Dan Goelzer

AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

Update No. 84
August-September 2023

Summary

SEC Adopts Cybersecurity Disclosure Rules. The Securities and Exchange Commission has adopted final rules on cybersecurity disclosure. New Item 1.05 of Form 8-K will require reporting companies to disclose any cybersecurity incident the company decides is material within four days of determining the materiality of the incident. Companies must "describe the material aspects of the nature, scope, and timing of the incident, and the material impact or reasonably likely material impact on the registrant, including its financial condition and results of operations." Audit committees should ask management to evaluate whether the company's existing disclosure controls and procedures regarding cybersecurity incidents are consistent with the new Form 8-K requirements. Audit committees may also want to make sure that management and the board have identified and entered into arrangements with outside experts and advisors who specialize in evaluating cybersecurity incidents. Board training on cybersecurity, including incident response dry runs, could also be considered. (more)

The Average Audit Fee Reached an All-Time High in 2022. In 2022, the average audit fee for an SEC-registered public company increased 11 percent over 2021 and hit an all-time high of $2.24 million. That is the headline finding of 20-Year Review of Audit Fee Trends 2003-2022, Ideagen Audit Analytics' annual analysis of fees paid to external auditors. For S&P 500 companies, the average audit fee was $10.78 million, also a record high and a 3 percent increase from FY2021. In one sense, however, audits became cheaper: Audit fees as a percentage of client revenue were $576 per $1 million of revenue in 2022, a 6 percent decrease from 2021 and a nine-year low. Audit committees may find it useful to compare changes in their company's fees with the information in the AA report. AA points out that "[a]udit fees paid to external auditors can be an indicator of audit complexity. Analyzing fees provides further insights into audit risk and auditor independence." (more)

Audit Committee Members Weigh in on NOCLAR Proposal. The PCAOB's proposal to broaden the scope of the auditor's responsibilities for audit client noncompliance with laws and regulations (NOCLAR) has attracted an unusually high level of comment from audit committee members. As of August 31, the Board had posted 137 NOCLAR public comments on its website. Fourteen of the comments express the views of audit committee members. Overwhelmingly, but not unanimously, audit committee members that have submitted comments oppose the NOCLAR proposal. Because of the potential impact on the audit committee's work, committees should ask their auditor or legal counsel to keep them informed of the progress of this initiative. (more)

Material Weaknesses are Increasing and an Accountant Shortage May Be to Blame. PwC reports a "resurgence" of public company material weakness disclosures. In The resurgence of the material weakness, PwC warns that, when material weaknesses are reported, "shareholders' confidence in the integrity of the financials and the control environment can be shaken, and reputations of company executives and governing boards (e.g. the Audit Committee) can be harmed by a loss of trust." In a July 11 article, the Wall Street Journal also reported on material weakness disclosures, noting that an increasing number of companies are reporting material weaknesses resulting from an inability to attract and retain enough qualified personnel to perform internal control responsibilities. Audit committees may want to reflect on whether personnel vacancies or turnover could be affecting their company's controls and what steps management could take to address these issues. (more)

PCAOB Charges Five Firms with Audit Committee Communications Failures. On July 28, the Public Company Accounting Oversight Board announced settled disciplinary orders sanctioning five audit firms for violating the Board's rules related to communications with audit committees. Three of the firms failed to obtain audit committee pre-approval for audit or non-audit services provided to public company audit clients. The other two firms failed to make and/or to document required audit committee communications, including communications concerning other accounting firms, in addition to the principal auditor, which participated in the audit. In announcing these cases, PCAOB Chair Erica Williams observed that "required disclosures are critical to ensure audit committees have the information they need to effectively oversee the auditor's work." (more)

Advice for Audit Committee Chairs on Conducting Special Investigations. Audit committee chairs are often asked to conduct investigations of suspected financial frauds, corrupt payments, or other sensitive and complex matters. Tapestry Networks, an independent firm supported by EY, convened the audit committee chairs of 100 large U.S. public companies to discuss oversight of special investigations. Based on that discussion, Oversight of Special Investigations, a publication in Tapestry's Viewpoints series, summarizes key issues regarding such investigations. Tapestry's paper has three sections, mirroring the stages of an investigation, and includes an appendix listing questions for audit committee chairs to consider in connection with special investigations. (more)

IAASB Issues Proposed Sustainability Auditing Standard. The International Auditing and Assurance Standards Board has issued Proposed International Standard on Sustainability Assurance 5000, General Requirements for Sustainability Assurance Engagements. Proposed ISSA 5000 would provide a framework for third-party assurance on sustainability reporting and would apply to sustainability information reported across any sustainability topic and prepared under multiple frameworks, including the ISSB's Sustainability Disclosure Standards S1 and S2. While assurance over sustainability reporting is not currently required in the United States, many companies that report sustainability information also provide some level of third-party assurance over at least part of the information. Accordingly, the standards under which such assurance is available are likely to be on the agenda for an increasing number of audit committees. (more)

A New Auditor is Likely to Charge Less, But Miss More Financial Statement Errors. A study conducted by three researchers at the University of Texas at Austin finds that, when companies change auditors, the new auditor is likely to charge a lower audit fee, compared to the prior auditor. But Audit fee discounts following auditor changes: Do they occur and impair audit quality? also finds that a large fee discount is associated with a greater likelihood that the successor auditor will fail to detect misstatements in the first year of the new audit engagement. Fee discounting and impaired audit quality result from the incoming auditor underestimating client risk. However, the impact on audit quality is short-lived. In the new auditor's second year, its understanding of the client improves, and fee discounting is no longer associated with failure to detect misstatements. Audit committees might want to keep this study in mind when considering the possibility of changing auditors to capture a significant fee reduction. (more)

Daniel L. Goelzer
301.288.3788
dangoelzer@gmail.com

The Update's website is www.auditupdate.com.

Updates issued after June 1, 2020, are available here. Updates issued between January 1, 2019, and May 31, 2020, are available here. An index to titles and topics in the Update beginning with No. 39 (July 2017) is available here.