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AUDIT COMMITTEE AND AUDITOR OVERSIGHT UPDATE

Update No. 76
August 2022

Summary

We Have Some Questions for You. The PCAOB Releases a New Audit Committee Resource. The PCAOB has issued a new publication for audit committees. Spotlight: Audit Committee Resources contains a series of questions that audit committees might consider asking "as part of their engagement and discussion with their auditors, including how the auditors are responding to the financial reporting and audit risks posed by the current economic environment." The questions are organized under six headings: Fraud and Other Risks, Initial Public Offerings and Mergers & Acquisitions, Audit Execution, How Firms Comply with Auditor Independence Requirements, Firms' Quality Control Systems, and Technology. As the PCAOB points out, many of the suggested questions could also be posed to management as part of the audit committee's oversight of the company's financial reporting and internal controls. **(more)**

Audit Committees Should be on the Look-Out for ESG Fraud Risks. Emerging fraud risks to consider: ESG, an article in On the audit committee's agenda, a publication of the Deloitte Center for Board Effectiveness, points out that environmental, social, and governance issues may entail fraud risks that audit committees should recognize and consider. For example, many companies provide ESG information to investors that is not governed by the same types of controls as those that apply to financial reporting processes; this may present opportunities to manipulate the ESG-related information. Similarly, linking compensation to ESG metrics may elevate fraud risk by creating incentives to misstate ESG data. In the Deloitte Center's view, ESG-related fraud risks "should be top of mind for audit committees and a focal point in fraud risk assessments overseen by the audit committee." The Deloitte Center article discusses some of these ESG risks, issues a "call to action" for audit committees to consider ESG in fraud risk assessments, and suggests questions audit committees should be asking in this area. **(more)**

Audit Committee Agenda Advice for the Second Half of 2022. Two firms – EY and Forvis – have offered advice on potential audit committee agenda items in connection with second quarter reporting and for the balance of 2022. In How audit committees can prepare for 2022 Q2 reporting, the EY Center for Board Matters summarizes recent and upcoming developments for audit committees to consider in connection with quarterly reporting. The EY Center identifies three "key points": Inflation, rising interest rates, supply chain disruptions, and market volatility; potential regulatory changes that may impact reporting requirements, disclosures, and enforcement trends; and ways that internal audit can incorporate ESG into its audit agenda. The paper also discusses risk management, accounting and disclosures, and SEC and other reporting considerations and suggests questions that the audit committee may want to pose to management and/or to the auditor.

Forvis, which was created by the merger of accounting firms BKD and Dixon Hughes Goodman, has released The Top 10 Topics for Audit Committees to Consider in 2022. This paper discusses issues that financial institution audit committees should focus on in discussions with management, internal and external auditors, and other advisors. These topics, many of which appear to be relevant beyond

financial institutions, are LIBOR transition, ESG, tax considerations, current expected credit loss accounting, cybersecurity, enterprise risk governance, culture and conduct risk, regulatory compliance/impact of Russia-Ukraine war, emerging technology, and "press the reset button" (i.e., step back and assess the audit committee's structure, priorities, and performance).

A high-level review of these papers, along with similar papers released by other firms earlier this year, could be helpful to an audit committee as a check that it is not overlooking topics that should be on its agenda. **(more)**

Ineffective ICFR is More Common; Staff Shortages May be the Cause. Audit Analytics has released its annual report on Sarbanes-Oxley Act Section 404 reporting, SOX 404 Disclosures: An Eighteen-Year Review. AA found that the percentage of companies filing a management assessment that reported ineffective internal control over financial reporting has increased across all company sizes. For fiscal year 2021, 23.7 percent of all management reports reported ineffective controls, up from 21.7 percent in 2020. This is the highest percentage of adverse management assessments since SOX 404 reporting began in 2004. Adverse auditor opinions on control effectiveness also rose in 2021 – from 4.8 percent of all ICFR opinions in 2020 to 5.8 percent in 2021. Lack of qualified accounting personnel was the most frequently cited control issue in adverse ICFR assessments -- 71.5 percent of adverse management assessments and 48.7 percent of adverse auditor assessments identified lack of qualified staff as a cause of ineffective controls. Oversight of the adequacy of internal control is one of the most fundamental responsibilities of a public company audit committee. Audit committees may want to reflect on whether the control weaknesses described in the AA report are affecting their company's controls. **(more)**

After 20 Years, It May be Time to Update Your SOX Compliance Program. In SOX modernization: Optimizing compliance while extracting value, Deloitte points out that, at many companies, controls have not been rethought since the enactment of the Sarbanes-Oxley Act in 2002. Although there have been significant developments in technology, methodology, and business and operating environments in the past two decades, Deloitte believes that "the SOX program at many companies may not have evolved at the same pace, or at all" and may instead have "continued to layer on additional controls while spending the same amount or more to achieve compliance without being able to extract value from the program." Deloitte recommends that companies "refresh, rethink, and modernize" their SOX programs in order to "achieve efficiencies, extract value and insights to share with other areas of the organization, and potentially lower the related cost of compliance while still achieving reasonable assurance for regulatory compliance." Audit committees may want to explore with management whether there are opportunities to modernize controls and whether management is taking full advantage of technology. **(more)**

IFAC Reports on the State of ESG Assurance. The International Federation of Accountants and the Association of International Certified Professional Accountants have released The State of Play in Reporting and Assurance of Sustainability Information: Update 2019-2020 Data & Analysis. The publication examines global practices for sustainability reporting. Among other things, the study finds that 92 percent of the 1,400 companies surveyed disclose some sustainability information, a slight increase from the 91 percent that made such disclosure in 2019; that 58 percent of companies that report sustainability information provide some level of third-party assurance on it, up from 51 percent in 2019; and that audit or audit-affiliated firms conducted 61 percent of these assurance engagements. The State of Play report contains detailed information concerning ESG reporting and assurance practices in different industries and on a country-by-country basis. Audit committees might find this material of interest in benchmarking their company's approach to ESG disclosure and assurance. **(more)**

SEC Adopts Pay Versus Performance Disclosure. On August 25, the SEC adopted rules requiring U.S. public companies to disclose information reflecting the relationship between executive compensation actually paid and the company's financial performance. The pay versus performance rules will require companies to provide a table disclosing certain executive compensation and financial performance measures for the company's five most recent fiscal years. The new rules will also require a "clear description" of the relationships between the financial performance measures and the executive compensation actually paid to the company's principal executive officer and to certain other executives. The company must also describe the relationship between its total shareholder return and the total shareholder return of its industry peer group. At most companies, both the audit committee and the

compensation committee will likely play a role in overseeing compliance with the pay versus performance disclosure rules. While the substance of how the company links pay and performance falls in the compensation committee's realm, oversight of the procedures and controls that will be necessary to support the new disclosures is within the audit committee's mandate. **(more)**

Where's the Economy Headed? Ask Your Audit Partner. The Center for Audit Quality has released Audit Partner Pulse Survey, the results of a survey of 700 U.S. public company audit partners on a range of topics, including the overall health of the economy, business transformation, and corporate disclosures. Audit partners are rather gloomy about the economy's prospects for the next 12 months -- only 16 percent have an optimistic or very optimistic economic outlook, while 44 percent are pessimistic, and 40 percent are neutral. The survey also asked respondents to identify the short- and long-term ESG priorities of companies in their industry. The top short-term ESG priorities were cyber risk, enhancing sustainability reporting, and building a more diverse board/leadership team. The top long-term ESG priorities were the same, except that climate-risk replaced diversity in the top three. **(more)**