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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 of the company's relationship with its auditor.

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The SEC's Agenda – ESG Tops the List

On June 11, the Office of Management and Budget's Office of Information and Regulatory Affairs released the [Spring 2021 Unified Agenda of Regulatory and Deregulatory Actions](#). This government-wide list includes the [SEC's rulemaking agenda](#). As the SEC's accompanying [press release](#) and related remarks of Chair Gensler make clear, mandatory public company environmental, social, and governance (ESG) disclosure is the SEC's top priority.

The first topic listed in the SEC's rulemaking agenda press release is “[d]isclosure relating to climate risk, human capital, including workforce diversity and corporate board diversity, and cybersecurity risk.” Listed below

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are the five specific rulemaking projects on the SEC's published agenda that relate to public company disclosure on these issues, along with the SEC's description of each project:

- [Corporate Board Diversity](#). The Division is considering recommending that the Commission propose rule amendments to enhance registrant disclosures about the diversity of board members and nominees.
- [Disclosure of Payments by Resource Extraction Issuers](#). The Division is considering recommending that the Commission review the rules under Section 1504 of the Dodd-Frank Act to determine if additional amendments might be appropriate. (Section 1504 requires SEC-reporting companies that engage in resource extraction to disclose to the SEC payments made to the federal government or foreign governments for the commercial development of oil, natural gas, or minerals. See [If at First You Don't Succeed: SEC Adopts Revised Resource Extraction Disclosure Rule, December 2020 Update](#).)
- [Climate Change Disclosure](#). The Division is considering recommending that the Commission propose rule amendments to enhance registrant disclosures regarding issuers' climate-related risks and opportunities.
- [Human Capital Management Disclosure](#). The Division is considering recommending that the Commission propose rule amendments to enhance registrant disclosures regarding human capital management.
- [Cybersecurity Risk Governance](#). The Division is considering recommending that the Commission propose rule amendments to enhance issuer disclosures regarding cybersecurity risk governance.

The SEC classifies each of these projects as at the "proposed rule stage." The Division referenced in these descriptions is the SEC's Division of Corporation Finance.

In a [June 23 speech at London City Week](#), Chair Gensler expanded on his plans with respect to climate change and human capital management disclosure. As to climate, he noted that the Commission had received over 400 letters in response to a request for comment on climate change disclosure Acting Chair Lee issued last Spring. Chair Gensler added:

"Today, investors increasingly want to understand the climate risks of issuers. Investors representing literally tens of trillions of dollars of assets under management are looking for consistent, comparable, decision-useful information to determine whether to invest, sell, or make a proxy vote one way or another.

"I've asked staff for recommendations for our consideration around governance, strategy, and risk management related to climate risk. In addition, staff are looking into a range of specific metrics, such as greenhouse gas emissions, to determine which are most relevant to investors in our markets."

He also suggested that the Commission may require companies that make commitments or forward-looking statements with respect to climate change, or that operate in countries that impose climate-related targets, to make ongoing disclosures concerning their progress.

As to human capital management, Gensler said:

"[I]nvestors have said that they want to better understand one of the most critical assets of a company: its people. To that end, I've asked staff to propose recommendations for the Commission's consideration on human capital disclosure.

“This builds on past agency work and could include a number of metrics, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics including diversity, and health and safety.”

Comment: While Chairman Gensler is clearly committed to disclosure rulemaking on climate change, human resources, and certain other ESG topics, these initiatives will undoubtedly be controversial and unlikely to have unanimous Commission support. In particular, Commissioner Hester Peirce has been an outspoken skeptic of inclusion of ESG topics in the SEC’s disclosure framework. See, e.g., [Chocolate-Covered Cicadas](#), Remarks before the Brookings Institution (July 20, 2021) (“People want hard data to allow apples to apples comparisons. The natural desire for ESG certainty, however, runs into the many real-life uncertainties and complications that characterize the overflowing ESG bucket. Any ESG rulemaking will have to confront these difficult realities.” [footnotes omitted])

It is virtually certain that the SEC will propose a range of mandatory ESG disclosures before the end of this year. As noted in prior [Updates](#), it also seems inevitable that oversight of these disclosures will become an important aspect of the audit committee’s work. See, e.g., [Climate Change is Rapidly Becoming an SEC Priority](#), [March-April 2021 Update](#) and [What is the Audit Committee’s Role in ESG Oversight?](#), [December 2020 Update](#). Audit committees should pay close attention to the SEC’s specific proposals when they appear and discuss with management the implications for the company’s information systems and disclosure controls and procedures.

Protiviti: Companies are Spending More Time and Money on SOX Compliance

Consulting firm Protiviti has released the 2021 edition of its annual survey of Sarbanes-Oxley Act (SOX) compliance costs, [SOX Compliance and the Promise of Technology and Automation](#). A majority of companies represented in the survey reported that both internal costs associated with compliance with SOX internal control over financial reporting (ICFR) requirements and hours devoted to such compliance increased in 2020. However, as in past years, a significant majority of respondents also reported substantial improvements in their company’s ICFR as a result of SOX. (The prior annual survey is summarized in [Protiviti’s Annual Survey Finds Rising SOX Compliance Costs](#), [July-August 2020 Update](#).)

As described in the executive summary, key findings of the 2021 survey are:

- [Internal SOX compliance costs continue to rise, but the results are more of a mixed bag](#) -- While SOX compliance costs have gone up for a number of groups of organizations, other companies have seen slight decreases. This is to be expected given the dynamics of the past year and changing operating models.
- [Hours continue their upward march](#) – SOX compliance hours increased for most organizations, and among these companies, most experienced increases of 10% or more. However, Digital Leaders have experienced a lesser impact in terms of substantial increases in hours, suggesting they are gaining some advantages through their greater use of technology and automation in the SOX compliance process. [The concept of Digital Leaders is explained below.]
- [With technology and automation, Digital Leaders stand out](#) -- In numerous aspects of the SOX compliance process, from the use of technology tools to automating controls in different processes, Digital Leaders are significantly more advanced than other organizations. Digital Leaders clearly are leveraging these tools to reap the benefits they deliver in terms of greater efficiencies for documentation and testing.
- [Automation presents challenges](#) – Implementing automation in the SOX compliance process can present challenges for any organization. Specific hurdles include the overall level of effort, change

management considerations, stakeholder buy-in and overall investment. However, there is a roadmap to achieve short-term and long-term successes.

Protiviti's findings are based on the results of an online survey conducted in March 2021 in collaboration with AuditBoard, a cloud-based platform offering audit management and compliance solutions. The positions held by the 660 survey respondents included audit manager (18 percent), chief financial officer (13 percent), chief audit executive (12 percent), audit director (11 percent), and finance director (11 percent). The industries represented covered a wide range, with Financial services--banking (13 percent), Manufacturing and distribution (other than technology) (10 percent), and Technology (software/high-tech/electronics) (8 percent), the top three. Thirty-four percent of the non-financial services organizations represented in the survey had \$5 billion or more in annual revenue, and 56 percent of the financial services companies had \$10 billion or more in assets under management. Eighty-two percent of the companies represented were subject to both SOX Section 404(a) (management reporting on ICFR effectiveness) and Section 404(b) (auditor reporting on ICFR effectiveness).

For the first time this year, Protiviti classified responding companies according to their self-assessed level of digital maturity and presented results separately for those classified as "Digital Leaders." Digital Leaders were those companies categorized as either "digital experts" (organizations that have a proven track record of adopting emerging technologies) or as "digital top performers" (organizations that have a proven track record of disrupting traditional business models). Twenty-seven percent of companies in the survey were deemed to be Digital Leaders.

Some highlights of the 2021 survey are discussed below.

Internal SOX Compliance Costs

As noted above, SOX compliance costs rose for most companies. Changes in compliance costs varied with filer status and company size:

- The average annual internal cost of SOX compliance for the largest public companies (large accelerated filers) declined to \$1.328 million, from \$1.371 million in the prior survey. Internal compliance costs rose for all other filer categories (accelerated filers, smaller reporting companies, and emerging growth companies).
- For Digital Leaders, internal compliance costs averaged \$1.44 million. For all other companies, cost averaged \$1.199 million. Since this is the first year that Protiviti has grouped companies according to their digital sophistication, Digital Leader comparisons to prior years are not available.

On an industry sector basis, companies in Energy and Utilities companies had the highest average internal compliance costs (\$1.446 million), followed by Technology, Media and Telecommunications (\$1.402 million). Healthcare Providers had the lowest costs (\$922,220). In last year's survey, Technology, Media and Telecommunications lead the list.

Hours Devoted to SOX Compliance

A majority of companies reported that hours devoted to SOX compliance increased in fiscal 2020. Fifty-eight percent of Digital Leaders and 52 percent of other organizations said that their internal hours increased. In contrast, 17 percent of Digital Leaders and 18 percent of other organizations reported a decrease in compliance hours.

Protiviti observes that Digital Leaders appear to have experienced smaller increases in hours than other companies. Of those Digital Leaders reporting increased hours, fewer reported increases exceeding 10 percent than did their less sophisticated peers. "This can be an indication of some advantages they are gaining through the use of technology and automation in the SOX compliance process. In addition, given their greater use of

technology and automation, it is possible that amid the pandemic, Digital Leaders were less impacted by newly implemented remote testing requirements.”

The number of organizations reporting decreased SOX compliance hours rose in 2020 compared to the prior survey. Protiviti notes that this is “another likely effect of the pandemic and the ensuing changes on compliance activities, including but not limited to curbs on traveling and office visits.”

Technology and Automation

Protiviti’s annual surveys have historically pointed to the benefits of automating controls. In Protiviti’s view, “automated controls and testing deliver numerous benefits -- there are countless examples that can be found among Digital Leaders and other organizations.” The survey asked respondents to identify the five greatest challenges to automating SOX compliance processes in fiscal 2020. The challenges reported, along with the percent of respondents citing each, were:

- Level of effort to implement, train, govern, and maintain – 56 percent.
- Lack of time to spend exploring automation due to other priorities – 55 percent.
- Many areas of the SOX control environment are not conducive to automation – 49 percent.
- Lack of funding and/or executive support for automation – 41 percent.
- Lack of knowledge on available tools and technology – 41 percent.

According to Protiviti, these challenges are compounded by the fact that, “when it comes to SOX compliance and testing, management often times does not trust automation” because of “concerns about looking at full populations of data which may reveal exceptions that need to be addressed.”

Protiviti suggests the following “path to success for those who have yet to undertake any automation-related initiatives”:

“The first key step is to get started, ideally focusing on automating one area that may present a relatively easy opportunity for success. Once the SOX compliance team achieves a few such “wins,” automating the testing process becomes easier to put into place. Also, if the internal audit group helps develop the automation, it subsequently has the opportunity to turn it over to the business to manage. This represents a win both for internal audit and the business.

“In addition, if there is an opportunity to work in partnership with the external auditor to automate testing, the trust factor between the two groups will grow, furthering the possibility that the external auditor can increase its reliance on internal audit’s testing of controls * * *.”

Perceptions of the SOX Compliance Process and ICFR Reporting

As in past years, respondents were generally positive on the benefits of SOX. Sixty-eight percent of respondents believe that their organization’s ICFR structure has “significantly” or “moderately” improved since an ICFR external audit became required, up from 60 percent last year. However, the number of respondents with a negative view also increased: Four percent of respondents said that their company’s ICFR structure had been either “minimally weakened” or “moderately weakened” since external auditor ICFR reporting began, compared to one percent who held that view last year. Six percent reported that they did not know how the company’s ICFR had changed.

The primary benefits of SOX compliance cited by respondents were:

- Improved ICFR structure – 59 percent (Digital Leaders), 64 percent (other organizations).

- Continuous improvement of business processes -- 55 percent (Digital Leaders), 48 percent (other organizations).
- Enhanced understanding of control design and control operating effectiveness -- 52 percent (Digital Leaders), 63 percent (other organizations).
- Improved compliance with SEC rules -- 50 percent (Digital Leaders), 49 percent (other organizations).
- Ability to better identify duplicate or superfluous controls -- 45 percent (Digital Leaders), 37 percent (other organizations).
- Improvement in company culture related to risks and controls -- 44 percent (Digital Leaders), 54 percent (other organizations).

Comment: While SOX compliance costs continue to rise for most categories of companies, Protiviti's annual surveys have also documented the possibility of cost reductions (or at least slower increases) based on greater use of automation and technology. The concept of analyzing SOX compliance costs based on the level of company digital sophistication seems to further illustrate this point. As noted in last year's [Update](#), audit committees may want to explore with management whether it is taking advantage of opportunities to automate compliance and, if not, why not. Discussion of the five challenges to automating SOX compliance that Protiviti identified in this year's survey could be a starting point.

How Audit Committees Can Maximize Their Value

Tapestry Networks ("Tapestry"), a professional services company that "enables senior leaders from the public and private sector to engage each other and their external environment directly and constructively to achieve higher ground on some of the biggest issues confronting society today," has released [Adding value: Perspectives on the audit committee's dynamic role](#) ("[Adding Value](#)"). From May 13 to June 25, 2021, Tapestry convened six virtual meetings with the audit committee chairs of approximately 100 large U.S. public companies to exchange views on how audit committees can maximize the value they deliver to their companies and boards. [Adding value](#), which appears in the July 2021 edition of Tapestry's publication [Viewpoints](#), synthesizes the discussion at these meetings. Tapestry's audit committee networks are sponsored by EY, and EY representatives participated in the six virtual meetings.

Adapting Board and Audit Committee Processes

The pandemic disrupted decades-old audit committee practices and norms. Committees are now assessing the extent to which these changes should become permanent. For example, there appears to be some tension between the recognition that virtual meetings are an efficient and effective means of conducting audit committee business and the recognition that they cannot completely replace in-person meetings:

- Virtual meetings are efficient and generally effective. Among other things, virtual meetings avoid the "wear and tear" of travel, result in crisper and more disciplined presentations, and enable audit committees to engage directly with a broader segment of company management. Video conferencing has also encouraged splitting meetings into shorter segments, which helps to maintain focus.
- Technology is not a replacement for in-person meetings. Tapestry notes that many audit committee chairs "pointed to elements of culture and trust that were difficult to replicate in the virtual world." Further, virtual meetings can devolve into check-the-box exercises and are not conducive to sidebar conversations or getting to know people on a personal level.

Most audit committee chairs expect that, in the future, committees will employ a combination of virtual and in-person meetings. One participant said, "We plan to continue to cover more routine and administrative items in

virtual, off-cycle meetings and save the strategic conversations for in person. It takes more hours, but it is more productive.”

Reshaping Audit Committee Agendas

Discussants singled out environmental, social, and governance (ESG) disclosure and performance as a newly emerging area of audit committee responsibility. In many cases, the audit committee’s role is to assess the quality of ESG reporting and the controls used to ensure its accuracy. One participant said, “While ESG responsibility resides in the nominating and governance committee, the audit committee’s contribution is to validate the numbers. We look closely at the design and testing of the controls. Before the company releases data, it is important to do more to get comfort around completeness and accuracy.” Since ESG has both strategic and disclosure aspects, it affects the work of several committees. As boards delegate ESG responsibilities to different committees, committee charters should be updated to reflect these new responsibilities.

Participants also cited a variety of other topics as audit committee agenda priorities:

- Risk oversight. The pandemic caused audit committees to rethink their approach to risk oversight. Some audit committees are enhancing their oversight is by scheduling deep dives on specific, high-risk topics either for the committee or the full board. Some participants raised the issue of whether the common approach of delegating risk oversight to the audit committee was adequate. One suggested instead a subcommittee on enterprise risk management comprised of the chairs of each committee.
- Cybersecurity and data privacy. Ransomware attacks and the “evolving privacy landscape” were mentioned as emerging challenges. “While cybersecurity has been a priority for many years, recent events have raised the stakes for audit committees.”
- Finance function talent. Audit committee oversight of the finance function is presenting new challenges. Finance talent is in short supply and, as geographic location becomes less relevant, it is easier for professionals to change jobs. “The success finance professionals have achieved while working remotely is testing companies’ abilities to attract and retain top talent.”
- Internal audit oversight. “The remote environment strained internal audit teams, who are typically accustomed to face-to-face engagement. In addition, as functions adopt new technologies, some audit chairs wonder whether they have the right internal audit leadership to take advantage of these capabilities.”
- Transactions and integration. In a virtual environment, there are significant challenges associated with performing due diligence and with integrating companies virtually.

Enhancing Committee Composition

Audit committee chairs commented on committee composition and “how best to refresh the committee, strengthen its membership, and ensure that it is adding as much value as possible.” Observations in this area fell into three categories.

- A mix of skills, backgrounds, and expertise. Boards are taking a broader view of who should serve on the audit committee. Desirable attributes of new committee members include IT/cybersecurity expertise (e.g., chief information or chief information security officers), complementary financial skills (i.e., individuals with financial expertise, but different backgrounds, such as a retired auditor and a CFO), and diversity (“As companies revisit their records and responsibility on diversity, equity, and inclusion, the push for diversity has spurred competition for board candidates.”).
- Training and development initiatives. The pandemic may have long-term consequences for board training and onboarding. The virtual meetings are well-suited to the initial stage of onboarding, but not

to building personal relationships. Service on the audit committee can be a good way to learn about the company.

- A balanced approach to tackling audit committee responsibilities. Participants raised questions about the best way for the chair to use the talent on the audit committee. Some favor delegating portions of the committee's work—especially work between meetings—to members with specialized expertise Others were uncomfortable with delegation, fearing that it would lead to “silos that make for inefficiencies.”

Comment: Adding value sees the disruption caused by the pandemic as an opportunity: “Audit committees have a once-in-a-generation opportunity to reshape the way in which they convene, the issues that rise to the top of a crowded agenda, and their own perspectives and membership. Through all of this, audit committee chairs see it as imperative to add even more value to their companies and boards than ever before.” Audit committee members may want to consider the points raised in the Tapestry conversations and consider whether any have applicability to their committee and its work.

Experience Counts – It Helps to Have an Accountant on the Audit Committee and a Chair with Prior Committee Service

Recent academic studies examine the consequences of two aspects of audit committee membership – accounting expertise and committee chair familiarity with the company. The findings of these studies support what one might suspect: Having an experienced accountant or auditor on the committee (as distinguished from a financial expert who merely supervised financial reporting) lowers audit fees and reduces the risk of restatements. And, appointing an audit committee chair with prior experience on the company's audit committee improves committee monitoring of financial reporting and reduces the risk of financial reporting misstatements, as compared to selecting an external successor.

Impact of Audit Committee Member Accounting Expertise

In [Audit Committee Accounting Expertise and the Mitigation of Strategic Auditor Behavior](#), which appears in the July 2021 issue of [The Accounting Review](#), James C. Hansen (Weber State University), Ling Lei Lisic (Virginia Polytechnic Institute and State University), Timothy A. Seidel (Brigham Young University), and Michael S. Wilkins (University of Kansas) report the results of their study of the impact of audit committee member accounting or auditing expertise on the behavior of auditors.

This research applies the concept of “credence goods” to audit oversight. A credence good (or service) involves a situation in which (1) the seller is an expert who both recommends and provides a level of service to the buyer; (2) the buyer cannot assess how the service is delivered and must rely on the seller's recommendation; and (3) the buyer cannot evaluate how well the service is performed. Auditing is a credence good because the outcome of an audit is unobservable, and the auditor determines how much effort to exert. The authors assert that this situation creates the risk of “strategic auditor behavior” – that is, that the auditor may expend either more effort (“over-auditing”) or less effort (“under-auditing”) than is necessary to provide the required level of assurance.

The authors hypothesize that “stronger audit committee oversight, operationalized as the presence of accounting expertise among audit committee members, should mitigate over- and under-auditing when information asymmetries are driven by accounting and auditing complexities.” This is because “audit committees with a better understanding of accounting issues and the proper nature, extent, and timing of audit procedures should be better able to ensure an appropriate alignment between audit effort and audit risk.” To test these propositions, the authors studied the level of audit effort in four situations:

- (1) A change in standards which reduces the level of audit effort necessary to audit a particular account (resulting in a risk of over-auditing if the auditor fails to reduce audit effort in response to the change in standards).

- (2) The identification and remediation of a material weakness in internal control (resulting in a risk of over-auditing because of auditor concern over increased PCAOB inspection scrutiny notwithstanding remediation of the material weakness).
- (3) A new engagement in high competition audit market (resulting in possible competitive pressure to under-audit).
- (4) A longer tenure engagement in a low competition market (resulting in a possible incentive to over-audit).

According to the abstract, the study results indicate that, when audit committees have accounting expertise, the risks of under- or over-auditing in these situations is mitigated. Specifically, when such expertise exists on the audit committee, clients “(1) pay lower fees when changes in standards decrease required audit effort; (2) pay a smaller fee premium in the presence of remediated material weaknesses; and (3) have a reduced likelihood of restatement when audit market competition is high.” The authors also note: “Our findings in the under-auditing setting generally are strongest among non-Big 4 engagements, consistent with non-Big 4 auditors being less sensitive to market-wide disciplining mechanisms such as reputation, legal liability, and professional regulation.”

As to the fourth situation (longer tenure/low competition), the researchers found that “although audit fees are higher when tenure is long in less competitive audit markets, audit committee accounting expertise attenuates these fee increases, consistent with the curtailment of over-auditing in these engagements.”

The research also looked at the type of audit committee expertise that impacted auditor behavior. The study found “evidence that the nature of audit committee members’ accounting expertise differentially impacts the committee’s ability to curtail over- and under-auditing.” Specifically, audit committee member expertise in accounting and auditing, as opposed to experience in supervising financial reporting, is a better predictor of the committee’s ability to reduce the likelihood of over- and under-auditing.

Impact of Audit Committee Chair Prior Service on the Committee

In [Audit Committee Chair Succession and Financial Reporting Quality: Does Firm-Specific Knowledge Matter?](#), Linda A. Myers, Roy Schmardebeck, and Stefan Slavov, all of the University of Tennessee, Knoxville, examined whether a new audit committee chair provides more effective monitoring of the company’s financial reporting when the incoming chair served previously as a member of the company’s audit committee. They find that new audit committee chairs with firm-specific knowledge (as indicated by prior service on the audit committee) are better financial reporting monitors, relative to new chairs without such knowledge. Myer, Schmardebeck, and Slavov conclude: “[I]nternal successor AC chairs are associated with more effective monitoring during the succession period but the relative benefits of this firm-specific knowledge decay over time.”

Specific findings of this study include:

- Companies are less likely to misstate their financial statements during the audit committee chair succession period when the chair is an internal successor. (The succession period is the first three years of a new chair’s tenure.) “This supports our hypothesis that the higher firm-specific knowledge of internal successors allows them to be more effective monitors during the succession period. In additional analyses, we also find that higher firm-specific knowledge of internal successors improves AC chair monitoring effectiveness related to core misstatements * * *, the propensity to meet or just beat earnings benchmarks * * *, and internal control quality * * *.”
- Internal successors provide more effective monitoring of financial reporting processes, relative to external successors, in the first two years of the succession period. By the third year, the difference between internal and external chairs is not statistically significant. The authors suggest that, during the first two years of service, “external successors are able to accumulate sufficient firm-specific knowledge such that their monitoring effectiveness is indistinguishable from that of internal successors.”

- Internal successors are more effective monitors even when external successors have industry, accounting, or supervisory expertise. Further, prior experience as an audit committee chair at a different company does not compensate for a lack of firm-specific knowledge.
- Internal successors with two years or more of prior audit committee service provide more effective monitoring; shorter periods of pre-appointment audit committee service do not yield similar benefits.

The authors conclude with this observation:

“Our results should be of interest to boards of directors, external auditors, and regulators, as well as other parties interested in the AC chair’s role in promoting financial reporting quality. First, boards should consider how their policies on committee chair succession planning impact AC monitoring, and whether a change in these policies could improve future financial reporting outcomes. Second, auditors should consider how AC chair renewal impacts financial reporting quality and whether firm policies and experience related to AC chair renewal necessitate modifications in their risk assessments and audit procedures. Finally, our findings can help to inform debates related to the disclosure of AC activities because they underscore the potential benefits of disclosure about a firm’s AC chair renewal and succession planning strategies.”

Comment: Boards may want to consider the implications of these research findings as they add new members to the audit committee and address audit committee chair succession planning. That individuals with accounting or audit experience can add value to the audit committee, and that there are clear benefits of having an audit committee chair who is already familiar with the company’s financial reporting processes, are not surprising conclusions. Many boards and nomination and governance committees probably already at least implicitly factor these considerations into their decision-making. The challenge is to harmonize those factors with other goals, such as constructing an audit committee that includes members with a mix of complementary skills and with diversity in backgrounds and viewpoints. See the “Enhancing Committee Composition” section of [How Audit Committees Can Maximize Their Value](#), above.

On the Update Radar: Things in Brief

CAQ Analyses the Value of the Audit. The Center for Audit Quality has published [Value of the Audit: A Brief History and the Path Forward](#). *Value of the Audit* provides an introduction to the financial reporting process and its participants and explains how their work supports the functioning of the capital markets. The paper presents these issues from the perspective of the auditing profession. However, for new audit committee members or others seeking a foundation in the basics of financial reporting and the auditor’s responsibilities, it is a useful and understandable summary of the financial reporting ecosystem.

The paper has four sections. It first summarizes the importance of well-functioning capital markets to the economy. Second, *Value of the Audit* discusses the importance of audited financial statements to the operation of the capital markets. The third section – the heart of the paper -- analyzes the roles and responsibilities of the various participants in the financial reporting supply chain, including management, audit committees, and independent auditors. With respect to auditors, the paper emphasizes the importance of both expertise and independence: “Many factors lead to a quality audit, but it is the combination of auditor expertise and independence that bolsters the level of trust and confidence in company financial statements and forms the basis of audit quality—and, thus, value to capital markets.” The final section discusses the growing importance to investors and other financial statement users of information outside the financial statements, such as non-GAAP measures, key performance indicators (KPIs), and environmental, social, and governance (ESG) disclosures. The paper concludes by suggesting that “public company auditors [are] a viable option for companies, audit committees, investors, and other stakeholders seeking assurance on the reliability of other company-reported information, such as ESG information, non-GAAP financial measures, and KPI disclosures.”

The State of Sustainability Assurance: It Varies. The International Federation of Accountants (IFAC) and the Association of International Certified Professional Accountants (Association), in partnership with research and data provider Audit Analytics, have published [The State of Play in Sustainability Assurance](#). The report examines global practices for sustainability reporting, including the extent to which companies are obtaining assurance over their sustainability disclosures, which standards are used as the basis for third-party assurance, and what types of firms are providing sustainability assurance services. In their Forward to the report, IFAC CEO Kevin Dancy and Association CEO for Public Accounting Susan Coffey state: “In short, the data shows a situation that is still evolving, with significant differences in practices across different jurisdictions.”

Key findings of the [State of Play](#) report include:

- 91 percent of the companies reviewed report some level of sustainability information.
- 51 percent of companies that report sustainability information provide some level of assurance on it.
- 63 percent of these assurance engagements were conducted by audit or audit-affiliated firms.
- 88 percent of assurance engagements employing an audit firm made use of the International Standard on Assurance Engagements 3000 (Revised), while other service providers often rely on alternative assurance standards.
- 83 percent of all assurance engagements result in limited assurance reports.

The theme of the report is that inconsistencies between companies as to whether to obtain assurance, and inconsistencies between assurance providers and the standards they follow, undermine confidence in sustainability disclosures. “As it stands, around half of companies reviewed are publishing sustainability information that is subject to any assurance. For those that do obtain assurance, it is often being provided by consultants or others, and not by independent professional accountants who possess the unique combination of skills, qualifications, experience, and the professional ethical obligation to act in the public interest. * * * With investors increasingly incorporating sustainability matters into their asset allocation decisions, low-quality sustainability assurance is presenting a significant, global investor protection issue.”

The [State of Play](#) report contains detailed information concerning 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.

How Does ESG Affect Accounting and Financial Reporting? Deloitte has released [Do ESG Matters Affect Accounting and Financial Reporting Today?](#), a brief primer on potential effects of environmental, social, and governance (ESG) matters on a company’s financial accounting and reporting in the context of the existing accounting guidance and the current regulatory environment. With respect to accounting, Deloitte points to an FASB staff paper published in March, [Intersection of Environmental, Social, and Governance Matters With Financial Accounting Standards](#). That paper highlights the connection between ESG matters and the financial statements. Deloitte sets out three of these examples of accounting impacts in its publication, including cases in which ESG matters could affect the impairment of an intangible assets, the useful life of an asset, or the value of inventory. As to financial reporting considerations, Deloitte summarizes and cites recent SEC activities that point to the Commission’s increased attention on how companies apply existing rules to account for ESG risks and impacts to their business. In this regard, the authors opine that an increase in SEC comment letters related to ESG matters is likely. Audit committee members seeking to understand how ESG risks can affect the financial statements and audit risk may find this publication useful.

The Audit Blog

I am a co-founder of [The Audit Blog](#) and blog on developments in auditing and financial reporting, on auditor oversight and regulation, and on sustainability disclosure. Occasionally, items that appear in the [Audit Committee and Auditor Oversight Update](#) also appear on the blog. Recent posts include --

- [The Housecleaning at the PCAOB: Why it Matters](#) (Dan Goelzer, July 6, 2021)

The blog is available [here](#). You can follow it [@BlogAuditor](#) on twitter or [@the-audit-blog](#) on medium.com.

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Prior Updates issued between January 1, 2019, and May 31, 2020, are available [here](#). Updates issued after June 1, 2020, are available [here](#).