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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.

### **In This Update:**

[PCAOB Releases 2021 Inspections Outlook and Audit Committee/Auditor Dialogue Tool](#)

[CAQ Provides Guidance on Auditor ESG Assurance](#)

[EY on How Audit Committees Can Prepare for First Quarter Reporting](#)

[FERF Finds that Audit Fees Continue Their Upward March](#)

[Accounting Class Actions Increase and Settlements are More Expensive](#)

[On the Update Radar: Things in Brief](#)

[Climate Change is Rapidly Becoming an SEC Priority](#)

[The Audit Blog](#)

## **PCAOB Releases 2021 Inspections Outlook and Audit Committee/Auditor Dialogue Tool**

On April 6, the PCAOB released [Spotlight: Staff Outlook for 2021 Inspections](#) (2021 Outlook). This annual publication outlines areas the Board plans to focus on during the current inspection cycle. In addition, the [2021 Outlook](#) provides an overview of changes in the inspections process, such as enhancing the unpredictability of inspections and the selection of nontraditional financial statement areas for review. The PCAOB also explains how inspections will address COVID-19 financial reporting and audit risks. The Board simultaneously released a separate document to assist audit committees in discussing inspection issues with their auditor. [Audit Committee Resource: 2021 Inspections Outlook](#) suggests questions related to the 2021 inspection focus areas that “audit committees—at their discretion—could use to further engage with their auditors.”

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## Staff Outlook for 2021 Inspections

The Board's 2021 inspection plan has two primary objectives: to respond to the financial reporting and audit risks posed by COVID-19 and to reduce the predictability of inspections. As to COVID-19:

- The Board plans to select audits for review in industries experiencing significant disruptions or elevated risks during the pandemic, such as transportation, entertainment, hospitality, manufacturing, certain aspects of the retail segment, and commercial real estate (including real estate investment trusts).
- Inspections will focus on financial statement items and other reporting matters that have been particularly affected by the pandemic, such as impairments, going concern assessments, allowance for loan losses, and increased risk of fraud.

As to predictability:

- The Board intends to significantly increase the percentage of audits select randomly (rather than based on audit risk or difficulty), especially for the largest accounting firms.
- Inspectors will select accounts that have not traditionally been addressed for review. Since the Board has historically focused on the financial statement aspects that are the most challenging to audit, this apparently means that in 2021 inspections will concentrate on lower-risk, more routine accounts. The Board adds that it "will, of course, also continue to target areas that we believe pose higher risks of material misstatement in particular audits, or that are the subject of recurring audit deficiencies."

In addition to these process changes, in 2021 the Board plans to place emphasis on these topics:

- Audit areas with continued deficiencies. The 2021 Outlook identifies revenue, accounting estimates, internal control over financial reporting, and independence as audit areas with recurring deficiencies and opportunities for improvement. In this context, the inspectors will also focus on audit firm procedures to identify and remediate audit deficiencies.
- Firms' quality control systems. The Board plans to review audit firm quality control systems "as part of our goal to move towards a more preventative regulatory approach." In addition, continuing the approach taken in 2020, inspections will include quality control areas likely to be affected by COVID-19, including "leadership communications, consultation requirements, client acceptance and continuance procedures, real-time monitoring, and pre-issuance reviews."
- Firm compliance with auditor independence requirements. Inspections continue to identify deficiencies that "suggest some firms may not have appropriate quality control systems in place to prevent and/or detect violations of applicable independence rules." The 2021 Outlook cites, among other things, compliance with audit committee pre-approval of non-audit services and auditor communications with the audit committee regarding independence as areas of attention.
- Fraud procedures. 2021 inspections will assess how auditors identify and assess risks of material misstatement due to fraud and how auditors design and implement audit responses to these risks. Inspectors also plan to focus on how auditors incorporate unpredictability in their selection of audit procedures.
- Critical audit matters. PCAOB standards require the auditor to identify and communicate in the audit report critical audit matters (CAMs) identified in the audit. CAMs are those aspects of the audit that involved challenging, subjective, or complex auditor judgment. See More PCAOB Advice for Audit Committees on CAMs, July 2019 Update). Inspectors will review how individual engagement teams applied the CAM requirement.

- Implementation of new auditing standards. New PCAOB requirements for the auditing of accounting estimates and for the auditor's use of the work of specialists took effect for audits of fiscal years ending on or after December 15, 2020. The Board will review how firms implemented these new standards.
- Supervision of audits involving other auditors. Inspections will assess how auditors supervised the work of other participating auditors, particularly given travel restrictions due to COVID-19.
- Responding to cyber threats. If there was a cyber incident affecting a public company or broker-dealer selected for review, the inspectors will evaluate how the engagement team applied the audit firm's cyber incident guidance, including whether and how the team reevaluated its risk assessment or modified the audit to address the effects of the breach on controls.
- Auditing digital assets. The inspection staff will select audits for review where transactions in digital assets are material to the financial statements and will review how the audit firm identified and assessed the risks of material misstatement, including valuation issues.

In 2020, the PCAOB invited the audit committee chairs of most U.S. public companies with audits selected for inspection to speak with the inspection staff. See [The PCAOB Speaks – With Audit Committee Chairs, January-February 2021 Update](#). The Board plans to continue this practice in 2021.

### Audit Committee Resource

The new Audit Committee Resource suggests specific questions that audit committees might ask their auditor in the areas highlighted in the [2021 Outlook](#). Examples of these questions are:

- Auditor's risk assessments. How has the auditor assessed risks of material misstatement related to the public company's technology systems, including relevant cyber threats, and how has it addressed those potential risks?
- Firm compliance with auditor independence requirements. How can the audit committee and management assist the auditor in complying with independence requirements?
- Critical audit matters. What items, if any, were considered "close calls" but ultimately not identified as a CAM by the auditor? Why were these items not determined to be CAMs?
- Implementation of new auditing standards. Was the audit of the company's estimates affected by the PCAOB's new requirements?
- Supervision of audits involving other auditors. Did restrictions on travel and in-person interactions create challenges for supervision and review of work performed by other auditors? If so, how were these challenges addressed?

Comment: The [2021 Outlook](#) provides audit committees with insight into why a company's engagement may – or may not – be selected for review this year and why the inspectors may emphasize some aspects of the audit and ignore others. In addition, areas of PCAOB inspection emphasis may become areas of additional auditor focus in subsequent audits. Accordingly, audit committees may find the Audit Committee Resource publication helpful in planning discussion of the company's 2021 audit with the auditor.

The [2021 Outlook](#) may also be helpful in evaluating the results of the 2021 inspections when they become available. One would assume that de-emphasizing high risk/high challenge engagements and financial statement areas will result in fewer inspection findings. Accordingly, the results of the 2021 inspections may not be comparable to those in prior years. Conversely, deficiencies identified in 2021 may be of particular concern if they relate to aspects of the audit that should have been relatively routine.

## CAQ Provides Guidance on Auditor ESG Assurance

In July 2020, the Center for Audit Quality (CAQ) released a web-based report outlining the evolving role of auditors in ESG reporting. See [The Role of Auditors in Company-Prepared ESG Information: Present and Future](#) and [New Report Reveals How Auditors Enhance The Reliability of Company-Reported ESG Information](#) (CAQ Press Release, July 1, 2020). The 2020 CAQ report also examines the types of ESG information companies disclose and the reporting standards and frameworks for presenting ESG data.

The CAQ has now issued a companion publication, [The Role of Auditors in Company-Prepared ESG Information: A Deeper Dive on Assurance](#) (March 2021). This report discusses the assurance services that auditors can provide to enhance confidence in ESG reporting and why companies may seek assurance on their ESG disclosures. The new publication also includes issues that boards should consider when planning to obtain assurance on ESG information. Audit committees may find this publication of particular interest, since the decision to retain the financial statement auditor to provide assurance on ESG reporting would fall within the committee's responsibilities. Key points in the new publication that may be useful to audit committees considering third-party ESG assurance are summarized below.

### Why Might a Company Seek Assurance on ESG Information?

The CAQ suggests five reasons why a company might decide to obtain assurance of ESG disclosures:

- The board may want to assess whether public disclosures about ESG are of high quality, particularly considering the importance investors are increasingly placing on ESG performance.
- ESG disclosures are important to investors in understanding the company's long-term value creation strategy, and third-party assurance can provide "insight into the reliability of management's assertions, data, and disclosures."
- Assurance can enhance management's confidence in the company's ESG disclosure, including in "the data, processes, procedures, expertise, and oversight necessary to produce reliable ESG information."
- Third-party assurance can enhance the reliability of ESG information in the eyes of non-investor stakeholders, such as customers, suppliers, and prospective employees.
- Assurance may impact a company's rankings and ratings on sustainability indices, such as the Dow Jones Sustainability Index.

The 2020 CAQ report (cited above) includes examples of auditor-provided assurance on ESG disclosures.

### Why Engage a Public Company Auditor to Provide Third-Party Assurance?

Assurance on ESG reporting can be provided by a range of professionals, including audit, engineering, and consulting firms. (The latter two would provide "certification" or "verification" services). An audit firm can perform a review or examination attestation in accordance with the AICPA's Statements on Standards for Attestation Engagements. The CAQ explains that an auditor attestation engagement differs from assurance obtained from other types of providers because, among other things, the auditor is required to be independent; required to maintain a system of quality control; and required to adhere to continuing professional education, ethics, and experience requirements.

The CAQ notes that a public company may use the same accounting firm for both its financial statement audit and for attestation of its ESG information. "Performing a review or examination engagement of a public company's ESG information is considered a permissible service for the independent accounting firm performing the financial statement audit, subject to pre-approval from the audit committee."

## What ESG Information Can Be in the Scope of an Attestation Engagement?

In an attestation engagement performed under the AICPA's standards, the auditor obtains assurance that the information that is the subject of the attestation is measured, evaluated, or presented in accordance with specified criteria. The auditor's ability to perform an attestation engagement depends on the information to be evaluated and the availability of measuring criteria. For example, quantitative metrics reported in accordance with the standards of the Sustainability Accounting Standards Board or the Global Reporting Initiative can be the subject of an attestation. In contrast, qualitative statements that cannot be measured or evaluated against a set of criteria may not be appropriate for an attestation engagement.

## What Level of Attestation Service Can Be Obtained on ESG Information?

The CAQ describes two types of attestation engagement:

- **Examination:** An examination performed by an auditor results in an independent opinion indicating whether the ESG information is, in all material respects, in accordance with the specified criteria. An examination engagement provides the closest equivalent to the reasonable assurance obtained in a financial statement audit.
- **Review engagement:** Review engagements are more limited in scope than examination engagements. The objective of a review engagement is for the auditor to express a conclusion about whether any material modifications should be made to the ESG information for it to be in accordance with the specified criteria.

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The new CAQ report concludes with a series of questions that boards may want to ask of management as part of considering whether a company that is disclosing ESG information should enter into an attestation engagement. The 2020 CAQ report also suggests questions for board members when discussing ESG reporting with management and investors.

**Comment:** As noted in [ESG is Rapidly Becoming an SEC Priority](#) in this [Update](#), ESG reporting is likely to be a high priority SEC disclosure issue in 2021 and beyond. Further, investor demand for and use of ESG information has grown rapidly during the last several years and is continuing to increase. Audit committees will need to focus on what their company is disclosing and what systems and controls are in place to ensure that such disclosures are accurate and reliable. In this environment, third-party assurance of ESG disclosures is likely to become more common and may eventually be an SEC requirement. The CAQ's publication is a good introduction to the subject of auditor ESG assurance. It is a topic with which many audit committees may need to become familiar.

## **EY on How Audit Committees Can Prepare for First Quarter Reporting**

The EY Center for Board Matters has issued [How audit committees can prepare for 2021 Q1 reporting](#). The report notes that companies are navigating “ongoing global volatility, an uneven economic recovery and changes in the US administration” and that, in this “uncertain and fluid business landscape”, audit committees are focused on “reviewing scenario plans, stress tests and enterprise risk management (ERM) information while overseeing high-quality financial reporting.” The EY Center suggests a range of specific matters for audit committee consideration in their oversight of 2021 first quarter reporting.

The topics the EY Center identifies, and examples of the issues or actions that it recommends audit committees consider, are summarized below. (In some cases, issues and actions have been shortened or paraphrased.)

## Risk Management

Audit committees should continue to monitor the economic recovery and other drivers of risk. Examples of actions the EY Center suggests audit committees may want to take include:

- Evaluate audit plan adjustments to address changes in risk profile, risk appetite and tolerances identified by the ERM program. Evaluate how internal audit's risk coverage has been adjusted due to travel restrictions. Consider whether the key control validation process has materially changed and any impacts on the control environment.
- Determine whether the organization has assessed and modeled the effects of potential changes to US, state, and foreign tax laws, including impacts on "significant transformations" such as workforce changes, digital and supply chain transformation, and M&A.
- Evaluate whether company plans will change risks or necessitate changes in the design of internal controls. Consider how process changes, such as those stemming from COVID, are impacting the performance and effectiveness of key controls.
- Evaluate whether new fraud risks have arisen or existing fraud risks have changed.
- Consider additional metrics the board and audit committee should monitor in the changing environment.

## Accounting and Disclosures

Audit committees should assess accounting and disclosure implications arising from ongoing impacts of the pandemic, changing business environment, and macroeconomic conditions. Examples of accounting and disclosure impacts cited by EY include:

- Asset realizability and impairment (e.g., inventory, indefinite-lived intangible assets including goodwill, long-lived assets, and other investments).
- Revenue recognition, with a focus on material modifications to existing contracts and arrangements, variable consideration and changes in estimates, and collectability assessments.
- Loss contingencies, changes in assumptions and ranges in estimates related to contractual commitments, guarantees, indemnifications, self-insurance, legal exposures, and other contingencies.
- Fair value measurements for financial and nonfinancial assets and liabilities.
- Accounting related to employee transition matters (e.g., termination, severance, furlough) and changes to employment benefits.

## Financial Reporting

Audit committees should monitor developments at the SEC and other regulators and assess the impact on reporting requirements and disclosures. Examples of possible audit committee actions in this regard include:

- Consider the implications for the timing of SEC filings, such as the likelihood of financial statement adjustments after the earnings release and the likelihood of material subsequent events that may bear on the fairness and completeness of the financial statements in the earnings release.
- Discuss implications for operations, liquidity, and financial condition. Consider enhancements to MD&A disclosures, including any known material events and uncertainties related to forward-looking information, such as the company's ability to meet its short-term and long-term cash needs.

- Monitor how the company is addressing the SEC’s new requirements for disclosures about human capital resources. Consider any voluntary human capital-related disclosures in the company’s public communications (e.g., in a sustainability report).
- Re-evaluate the use of non-GAAP measures. Consider whether any COVID-19-related adjustments are appropriate and whether any changes in non-GAAP financial measures (or key performance indicators) are appropriately disclosed and consistently applied.

### Growing ESG Expectations

Climate change, and ESG issues more broadly, are a focus of the Biden Administration and the SEC. If ESG metrics are key performance indicators in an SEC filing, it is critical that audit committees consider:

- Data quality and controls.
- Disclosure processes and controls.
- Consistency in disclosures across the company’s various external reporting outlets (e.g., SEC filings, earnings releases, annual report and shareholder letter, and sustainability report).
- The role of internal and external audit.

### Inquiries with Management, Compliance Personnel, and Auditors

The EY Center suggests that audit committees consider new questions, in addition to the usual inquiries, as part of their dialogue with management, compliance and the auditors. Examples are:

- How have management and the auditors adjusted their approach to physical inventories and cycle counts?
- Can financial reporting, compliance, and audit procedures (internal and external) be adequately performed through physical and remote working procedures? What options are there to facilitate timely collection, processing, and reporting of information for internal use and regulatory filings?
- What more should be done through technology, training, and manager support to optimize remote working, connectivity, engagement, security, and productivity?
- How is the organization monitoring compliance with federal, state, and local regulations and guidelines around reopening of businesses, employee/customer health and safety, privacy, and confidentiality?

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The EY Center’s report also lists the top ten global risks in 2021, as determined by the World Economic Forum (WEF). According to the WEF, the three highest 2021 risks, based on likelihood of occurrence, are extreme weather, climate action failure, and human environmental damage. The greatest risks, ranked by impact, are infectious diseases, climate action failure, and weapons of mass destruction. The Center suggests that “audit committees should evaluate whether management has considered these global risks in its risk assessments and risk mitigation strategies to be adaptive to the changing external environment.”

Comment: While the EY Center’s report is aimed specifically at first quarter reporting, the topics discussed have broad relevance and are a good checklist for matters that audit committees may want to focus on throughout the current year. The list of issues is extensive and detailed, and audit committees may want to review it to identify any gaps in, or additions to, the issues the committee plans to consider in the first quarter of 2021 and beyond. For other agenda suggestions, see [What Should be on the Audit Committee’s 2021 Agenda?](#), [January-February 2021 Update](#).



## FERF Finds that Audit Fees Continue Their Upward March

The Financial Executives Research Foundation (FERF), the research affiliate of Financial Executives International (FEI), has released the 2020 results of its annual survey of audit fees. The [11th Annual Public Company Audit Fee Report](#), sponsored by the Center for Audit Quality, is [available here](#) for purchase. The study finds that average audit fees increased six percent from 2018 to 2019. This continues the trend of recent years. For example, the 2018 FERF audit fee survey, discussed in [FERF: The Median Public Company Audit Fee Rose in 2017, But Some Companies Have Found Ways to Avoid Paying More, January-February 2019 Update](#), found that the median public company audit fee rose 2.5 percent in 2017.

The 2020 FERF report examines fees paid to external auditors for auditing and related services between June 2019 and May 2020. The study is based on two surveys and on data from SEC filings. FERF states that more than 50 financial executives at public companies responded to its survey, along with an additional survey of 88 audit engagement partners. Idaciti, a provider of financial and non-financial data, obtained audit fee information from the SEC filings of roughly 6,200 public companies for the study.

According to the [February 25 edition of FEI Daily](#), FERF found that the average audit fee increased from \$2.315 million in 2018 to \$2.455 million in 2019. The increase was not, however, uniform across companies. The biggest companies, large accelerated filers, experienced a 5 percent increase in average audit fees paid, while the next tier, accelerated filers, experienced a 12 percent increase. For smaller public companies (non-accelerated filers), the average audit fee fell 9 percent.

Fifty-seven percent of survey respondents attributed higher fees to increases in audit scope. Scope increases were, in turn, frequently driven by new accounting standards, such as those related to lease accounting and current expected credit losses. Fifty-six percent of public company respondents cited accounting standards changes as the major driver of fee increases, while 21 percent cited acquisitions. In contrast, 42 percent of auditor respondents thought that changes to internal controls over financial reporting “contributed most” to their effort to complete the most recent audit. FERF also reports that most public company respondents said that the external audit enhanced the quality of the company’s financial reporting.

FERF’s publicly-available [press release](#) highlights several other interesting findings of the 2020 report:

- Sixty-nine percent of public company respondents indicated that their audit and quarterly reviews were impacted by COVID-19. Virtual execution of internal controls (cited by 50 percent of company respondents) and virtual retention of internal control documentation (cited by 48 percent) had the greatest effect on audits and quarterly reviews.
- Sixty-two percent of auditors stated that COVID-19 and auditing in a remote environment increased audit and quarterly review effort. From the perspective of these engagement partners, the aspects of the audit most impacted by the pandemic were managing and training teams in a virtual environment (cited by 72 percent), client inquiries and meetings (cited by 60 percent), and goodwill and asset impairment considerations (cited by 45 percent).
- Public company respondents believed that the pandemic-driven shift to virtual auditing will continue. Eighty-seven percent of company respondents expect there to be an increase in virtual meetings with external auditors, and 83 percent anticipate a reduction in audit team time spent on site.
- Eighty-two percent of public company respondents stated that their auditors have deployed data analytics or emerging technologies as part of the audit process.
- Fifty-six percent of auditor respondents stated that audit effort could be reduced without impacting audit quality if management’s ICFR team or the internal audit function provided additional assistance. Forty-six percent of auditors cited “additional experience testing IT general controls and/or application controls” when asked what would be most beneficial to increasing external audit reliance on internal audit, while 24 percent cited “experience assessing internal control exceptions and/or deficiencies.”



Comment: While each company faces unique circumstance, audit committees may want to consider whether changes in their audit fee generally parallel those for similar companies, as reflected in the FERF report. If the company seems to be an outlier, the reasons should be explored. In addition, the FERF survey's reference to the views of auditors on ways that the company's internal control function could reduce external audit effort may be of interest to audit committees. Focusing internal audit on testing that could pay dividends in terms of reduced external auditor effort may be an effective strategy, both in terms of internal audit's core responsibilities and in terms of controlling audit costs.

## Accounting Class Actions Increase and Settlements are More Expensive

Cornerstone Research has issued its annual report on accounting class action litigation. It makes clear that suing public companies for alleged accounting violations remains a growth industry.

In [Accounting Class Action Filings and Settlements—2020 Review and Analysis](#), Cornerstone found that, in 2020, 70 class actions were filed against public companies alleging accounting violations, a 4 percent increase from the 67 filings in 2019, and the highest number of new accounting cases since 2011. Over 30 percent of 2020 federal securities law class actions included accounting allegations. Settlements in accounting cases represented 84 percent of the total cost of settling securities law class actions. The total value of accounting case settlements in 2020 tripled, from \$932 million in 2019 to \$3.5 billion in 2020, although the median settlement amount rose only slightly.

Some other indicators of the number, magnitude, and cost of accounting class actions in 2020 include:

- The total value of accounting class action settlements arose, from \$932 million in 2019 to \$3.546 billion in 2020. The steep increase in settlement value may not, however, be very meaningful since the median settlement amount increased less than 2 percent. Cornerstone notes that the aggregate settlement figure was due primarily to a small number of very large settlements. In cases where the information on insurance was publicly available, 89 percent of 2020 settlement funds were contributed by D&O insurers.
- In the 70 accounting cases filed in 2020, average market capitalization losses, as measured by the change in the defendant company's market capitalization during the class period, was \$67.8 billion – up from \$54.8 billion in 2019, and 77 percent higher than the 2011-2019 average. In four of the 2020 cases, alleged market capitalization losses were \$5 billion or greater.
- Thirty-eight accounting class actions were settled in 2020, compared to 34 settlements in 2019. Six accounting class action settlements exceeded \$100 million, and as noted above, the aggregate value of settlements nearly tripled. In contrast, last year Cornerstone reported that in 2019 the total value of class action settlements against public companies alleging accounting violations declined. See [Accounting Class Action Numbers Continue to Grow, April-May 2020 Update](#).
- The size of the companies settling accounting class actions is increasing. The median market capitalization of the 2020 settling companies was \$934.1 million, almost 50 percent above the \$663 million 10-year median.

Restatements and internal control weaknesses continue to be fertile ground for class action litigation, although less so than in 2019. Sixteen percent (11) of the 2020 new accounting cases involved restatements; this was the lowest number of accounting class action filings involving restatements in 10 years. All 2020 restatement cases included an internal control weakness allegation; over the past 10 years, more than 75 percent of restatement cases have included allegations of internal control weaknesses. Forty-one cases were filed alleging internal control violations; in 16 of those, the company had disclosed an ICFR weakness, while in the remaining 25 no such announcement had been made.

As to the industries that attracting accounting class actions:

- The greatest number of 2020 cases were filed against companies in the Consumer Non-Cyclical sector (which includes biotechnology, healthcare, and pharmaceuticals) and against companies in the Financial sector, with 15 cases filed against companies in each sector. Consumer Non-Cyclical was also the most-sued sector in both 2019 and 2018, and the Financial sector was the second most popular defendant sector in both of those years. Cases against companies in the Technology sector (which was in third place) more than doubled to nine in 2020, up from four in 2019.
- Companies in the Consumer Non-Cyclical sector also settled the most cases in 2020. By dollar amount, the Financial sector had the highest median settlement amount, \$17.6 million.

Readers should note that some of the class action filings numbers in Cornerstone's 2020 and 2019 reports are not directly comparable. The 2020 report appears to exclude cases challenging mergers and acquisitions on accounting grounds and reports only "core accounting cases" – that is, non-M&A cases alleging violations of generally accepted accounting principles (GAAP) or other reporting standards or weaknesses in internal control over financial reporting (ICFR). M&A accounting class actions typically are filed under the proxy or takeover provisions of the federal securities laws and frequently allege a failure to reconcile a non-GAAP measure to a GAAP measure. Such cases are often brought by attorneys seeking a quick settlement involving a disclosure correction and the payment of attorney's fees. See [Accounting Class Actions Rise, But Settlements Fall, April-May 2018 Update](#). While such M&A actions were included in the aggregate accounting class action numbers in prior reports, this year Cornerstone relegates them to an appendix.

Comment: Accounting class action litigation against public companies is clearly flourishing. And, as noted in [Securities Law Class Actions are Mushrooming, But More Cases are Being Dismissed and the Survivors are Settling for Less, March 2018 Update](#), the risk that a public company will be named in a securities law class action is increasing, particularly for companies engaged in M&A activity. Accounting issues remain a significant line of attack for the plaintiff's bar, and restatements and disclosure of internal control weaknesses are likely to attract litigation, if they coincide with a significant drop in stock price. At the same time, the cost of settling accounting cases is on a general upward trend. The best protection against litigation is diligence and care in overseeing the company's financial reporting.

## On the Update Radar: Things in Brief

**Climate Change is Rapidly Becoming an SEC Priority.** The SEC is signaling that disclosure concerning climate change, and ESG issues broadly, will be a priority in 2021. New SEC Chair Gary Gensler was sworn in on April 17. At his confirmation hearings, he said that investors want climate risk disclosure and that more detailed SEC guidance on such disclosure would be beneficial. However, even prior to Chair Gensler's arrival, Acting SEC Chair Allison Lee took a series of steps to ramp up the SEC's focus on climate:

- [Statement on the Review of Climate Related Disclosure](#). On February 24, Acting Chair Lee issued a [statement](#) directing the Division of Corporation Finance to review climate-related disclosure in public company filings. In 2010, the SEC issued [guidance](#) to public companies on how its disclosure requirements apply to climate change matters. Chair Lee asked the staff to review "the extent to which public companies address the topics identified in the 2010 guidance, assess compliance with disclosure obligations under the federal securities laws, engage with public companies on these issues, and absorb critical lessons on how the market is currently managing climate-related risks."
- [2021 Examination Priorities](#). On March 3, the SEC's Division of Examinations [announced](#) that ESG would be one of its priorities in examinations of broker-dealers, investment advisers, mutual funds, and other SEC-regulated entities. Its [2021 Examination Priorities](#) publication explains that advisers and investment companies increasingly offer ESG investment strategies. The Division "will review the consistency and adequacy of the disclosures advisers and fund complexes provide to clients

regarding these strategies, determine whether the firms' processes and practices match their disclosures, review fund advertising for false or misleading statements, and review proxy voting policies and procedures and votes to assess whether they align with the strategies."

- [Enforcement Task Force Focused on Climate and ESG Issues](#). On March 4, the SEC [announced](#) the formation of a task force in the Division of Enforcement "to proactively identify ESG-related misconduct." The initial focus of this enforcement group "will be to identify any material gaps or misstatements in issuers' disclosure of climate risks under existing rules." The task force will also analyze disclosure and compliance issues relating to investment advisers and investment funds that claim to apply ESG strategies.
- [Request for Comment on Climate Change Disclosure](#). On March 15, Chair Lee issued a [statement](#) inviting public comment on the Commission's disclosure rules and guidance applicable to climate change disclosures, and whether and how the rules and guidance should be modified. The request for comment includes 15 specific questions. One of the questions notes that the SEC staff is evaluating a range of ESG disclosure issues and asks whether climate-related requirements should be one component of a broader ESG disclosure framework.

Climate change and other ESG issues will almost certainly be at the top of the SEC's agenda in 2021 and beyond. It is likely that the SEC will adopt some form of new disclosure requirements, at least as to climate. In the meantime, audit committees should understand what climate and ESG disclosures their company is making and how those disclosures align with the existing SEC guidance. It would also be prudent to ask management to compare the company's disclosures with those of others in the same industry and to describe the controls and procedures that are in place to assure the accuracy of these disclosures. It appears that the SEC staff, including the Division of Enforcement, may be asking some companies these same questions.

## 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. The blog is available [here](#). You can follow [@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](#).