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September 8, 2015

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Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Concept Release: Possible Revisions to Audit Committee Disclosures; File No. S7-13-15

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is an autonomous 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.

The CAQ commends the Securities and Exchange Commission (SEC or Commission) for recognizing the vital role audit committees serve in protecting the interests of investors and for seeking comment on whether and how disclosures could be improved to further highlight audit committee responsibilities and the manner in which they are executed with respect to oversight of the auditor through its *Possible Revisions to Audit Committee Disclosures* concept release (the Release). We appreciate the opportunity to share our views on the Release and respectfully submit the observations of the CAQ, but note that they are not necessarily the views of any specific member firm, individual, or CAQ Governing Board member.

In this letter, we offer for the Commission's consideration our views regarding the issues raised in the Release, organized into the following sections:

I. General Views: Critical Role of Audit Committees
II. Prescriptive vs. Principles-based Disclosure
  a. Positive Trends in Voluntary Disclosure
  b. Unintended Consequences
III. Concurrent Regulatory Proceedings

I. General Views: Critical Role of Audit Committees

The SEC's focus on audit committee disclosures can be appreciated in light of the essential role the audit committee plays in protecting the interests of investors by broadly overseeing a company's financial reporting process. Given the importance of audit committees to the proper functioning of capital markets and protection of investor interests, it is vital for investors and other stakeholders to understand and have confidence in the audit committee's processes and communications. Public disclosures are the primary channel through which audit committees communicate with investors and other stakeholders about their critical responsibilities, and how they execute those responsibilities.[1] Accordingly, we commend the SEC for seeking public comment on the audit committee's disclosures related to its role.

Our comments are guided by certain core beliefs that serve as the foundation of our views and, in our opinion, should be considered integral to any discussion of the role of audit committees and related disclosures. Our core beliefs are:

- High quality audits are critical to capital markets because they give the public enhanced confidence in the credibility and reliability of audited financial statements;
- A strong, independent audit committee promotes audit quality and accurate and transparent financial reporting by management by fostering an independent audit environment aligned with investor interests and protected from undue management influence;
- There should not be a one-size-fits-all approach to the audit committee report. Audit committees can best serve investors by tailoring disclosures specifically to the distinct opportunities and challenges of the company; and
- Audit committees have a unique understanding of a company's financial reporting process, which gives them valuable insight into which disclosures are relevant to their shareholders.

II. Prescriptive vs. Principles-based Disclosure

The CAQ believes that the best route to promote informative and relevant audit committee disclosures is through the encouragement of a voluntary, market-driven approach rather than by mandating additional prescriptive disclosures. The continuing positive trend of enhanced audit committee disclosures, as further discussed below, informs our belief that a market-driven approach is most effective, and we are concerned that adding prescriptive requirements could discourage this positive trend and stifle innovation. If the SEC does pursue rulemaking, we believe it should be a principles-based framework that allows audit committees the flexibility to adapt disclosures to their individual circumstances. However, we believe audit committees already are enhancing their disclosures beyond what is currently required, and we have not seen evidence of market demand for mandated, prescriptive disclosures. Continued enhanced, voluntary disclosure practices could be supported by the SEC through speeches and staff pronouncements that encourage the development of best practices and offer recommendations for informative, stakeholder-centric disclosures.

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[1] See The Conference Board Governance Center Task Force on Corporate/Investor Engagement's '*Guidelines for Engagement*' Research Report 1541-14-RR, pgs. 7-8, published in 2014.

In addition to potentially stifling innovation and differentiation that the market is currently providing, a mandatory set of prescriptive disclosures likely would not be able to account for the myriad of unique company challenges and particular circumstances audit committees encounter. It also is our belief that the audit committee, taking into consideration input from investors and other stakeholders, is best positioned to determine which disclosures to include because it can take a holistic view of the financial reporting process and consider relevant factors, including what information could be material based on communication with, or requests from, those investors and other stakeholders.

a. Positive Trends in Voluntary Disclosure

The Release cites the Audit Committee Collaboration's[2] publication, "*Enhancing the Audit Committee Report: A Call to Action*" (*A Call to Action*)," [3] which calls for strengthened disclosures, acknowledging that public disclosures are the primary channel through which audit committees can inform investors and other stakeholders, and encouraging public company audit committees to *voluntarily* improve their disclosures. It also notes the positive growing trend of voluntary, enhanced disclosure and provides examples from large public companies' 2013 proxy statements demonstrating innovative and effective leading audit committee disclosure practices.[4]

A Call to Action is not the only publication to note the positive market trends of increasing voluntary disclosures that are leading to tailored, innovative and enhanced audit committee disclosures. The Release notes several recent studies[5] that suggest a growing trend among audit committees to voluntarily enhance their disclosures. This trend is also supported by analysis from EY's Center for Board Matters annual proxy season update on audit committee reporting. The report following the 2014 proxy season concludes that, "research shows a consistent movement by Fortune 100 companies to enhance the depth and scope of audit committee-related disclosures. Top companies are progressively supplementing mandatory disclosures with additional voluntary information sought by investors."[6]

The Fortune 100 companies are not the only ones in which there are recent voluntary increases in enhanced disclosures. In 2014, the CAQ and Audit Analytics[7] began taking a deeper dive into audit committee reporting and applying a "barometer"[8] to measure the robustness of disclosures among Standard & Poor's (S&P) 500 large-cap companies, S&P Mid Cap 400, and S&P Small Cap 600. We recently received updated information on disclosure practices by companies in these indices from the 2015 proxy season, and highlight a sample of the information that will be published in the 2015 Barometer, set for publication this fall (*see Table 1 on the following page)*. This data demonstrates that, particularly as it relates to the audit committee's role in overseeing the external auditor, the 2015 proxy statements show positive trends in voluntary, enhanced disclosures.

In fact, there was double digit growth in the percentage of S&P 500 companies disclosing information in several key areas, including discussions around appointing the external auditor, the audit committee's considerations and involvement in approving the engagement partner, engagement partner rotation, and criteria considered when evaluating the audit firm. We believe, and as the data in Table 1 suggests, growing numbers of audit committees are responding to evolving market needs by providing more meaningful information around the

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[2] The Center for Audit Quality is a member of the Audit Committee Collaboration. *Enhancing the Audit Committee Report, A Call to Action* was published in November 2013.
[3] See pg. 5 of the Release.
[4] See pgs. 8-16 of the *Call to Action*, with excerpts from the 2013 proxy statements of Coca-Cola, Prudential Financial, General Electric Company, Citigroup Inc., Pfizer Inc., Comcast Corporation, McDonald's Corporation, et. al.
[5] See pgs. 17-18 of the Release.
[6] See *Audit Committee Reporting to Shareholders 2014 Proxy Season Update*, EY Center for Board Matters (August 2014).
[7] Audit Analytics is an independent research provider that enables accounting, legal and investment communities to analyze auditor market intelligence, public company disclosure trends and risk indicators.
[8] The "barometer" of audit committee transparency is focused on measuring the content of proxy statement disclosures in certain key areas, including auditor oversight and audit committee scope of duties. See the "*Audit Committee Transparency Barometer*" (December 2014).

audit committee's role, particularly in overseeing the external auditor. Such increases in voluntary, enhanced disclosures could be furthered by the SEC's encouragement and continued monitoring of the trend.

Table 1. Select 2015 Proxy Disclosures Compared to 2014

Category	Disclosure Question	YEAR	S&P 500	S&P Midcap	S&P Small Cap
Audit Firm Selection	Do they disclose the length of time the auditor has been engaged?	2014	47%	42%	50%
		2015 (Change from '14)	54% (+7%)	44% (+2%)	46% (-4%)
	Is there a discussion of audit committee considerations in appointing the external auditor?	2014	13%	10%	8%
		2015 (Change from '14)	25% (+12%)	16% (+6%)	11% (+3%)
Approval of audit engagement partner	Is it explicitly stated that the audit committee is involved in selection of the audit engagement partner?	2014	13%	1%	1%
		2015 (Change from '14)	31% (+18%)	5% (+4%)	3% (+2%)
	Is it stated that the engagement partner rotates every five years?	2014	16%	3%	4%
		2015 (Change from '14)	26% (+10%)	5% (+2%)	5% (1%)
Auditor evaluation/ supervision	Is there a discussion of criteria considered when evaluating the audit firm?	2014	8%	7%	15%
		2015 (Change from '14)	25% (+17%)	24% (+17%)	22% (+7%)

We also note the growing trend whereby many companies are reorganizing audit committee disclosures in a single location within the proxy statement to make the information easier to find, as further evidence that audit committees are voluntarily and proactively improving disclosures. We believe that such efforts should be encouraged.

b. Unintended Consequences

The Release asks about disclosing highly detailed information that, by its nature, gets into the specific content and precise information that flows between the auditor and audit committee.[9] The audit committees must be able to communicate openly and candidly with its external auditor to effectively carry out its duties. Prescriptive requirements requiring detailed disclosure beyond the general substance of those communications could have a chilling effect on the communication between the auditor and audit committee. Furthermore, given differences in facts and circumstances across companies, a voluntary, market-based approach to audit committee disclosures may provide the flexibility needed to deliver the right information to investors and other stakeholders, whereas, an overly prescriptive approach could discourage innovation in audit committee reporting by promoting boilerplate disclosures focused on meeting prescriptive requirements that may not be meaningful for each company.

The CAQ believes that mandating prescriptive disclosures, including several metrics discussed in the Release (e.g., the frequency with which the audit committee met with the auditor, the length of time the engagement partner and team members have served in their roles, the number of prior audit engagements performed), would not necessarily lead to an increase in meaningful information regarding the work of the audit committee or auditor. Taking into consideration what is relevant to its company and what its investors and the markets might find important, the audit committee may elect to disclose such metrics, but to prescribe that all audit committees disclose all of them could result in the addition of information that may not be material to investors, is not directly linked to enhanced financial reporting or audit quality, and could risk promoting the use of simplistic

[9] For example, see Question 12 related to communications regarding how the auditor planned and performed the audit and other information required by *PCAOB Auditing Standard 16*, which requires the auditor to communicate with the audit committee regarding certain matters related to the conduct of the audit.

bright line measures that are not meaningful as a means to judge audit committee performance. Some observers have already noted that some of the disclosures considered in the Release "could significantly expand the length of audit committee reports and other proxy disclosures about audit committees, require disclosure about matters that arguably are not material to investors, and lead to increased risk of exposure for companies and their audit committee members."[10]

Further, the audit committee should consider many factors when determining what to include in its report. Input from investors is one such important consideration. Increasingly, investors are communicating with audit committees about the types of disclosures they find useful. For instance, in each proxy season since 2012, the pension fund of the United Brotherhood of Carpenters and Joiners of America has written letters to a number of companies seeking additional audit committee disclosures related to the audit committee's responsibilities with regard to the external auditor. Additionally, Michelle Edkins, Global Head of Corporate Governance at BlackRock, Inc., has noted that the audit committee's process for overseeing the external audit and auditor was among several elements that investors would be interested in seeing in the audit committee report.[11] In its *Proxy Voting Guidelines for U.S. Securities,* BlackRock further highlighted its expectations around audit committee reports noting, "[w]e look to the audit committee report for insight into the scope of the audit committee's responsibilities, including an overview of audit committee processes, issues on the audit committee's agenda and key decisions taken by the audit committee."[12] Colin Melvin, CEO of Hermes Equity Ownership Services, articulated a desire for a "description of what [audit committees] are doing, to understand specific issues between [audit committees], the company, and the numbers."[13] With the increase in communication and engagement between audit committees and investors and, as we discuss above, the increase in audit committees enhancing their reports, we believe that audit committees and the market are in the best position to continue to determine which disclosures are most meaningful to the company's investors and other relevant market participants.

The Sarbanes-Oxley Act created common obligations for audit committees. Under the Act, the audit committee must be independent of management and responsible for appointing, compensating, and overseeing the work of the independent external auditor. How an audit committee fulfills these obligations or the processes they employ to execute such responsibilities may vary, and related disclosures could give investors greater insight into audit committee performance. With these considerations in mind, the CAQ encourages the SEC to evaluate the benefit of allowing audit committees – with the input of the markets and investors – to continue to determine what information is important to disclose.

III. Concurrent Regulatory Proceedings

In our opinion, the concurrency of various regulatory proceedings at the SEC and the Public Company Accounting Oversight Board (PCAOB) allows for any potential related disclosure considerations to be looked at holistically.

As the SEC considers how disclosures may help investors and other stakeholders understand and evaluate an audit committee's performance and its oversight of the external auditor, it is important also to consider the PCAOB's *Supplemental Request for Comment: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form* (the Supplemental Request) and the PCAOB's pending concept release seeking public comment on the content and possible uses of 28 proposed quantitative audit quality indicators (AQIs), as the potential exists for information and disclosures to be addressed in more than one rulemaking.

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[10] See *Harvard Law School Forum on Corporate Governance and Financial Regulation* post by Michael Scanlon of Gibson, Dunn & Crutcher (July 16, 2015).
[11] See Tapestry Networks *ViewPoints, Issue 21*, pg. 7 (May 21, 2013).
[12] See BlackRock's *Proxy Voting Guidelines for U.S. Securities*, pg. 7 (February 2015).
[13] See Tapestry Networks *ViewPoints, Issue 21*, pg. 7 (May 21, 2013).

For example, the SEC Release explores audit committees' disclosure of the engagement partner and information about other audit participants in the proxy or in other alternative locations. As we have stated in our August 28, 2015 letter to the PCAOB,[14] the CAQ supports disclosure of the engagement partner and information about certain other audit participants in PCAOB Form AP (as proposed in the Supplemental Request). We also support disclosure of the engagement partner by the audit committee in the proxy if the audit committee determines it important to disclose this information, along with any further discussion or context the audit committee may wish to disclose.

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We thank the SEC for providing the Center for Audit Quality with the opportunity to express its views on the Release. As described above, the CAQ is supportive of continuing to improve and enhance audit committee disclosures through a voluntary, market-driven approach. As the data cited in this letter suggests, audit committees are increasingly affording improved transparency regarding their roles and responsibilities. We believe it would be prudent for the SEC to encourage and continue to let audit committees voluntarily enhance and tailor their disclosures based on their particular circumstances.

We caution that a prescriptive, one-size-fits-all framework for disclosure may not improve the information that investors get and could, in fact, reverse the trend of enhanced and differentiated reporting that has been occurring and therefore lessen the value of the audit committee report. Should the SEC pursue rulemaking on this issue, we strongly encourage the Commission to adopt a principles-based framework that will allow audit committees the flexibility to continue to provide the information to their shareholders that is most relevant and meaningful based on the key issues and particular circumstances each company is facing.

Alongside our partners in the Audit Committee Collaboration, the CAQ has worked extensively and proactively on the topic of audit committee disclosure since 2012. We are prepared to assist the SEC in any way we can and welcome a continued dialogue on this important issue. We would be pleased to discuss our comments or answer any questions that the Staff or Commissioners may have regarding the views expressed in this letter.

Sincerely,

Cynthia M. Fornelli

Cynthia M. Fornelli
Executive Director
Center for Audit Quality

cc:

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[14] See CAQ Comment Letter on PCAOB's Supplemental Request (August 28, 2015).

<u>PCAOB</u>
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