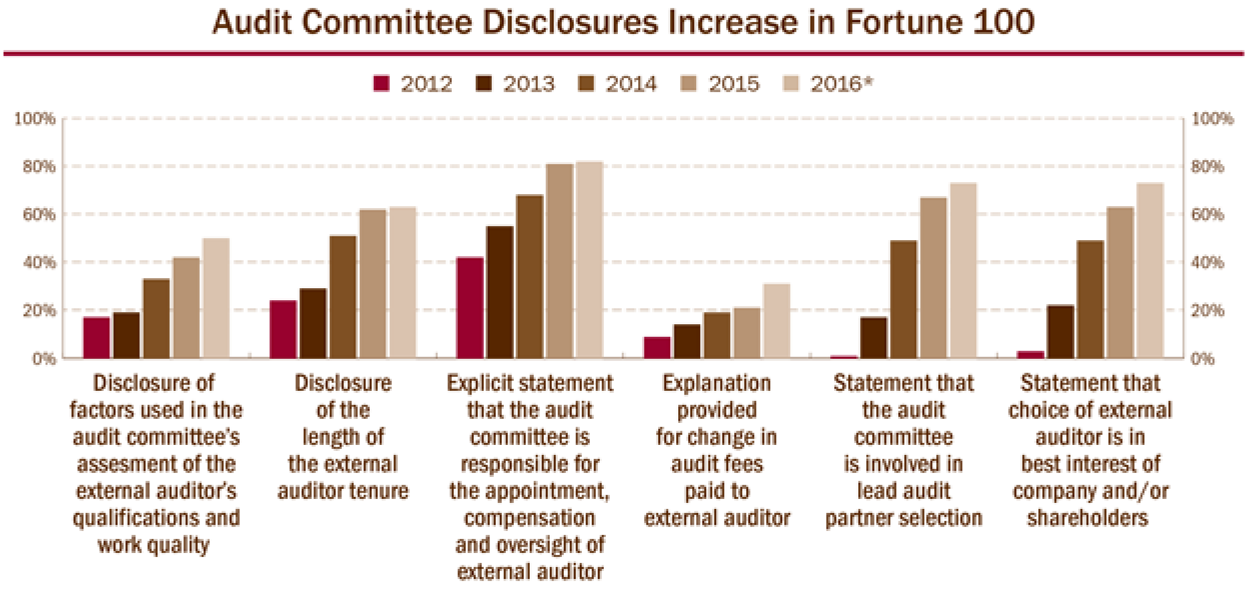
By Lindsay Frost September 30, 2016

Audit committees are continuing to voluntarily disclose more on proxies, particularly with explicit statements regarding their responsibilities and their work with external auditors, according to a recent review of Fortune 100 companies by the **EY** Center for Board Matters.

The **SEC** and **Public Company Accounting Oversight Board** have published concept releases and final rules, respectively, this year. Considering the amount of attention regulators are giving to this topic, boards are being encouraged to consider further transparency. Similarly, investors are asking for more transparency, as well.

"More audit committees are saying, 'Here [are] our responsibilities and the process by which we discharge them," says **Jon Lukomnik**, executive director at the **Investor Responsibility Research Centre Institute** (IRRC). "It's interesting because you are constantly balancing the right level of disclosure, and investors want to know that the lights are on when someone is home."

According to EY, the biggest increase in disclosures in proxies over the past five years includes the audit committee's involvement in choosing the lead audit partner, explanation of changes in audit fees and factors considered in assessing the work of the external auditor, among others.



*Proxies filed at 78 Fortune 100 companies through August 15

Source: EY Center for Board Matters

"Audit committees are disclosing more due to a variety of factors," writes **Ann Yerger**, executive director of the EY Center for Board Matters, in an e-mail. "Some are responding to investor requests for additional insights on audit committee processes and oversight activities. Some are proactively enhancing disclosures in anticipation of investor requests, or to provide 'first in class' disclosures — or to showcase the audit committee's oversight work."

In July 2015, the **SEC** issued a concept release on possible revisions to audit committee disclosures, asking if there should be greater transparency around the work of audit committees. The release included a list of 74 questions that audit committees would be required to answer in their yearly proxy statement regarding how they oversee their external auditors.

According to the general consensus of the comment letters to the SEC on the release, board directors, management and auditors generally expressed that they do not want more prescriptive SEC-required disclosures, but were generally in favor of voluntary disclosures that are 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," according to EY's late-September report on audit committee disclosures. "Mandatory requirements could result in boilerplate disclosures."

However, many of the investors supported mandatory disclosures due to what they say is a lack of information required under the current SEC rules. Regardless of a stakeholder's stance, sources say, audit committees should continue to consider providing more transparency to investors in several key areas.

"Investors remain interested in an enhanced auditor report," Yerger writes. "Their expectations of audit committee transparency are likely to continue to evolve."

Audit Partner Disclosure

The PCAOB also has been busy with requiring more transparency from auditors themselves. Effective in January, audit firms will be required to submit a separate form to the PCAOB disclosing the name of the audit engagement partner, or lead partner, that is in charge of a company's audit. Beginning in June of next year, audit firms must also publicly disclose the names of other audit firms involved in a company's audit.

Companies seem to be realizing the importance of disclosing information about the audit partner as well, according to the EY data. In 2012, only 1% of Fortune 100 companies included a statement in the proxy that the audit committee was involved in the lead audit partner selection, while in 2016, 73% of companies provided this.

"It's been a while since [audit committee disclosure rules] were originally coming out, and some feel those reports are stale or boilerplate and don't go into enough detail, so this is a movement towards encouraging more from them," says **Doug Chia**, executive director of the **Conference Board**'s governance center.

Additionally, 13% of companies this year disclosed the year that the lead audit partner was appointed, while only 3% disclosed this in 2012.

For example, in **Cintas Corp.**'s September proxy, the company wrote that the audit committee "periodically reviews and evaluates the performance of [EY's] lead audit partner, oversees the required rotation of [EY's] lead audit partner responsible for the Company's audit and reviews and considers the selection of the lead audit partner."

"Although it's not required, you are increasingly seeing a number of audit committees stating what the auditor tenure is, the requirement to rotate auditors every five years, and an increasing number of audit committees saying they are involved in selecting a new audit partner," says Lukomnik. "It's all designed to say, 'Look, we are paying attention and taking our responsibilities seriously.'"

Auditor Assessment Factors

Investors have been requesting more information about the audit committee's roles and responsibilities as their workload and compliance requirements continue to increase, sources say. Investors want to know step-by-step how an audit committee completes its work.

"A lot of what investors are asking for is process-related," Chia says. "Did you seriously consider another audit firm? Did you press the auditor on fees? Did you consider audit partner rotation and the length of time the auditor has been there? The process questions are easy to ask and easy to answer, but the difficult question is how well the audit committee is performing."

According to the EY data, 82% of companies this year included an explicit statement in the proxy that the audit committee is responsible for the appointment, compensation and oversight of the external auditor, compared to 42% in 2012. **Clorox**'s recent proxy included this statement, for example.

Meanwhile, half (50%) of the proxies disclosed specific factors used in the audit committee's assessment of the external auditor's qualifications and work quality, compared to 17% in 2012.

For example, in **Kimball International**'s September proxy, the company wrote that it chose Deloitte for its accounting firm based upon performance on past audits, including the expertise of the engagement team; experience, client service and responsiveness; leadership, management structure and ethical culture; and the amount of fees charges in relation to scope of work performed.

Additionally, 81% of proxies included a statement that the audit committee considers non-audit fees and services when assessing the auditor's independence, and 31% provided an explanation for a change in audit fees paid to the auditor, compared to 9% in 2012. **Estée Lauder Companies** included a statement on consideration of non-audit fees in its most recent proxy, for example.

Also, **Angiodynamics** included in its recent proxy that it has begun a bidding process for naming a new audit firm for fiscal 2017. The company also detailed specific auditor fees and the services they represent in its proxy.

Other noteworthy statistics involve further disclosure around fees, auditor tenure, audit committee composition and accessibility of the audit committee charters from the proxy statements.

Looking forward, sources say further rulemaking on audit committee disclosures are not expected in the near term, but regulators will continue to keep an eye on what companies are volunteering.

“I think the concept release seems to be having its intended effect and the industry has been promoting some of the same principles,” Chia says.