



2015

AUDIT COMMITTEE TRANSPARENCY BAROMETER



**CENTER
FOR AUDIT
QUALITY**

Serving Investors, Public Company Auditors & the Markets

AUDIT ANALYTICS®

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The Center for Audit Quality (CAQ) is an autonomous, nonpartisan public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs.

For more information, visit www.thecaq.org.

About Audit Analytics

Audit Analytics is an independent research provider that enables the accounting, legal and investment communities to analyze auditor market intelligence, public company disclosure trends and risk indicators.

For more information please

e-mail info@auditanalytics.com or call 508-476-7007.

Overview

In 2014, the CAQ, together with Audit Analytics, undertook an effort to gauge how public company audit committees approach the public communication of their financial reporting oversight activities by measuring the robustness of proxy disclosures among companies in the Standard & Poor's (S&P) Composite 1500. This index is comprised of the S&P 500 large-cap companies (S&P 500), the S&P MidCap 400 (S&P MidCap), and the S&P SmallCap 600 (S&P SmallCap).¹

In our second year of tracking this “barometer” of proxy disclosures, we find that while the numbers declined slightly in some categories, overall there were encouraging trends in 2015 with respect to voluntary, enhanced disclosure around external auditor oversight, an important facet of the audit committee's broader financial reporting oversight role.

More specifically, the data shows double-digit growth in the percentage of S&P 500 companies disclosing information in several key areas of external auditor oversight, including external auditor appointment, engagement partner selection, engagement partner rotation, and evaluation criteria of the external audit firm. We believe, and the data suggest, that audit committees are responding to an increasing interest by investors, regulators, and other stakeholders in the roles and responsibilities of audit committees² by providing the marketplace with more meaningful information about their role

in external auditor oversight. However, as some of the examples of leading disclosure practices in this Barometer show, audit committees also are tailoring these enhanced disclosures specifically to the company, and not using a one-size-fits-all approach.

These trends are consistent with findings from the EY Center for Board Matters, which has tracked audit committee reporting trends among Fortune 100 companies since 2012.³ Its latest report states: “Over the past four years, our data shows that companies have significantly increased their voluntary proxy disclosures relating to the audit committee's oversight of the auditor. Initiatives by regulators, investors, corporate governance leaders and other stakeholders have encouraged these disclosures by raising awareness of the role of audit committees and noting the benefits of greater transparency such as increased investor confidence.”

There also have been developments over the past year that have encouraged enhanced reporting by companies during the 2015 proxy season, including speeches⁴ by Securities and Exchange Commission (SEC) commissioners and staff signaling the issuance of the SEC's July 2015 concept release on audit committee disclosures. In the concept release⁵, the SEC solicited public comment on possible revisions to audit committee reporting requirements, primarily focusing on the role of the audit committee with respect to overseeing the external auditor.

¹ The 2014 Audit Committee Transparency Barometer is available at <http://www.thecaq.org/docs/reports-and-publications/2014-audit-committee-transparency-barometer.pdf?sfvrsn=2>.

² See Audit Committee Collaboration, *Enhancing the Audit Committee Report: A Call to Action*, November 2013, pgs. 5–7, for a discussion of this stakeholder interest in audit committee roles and responsibilities, as well as the SEC Concept Release: Possible Revisions to Audit Committee Disclosures, July 2015. Available at <http://www.sec.gov/rules/concept/2015/33-9862.pdf>.

³ See EY Center for Board Matters, “Audit committee reporting to shareholders in 2015,” September 2015. Available at <http://www.ey.com/GL/en/Issues/Governance-and-reporting/EY-audit-committee-reporting-to-shareholders-in-2015>.

⁴ For example, see SEC Chief Accountant James Schnurr's December 2014 remarks before the AICPA National Conference on Current SEC and PCAOB Developments. Available at <http://www.sec.gov/News/Speech/Detail/Speech/1370543609306>. Also, SEC Chair Mary Jo White referenced an early 2015 SEC concept release in her remarks at the PCAOB Investor Advisory Group meeting on October 20, 2014.

⁵ See SEC Concept Release: Possible Revisions to Audit Committee Disclosures, July 2015. Available at <http://www.sec.gov/rules/concept/2015/33-9862.pdf>.

Overview (continued)

Another contributing factor to enhanced reporting this year, also referenced by the EY Center for Board Matters report, are requests from several investment groups and pension funds for additional information relating to the audit committee's oversight of the external auditor. For example, the United Brotherhood of Carpenters Pension Fund (Carpenters) wrote letters to 91 S&P 500 companies ahead of the 2015 proxy season seeking additional disclosures around the audit committee's role in appointment, compensation, and retention of the external auditor.⁶ Fifty-nine of the 91 companies that received these letters disclosed at least one of the requested disclosures, and 17 disclosed all of the requested disclosures.⁷ This is the third year that the Carpenters have sent letters to companies urging them to enhance disclosures around external auditor oversight.

Our 2015 proxy analysis reveals a pronounced consolidation of disclosures related to external auditor oversight within the proxy statement, minimizing the inefficiency of having these disclosures in multiple locations outside of the proxy. For S&P 500 companies, this consolidation is evidenced by movement of certain disclosures related to external auditor oversight to a single, dedicated section of the proxy or the audit committee report. For S&P MidCap and S&P SmallCap companies, this is evidenced by incorporation of information from the audit committee charter into the company's proxy statement.

Methodology

Consistent with the methodology used last year, the most current S&P Composite 1500 proxies were reviewed (filed through the end of June 2015). The locations of the related disclosures were categorized as follows, for purposes of discussing the findings:

- Audit committee report—The disclosure appears in the audit committee report, but in certain instances, the disclosure also was duplicated in other sections of the proxy.
- Proxy or proxy including audit committee report—The disclosure appears somewhere in the proxy, which includes both the audit committee report and other sections of the proxy.

Auditor Oversight by the Audit Committee

As emphasized in the *2014 Audit Committee Transparency Barometer*, oversight of the external auditor is an extremely important function of the audit committee, and one that has received increased focus from investors and other stakeholders, as well as the SEC through its recently issued concept release. The 2015 proxy season saw notable enhancement in certain disclosures related to the oversight of the external auditor, particularly within the S&P 500. Some key highlights of the 2015 proxy season include enhancements in disclosures related to audit firm selection/ratification, audit firm compensation, audit firm evaluation/supervision, and selection of the audit partner.

Audit Firm Selection/Ratification

The proxies reviewed in 2015 show enhanced discussion of the ratification of the appointment of the audit firm (Figure 1). Included in these enhanced disclosures was a more robust discussion of the audit committee's considerations in recommending the appointment of the audit firm as well as the length of time an audit firm has been engaged (Figure 2). This was particularly evident among the S&P 500 companies reviewed. Some S&P MidCap and S&P SmallCap companies also incorporated this information from the audit committee charter into the company's proxy statement, thus making these disclosures more prominent.

⁶ See EY Center for Board Matters, "Audit committee reporting to shareholders in 2015," September 2015. Available at <http://www.ey.com/GL/en/Issues/Governance-and-reporting/EY-audit-committee-reporting-to-shareholders-in-2015>.

⁷ See Council of Institutional Investors Governance Alert, "Carpenters' Fund Continues to Make Progress on Auditor Disclosure," July 2015. Available at http://www.cii.org/article_content.asp?edition=4§ion=13&article=603.

The following are two examples of these enhanced disclosures:

EXAMPLE 1—AUDIT FIRM SELECTION/RATIFICATION

Source: American International Group, Inc. (S&P 500), 2015 Proxy Statement, Proposal to Ratify Auditor:

[Independent Auditor] has served as AIG’s independent registered accounting firm since 1980 and reports directly to the Audit Committee. In selecting [Independent Auditor] as AIG’s independent registered accounting firm for 2015, the Audit Committee considered a number of factors, including:

- the quality of its ongoing discussions with [Independent Auditor] including the professional resolution of accounting and financial reporting matters with the national office,
- the professional qualifications of [Independent Auditor], the lead audit partner and other key engagement partners,
- [Independent Auditor]’s independence program and its processes for maintaining its independence,
- [Independent Auditor]’s depth of understanding of AIG’s global businesses, accounting policies and practices and internal control over financial reporting,
- [Independent Auditor]’s expertise and capabilities in handling the breadth and complexity of AIG’s businesses and global footprint including approximately 425 audit, statutory, and other audit-related reports,
- the appropriateness of [Independent Auditor]’s fees for audit and non-audit services (on both an absolute basis and as compared to its peer firms),
- consideration of [Independent Auditor]’s known legal risks and significant proceedings that may impair their ability to perform AIG’s annual audit,
- the most recent PCAOB inspection report on [Independent Auditor] and the results of “peer review” and self-review examinations, and
- the results of management’s and the Audit Committee’s annual evaluations of the qualifications, performance and independence of [Independent Auditor].

.....
Note: Although AIG’s 2014 Proxy Statement included a discussion of how the independent auditor was ratified, there was no discussion around the factors considered in audit firm selection.

EXAMPLE 2—AUDIT FIRM SELECTION/RATIFICATION

Source: Primerica, Inc. (S&P MidCap), 2015 Proxy Statement, Audit Committee Report:

“...[Independent Auditor] has served as the Company’s independent public registered public accounting firm since before the IPO in 2010. Prior to retaining [Independent Auditor] for fiscal 2014, the Audit Committee evaluated [Independent Auditor]’s performance with respect to fiscal 2013.

In conducting this annual evaluation, the Audit Committee reviewed responses to questionnaires completed by members of the Audit Committee and management that covered areas such as independence (including the extent of non-audit services and fees), technical expertise, industry knowledge and communications with the Audit Committee. The Audit Committee also considered [Independent Auditor]’s tenure and the impact on the Company of changing auditors.”

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Note: There was no discussion around the factors considered in audit firm selection in Primerica’s 2014 Proxy Statement.

Figure 1: Audit Committee's Considerations in Appointing Audit Firm

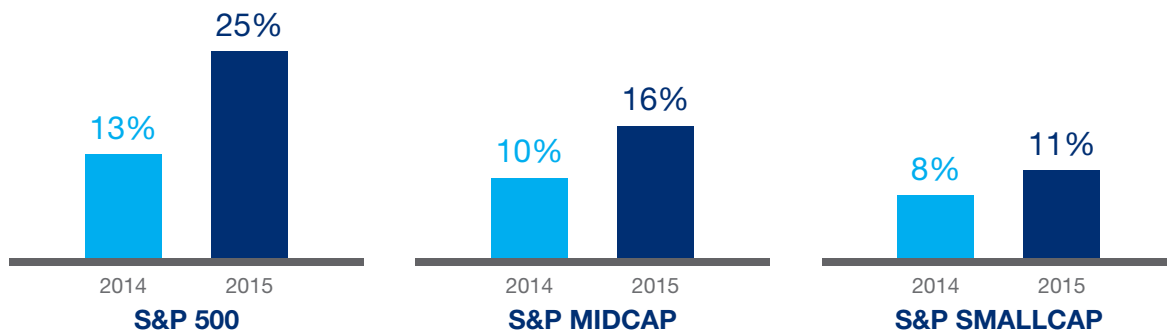
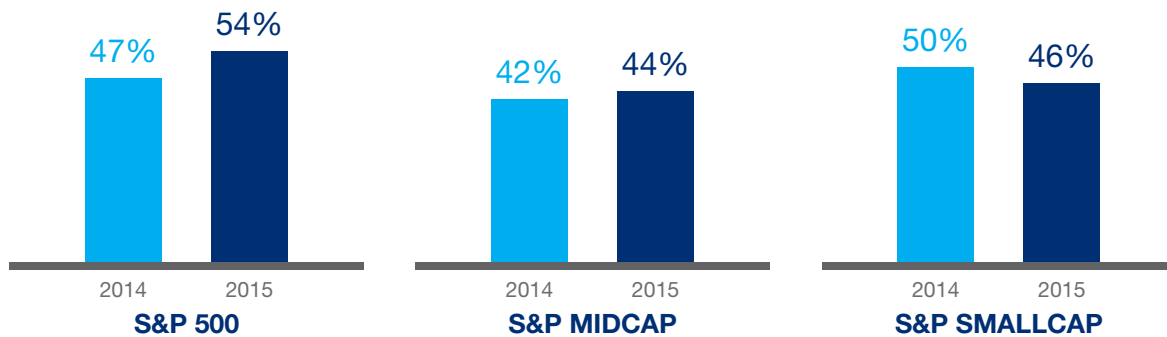


Figure 2: Disclosure of Length of Time Audit Firm Engaged



Audit Firm Compensation

This year's *Barometer* includes a review of additional auditor compensation disclosures to determine whether more audit committees are explicitly stating the role they play in determining the audit firm's compensation. Disclosure that the audit committee is responsible for audit firm compensation doubled from the prior year among

S&P 500 companies, and there were increases in this disclosure among S&P MidCap and S&P SmallCap companies as well (Figure 3). The data seems to support that audit committees are making a concerted effort to share with investors the direct and primary role they play in determining audit firm compensation both in the ratification of the appointment of the audit firm section of the proxy and the audit committee report.

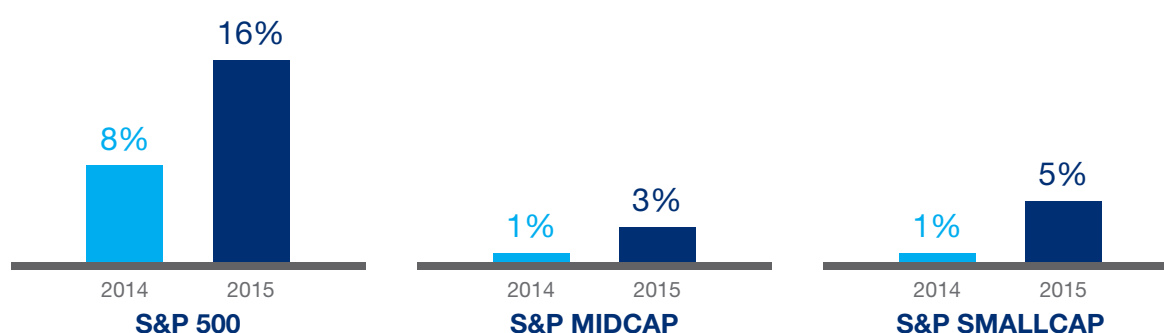
EXAMPLE 1—AUDIT FIRM COMPENSATION

Source: Xcel Energy, Inc. (S&P 500), 2015 Proxy Statement, Proposal to Ratify Auditor:

“...Audit fee negotiations associated with the retention of [Independent Auditor] as the Company’s independent accounting firm are handled by the Audit Committee. The Audit Committee participates in the selection of [Independent Auditor]’s lead engagement partner and such engagement partner is rotated periodically.”

Note: There was no disclosure related to the audit committee’s role in audit firm fee negotiations in Xcel Energy’s 2014 Proxy Statement.

Figure 3: Audit Committee Responsible for Audit Firm Compensation



Audit Firm Evaluation/Supervision

Disclosure of the evaluation of the audit firm increased significantly, tripling among S&P 500 and more than tripling among S&P MidCap company proxies (Figure 4). This discussion was included within the proposal to ratify the auditor section of the

proxy or the audit committee report and was often connected to the appointment of the auditor.

The example below illustrates an S&P 500 company that, from 2014 to 2015, provided significantly more context around the process for evaluating the audit firm, tying that discussion to audit firm appointment.

EXAMPLE 1—AUDIT FIRM EVALUATION/SUPERVISION

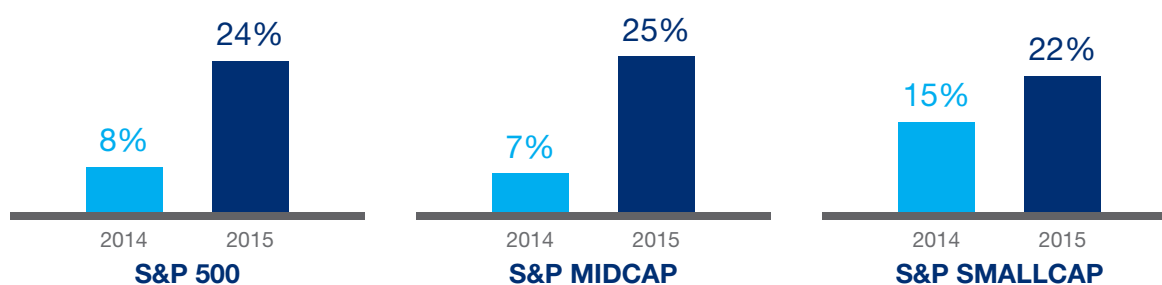
Source: Vertex Pharmaceuticals, Inc. (S&P 500), 2015 Proxy Statement, Proposal to Ratify Auditor:

In determining whether to reappoint our independent registered public accounting firm, our audit and finance committee undertakes an annual formal evaluation of the independent registered public accounting firm, during which it considers the quality of its discussions with and the performance of the lead audit partner, the audit team assigned to our account, the potential impact of changing our independent registered public accounting firm, the overall strength and reputation of the firm and issues pertaining to auditor independence, including fees that our independent registered public accounting firm receives for non-audit services.

Source: Vertex Pharmaceuticals, Inc. (S&P 500), 2014 Proxy Statement, Proposal to Ratify Auditor:

In determining whether to reappoint our independent registered public accounting firm, our audit and finance committee considers the quality of its discussions with and the performance of the lead audit partner, the audit team assigned to our account and the overall strength and reputation of the firm.

Figure 4: Discussion of Criteria Considered When Evaluating Audit Firm



The most recent proxies of some S&P SmallCap and S&P MidCap companies also tied in the discussion of the evaluation of the audit firm with the appointment of the audit firm. An example is provided below:

EXAMPLE 2—AUDIT FIRM EVALUATION/SUPERVISION

Source: Daktronics, Inc. (S&P SmallCap), 2014 Proxy Statement⁸, Audit Committee Report:

“...The Audit Committee recognizes the importance of maintaining the independence of the Company’s independent registered public accounting firm, both in fact and appearance. Each year, the Committee evaluates the qualifications, performance and independence of the Company’s independent registered public accounting firm and determines whether to re-engage the current independent registered public accounting firm. In doing so, the Audit Committee considers the quality and efficiency of the services provided by the independent registered public accounting firm, its capabilities and its technical expertise and knowledge of the Company’s operations and industry.

Based on this evaluation, the Audit Committee of the Board of Directors recommended the appointment of [Independent Auditor] as our independent registered public accounting firm to examine our consolidated financial statements and internal controls over financial reporting for fiscal 2015.”

Source: Daktronics, Inc. (S&P SmallCap), 2013 Proxy Statement, Audit Committee Report:

“...The Committee has concluded that the independent registered public accounting firm is independent from the Company and its management. The Committee discussed with our independent registered public accounting firm the overall scope and plans for its audits. The Committee meets with the independent registered public accounting firm, with and without management present, to discuss the results of its examinations, the evaluations of our internal controls, and the overall quality of our financial reporting.”

⁸ As the proxies reviewed were through the end of June 2015, and this company files its proxy in July, the July 2014 proxy was the most current proxy included for purposes of this sample. We note that the subsequent July 2015 proxy continued to include this enhanced disclosure.

Selection of Audit Partner

Alongside enhanced disclosure around factors considered in selecting an audit firm, there was also more robust discussion around the role the audit committee plays in engagement partner selection (Figure 5), as well as a statement that the

engagement partner rotates every five years (Figure 6). This was particularly evident among this year's S&P 500 proxies, as shown in the charts below.

An example of these enhanced disclosures is shown below:

EXAMPLE 1—SELECTION OF AUDIT PARTNER

Source: Goodyear Tire & Rubber Co. (S&P 500), 2015 Proxy Statement, Proposal to Ratify Auditor:

“...In accordance with SEC rules and [Independent Auditor]’s policies, audit partners are subject to rotation requirements to limit the number of consecutive years an individual partner may provide service to us. For lead and concurring audit partners, the maximum number of consecutive years of service in that capacity is five years. We select the Company’s lead audit partner pursuant to this rotation policy following meetings between the Chairman of the Audit Committee and candidates for that role, as well as discussion by the full Committee and with management.”

Note: There was no disclosure related to the selection of the audit partner in Goodyear’s 2014 Proxy Statement.

A table summarizing the results of these and other findings related to auditor oversight disclosures can be found on the next page.

Figure 5: Statement That Audit Committee Is Involved in Audit Partner Selection

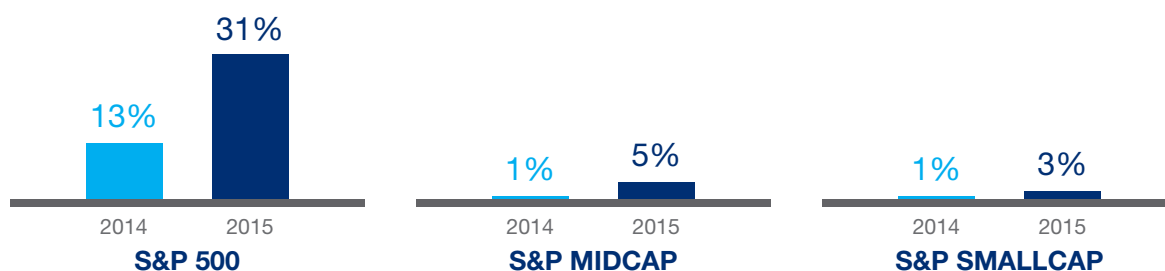
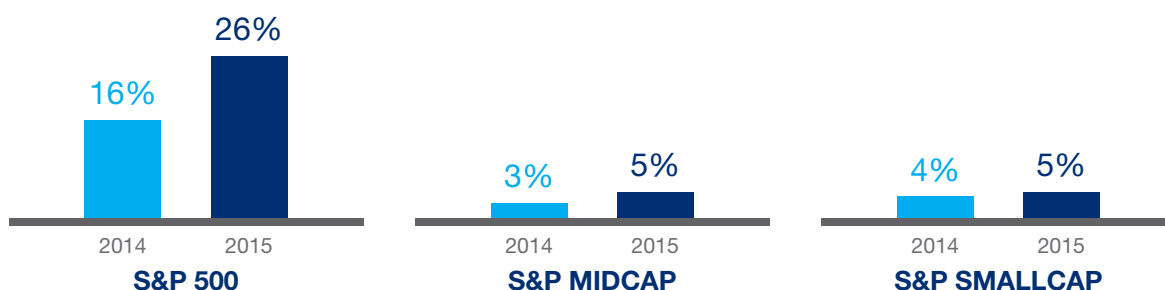


Figure 6: Statement That Audit Partner Rotates Every Five Years



Auditor Oversight Proxy Statement Disclosures Among S&P Companies

CATEGORY	DISCLOSURE QUESTION	YEAR	S&P 500	S&P MIDCAP	S&P SMALLCAP
Audit Firm Selection	Is there a discussion of audit committee considerations in appointing the external auditor?	2015	25%	16%	11%
		2014	13%	10%	8%
	Do they disclose the length of time the auditor has been engaged?	2015	54%	44%	46%
		2014	47%	42%	50%
Audit Firm Compensation	Is there a discussion of audit fees and its connection to audit quality?	2015	10%	2%	2%
		2014	13%	4%	1%
	Is there a discussion of how the audit committee considers auditor compensation?	2015	0%	0%	0%
		2014	1%	1%	0%
	Is there a discussion of how non-audit services may impact independence?	2015	78%	67%	63%
		2014	83%	69%	58%
	Is there a statement that the audit committee is responsible for fee negotiations?*	2015	16%	3%	5%
		2014	8%	1%	1%
	Is there an explanation provided for a change in fees paid to the external auditor?*	2015	25%	24%	28%
		2014	28%	30%	24%
Audit Firm Evaluation/ Supervision	Is there a discussion of criteria considered when evaluating the audit firm?	2015	24%	25%	22%
		2014	8%	7%	15%
	Is there a disclosure of significant areas addressed with the auditor?	2015	1%	0%	1%
		2014	3%	2%	1%
Selection of Audit Partner	Is it stated that the engagement partner rotates every five years?	2015	26%	5%	5%
		2014	16%	3%	4%
	Is it explicitly stated that the audit committee is involved in selection of the audit engagement partner?	2015	31%	5%	3%
		2014	13%	1%	1%

Note: Audit committee report percentages are not presented in the above table as most of the amounts are not material. Proxy percentages above reflect disclosures in the entire proxy, including the audit committee report. One category, however, did have meaningful results in the audit committee report—a discussion of how non-audit services may impact independence (included in 49% of S&P 500, 43% of S&P MidCap, and 39% of S&P Small Cap audit committee reports).

** These are new questions added to the 2015 Audit Committee Transparency Barometer. 2014 data is presented for comparative purposes but was not initially published in the 2014 Audit Committee Transparency Barometer.*

Conclusion

The *2015 Audit Committee Transparency Barometer* shows that growing numbers of audit committees are responding to evolving market needs by providing more meaningful information around the audit committee's role in overseeing the external auditor. These efforts by audit committees to enhance their disclosures are encouraging given the importance of meaningful, tailored information for investors and other stakeholders. The CAQ and Audit Analytics hope to see these positive trends continue in future readings of the *Audit Committee Transparency Barometer* in the coming proxy seasons.



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