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AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

Update No. 94
September-October 2024

Summary

SEC Charges Audit Committee Chair with Fraud. The SEC has charged the former chair of the audit committee of Kubient, Inc. with engaging in fraud, making false statements to the company's auditor, and aiding and abetting false SEC filings in connection with the over-statement of the company's revenue. Among other things, the SEC's complaint alleges that an employee informed the audit committee chair of questions concerning data used to support recognition of almost three-quarters of Kubient's revenue but the chair did not take meaningful steps to understand the circumstances underlying the employee's discovery. The chair is also alleged to have failed to inform Kubient's independent auditor of the audit committee meeting at which the committee discussed the employee's concerns and to have orally advised the auditor, in response to questions, that she was not aware of any tips or complaints regarding the company's financial reporting. While SEC enforcement cases against audit committee members are rare, the SEC can be expected to act aggressively when an audit committee member ignores obvious red flags and takes steps to conceal them from the company's auditor. (more)

PCAOB Spotlight on Independence Deficiencies Includes Advice for Audit Committees. The PCAOB staff has issued Spotlight: Inspection Observations Related to Auditor Independence (September 2024). The Spotlight highlights PCAOB inspection observations on independence and describes common deficiencies that resulted in the issuance of inspection comments. The Spotlight also discusses good practices and other reminders for audit firm compliance with the SEC and PCAOB independence standards and rules. The report concludes with suggestions regarding audit committee oversight of auditor independence. Audit committees should review the PCAOB's suggested audit committee independence oversight considerations and integrate them into their work. (more)

PCAOB Files More Audit Committee Communications Cases. On September 24, the PCAOB announced settled disciplinary proceedings against four audit firms for violating the Board's rules related to communications with audit committees. Two of the cases also allege failures to document audit committee pre-approval of tax services. These cases are part of a continuing PCAOB crackdown on firms that fail to make required communications to client audit committees. Audit committees should have a general understanding of the types of information their auditor is required to communicate and should ask questions if they do not receive the required communications. (more)

CAQ Finds that 92 Percent of Institutional Investors Rely on CAMs. A survey of 100 institutional investors conducted by KRC Research for the Center for Audit Quality finds that 92 percent of respondents use critical audit matters when making investment decisions. The survey also found that 78 percent of respondents "always" or "often" read the CAMs section of the auditor's report on companies they invest in or are researching, and that 90 percent of these institutional investors are either "satisfied" or "very satisfied" with the quality and clarity of CAMs. The results of this research are reported in The Center for Audit Quality Critical Audit Matters Survey Research Findings--Q3 Survey. If institutional investors are in fact taking CAMs as seriously in their decision-making as the CAQ-KRC survey indicates, audit committees should also pay close attention to their company's CAMs. In particular, audit committees should consider whether any CAMs in their company's audit report suggest weaknesses in the company's financial reporting processes that could be remediated. (more)

2023 PCAOB Target Team Report: Crypto, Multi-Location Audits, and Significant Transactions. The PCAOB has released Spotlight: Observations From the Target Team's 2023 Inspections. The Board's annual inspections program includes a "target team" -- a group of inspectors that conduct reviews across many audit firms with a focus on specific emerging audit risks and other issues. In 2023, the target team focused on reviewing audits that included risks in three areas: (1) material crypto asset activities, (2) multi-location audits, and (3) significant or unusual events or transactions. The target team Spotlight could be useful to an audit committee in understanding what aspects of the company's audits are likely to attract PCAOB inspection staff attention. In addition, audit committees of companies where any of the 2023 focus areas are an aspect of the audit may want to review those topics in the Spotlight report as preparation for discussing with the auditor how it intends to address these issues in future audits. (more)

What Backlash? ESG Reporting Continues to Grow. New reports from two organizations that monitor the state of sustainability reporting provide insight into how widespread the practice has become and the evolution of these disclosures.

The Governance & Accountability Institute released Sustainability Reporting In Focus 2024, the thirteenth edition of its annual series tracking sustainability reporting by companies in the Russell 1000 index. G&AI observes that its research "continues to show a steady increase in the total number of companies publishing annual sustainability reports, which is now widely recognized as essential for both large- and mid-cap U.S. publicly-traded companies." G&AI found that 93 percent of Russell 1000 companies published a sustainability report in 2023, up from 90 percent in 2022. The Sustainability Accounting Standards Board's disclosure standards are the most widely used ESG disclosure framework.

Teneo, a global advisory firm, published Stand by ESG? Our Annual State of U.S. Sustainability Reports, its fourth annual report. Teneo analyzed 250 sustainability reports from S&P 500 companies published during 2024 prior to September 11. Teneo notes two "mega-trends" affecting ESG reporting and strategy -- increasing requirements from regulators for more ESG disclosure and increasing anti-ESG political and activist pressure. Based on its review, Teneo provides "Top Ten Takeaways From 2024 Sustainability Reports." For example, two of Teneo's takeaways are that sustainability reports are getting longer (on average, 80 pages in 2024) and that more companies are reporting that the CEO is ultimately responsible for ESG strategy (32 percent in 2024).

Both G&AI and Teneo highlight that, while sustainability reporting has been voluntary in the United States, mandatory reporting will soon be a reality for many companies. Audit committees should consider whether management is prepared for this transition and how the company's reporting will be impacted by mandatory sustainability disclosure requirements. (more)

CAQ Surveys Audit Committee Members and Investors on Engagement Performance Metrics. In April, the PCAOB issued two proposals that would significantly expand the disclosures that certain accounting firms must make regarding their performance of audit engagements and their operational and financial condition. A primary objective of these new disclosures would be to aid audit committees in their oversight. In response to the PCAOB's proposals, the Center for Audit Quality conducted surveys of audit committee members and investors to gather data concerning how they evaluate audits. Among other things, the CAQ found that 95 percent of audit committee survey respondents believe that the information currently available meets all or most of their audit oversight needs; 43 percent would like additional information on their company's audit engagement; and 48 percent agree or somewhat agree that mandated public disclosure of engagement-level performance metrics could lead to unintended consequences and should be voluntary. As to the institutional investor survey respondents, 92 percent believe that the information currently available to them meets all or most of their audit quality assessment needs; 46 percent would like more information about the auditing process; and 83 percent strongly or somewhat agree that mandated public disclosure of engagement-level performance metrics could lead to unintended consequences and should be voluntary.

In a supplemental comment letter filed with the PCAOB, the CAQ asserts that the results of these surveys indicate that more research is necessary to establish whether evidence supports the need for and benefits of the PCAOB's proposed metrics and that any reporting should be voluntary. (more)

Its Enforcement Task Force is Gone, but the SEC is Still Bringing ESG Cases. In 2021, the SEC announced the formation of the Climate and ESG Task Force in the Division of Enforcement to pursue ESG-related misconduct. While this task force brought several significant cases, only one major enforcement action alleged that a public company had committed ESG-related disclosure violations. On September 12, Bloomberg reported that the SEC had quietly disbanded the task force. But a recent action filed almost simultaneously with that report demonstrates that the Commission is still interested in ESG disclosure enforcement.

On September 10, the Commission issued an order charging Keurig Dr Pepper Inc. with making inaccurate statements regarding the recyclability of its K-cup beverage pods. Keurig's annual reports for 2019 and 2020 stated that K-cup pods "can be effectively recycled." This statement was true in that Keurig had conducted testing which showed that pods could, as a matter of technology, be processed for potential reuse. However, Keurig did not disclose that two of the largest recycling companies had expressed significant concerns to Keurig regarding the commercial feasibility of curbside recycling of K-cup pods and did not intend to accept the pods for recycling. The SEC's order, to which Keurig consented without admitting or denying the Commission's allegations, finds that Keurig violated the reporting provisions of the Securities Exchange Act and requires the company to pay a civil penalty of $1.5 million.

This action suggests that the SEC staff remains open to cases with an ESG nexus. Companies and their audit committees should be alert for ESG-related statements in SEC filings or other disclosures, such as sustainability reports, that the Commission could characterize as incomplete or misleading. (more)

The Audit Blog. The Audit Blog provides commentary on developments in auditing and financial reporting, auditor oversight and regulation, and sustainability disclosure. Recent blog posts include –

- Enhanced Auditor Quality Control: Companies Will Feel the Effects (Dan Goelzer, September 20, 2024)

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

Update Nos. 89-present (March 2024 to present) and summaries are available here. Update Nos. 76-88 (August 2022 to February 2024) and summaries are available here. Update Nos. 60-75 (June 2020 to July 2022) are available here. Update Nos. 49-59 (January 2019 to May 2020) are available here. Updates prior to No. 49 are available on request.

An index to titles and topics in the Update beginning with No. 39 (July 2017) is available here.