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AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

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This Update summarizes recent developments relating to public company audit committees and their oversight of financial reporting and the company's relationship with its auditor.

In This Update

Audit Committees are Disclosing More About Members' Skills and Less About Auditor Oversight

The Center for Audit Quality (CAQ) and Ideagen Audit Analytics (IAA) have released the Audit Committee Transparency Barometer 2025 (Barometer 2025), the twelfth edition of the CAQ's annual analysis of audit committee disclosures. The press release announcing Barometer 2025 reports that "while skills matrix disclosure continues at high rates and disclosure of cybersecurity expertise on boards has grown, most disclosure areas have stagnated or declined." Key findings of the 2025 report include:

- Ninety percent of S&P 500 companies disclosed the board of directors' skills matrix, an increase from 85 percent in 2024. S&P MidCaps and S&P SmallCaps also increased this disclosure.

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- Sixty-five percent of S&P 500 boards disclosed they have a cybersecurity expert, a five percent increase from 2024.

- "Stagnation and decline" of audit committee disclosures occurred across several measures. For S&P 500 companies, disclosure of the annual evaluation of the external auditor decreased from 39 percent to 38 percent; disclosure of considerations in appointing or re-appointing the external auditor was flat at 50 percent; and disclosure of factors contributing to the selection of the audit partner decreased from 17 percent to 16 percent.

The Transparency Barometer tracks S&P 1500 audit committee disclosures on thirteen topics (two of which include subtopics) and breaks down disclosures between the S&P 500, the S&P MidCap 400, and the S&P SmallCap 600. For a discussion of last year's report, see CAQ and IAA: Companies are Saying More About Their Board's Cyber and ESG Expertise, November 2024 Update. Highlights of Barometer 2025 are discussed below.

Frequent Disclosures

In 2025, the five most frequently disclosed topics (ranked according to their S&P 500 disclosures) were:

- Disclosure that the board of directors has a skills matrix. The report states that a skills matrix is "a helpful tool in evaluating the overall competency of the board to ensure the board is equipped with the skills needed to exercise effective oversight." As noted in the press release, 90 percent of S&P 500 companies disclosed a skills matrix, up from 85 percent last year. Eighty percent of S&P MidCap companies disclosed a matrix, up from 75 percent in 2024, and 70 percent of S&P SmallCaps disclosed a matrix, an eight percent increase from 62 percent.

- Discussion of how non-audit services may impact independence. Eighty-five percent of the S&P 500, 82 percent of S&P MidCaps, and 75 percent of S&P SmallCap companies discussed the relationship between non-audit services and auditor independence. In 2024, the frequency of this disclosure was almost the same (S&P 500: 85 percent, S&P Midcaps: 80 percent, and S&P SmallCaps: 74 percent).

- Disclosure of the length of time the auditor has been engaged. Seventy-five percent of the S&P 500, 61 percent of the MidCap 400, and 56 percent of the SmallCap 600 disclosed auditor tenure. This reflects a slight increase over 2024 when 73 percent of the S&P 500, 61 percent of the MidCap 400, and 57 percent of the SmallCap 600 disclosed tenure.

- Disclosure that the board of directors has a cybersecurity expert. Technology and cybersecurity continue to be a focus of board and audit committee oversight. Sixty-five percent of S&P 500 companies indicated that their board had a cybersecurity expert, a five percent increase. Forty-six percent of the S&P MidCap and 44 percent of SmallCaps disclosed such expertise in 2025, increases of 5 percent and seven percent, respectively. Barometer 2025 observes that "this disclosure was one of few where we see an increase."

- Disclosure that the audit committee is responsible for cybersecurity risk oversight. Sixty-four percent of the S&P 500, 55 percent of the S&P MidCap 400, and 53 percent of the SmallCap 600 disclosed that the audit committee had cybersecurity risk oversight responsibility. In 2024, 64 percent of the S&P 500, 53 percent of the S&P MidCap 400, and 50 percent of the SmallCap 600 made this disclosure. Audit committee cybersecurity responsibility disclosure has risen sharply in the past eight years. In 2016, only eleven percent of the S&P 500 (and five percent of Mid-Caps and four percent of SmallCaps) discussed audit committee oversight of cybersecurity risk.

Infrequent Disclosures

Of the 13 topics that the CAQ and IAA track, those least frequently disclosed were:

- Disclosure related to a discussion of audit fees and their connection to audit quality. Only seven percent of the S&P 500 and three percent of S&P MidCaps discussed the relationship between audit fees and audit quality. No SmallCap companies addressed this issue.

- Disclosure related to a discussion about how the audit committee considers the length of auditor tenure. While auditor tenure was the second most frequent disclosure, discussion of how the audit committee views tenure was second from the bottom in disclosure frequency. Fourteen percent of S&P 500 companies discussed the audit committee's view of the length of auditor tenure, as did five percent of MidCaps and four percent of the SmallCaps.

Oversight of the External Auditor – Plateaued or Declining

As discussed above, two auditor oversight topics were among the most frequently disclosed (how non-audit services impact independence and auditor tenure), and two were the least frequently disclosed (the relationship between audit fees and audit quality and how the audit committee considers auditor tenure). Barometer 2025 also analyzes trends in three other areas related to auditor oversight:

- Disclosure that the evaluation of the external auditor is at least an annual event. S&P 500 disclosure rates for the annual external auditor evaluation decreased for the first time since the Barometer's inception, falling from 39 percent in 2024 to 38 percent in 2025. For MidCaps, this disclosure rose one percent to 23 percent in 2025, and for SmallCaps it rose two percent to 22 percent.

- Disclosure related to a discussion of audit committee considerations in appointing or re-appointing the external auditor. The disclosure rate for the discussion of factors the audit committee considers when appointing or re-appointing the external auditor was stagnant at 50 percent for companies in the S&P 500. For S&P MidCap companies, this disclosure fell one percent from 35 percent in 2024 to 34 percent in 2025. For S&P SmallCaps, it rose from 29 percent to 30 percent, up one percentage point from 2024.

- Disclosure that the audit committee participates in the selection of the engagement partner and of how the audit committee is involved. Fifty-three percent of S&P 500 companies explicitly state the audit committee's involvement in selecting the audit partner, but only 16 percent discuss factors contributing to the selection, a one percent decrease from 2024. The CAQ states: "The engagement partner plays a key role in setting the tone for the engagement team. Increased disclosure of audit committees' involvement in, and process for, selecting the engagement partner provides stakeholders with confidence that the audit committee has sufficient oversight of the selection of the engagement partner and determine who is best suited to lead the engagement team to execute the audit effectively through change and disruption."

Regarding 2025 auditor oversight disclosures generally, the report states that the CAQ and IAA "see an opportunity for audit committees to provide greater transparency into how evolving risks impact the audit committees' considerations in determining how external auditors are evaluated, appointed/(re)appointed, and how audit partners are selected." They further note that "[i]ncreasing disclosures of these areas will provide stakeholders with greater insight into how the audit committee oversees the external auditor, and how that oversight continues to evolve and adapt in response to change and disruption."

Disclosure Examples and Audit Committee Questions

As in prior years, an appendix to Barometer 2025 presents examples of effective disclosures from specific audit committee reports for each of the 13 disclosure topics tracked in the annual analysis. Another

appendix contains a detailed pro forma description of an audit committee and its responsibilities, along with a model audit committee report. A final appendix, "Questions to Consider When Preparing Audit Committee Disclosures," lists questions to aid in drafting disclosures concerning the work of the audit committee. These questions are arranged under the thirteen disclosure topics tracked in the Barometer.

Audit Committee Takeaways

Audit committees can use the Barometer 2025 to benchmark their company's disclosures. Further, committees should consider expanding their audit committee reports, particularly in auditor oversight areas that the report flags as declining or in need of improvement. The Questions to Consider appendix may be useful to committees in evaluating and enhancing their disclosures.

Disclosure of a directors' skills matrix, which has become popular, may well be useful to investors. But the audit committee's core responsibility is financial reporting and auditor oversight. Transparency concerning that work should be the paramount goal. As Barometer 2025 states: "Audit committees have an opportunity to re-evaluate their disclosures in light of the period of disruption that we are facing, to provide greater transparency to investors and other stakeholders about how the audit committee is fulfilling its oversight responsibilities. These disclosures ultimately enhance trust and instill confidence in the audit committee's leadership."

SEC Public Company Enforcement Dipped Sharply in 2025

During fiscal year 2025, the Securities and Exchange Commission brought 30 percent fewer cases against public companies and their subsidiaries than in FY 2024, and 93 percent of the 2025 cases were brought before January 25, 2025 – the day on which Biden Administration SEC Chair Gensler resigned. Those findings are reported in SEC Enforcement Activity: Public Companies and Subsidiaries—Fiscal Year 2025 Update, the annual report of Cornerstone Research and the New York University Pollack Center for Law & Business on SEC enforcement actions against public companies. Cornerstone and the Pollack Center issued a press release on November 19 summarizing their 2025 report. In addition to the drop in total public company actions, the press release notes that monetary settlements in FY 2025 were the lowest for any year with an SEC administration change and the second-lowest in the Cornerstone/NYU database.

The Cornerstone/Pollack Center report analyzes information from the Securities Enforcement Empirical Database (SEED), which tracks SEC enforcement actions against public companies and subsidiaries since FY 2010. For a discussion of last year's report, see SEC Enforcement in 2024: Fewer Cases But More in Penalties, December 2024 Update.

Number of Actions Against Public Companies and Their Subsidiaries

During FY 2025 (October 1, 2024, to September 30, 2025), the SEC initiated 56 actions against public companies and their subsidiaries. Fifty-two of those actions were brought under Chair Gensler and four under the new, post-inauguration SEC administration. (Mark Uyeda served as Acting Chair following Chair Gensler's resignation and Paul Atkins became Chair on April 21). In comparison, in FY 2024, the Commission brought 80 enforcement actions against public companies and subsidiaries.

The SEC initiated three public company actions in the second half of FY 2025, two of which were brought in the fourth quarter. Both the second-half and fourth-quarter numbers were the lowest in SEED by a wide margin. The prior second-half low was 19 in FY 2017, and the prior fourth-quarter low was six in FY2011.

The Cornerstone/Pollack Center report suggests that the decline in enforcement activity may be temporary:

> "The reduced enforcement activity in FY20 25 under Chair Atkins may be in part due to the higher number of actions earlier in the fiscal year under Chair Gensler as well as the change SEC priorities and the appointment of a new Director of Enforcement, Military Judge Margaret 'Meg" Ryan, who was

sworn in on September 2, 2025. Enforcement activity under Chair Atkins could see a boost as Judge Ryan has more time in her role and Chair Atkins's priorities are more firmly established." (footnotes omitted)

Settlement Amounts

The SEC imposed monetary relief totaling $808 million in public company cases settled during FY 2025. This represents the second-lowest annual settlement amount in SEED and is less than half of the FY 2016 – FY 2024 average annual monetary settlement total of $1.9 billion. In FY 2024, total monetary settlements in public company cases were to $1.5 billion. In FY 2025, the average monetary settlement was $15 million, down from $19.8 million in FY 2024 and the second-lowest since 2016. However, the median monetary settlement of $4 million was higher than the fiscal year 2024 median of $3.2 million. Civil penalties accounted for roughly 85 percent of the total 2025 settlement amount, while disgorgement and prejudgment interest were about 15 percent.

Focus on Issuer Reporting and Disclosure

Forty-one percent of the FY 2025 SEC actions against public companies and subsidiaries included allegations of issuer reporting and disclosure violations. This was ten percent higher than the 31 percent that included such charges in FY 2024 and higher than the 38 percent average from 2016-2024. Three of the four public company actions filed under the new SEC administration included charges related to reporting and disclosure. The Cornerstone/Pollack Center report predicts: "Actions with issuer reporting and disclosure allegations are expected to continue into FY 2026 as chair Atkins has signaled his administration will 'return' to the 'core mission that Congress set' for the SEC, which prioritizes 'protecting investors; furthering capital formation; and safeguarding fair, orderly, and efficient markets.'"

Cooperation

According to the report, the SEC noted cooperation in its settlements with 73 percent of public company and subsidiary defendants in FY 2025. (There were 66 settling defendants in FY 2025.) While slightly lower than the 75 percent cooperation rate in 2024, the 2025 rate was higher than the FY 2016 to FY 2024 average of 65 percent and the third highest of any fiscal year in SEED. The report attributes the level of cooperation to former Chair Gensler's support for the practice. A defendant is deemed to have cooperated based on self-reporting, remediation, and the SEC's noting cooperation in the settlement announcement.

Audit Committee Takeaways

For audit committees interested in anticipating the level and focus of the SEC's enforcement program over the next several years, the 2025 Cornerstone/Pollack Center report provides only limited guidance. It could suggest a lessening of SEC enforcement intensity. The sharp drop in public company cases following the change in SEC leadership might support that view, as does Chair Atkins's repeated statements that the SEC should stop "regulation by enforcement" and avoid bringing cases based on creative or novel legal theories. See, e.g., Keynote Address at the 25th Annual A.A. Sommer, Jr. Lecture on Corporate, Securities, and Financial Law (October 7, 2025).

However, there is also reason to anticipate that the new SEC will be active in enforcing public company disclosure and reporting requirements. As noted above, Chair Atkins has stressed returning the agency to its core mission, which suggests that traditional disclosure and reporting matters will be a priority, at least where they involve allegations of fraud. Moreover, policy changes may not be the primary cause of the drop in enforcement actions against public companies following Chair Gensler's departure. The advent of the new presidential Administration corresponded with a substantial reduction in SEC staffing, in part due to voluntary departures and in part due to DOGE-inspired initiatives. Therefore, the Commission may simply not have had sufficient personnel to continue enforcement at prior levels. Over time, that constraint is likely to be mitigated.

On balance, audit committees should assume that SEC enforcement will remain active where public companies have engaged in fraudulent reporting. It is, however, likely that, during the next three years, the Enforcement Division will not pursue novel cases, such as those that seek to expand the scope of the internal control requirements into new realms. See SEC Seeks Shelter from Solar Winds Case in this Update. Bread-and-butter fraud-based disclosure enforcement against public companies and their insiders is, however, likely to continue, if not intensify.

Most Audit Reports Contain a CAM, But Only One

Ideagen Audit Analytics (IAA) has released Critical Audit Matters: A five-Year Review 2020-2024, a study of critical audit matters (CAMs) that appeared in audit reports filed by SEC-registered companies between 2020 and 2024. IAA finds that in both FY 2023 and FY 2024, 68 percent of auditor reports contained at least one CAM, up from 62 percent in 2020, the first year of CAM reporting. However, for audit opinions that contained a CAM, the average number of CAMs per opinion has fallen from 1.51 in 2020 to 1.27 in 2024. Revenue recognition was the most frequent CAM topic, appearing in 17 percent of FY 2024 CAMs, up from 12 percent in 2020. For a discussion of IAA's 2023 report (covering FY2020-2022), see More Audit Reports Contain CAMs, But There are Fewer CAMs Overall, February 2024 Update.

Background

As described in earlier Updates (see, e.g., The CAQ Summarizes CAM Reporting, January-February 2021 Update and More PCAOB Advice for Audit Committees on CAMs, July, 2019 Update), a CAM is defined as any matter arising from the audit of the financial statements that was (1) communicated or required to be communicated to the audit committee, (2) relates to accounts or disclosures that are material to the financial statements, and (3) involved especially challenging, subjective, or complex auditor judgment. The auditor's report must identify each CAM, describe the main considerations that led the auditor to determine that the matter was a CAM, describe how the auditor addressed the CAM in the audit, and refer to the financial statement accounts or disclosures related to the CAM. The requirement that public company auditors' reports include a discussion of CAMs began with large accelerated filers (companies with public float of $700 million or more) for fiscal years ending on or after June 30, 2019.

IAA 2025 Review Findings

Highlights of the IAA review include the following:

- The number of audit reports containing one or more CAMs continues to fall, along with the number of reporting company audit opinions, but the share of opinions containing a CAM is steady. In FY 2024, 4,637 audit opinions included at least one CAM, out of 6,834 opinions filed with the SEC. In 2023, there were more opinions with CAMs (4,807), but also more total audit opinions (7,111). In both years, 68 percent of audit opinions included a CAM.

- The number of CAMs is also falling, both in absolute numbers and in terms of CAMs per audit opinion. The 5,908 total CAMs in FY2024 was the lowest number during the five years on which IAA reported. (In FY2021, there were 7,012 CAMs.) The average number of CAMs per opinion hit a five-year low of 1.27 in FY2024, declining from 1.31 in 2023 and 1.51 in 2020.

- Most audit reports contain only one CAM. The frequency of opinions with only one CAM has increased every year. In FY2024, 77 percent of opinions with CAMs had only one. Nineteen percent of opinions contained two CAMs, and three percent contained three. Deutsche Bank, with six CAMs, had the highest number in 2024.

- Revenue recognition continues to be the top CAM topic, followed by allowance for credit losses. As mentioned above, 17 percent of CAMs are related to revenue recognition. Revenue recognition was also the most common topic during the 5-year period of the study; 14 percent of

CAMs during that period discussed revenue recognition. IAA offers this explanation of the frequency of revenue recognition CAMs: "The revenue recognition standard FASB ASC Topic 606, Revenue From Contracts With Customers, was a significant change in US GAAP. It requires a five-step approach to recognizing revenue and includes numerous aspects where significant judgments may apply. Frequent sub-topics illustrate the judgmental areas and include performance obligations, variable consideration, stand-alone selling price and percentage of completion method."

- Allowance for credit losses was the second most common CAM topic. Allowance for credit losses, discussed in nine percent of CAMs, rose to second place in 2024 from third place in 2023. IAA observes: "Under the Current Expected Credit Losses (CECL) model, which replaced the previous "incurred loss" model, companies must estimate the full amount of expected credit losses over the lifetime of a financial asset. This is a forward-looking process that relies heavily on management's judgment and assumptions. * * * These factors introduce a high degree of estimation uncertainty, which makes the allowance for credit losses a challenging and complex area for management to get right."

- CAM topics by industry. The audit issues that involve especially challenging, subjective, or complex auditor judgment vary by industry. As discussed, revenue from customer contracts is the most common CAM topic among all public companies and the most common CAM topic in audit opinions for companies in four industries: Technology, trade and services, manufacturing, and industrial applications and services. The table below, which appears on page 12 of IAA's report, shows the most frequent CAM topic for each industry group IAA tracks.

#1 CAM topic by industry: FY2024

Industry	CAM topic	Total CAMs	% of CAMs
Finance	Allowance for credit losses	415	41%
Technology	Revenue from customer contracts	315	41%
Energy & transportation	Regulatory assets and liabilities	156	19%
Trade & services	Revenue from customer contracts	152	20%
Manufacturing	Revenue from customer contracts	151	18%
Life sciences	Research and development expenses	143	23%
Real estate & construction	Real estate investments	125	24%
Industrial applications and services	Revenue from customer contracts	108	20%

Source: Ideagen Audit Analytics, Critical Audit Matters: A Five-Year Review 2020-2024 (2025), page 12.

- Going concern qualifications and CAMs do not seem to mix. When the auditor concludes that there is substantial doubt about the entity's ability to continue in business for one year after the financial statement date, the audit opinion must contain a paragraph reflecting that doubt. In FY2024, only 37 percent of going concern opinions contained a CAM. Since 68 percent of all opinions contained at least one CAM, an opinion with a going concern paragraph was about half

as likely to report a CAM as the average opinion. Other debt and the going concern determination were the most common CAM topics in going concern opinions that contained a CAM.

Audit Committee Takeaways

Audit committees might find the IAA study useful as a tool for comparing the number and nature of their company's CAMs with the study's overall findings and with trends in the same industry. Audit committees of companies that have no CAMs – or more than two CAMs – may want to discuss with their auditor why their company differs from the broad averages. The PCAOB has provided guidance concerning the types of questions audit committees should raise with their auditor concerning CAMs. See More PCAOB Advice for Audit Committees on CAMs, July 2019 Update.

Being Mean to an Auditor Hurts Audit Quality, and It Happens a Lot

Auditors frequently face client incivility -- "low-intensity deviant behavior with ambiguous intent to harm the target" – and, when they do, they are less likely to challenge aggressive financial reporting. There are, however, coping strategies that may reduce the adverse effects of client incivility on the auditor's judgment. These are some of the findings of The Influence of Client Incivility and Coping Strategies on Audit Professionals' Judgments, a survey and experimental study that Tim D. Bauer (University of Waterloo), Sean M. Hillison (Virginia Tech), and Ala Mokhtar (University of Waterloo) conducted. Their paper appears in a recent issue of Contemporary Accounting Research.

Frequency of Incivility Directed at Auditors

The authors surveyed 70 auditors and found that most have encountered client incivility. Over 75 percent "report instances where clients rudely told them how to perform their work or rudely questioned their work procedures, and one third report being subjected to bullying by clients." Only two respondents (three percent) reported never experiencing any negative client acts. The three most common negative acts were "receiving an excessively slow response to their requests without good reason (90%), rudely being told when and how to do their work (77%), and rudely having their work procedures questioned (77%)."

Managers and seniors experienced negative client acts more frequently than either partners or staff. Staff – the most junior members of an engagement team -- reported the fewest negative client acts. "For example, 55% of managers and 53% of seniors reported clients rudely questioning their work procedures at least sometimes, while only 21% of partners and 14% of staff report such behavior." The authors speculate that partners may report fewer experiences of incivility over their careers because they have forgotten what it was like to be a senior or manager and have "become out-of-touch with their experiences prior to making partner."

Coping Strategies

The authors also find that auditors react to client hostility with various coping strategies. They divide coping strategies into active, passive, and retaliatory. "Active coping (e.g., talking to the perpetrator) involves taking direct action to address the stressor, while passive coping (e.g., confiding in a friend) involves managing responses to the stressor." Retaliation entails scrutinizing the client's work more carefully. Retaliation is, however, difficult to isolate, since "increasing scrutiny could be viewed as auditors increasing professional skepticism, due to elevated risk assessment, or as a form of revenge; we are unable to identify which reason drove respondents' behavior."

The most common active coping strategies are:

- Trying to figure out what the auditor could do to improve the situation (70 percent).
- Taking some actions to improve the situation (67 percent).

- Talking to someone at their accounting firm (e.g., partner or counselor) who could do something about the situation (57 percent).

(In this discussion, percentages represent the share of participants who reported using a particular coping strategy "often or almost always." Respondents may have used more than one strategy in response to instances of incivility.)

The most common passive strategies are:

- Concentrating on other areas of their work where things are going better (51 percent).
- Just accepting the situation because it is an expected part of the job (45 percent).
- Talking with someone (e.g., a friend) about how they are feeling (39 percent).

Partners (47 percent) actively talk with the perpetrator more than managers (9 percent), seniors (11 percent), or staff (21 percent). Conversely, managers (73 percent), seniors (61 percent), and staff (42 percent) are more likely to passively accept the situation than partners (16 percent).

Responding to client incivility by scrutinizing the client's work more carefully – retaliation -- is less frequent than either active or passive responses. Only 27 percent of respondents reported utilizing retaliation, as defined in the study, in response to uncivil client behavior.

Experiment – How Incivility and Coping Affect Audit Quality

The authors also conducted an experiment involving 114 practicing senior auditors, in which they exposed auditors to client incivility. The goal was to examine the relationship between client incivility and auditors' propensity to challenge aggressive reporting or seek additional information. The study also explored how active or passive coping affected these propensities.

In the experiment, the client had recorded an inadequate inventory write-down. After being subjected to incivility and led through various coping strategies, the authors asked subjects what write-down amount they would propose. The researchers' premise was that auditors who selected a higher write-down amount or requested more information were more likely to challenge aggressive reporting.

The study found that incivility reduced the degree to which the subjects challenged the client's write-down or sought more audit evidence, although that active coping partially counteracts the effects of the incivility:

> "As predicted, we find that auditors' write-down amounts are lower when they experience client incivility (vs. not) and are not prompted to cope, but increase when they are prompted to cope actively. We find no evidence that amounts increase when auditors are prompted to cope passively. Consistent with the theoretical model, our supplemental results show that auditors' emotional distress mediates the effect of client incivility on proposed write-down amounts when not prompted to cope, and active coping moderates the effect of emotional distress on this judgment. We also examine auditors' evidence collection behavior. In line with theory, we find that auditors are less likely to follow up with uncivil clients when not prompted to cope. But coping's effect in this judgment context is theoretically uncertain, and we find that neither active nor passive coping increases auditors' likelihood of following up with uncivil clients."

Lessons for Audit Firms

The study authors believe that their work provides lessons for audit firms. "For audit firms committed to maintaining high audit quality, it is critical to assess the risks associated with serving uncivil clients. Client incivility pervades the audit profession, and there is no reason to believe that it will diminish." Since active coping mitigates some the effects of uncivil client behavior, this research suggests firms should

encourage active coping. Audit firms may also want to consider a broader set of remedies, such as training or dialogue on client incivility and coping, "to ensure auditors are aware of different coping responses, how to engage in them, and which ones could benefit their judgments and mental well-being the most."

Audit Committee Takeaways

Audit committees should be alert to incivility directed at audit personnel by company employees. Some employees find it expedient to try to intimidate the auditor into accepting dubious client accounting decisions. However, the long-term consequences of this approach can include the need to restate, an SEC investigation, and/or private litigation against the company and its directors. Audit committees should encourage the engagement team to bring instances of attempted intimidation to the committee's attention and ensure that management understands that such behavior will not be tolerated.

On the Update Radar: Things in Brief

SEC Seeks Shelter from the SolarWinds Case. The Securities and Exchange Commission has apparently thrown in the towel in its controversial campaign to use the internal control requirements of the Securities Exchange Act as a tool to sanction public companies for cybersecurity weaknesses.

In 2023, the SEC brought an enforcement action against SolarWinds Corporation and its Chief Information Security Officer, charging the company with, among other things, violating the requirement in Section 13(b)(2) of the Exchange Act to devise and maintain a system of internal accounting controls. SolarWinds had been the victim of Russian hackers who surreptitiously inserted a vulnerability into one of its software products, making SolarWinds' customers' IT systems susceptible to exploitation. The SEC's theory was that the company's source code, databases, and software products were its most vital assets, but, because of poor access controls, weak internal password policies, and VPN security gaps, SolarWinds failed to limit access to those assets "only in accordance with management's general or specific authorization" as required by Section 13(b)(2).

In 2024, the SEC's case suffered a serious setback when a federal district court held that Section 13(b)(2) does not apply to cybersecurity controls. In SEC v. SolarWinds Corp., the court stated that "the statutory requirement that a public issuer 'devise and maintain a system of internal accounting controls' is properly read to require that issuer to accurately report, record, and reconcile financial transactions and events. A cybersecurity control does not naturally fit within this term, as a failure to detect a cybersecurity deficiency (e.g., poorly chosen passwords) cannot reasonably be termed an accounting problem." See A Shift in the Winds: Court Rejects SEC's Use of Internal Control Authority to Police Cybersecurity, August 2024 Update.

On November 20, the SEC announced that it had filed a joint stipulation with SolarWinds Corporation and its CISO to dismiss, with prejudice, the Commission's civil enforcement action. The announcement adds that "the Commission's decision to seek dismissal is 'in the exercise of its discretion' and 'does not necessarily reflect the Commission's position on any other case.'"

For audit committees, the dismissal of the SEC's SolarWinds case is good news, in that it marks the end of the Commission's initiative to expand the scope of the Exchange Act's internal control requirements beyond financial reporting. Even prior to the SolarWinds judicial decision, Commissioners Peirce and Uyeda had forcefully argued against the expansive interpretation of Section 13(b(2) deployed in that case. See Shoot the Wounded! SEC Charges that Inadequate Cybersecurity is an Internal Accounting Control Violation, July 2024 Update.

However, with or without internal accounting controls as one of its theories, cybersecurity disclosure is likely to remain an area of SEC focus. The SolarWinds case included an allegation that the

company misled investors by overstating its cybersecurity practices and downplaying risks associated with its products. While the district court rejected the Commission's other claims, it permitted that aspect of the case to proceed. Moreover, since the SolarWinds case, the SEC has adopted specific new disclosure requirements on cybersecurity risk management and strategy, governance, and material incident reporting. See SEC Adopts Cybersecurity Disclosure Rules, August-September 2023. The Commission may actively enforce these new rules and, even if the current SEC administration does not, the rules may provide fodder for the private securities class action bar. For these reasons, oversight of cybersecurity disclosure should remain an audit committee priority.

Court of Appeals Pauses California Climate Disclosures. The Court of Appeals for the Ninth Circuit has issued an order temporarily blocking implementation of California Senate Bill 261 (SB 261). SB 261, the Climate-Related Financial Risk Act, requires U.S. public and private entities with annual global revenue exceeding $500 million that do business in California to disclose their climate-related financial risks and the measures they are taking to reduce and adapt to those risks. See California Outflanks the SEC on Climate Disclosure, October 2023 Update. The first reports under this law are due January 1, 2026, although the court's order suspends that deadline.

The U.S. Chamber of Commerce and other plaintiffs challenged the validity of SB 261, and its companion legislation, Senate Bill 253 (SB 253), on First Amendment and other grounds. The district court held that, while both statutes regulate commercial speech, the plaintiffs had not established that they were likely to succeed in showing the laws are unconstitutional and refused to enjoin their enforcement. See California Climate Disclosure Laws Survive a Challenge, September 2025 Update. Plaintiffs appealed that decision to the Ninth Circuit, which granted an injunction against enforcement of SB 261 pending its decision on whether to reverse the district court's order. The Court of Appeals will hear oral argument on January 9, 2026.

While the Court of Appeals agreed to pause SB 261, it declined to enjoin SB 253, the Climate Corporate Data Accountability Act. SB 253 requires U.S. entities with annual global revenue exceeding $1 billion that do business in California to report their Scope 1, 2, and 3 greenhouse gas (GHG) emissions. The due date for initial GHG reporting under SB 253 is August 10, 2026. Presumably, the Court of Appeals will issue its decision on the appeal from the district court's refusal to enjoin either of the laws prior to August 10.

Coincidentally, on the same day that the Court of Appeals enjoined enforcement of SB 261, the California Air Resources Board held a public workshop to address various issues concerning the implementation of SB 253 and SB 261. Among other things, CARB announced during the workshop proposals on the definition of "doing business in California" for purposes of SB 253 and SB 261 and on the ability of parents and subsidiaries to file consolidated reports. CARB's PowerPoint presentation at the workshop, updated FAQs regarding compliance with SB 253 and SB 261, and a final SB 261 compliance checklist are available online.

On December 1, CARB issued an Enforcement Advisory stating that – as the court order requires -- it will not enforce SB 261 against entities that fail to post and submit reports by the January 1, 2026, statutory deadline. CARB said that it "will provide further information—including an alternate date for reporting, as appropriate—after the appeal is resolved." CARB has also issued instructions for companies that choose to submit reports voluntarily.

The Court of Appeals' temporary injunction creates considerable uncertainty for companies that are subject to SB 253 and SB 261 reporting. Most companies subject to SB 261 have probably finalized or are near finalizing their reports. Those companies now face a choice between going ahead with the disclosure voluntarily or waiting to see what happens next in the ongoing litigation. Companies subject to GHG emissions disclosure under SB 253 will need to continue preparing to file their first reports by August 10, 2026, as that deadline remains in effect. However, either the Court of Appeals or CARB may alter or suspend that date. Audit committees of companies subject to California's climate disclosure requirements should explore whether management has processes in place to

collect the information needed to comply and, if so, how best to proceed, considering the Court of Appeals injunction.

What Keeps Internal Audit Up at Night? Technology, business transformation, and digitization are internal audit's primary concerns according to consulting firm Jefferson Wells' 2025 Internal Audit Priorities Annual Survey. The top concerns of audit committees are similar, with Generative Artificial Intelligence (GenAI) now second only to data privacy and cybersecurity. Jefferson Wells' study involved 257 audit leaders from U.S. for-profit companies across different industries and regions.

For internal audit leaders, the leading emerging risks reported by survey participants were:

- Cybersecurity (41 percent)
- GenAI (35 percent)
- Business transformation/digitization (27 percent)
- Economic uncertainty (26 percent)

The top three internal audit emerging risks were the same last year, while economic uncertainty was unranked in 2024. Jefferson Wells notes that strategic risk has fallen in importance over the past two years "as technological advancements have shifted auditors' attention away from strategy."

For audit committees, the top emerging risks were:

- Data privacy & cybersecurity (52 percent)
- GenAI (39 percent)
- Strategic risk (29 percent)
- Business transformation/digitization (22 percent)

While cybersecurity was also the number one audit committee concern in 2024, GenAI rose 13 percentage points in 2025 to second place, surpassing strategic risk.

In terms of activities, the top five initiatives in which internal audit was involved were fraud investigations (57 percent), enterprise risk management (57 percent), new technologies or applications (49 percent), process improvement (49 percent), and system implementations (48 percent). Internal audit departments with more than 100 staff members were also likely to be involved in corporate strategy work. Third-party risk fell in priority to sixth place (43 percent). However, Jefferson Wells notes that 54 percent of respondents said internal audit is still conducting periodic audits of third-party vendor management programs, although only 24 percent reported that their internal audit departments "are evaluating Nth party risks and, surprisingly, 23% of audit shops are conducting actual on-site vendor audits for their organization." ("Nth party risk" refers to risk that arises, not just from direct vendors (i.e., third parties), but from the vendors and subcontractors on which direct vendors rely.)

The Jefferson Wells report includes sections that detail survey findings on cybersecurity and technology risk, GenAI, and talent. Talent is a particular concern for internal audit leaders. Thirty-seven percent plan to increase their staff size in 2025, and 59 percent report that hiring employees with the right technical skills is one of their biggest challenges.

The Audit Blog

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Update Nos. 99-present (March-April 2025 to present) and summaries are available here. Update Nos. 89-98 (March 2024 to February 2025) 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.

The Update seeks to provide general information of interest to audit committees, auditors, and their professional advisors, but it is not a comprehensive analysis of the matters discussed. The Update is not intended as, and should not be relied on as, legal or accounting advice.