

September 2, 2015

Mr. Brent Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549-1090

Re: Request for Public Comment on Concept Release on *Possible Revisions to Audit Committee Disclosures*, July 1, 2015 (Release No. 33-9862, File No. S7-13-15)

Dear Mr. Fields:

Deloitte & Touche LLP is pleased to respond to the Securities and Exchange Commission's (the Commission) request for comments on its July 1, 2015 Concept Release on *Possible Revisions to Audit Committee Disclosures* (the Concept Release).

EXECUTIVE SUMMARY

In our experience, strong independent audit committees support audit quality. In addition to providing appropriate oversight of management and an entity's system of internal control over financial reporting, a strong audit committee raises the expectations of the external auditor to provide appropriate resources, exercise professional skepticism, and objectively assess conclusions reached by a company's management. Others confirm our own observations that strong audit committees contribute to audit quality, and thus more reliable financial reporting.¹

The Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) recognized the importance of independent audit committees to the audit process by explicitly mandating that the audit committee be "directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including resolution of disagreements between management and the auditor regarding financial reporting)." We support the Commission's consideration of the adequacy of current audit committee disclosure requirements regarding oversight of the external auditor, because we believe transparency into the audit committee's performance of these oversight duties can increase investors' confidence in the audit committee's performance as well as the independent audit process.

We recommend, however, that if in response to input from preparers and users the Commission determines that it should move forward with additional disclosure requirements for audit

¹ See, e.g., K. Hertz-Rupley, E. Almer & D. Philbrick, *Audit Committee Effectiveness: Perceptions of Public Company Audit Committee Members Post-SOX*, RESEARCH IN ACCOUNTING REGULATION, Vol. 23, Issue 2, pp 138-144 (Oct. 2011); International Auditing and Assurance Standards Board, *A Framework for Audit Quality: Key Elements that Create an Environment for Audit Quality* (Feb. 2014) (noting the importance strong company governance, and specifically audit committees, in supporting audit quality).

committees, those requirements be principles-based, to allow individual audit committees to exercise discretion in providing disclosures that give insight into their activities and performance.

When considering the potential disclosures addressed in the Concept Release, we focused on several principles that we encourage the Commission to take into account in determining whether a potential disclosure should be pursued as a requirement. First, any new disclosure requirements should serve to inform about the audit committee's performance of its oversight role as it relates to supporting audit quality and auditor independence, consistent with its duties under Sarbanes-Oxley. Second, any new disclosure requirements should encourage an audit committee to provide information relevant to its own activities; excessively specific or voluminous disclosure requirements may obscure relevant information and unintentionally drive a compliance-minded approach, rather than encouraging more meaningful and tailored disclosures. Finally, any new requirements should, when taken as a whole, be proportional to other required company and board disclosures, including those not related to the audit committee.

Moreover, in considering whether any new requirements are proportional to other required disclosures, we note that the audit committee's oversight of the external auditor is just one aspect of its responsibilities. Other areas of responsibility that support the performance and quality of the external audit, and of the company's financial reporting more generally, include the audit committee's:

- Qualifications and independence from management;
- Oversight of the company's financial reporting process and internal control over financial reporting; and
- Oversight of the company's internal audit function and financial fraud prevention programs.

We therefore encourage the Commission, when considering any changes to audit committee disclosure requirements, including those raised in the Concept Release, to consider how those changes would interact with other disclosure requirements to inform investors about the whole of the interconnected system designed to ensure quality in financial reporting.

OBSERVATIONS FROM OUR REVIEW OF S&P 100 PROXY STATEMENTS

As the Commission notes, the requirements for audit committee disclosures have not been updated substantially since 1999. However, in the years following Sarbanes-Oxley we have observed that many companies and their audit committees have expanded their proxy disclosures regarding the audit committee's oversight of the external auditor and related issues. In anticipation of the Concept Release, we analyzed the most recent proxy statements filed by the companies included in the S&P 100 index² to identify trends in audit committee reporting. Some of these trends may be relevant to consideration of any future regulatory action in this area.

Our general observations are that many companies and their audit committees are currently providing disclosures related to the oversight of the external auditor that go well beyond those

² Our review included the most recent annual proxy statements filed as of August 1, 2015, for the companies that were included in the S&P 100 index as of January 31, 2015.

that are currently required. These results not only indicate that market forces are already driving increased disclosures, but also underscore the benefits of allowing audit committees the flexibility to disclose the information that they believe is most relevant to the investors they represent. Specifically, we observed relevant disclosures in the following areas:

- ***Evaluation of the External Audit Firm.*** Sixty-one of the S&P 100 companies explicitly disclosed that the audit committee evaluates the external audit firm, often specifying the criteria used for the evaluation (*e.g.*, independence, qualifications, or performance). Over half of these 61 companies included additional disclosure about why the audit committee decided to re-appoint the incumbent audit firm. The criteria most often mentioned as considerations for re-appointment were the talent and experience of the audit firm, the appropriateness of fees, and the quality and candor of the auditor’s communications with the audit committee.
- ***Ratification of the External Audit Firm.*** Companies commonly provided information relevant to the appointment of the audit firm in the disclosure related to the ratification of the appointment or re-appointment of the external audit firm. Almost three-quarters of the S&P 100 stated explicitly that the members of the audit committee and/or the board believed that the continued appointment or retention of the incumbent external audit firm was in the best interest of the company and its investors. Sixty-four of the companies disclosed either the tenure of the incumbent external audit firm, or otherwise gave an indication of how long the firm had been the company’s auditor. Eighty percent of the companies disclosed what they would do if the majority of shareholders voted against ratifying the external audit firm (*e.g.*, consider whether to select another firm).
- ***Compensation of the External Audit Firm.*** All companies whose proxies we reviewed provided the required disclosure related to fees paid to the external auditor. Some companies provided additional disclosures related to the compensation of the external auditor. For example, more than three-quarters of companies whose proxies we reviewed explicitly stated that the audit committee compensates the external audit firm. Three other common articulations of the audit committee’s role were that: it approves audit engagement fees (40%); it is responsible for the audit fee negotiations (23%); and it sets the compensation for the external audit firm (7%).
- ***Approval of the External Audit Firm’s Scope and Plan.*** Just over 60% of the S&P 100 disclosed that the audit committee discussed with the external audit firm the overall scope of and plans for the audit.
- ***Changes in Lead Engagement Partner.*** Approximately 70% of the companies in our analysis disclosed that the audit committee or its chair is directly involved in the selection of the firm’s new lead engagement partner when rotation is required by SEC rules. A small number of companies that included this disclosure supplemented it with additional information such as:
 - Assessment of the lead partner candidates’ independence, objectivity and qualifications (*e.g.*, business judgment, multinational and industry experience);

- The role of management in the lead partner selection process (*e.g.*, recommending candidates, interviewing candidates); and
- Discussions with the full audit committee, if involvement in the selection process is led by the chair.

POTENTIAL CHANGES TO AUDIT COMMITTEE DISCLOSURE REQUIREMENTS

We believe that the significant range of disclosures that companies and audit committees are voluntarily providing is relevant in considering whether and what additional requirements are necessary. But we also believe the Commission’s exploration of whether additional requirements may drive more consistent and meaningful disclosures from all audit committees is appropriate.

As noted above, a fundamental precept of Sarbanes-Oxley is that the audit committee represents shareholders in selecting, compensating, and overseeing the external auditor. In our experience, most audit committees have embraced these duties in a way that supports audit quality. However, requiring disclosures focused on these duties could drive some audit committees to reexamine their own performance in light of the disclosure requirements, and thus encourage a more consistent high level of audit committee performance. Additional required disclosures also could result in more uniform reporting among companies that could assist investors in assessing an individual audit committee’s performance in a broader context.

This potential for increased comparability is only useful, however, if it allows for meaningful differentiation. Overly-detailed or specific disclosure requirements can make differentiation more difficult, either by obscuring relevant information or driving compliance-oriented disclosure at the expense of more meaningful and tailored disclosures. Therefore, in considering whether to pursue additional requirements, the Commission should consider some of the tenets of its Disclosure Effectiveness initiative. While we recognize that initiative is not initially focused on the annual proxy statement, where audit committee disclosures are typically found, we believe some of the principles underlying that initiative are equally relevant when considering possible additional audit committee disclosure requirements.

In this regard, we agree with a statement made by Keith Higgins, Director of the Division of Corporation Finance in an October 2014 speech:³ “The starting point for shaping company disclosure is remembering its purpose — that is, to provide investors the information they need to make informed investment and voting decisions.” He went on to observe that “An important element in the Disclosure Effectiveness initiative will be striking the right balance between principles-based requirements and line-item disclosures that inform investor decision-making.” We believe the same is true in considering audit committee disclosures.

There is likely to be variation in the volume and level of detail that investors want regarding an audit committee’s oversight of the external auditor. In considering potential additional requirements, we believe the Commission should focus on what investors need to make investment and voting decisions, recognizing that excessive and overly-specific disclosure

³ Keith F. Higgins, Director, Division of Corporation Finance: *Shaping Company Disclosure: Remarks before the George A. Leet Business Law Conference* (Oct. 3, 2014).

requirements could obscure relevant information. The Commission should also consider compliance costs for companies and potential unintended consequences of any potential new requirements. A principles-based approach would allow companies and audit committees the flexibility to tailor disclosures in a way that would better inform investors about their specific practices, while avoiding some of the costs and risks of overly-prescriptive requirements.

We have set out below more specific observations, consistent with our principles noted above, about the areas of substantive disclosure raised in the Concept Release. Consistent with our thoughts, as set out above, when considering the specific questions asked by the Commission in the Concept Release, we focused on potential disclosures that we believe would:

- Provide information about an audit committee's performance relative to its obligations to support audit quality and independence — focusing on its Sarbanes-Oxley oversight duties;
- Encourage an audit committee to provide information tailored to its own performance, and not result in overly-voluminous or boilerplate information; and
- Be proportional to other areas of the company's disclosures.

Audit Committee's Oversight of the Auditor

Disclosures that emphasize the direct reporting relationship between the audit committee and the external auditor, and give insight into the audit committee's assessment of audit quality and independence, could be valuable to investors in assessing an audit committee's performance of its Sarbanes-Oxley duties. These could include disclosures that give a clearer picture of the level and extent of communication between the external auditor and the audit committee, beyond the fact that communications required by PCAOB auditing standards and listing requirements occurred, such as the audit committee's practices with regard to:

- Meeting privately, or otherwise fostering the direct reporting relationship, with the external auditor;
- Meeting with key members of the audit team, including subject matter experts, industry experts, other specialists; and
- The assessment of the audit firm's performance and its system of quality control.

In considering how disclosure requirements could be crafted to allow an audit committee to provide information tailored to its own performance and in a manner such that the information provided would be proportional to other areas of company disclosure, we note that it would not be possible to adequately capture in a public disclosure document the full context of the two-way dialogue that occurs between the audit committee and the external auditor over the course of a year, nor do we think that investors need or want that level of detail. Moreover, overly-detailed disclosure requirements regarding the specific content of communications between the audit committee and the external auditor could potentially have a chilling effect on the free flow of information between the auditor and audit committee.

Candid discussions between the audit committee and the external auditor are the bedrock of a healthy direct reporting relationship. This includes discussions about the scope of the audit (including assessment of financial reporting risks), issues encountered during the audit, and discussions relevant to audit quality and independence. The specter of overly-prescriptive public disclosure about the details of these discussions has a high likelihood of discouraging candid

dialogue on these topics, which would run counter to the objective of Sarbanes-Oxley to strengthen the direct reporting relationship of the external auditor to the audit committee.

Therefore, we recommend that any new requirements should leave flexibility for companies and audit committees to provide transparency into their own practices in a way that supports audit committee performance and audit quality, but preserves open and candid communication between external auditors and audit committees. For example, rather than attempting to craft a requirement that would require detailed disclosures of specific communications and oversight activities, the Commission could encourage disclosures about the audit committee's general practices and its objectives in communicating with the external auditor, and an overall assessment of the effectiveness of its practices in achieving such objectives.

We also believe that the current outdated reference in the disclosure requirements related to required communications with the external auditor should be updated. We recommend, however, that rather than replacing the reference to AU sec. 380 with a reference to PCAOB Auditing Standard 16 (AS 16), the Commission should require a reference that the audit committee has discussed with the external auditor the matters required by PCAOB rules and auditing standards. This more general reference would reflect the fact that the PCAOB has included required communications in rules and standards other than AS 16 and would allow the SEC's rule to remain current in the event of future changes to PCAOB standards or their numbering.

Audit Committee's Process for Appointing or Retaining the Auditor

One of the core duties of the audit committee under Sarbanes-Oxley is the appointment of the external auditor. In addition to helping to ensure that the audit firm is best suited to the specific needs of the company, the audit committee's involvement in the decision to appoint the auditor establishes early-on the direct reporting relationship between the external auditor and audit committee. Therefore, disclosures that give insight into the audit committee's process and rationale for appointing the external auditor can provide important insight not only into the auditor's qualifications but also the audit committee's level of engagement and oversight.

Notably, the law that put the external auditor's appointment into the hands of the audit committee did not dictate that the audit committee use specific criteria in making the selection. The appropriate external auditor for any given company can depend on a myriad of considerations including sufficiency of resources, industry expertise, geographical reach, and, in the case of the incumbent auditor, the audit committee's direct experience with the auditor. Given the complexity of the decision, we suspect that for many companies it would be difficult to include a full but concise report of all factors that went in to the audit committee's decision to appoint the external auditor.

Therefore, any new disclosure requirements should encourage audit committees to provide information tailored to the processes it used and information that it considered.⁴ Very specific requirements to disclose whether or not an audit committee considered a particular factor or took

⁴ As noted in the Concept Release, the PCAOB and CAQ currently have projects related to potential audit quality frameworks and indicators. These projects are in their early stages, and we believe it is premature to consider questions in the Concept Release about whether any disclosure of the use of such indicators is appropriate.

a particular action (*e.g.*, sought proposals for the audit) could be interpreted as the Commission's view that the audit committee should do those things in all cases. We believe that audit quality could suffer if specific disclosure requirements drove audit committees to adjust their actions and related decision making to match those disclosure requirements, rather than tailor disclosures to what actually drove their decisions.

Qualifications of the Audit Firm and Certain Members of the Engagement Team Selected by the Audit Committee

In considering some of the very specific disclosure areas covered in this section of the Concept Release, we found the three principles discussed previously especially useful. First we considered whether these disclosures would serve to inform investors about the audit committee's performance to support audit quality and independence.

We do believe that some of the areas noted in the Concept Release are important components of the relationship between the external auditor and the audit committee. For example, just as we believe that the direct reporting relationship between the audit committee and the external auditor can be emphasized by early and direct audit committee involvement in the appointment of the audit firm, so too can audit committee participation in the process when a new lead engagement partner is chosen. In our experience, audit committees or their chairs actively participate in the process of assessing potential new lead engagement partners or other specialty partners when events require (*e.g.*, required rotation). The involvement of the audit committee in that process helps to establish a direct reporting relationship from the beginning. Describing the audit committee's involvement in that process could emphasize for investors the value the audit committee places on the direct reporting relationship with the external auditor, and in particular the lead engagement partner. Similarly, as noted above, additional disclosures about interactions with key members of the engagement team could emphasize more broadly the audit committee's direct engagement with, and oversight of, the auditor.

We are concerned, however, that a number of the potential disclosures raised in this section may be too detailed and, as such, may serve to obscure rather than illuminate more important disclosures.⁵ Moreover, requiring very specific disclosures — especially disclosures that have no demonstrable link to audit quality or independence — risks putting a prominence on those disclosures, at the expense of what may be more relevant and meaningful disclosure related to the audit committee's oversight of the external auditor.

For example, while auditor tenure is currently disclosed by almost two-thirds of the S&P 100, we have concerns that if the Commission were to require this disclosure, it would suggest that the Commission believes it has a relevance that is not supported by evidence. A similar risk exists with some of the other quantified disclosures on which the Commission has sought input, such as the number of meetings held between the external auditor and the audit committee. Requiring these kinds of disclosures may lead some to try to develop benchmarks with which to compare companies that do not appropriately take into account circumstances that lead to legitimate variations in practice.

⁵ As noted in the Concept Release, some of the disclosure items raised in this section — the identity of the lead engagement partner and the participation of other firms in the audit — are currently subject of a disclosure proposal by the PCAOB. We recommend that the SEC and PCAOB coordinate so that there are not duplicative disclosure requirements for this information.

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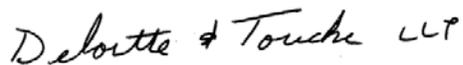
Because strong audit committees support audit quality, we believe that transparency into audit committee oversight activities can be valuable to enhance understanding of both the audit committee's performance and the audit process. While it is not necessary, or possible, to disclose all of the things that an audit committee does each year in fulfilling its duties, providing additional insight into the structure and key activities of the audit committee can help increase investor confidence both in the audit committee and the company as a whole.

As it considers this issue further, we urge the Commission to focus on principles of effective disclosure that will ensure that any new requirements result in relevant information, and not unnecessarily distract from more important disclosures or risk the development of boilerplate disclosures that do not allow for meaningful comparisons among companies.

We also encourage the Commission, in considering whether additional requirements are needed, to consider the voluntary disclosure practices that have developed in recent years, as evidenced by our proxy review and those performed by others. In this regard, we agree with Mr. Higgins's observation in his October 2014 speech, that there is a benefit to allowing companies the flexibility to consider how their disclosure can be enhanced to benefit their investors.⁶

If you have any questions or would like to discuss these matters further, please contact Tom Omberg at (212) 436-4126.

Very truly yours,



Deloitte & Touche LLP

cc: Mary Jo White, Chair
Luis Aguilar, Commissioner
Daniel Gallagher, Commissioner
Michael Piwowar, Commissioner
Kara Stein, Commissioner
Keith Higgins, Director, Division of Corporation Finance
James Schnurr, Chief Accountant
Brian Croteau, Deputy Chief Accountant

⁶ "But, I want to emphasize that disclosure effectiveness is not just about our rules. In recent years, some companies made significant changes to the presentation of their proxy statements to enhance the disclosure for investors. We want to encourage companies to make similar strides with their periodic reports — experiment with the presentation, reduce duplication and eliminate stale information that is both outdated and not required." Keith F. Higgins, Director, Division of Corporation Finance: *Shaping Company Disclosure: Remarks before the George A. Leet Business Law Conference* (Oct. 3, 2014).