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SEC Emphasizes Role of Audit Committee in New Developments and Continuing Trends in Auditor Oversight

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A recent speech by the SEC Chief Accountant provided guidance for audit committees on several key areas of responsibilities in new developments, and on perennial issues of auditor evaluation and independence.

New Revenue Recognition Standard. Audit committees should understand management's implementation plans and the status of the progress on the new revenue recognition standards, including any required updates to internal control over financial reporting. The audit committee should also communicate with auditors about any concerns the auditors may have regarding management's application of the standard.

Auditor Independence. Audit committees should "own" the selection of the audit firm, including making final decisions in the negotiation of audit fees. In its oversight of the audit relationship, audit committees must oversee auditor independence. The Office of the Chief Accountant (OCA) encourages audit committees and management to address independence questions with the SEC staff. If an auditor submits an independence matter to OCA, the SEC staff will sometimes reach out to the audit committee to understand its position.

Selecting a successor auditor poses a number of difficult issues. Audit committees should be mindful of any need to adjust prior period financial statements due to circumstances such as reporting discontinued operations, retrospective application of an adoption or change in accounting principle or the correction of an error. While either the successor auditor or predecessor auditor can be selected to audit those adjustments, audit committees should be mindful of entering into any relationships that would impair the predecessor auditor's independence after the end of that auditor's engagement period.

Auditor Tenure. Part of the PCAOB's new release on revising the auditor report, which we previously discussed here, would require disclosure of auditor tenure. Some audit committees already disclose tenure in the audit committee report as one of the matters the committees consider when evaluating auditors. The years of experience by an auditor may factor into a committee's auditor selection process, in evaluating the auditor's expertise, incentives and performance. The Chief Accountant emphasized that existing research is inconclusive as to whether any relationship exists between auditor tenure and audit quality or auditor independence.

Comment Period on PCAOB Release. Finally, the Chief Accountant noted that the PCAOB release is subject to approval by the Commission before it becomes effective. The Commission will publish a notice for public comment, and he encouraged companies to submit comments on the new standards.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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