Dan Goelzer

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 the company's relationship with its auditor.

In This Update

It's Another All-Time High! Audit Fees Rose Again in 2023

Two annual reports on audit and other fees paid to auditors have been released, and both reach the same conclusion: Fees hit a new high in 2023. Ideagen Audit Analytics' (IAA) annual analysis of fees paid to external auditors finds that in 2023 the average total fees that SEC-registered public companies paid to external auditors increased 13 percent over 2022 and hit a 20-year high of $3.064 million. The 2023 average tops the record set in 2022, when the average fee total was $2.715 million. Similarly, the Financial Executives Research Foundation's (FERF), annual fee survey finds that average audit fees increased 6.4 percent from 2022 to 2023. Last year FERF reported that the average audit fee increased 4.6 percent from 2021 to 2022. While these two studies have somewhat different methodologies and databases, both make clear that the long-term upward fee trend showed no signs of abating in 2023.

Ideagen Audit Analytics

IAA's analysis, Audit Fee Trends: A 20-year review, is based on the Audit Analytics SEC Audit Fee database, which includes all filers under the Securities Act of 1933 and the Securities Exchange Act of

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Dan Goelzer is a retired partner of Baker McKenzie, a major international law firm. The SEC appointed him to the Public Company Accounting Oversight Board as one of its founding members, and he served on the PCAOB from 2002 to 2012, including as Acting Chair from 2009 to 2011. Dan was on the Securities and Exchange Commission's staff for 16 years and served as SEC General Counsel from 1983 to 1990. He has chaired Deloitte's Audit Quality Advisory Council for eleven years, and, from 2017 to July 2022, was a Sustainability Accounting Standards Board member.

1934 since 2000. Fee information comes from SEC Forms 10-K, 20-F, 40-F, and DEF 14A, although IAA's analysis excludes subsidiaries and affiliates that are included in a parent's audit fees and Investment Company Act of 1940 filers. For a discussion of last year's IAA fee report, see The Average Audit Fee Reached an All-Time High in 2022, August-September 2023 Update. (The 20-year fee table in IAA's report is inconsistent with data reported for 2023-2004 in the fee table in last year's report, as is some of the other comparative information. The reason for these inconsistencies is not clear.)

Highlights of IAA's report include:

- Total fees SEC registrants paid to auditors increased even though the number of public companies fell. In 2023, the 6,842 public companies in IAA's analysis paid $20.96 billion in fees to their external auditors. Compared to 2022, this represents a 0.8 percent increase in total fees, despite an eleven percent decrease in the SEC registrant population. The 6,842 public companies that reported fees for FY2023 is the lowest number of reporting companies in the 20-year period covered in IAA's report, while the $20.96 billion in fees is the highest annual amount. As noted above, the average total fee payment in 2023 was $3.064 million, compared to $2.715 million in 2022.

- The average public company audit fee also increased in 2023, along with fees for non-audit services. Total fees are comprised of audit fees, audit-related fees, tax fees, and other fees. Looking only at the audit fee component of total fees, the average company paid $2.581 million, up 13 percent from $2.255 million in 2022. The average amount that SEC registrants paid for non-audit services (i.e., audit-related fees, tax fees, and other) was $483,000, a five percent increase from $460,000 in FY2022.

- Audit fees per $1 million of revenue rose, although this metric remains below its all-time high. In FY2023, audit fees per $1 million of client revenue averaged $610, an increase of 5 percent from $580 in 2022. Audit fees per million dollars of revenue peaked in FY2006 at $714. In 2013, audit fees were $557 per $1 million of revenue, the lowest in IAA's 20-year data series.

- The largest firms earn the lion's share of fees. The four largest accounting firms collected 69 percent of audit fees paid for FY2023. Last year, IAA reported that these four firms earned 92 percent of audit fees paid by SEC registrants in FY2022, although it is unclear whether these percentages are comparable. In 2023, PwC collected the highest average fees ($5.5 million per client). Deloitte was second in average fees, followed by EY.

- The average audit fee rose for companies of all sizes. In FY 2023, average audit fees increased 7.5 percent (to $5.75 million) for large accelerated filers. For the next size tier, accelerated filers, average audit fees increased by 5.5 percent to $1.62 million. The smallest public companies, non-accelerated filers, experienced a 12.4 percent increase in 2023 to $703,000.

- Industry matters in terms of average fees and fees per $1 million of revenue. The 2023 highest average audit fees were in Finance ($4.078 million) and Manufacturing ($3.218 million). The industries with the lowest average audit fees were Life sciences ($1.404 million) and Real estate and construction ($1.349 million). Despite their lower average fee ranking, Life sciences companies paid the highest audit fees versus revenue -- $1,407 per $1 million of revenue – 35 percent more than the next highest industry (Industrial applications and services). Companies in the Trade and services industry paid the least in audit fees relative to revenue -- $316 per $1 million in revenue.

IAA discusses several factors that have affected audit fees during the past 20 years. For example, new accounting standards, such as those governing revenue recognition, lease accounting, and credit losses, and increased audit complexity resulted in additional auditor effort. IAA also notes that new PCAOB and IASSB auditing standards have played a role and that further auditing standards changes took effect at the end of 2024. Rising costs for audit staff labor and technology have also been factors.

On the other hand, the SEC's 2020 change in the definition of accelerated filer mitigated the overall increase in audit fees because some companies were no longer required to obtain auditor attestation of the effectiveness of their internal control over financial reporting. In addition, the surge in special purpose acquisition company IPOs in 2020 and 2021 influenced audit fees overall and on average because "SPACs generally have lower audit fees than a traditional public company due to their lack of operations, smaller size, and short operating history." While these two factors may have affected average fee levels in the past, they will not impact future fee level changes.

Financial Education & Research Foundation

FERF, the research affiliate of Financial Executives International (FEI), released 15th Annual Public Company Audit Fee Report on December 17. The report is available here for purchase and an FEI press release summarizes some of the findings.

FERF's report examines fees companies paid to external auditors for auditing and related services between June 1, 2023, and May 31, 2024. The report is based on surveys distributed to FEI members and qualitative interviews. Representatives from 123 private companies/nonprofits and 50 public company members participated in the research, and eight senior-level finance professionals from five public companies and three private companies completed interviews. The Calcbench financial data platform provided FERF with audit fees reported by more than 4,000 SEC filers. For a discussion of last year's FERF report, see FERF: Audit Fees Rose 4.6 Percent in 2022, November-December 2023 Update.

In addition to the 6.4 percent 2023 audit fee increase, highlights of FERF findings, based on the FEI press release, include:

- Fifty-seven percent of FEI member company respondents reported "working harder" to support their 2023 audit as compared to the previous year. Changes to internal control over financial reporting were cited as the most common reason for an increase in company audit effort (43 percent), followed by changes to organizational structure, M&A, and turnover in company or audit team staff.

- Seventy percent of respondents indicated that the audit increased the quality of financial reporting. FERF attributes this to the "lack of significant changes from standard setters and regulators [which] contributed to a relatively calm audit landscape allowing for process improvements."

- Seventy-two percent of respondents reported an increase in IT audit effort, compared to 53 percent that reported such an increase last year. In FERF's view, "[t]he PCAOB's emphasis on internal controls and processes, coupled with companies continuing digital transformation journeys, are driving elevated IT audit efforts."

- Auditors used artificial intelligence in fewer than 20 percent of public company audits and in fewer than three percent of private company audits. FERF says that "use cases for AI have not evolved beyond other tools such as general ledger anomaly detection and financial statement tie-out."

Audit Committee Takeaways

Audit fees are likely to continue to increase. In addition to the new PCAOB standards referenced in IAA's report, financial reporting continues to become more complex. FEI's press release announcing the FERF report quotes Andrej Suskavcevic, President and CEO of FEI and FERF, as noting that "The FASB's Disaggregation of Income Statement Expenses standard represents a potentially large burden to implement and audit," and "In addition, audit firms will need to implement and comply with several new PCAOB standards in the next several years."

Audit committees may find it useful to compare changes in their company's fees with the information in these reports. As IAA pointed out in last year's report, audit fees can be an indicator of audit complexity, and analyzing changes in fees and how fee levels compare to those of comparable companies may provide insights into the company's level of audit risk.

Six Large Firms Describe Their Commitment to Audit Quality

The U.S. members of the six global network accounting firms issue annual audit quality reports. These reports describe the firm's commitment to audit quality, its performance on various self-selected quality-related audit metrics, and its plans to maintain and enhance the caliber of its audit performance. Because of their responsibility for the selection, evaluation, and retention of audit firms, audit committees are a key target audience for these reports.

The most recent reports for these six firms are listed below.

- BDO: 2023 Audit Quality Report: Cultivating the Seed of Audit Quality (undated, released June 25, 2024)
- Deloitte: Deloitte US 2024 Audit Quality Report (December 2024)
- Ernst & Young: Our commitment to audit quality (November 2024)
- Grant Thornton: Audit quality & transparency report 2023 (undated, released August 15, 2024)
- KPMG: FY24 Audit Quality Report (January 2025).
- PwC: Our focus on audit quality: 2024 Audit Quality Report (undated, released late 2024).

For a discussion of last year's reports, see Four Large Firms Report on How They See Their 2023 Audit Quality, January 2024 Update.

Report Content

Each report is primarily a narrative discussion of the firm's commitment to audit quality and how it seeks to achieve its quality objectives. The topics discussed in the reports vary from firm to firm, but include such matters as –

- A message from leadership regarding the firm's commitment to audit quality.
- A statement of the firm's culture and values, including the firm's commitment to ethics, and compliance with independence requirements.
- Discussion of how the firm defines audit quality and the ways in which it emphasizes quality in the performance of audit engagements.
- Description of how the firm monitors audit quality and the results of internal and external inspections.
- Recruiting, retention, and training of audit personnel, including commitment to workforce diversity.
- The role of technology in auditing, including the use of artificial intelligence.
- The firm's view of future auditing challenges and how it intends to address them.

- How the firm seeks to understand and incorporate into its practice the needs and interests of stakeholders, including whether and how the firm obtains independent input on governance or audit quality issues.

- The firm's governance structure, including identification of senior audit practice leadership.

For additional discussion of the typical content of this type of report, see CAQ's Guide to Audit Quality Reports, April 2023 Update.

Performance Metrics

The reports also contain metrics -- quantitative data relevant to audit performance. Since the reports are not subject to any common standard or content requirements, these metrics are not consistent across firms. One of the reasons that the PCAOB adopted rules to require disclosure of certain firm and engagement performance metrics was to standardize these disclosures, although it is unclear whether the SEC will permit those rules to take effect. See PCAOB Adopts Pared Back Engagement Performance Metrics and Audit Firm Reporting Rules, November 2024 Update and SEC Sidetracks PCAOB Engagement Metrics and Firm Reporting Rules in this Update.

Although the reports are not standardized, some measures are common to most of the reports. Below is an overview of how the current reports present eight metrics. Figures are for a firm's 2024 fiscal year, unless otherwise indicated.

1. PCAOB Inspection Results

PCAOB inspection reports are publicly available on the PCAOB's website. See 2023 PCAOB Large Firm Inspection Reports, August 2024 Update. Each of the firm quality reports includes the number (or percent) of audits in Part I.A. of their most recent PCAOB inspection report – 2022 or 2023, depending on when the quality report was issued. (Part I.A. describes engagements that the PCAOB found to have one or more deficiencies of such significance that the firm had not obtained sufficient appropriate evidence to support the audit opinion).

- BDO: "Our Part 1.A deficiency rates were 66% of 29 issuer audits inspected in 2022 and are expected to be higher in 2023, 53% of 30 issuer audits inspected in 2021, and 54% of 24 issuer audits inspected in 2020." (2023 Audit Quality Report, page 67)

- Deloitte: Seventy-nine percent of 56 audits inspected in 2023 inspection reports were without Part I.A findings. (2024 Audit Quality Report, pages 2 and 22)

- Ernst & Young: In the 2023 PCAOB inspection cycle, 22 engagements (37 percent of audits inspected) had Part I.A findings. (Our Commitment to Audit Quality, page 28)

- Grant Thornton: In Grant's 2023 PCAOB inspection report, 53.6 percent of inspected audits were included in Part I.A. (Audit Quality and Transparency Report 2023, page 18)

- KPMG: In KPMG's 2023 PCAOB inspection report, the PCAOB found Part I.A. deficiencies in 26 percent of inspected engagements. KPMG anticipates that its 2024 inspection report will have a 20 percent deficiency rate, "our lowest deficiency rate since at least 2009." (FY24 Audit Quality Report, pages 3, 7, and 11)

- PwC: In PwC's 2023 PCAOB inspection report, ten of 58 audits inspected were included in Part I.A. (2024 Audit Quality Report, page 5 and 45)

2. Use of Specialists

To address challenging or complex audit areas, firms typically assign personnel with specialized skills and knowledge to assist in assessing risk and designing and performing audit procedures.

- BDO: Audit hours performed by IT and tax professionals and auditor-employed specialists – 15 percent. (2023 Audit Quality Report, page 9)

- Deloitte: In FY2024, specialist hours were 17 percent of public company audit hours. Specialist hours are comprised of IT, tax, data analytics, valuation, and other. (2024 Audit Quality Report, pages 3 and 18)

- Ernst & Young: Percentage of U.S. public company audit hours generated by EY U.S. professionals with specialized skills -- 18.8 percent. Specialist hours are comprised of IT, tax, valuation, and other. (Our Commitment to Audit Quality, page 4)

- Grant Thornton: Information on specialist use not provided.

- KPMG: "In FY24, specialist hours were up 10% relative to FY21, exceeding 2.3 million hours." (FY24 Audit Quality Report, page 5)

- PwC: Specialists provided 16.9 percent of audit hours. (This includes hours incurred by acceleration center audit team members that performed work under the direct supervision of the specialist. The report states that acceleration centers, which are in the US, India, Argentina, Mexico, Malaysia, and the Philippines, "represent a global talent pool of people who work seamlessly with other team members to complete audit procedures for both public and non-public audits.") (2024 Audit Quality Report, pages 5 and 35; acceleration center described on page 19 and in footnote 10)

3. Restatements

The frequency with which financial statements on which the firm has expressed an opinion are subsequently restated is a common disclosure. Firms typically present this metric as the percentage of audited financial statements that were not restated.

- BDO: Information on restatements not provided.

- Deloitte: In FY 2024, 99.7 percent of issuer audit client (SEC registrants and registered investment companies) annual financial statements were not materially restated. There were five restatements. (2024 Audit Quality Report, page 20)

- Ernst & Young: In FY 2024, 15 restatements were filed by issuers that EY audits. The percentage of issuer audit clients that restated was 0.5 percent. This data reflects restatements that SEC registrants (including registered investment companies) reported in SEC filings to correct material errors in previously issued annual financial statements. (Our Commitment to Audit Quality, page 26 and footnote 40)

- Grant Thornton: Information on restatements not provided.

- KPMG: "[W]hen looking at restatement rates across public audits, the firm continues to perform well, and we have the lowest material restatement rate among global network firms." (FY24 Audit Quality Report, page 11)

- PwC: Issuer audit client 2023 annual financial statements that were restated in subsequent years – 0.1 percent (1 restated). For 2022 and 2021 financial statements, the comparable figures were

0.3 percent (5 restated) and 0.5 percent (9 restated), respectively. (2024 Audit Quality Report, page 37)

4. Number of Audit Professionals

In their audit quality reports, firms typically present a range of statistics on workforce size and composition, often with an emphasis on diversity. The number of employees in the audit practice is a measure of audit practice size.

- BDO: "[O]ver 3,700 U.S. assurance professionals." (2023 Audit Quality Report, page 15)
- Deloitte: Information on size of audit workforce not provided.
- Ernst & Young: Number of U.S. audit professionals on a full-time equivalent basis --13,540. (Our Commitment to Audit Quality, pages 4 and 18).
- Grant Thornton: In FY 2023, Grant had full-time equivalent audit/assurance personnel of 271 partners, 56 managing directors, 621 managers, and 1,845 associates. (Audit Quality and Transparency Report 2023, page 6)
- KPMG: 9,684 total audit personnel (1,385 partners/managing directors; 2,341 senior managers/managers; and 5,958 senior associates/associates). (FY24 Audit Quality Report, page 18)
- PwC: FY24 audit team members -- 16,235 (1,121 partners/managing directors, 2,565 directors/managers, 2,873 senior associates, 3,688 associates, and 5,988 acceleration center full-time equivalents. (2024 Audit Quality Report, page 19)

5. Leverage Ratio

The ratio of partners to staff is a measure of the availability of experienced, senior audit talent.

- BDO: Ratio of principals to all other assurance professionals – 1 to 7.7. (2023 Audit Quality Report, page 8)
- Deloitte: In FY 2024, the ratio of partners, principals, managing directors, senior managers, and managers to seniors and staff was 1 to 2.7. Partner, principal, managing director, and senior manager hours were 17 percent of public company audit hours. (2024 Audit Quality Report, page 18)
- Ernst & Young: Fiscal 2024 ratios of partners and managing directors to staff through senior managers --1 to 8.8. (Our Commitment to Audit Quality, page 20)
- Grant Thornton: FY 2023 ratio of partners to non-partners – 1 to 9 (Audit Quality and Transparency Report 2023, page 6)
- KPMG: Information on the ratio of partners to staff not provided. The information described above on the number of audit professionals implies that the ratio of partners and managing directors to other audit professionals is 1 to 5.0 (2,341 senior managers/managers + 5,958 senior associates/associates ÷ 1,385 partners/managing directors)
- PwC: The ratio of partners/managing directors to all other audit team members (including acceleration center FTEs) was 1 to 13.7; excluding acceleration centers, the ratio was 1 to 8.3. (2024 Audit Quality Report, pages 4 and 33)

6. Partners and Managing Directors Involved in Quality or Audit Oversight

Each firm assigns some partners and other senior personnel to provide oversight and guidance on issues relating to audit quality. The ratio of these professional practice or quality management partners to the total audit partner population is a data point regarding the firm's audit quality resources.

- BDO: Ratio of professional practice, quality management, inspections, and independence professionals to client-facing assurance professionals -- 1 to 17 (2023 Audit Quality Report, page 21)
- Deloitte: FY 2024 ratio of partners, principals, and managing directors in technical roles to total PPMDs -- 1 to 10. (2024 Audit Quality Report, page 19)
- Ernst & Young: Ratio of quality network and professional practice partners and managing directors to all audit and IT partners and managing directors – 1 to 6 (Our Commitment to Audit Quality, pages 4 and 24)
- Grant Thornton: FY2023 ratio of direct client-serving partners/managing directors to national office support partners/managing directors – 4.86 to 1. Number of client-serving full-time equivalents to national office FTEs -- 21.04 to 1 (Audit Quality and Transparency Report 2023, page 13)
- KPMG: Ratio of professional practice or quality management partners to the total audit partner population not provided.
- PwC: The ratio of partner/managing directors serving in technical support roles to total partners/managing directors was 1 to 5.7. (2024 Audit Quality Report, pages 5 and 36)

7. Audit Staff Turnover

Audit firms typically experience turnover as personnel take advantage of the training and expertise gained in auditing to move to employment opportunities in other aspects of business and finance. Turnover can be an issue for audit quality since new hires may require training and may not initially be familiar with the clients to which they are assigned.

- BDO: FY 2023 assurance practice retention rates: Principals and directors – 87 percent; managers – 85 percent; seniors and staff – 80 percent. (2023 Audit Quality Report, page 46)
- Deloitte: FY 2024 voluntary turnover rate -- 12 percent. (2024 Audit Quality Report, page 26)
- Ernst & Young: "Our retention at all ranks below partner (including managing directors) was 79%, 78% and 71% for fiscal 2024, 2023 and 2022, respectively." In fiscal 2024, the overall retention rate of U.S. audit staff was 84 percent for senior managers and managers and 76 percent for seniors and staff. (Our Commitment to Audit Quality, page 18)
- Grant Thornton: FY 2023 average annual retention rates by level: Managing director -- 93 percent; manager/senior manager/director -- 86 percent; senior associate – 74 percent; associate – 83 percent. (Audit Quality and Transparency Report 2023, page 7)
- KPMG: The FY24 retention level was 87 percent for managers and 77 percent for associates. (FY24 Audit Quality Report, page 18)
- PwC: The overall average annual voluntary turnover rate was 12.7 percent. By rank, the voluntary turnover rate was 11.3 percent for managing directors/directors/managers, 16.4 percent for senior associates, and 10.5 percent for associates. (2024 Audit Quality Report, page 4 and 25)

8. Continuing Professional Education

Professional education for audit staff personnel is an essential aspect of maintaining audit quality.

- BDO: "Our assurance professionals' average CPE hours for 2023 remains significantly higher than the minimum requirements and ranged from 57 to 87 average CPE hours depending on professional level." (2023 Audit Quality Report, page 53)

- Deloitte: 2024 average continuing education hours: Staff – 154; seniors – 145; managers/senior managers – 122; managing directors/partners – 82. Total continuing education hours were 2.6 million and average continuing education hours per person were 139. (2024 Audit Quality Report, page 27)

- Ernst & Young: Fiscal 2024 average learning hours (including IT professionals who worked on audits) – 101. (Our Commitment to Audit Quality, page 21)

- Grant Thornton: Average training hours by level in calendar year 2023: Partner, principal, managing director – 53; manager/senior manager/director – 72; senior associate – 65; associate – 66. (Audit Quality and Transparency Report 2023, page 15)

- KPMG: Average FY24 CPE hours by job level: Associate – 94; senior associate – 40; manager – 59; senior manager/director – 52; managing director – 58; partner/principal – 58. (FY24 Audit Quality Report, page 20)

- PwC: Each audit professional completed an average of 90 training hours. (2024 Audit Quality Report, pages 5 and 26)

Audit Committee Takeaways

These quality reports have become increasingly detailed and sophisticated. Audit committees should review their audit firm's audit quality report as part of their evaluation of the firm's performance and consideration of whether to continue to engage the firm. The reports may also serve as a basis for discussion among committee members and with the engagement partner regarding how the firm views audit quality and how its efforts to enhance quality may affect the company's audit. Similarly, audit committees considering a new auditor should examine the quality reports of the competing firms. Although these reports provide a significant amount of useful information, they may be less effective for comparing firms due to differences in content and varying methodologies for computing metrics.

On the Update Radar: Things in Brief

SEC Sidetracks PCAOB Engagement Metrics and Firm Reporting Rules. The Securities and Exchange Commission has postponed its decision whether to approve the PCAOB's firm and engagement performance metrics and firm reporting rules until March. It is uncertain whether these rules will become effective in their current form.

On November 21, the PCAOB adopted rules requiring registered accounting firms to disclose performance metrics regarding their larger audit engagements. These rules require firms that audit accelerated filers or large accelerated filers to publicly report eight metrics relating to specific audit engagements or to the firm's overall audit practice (e.g., hours worked by senior professionals relative to more junior staff across all of the firm's large accelerated and accelerated filer engagements and on each specific engagement). The Board also adopted expanded firm operational and financial condition reporting. Under the firm reporting rules, PCAOB-registered accounting firms would be required to disclose financial information (e.g., aggregate fees billed to issuer clients), governance information (e.g., the names of the individuals holding certain leadership positions), network relationships, and material events impacting the firm's audit services. See PCAOB Adopts Pared Back Engagement Performance Metrics and Audit Firm Reporting Rules, November 2024 Update.

PCAOB rules do not take effect unless the SEC approves them, and the Commission is required to solicit public comment before making approval decisions. The SEC published the firm reporting and performance metrics rules for comment in early December, and the comment periods expired on December 26 and January 2, respectively. Both rules attracted considerable comment. Opponents, including several of the large accounting firms, the AICPA, the Center for Audit Quality, and the U.S. Chamber of Commerce, argued that the rules had been rushed to approval without a full analysis of their costs and benefits, and that the performance metrics were potentially misleading. The American Bar Association's Law and Accounting Committee questioned the PCAOB's authority to require the performance metrics disclosures. On the other hand, investor advocates, including the CFA Institute, the Council of Institutional Investors, and the Consumer Federation of America strongly supported the rules, arguing that they would provide audit committees and investors with useful information that would better inform decision-making and auditor evaluation.

On January 14, the SEC issued an order extending the public comment period on both rules until February 4, 2025. Under the statute governing SEC approval of PCAOB rules, this postpones the deadline by which the Commission must approve the rules or institute a formal proceeding to determine whether to disapprove them until March 5 for firm reporting and until March 11 for performance metrics. If the Commission fails to either approve a proposed rule or institute disapproval proceedings before the statutory deadline, the rule is deemed to have been approved.

In conjunction with the change in the Presidential administration, SEC Chair Gensler resigned from the Commission on January 20 and Democratic Commissioner Lizárraga resigned on January 17. President Trump has announced his intention to nominate former SEC Commissioner Paul Atkins as the new SEC Chair, but Mr. Atkins is unlikely to take office by March. Accordingly, the Commission that will decide whether to approve these rules will consist of Hester Peirce, Mark Uyeda, and Carolin Crenshaw. Both Commissioners Peirce and Uyeda have been critical of prior proposals from the current PCAOB and, given the objections raised in the public comments, it is possible that one or both of these Commissioners will not vote to approve the pending rules. Moreover, regardless of the fate of the current proposals, after Paul Atkins takes office and the Commission makes decisions on the membership of the PCAOB going forward, it is possible that these topics will be revisited.

What Should be on the Audit Committee's 2025 Agenda? – Part II. The December 2024 Update included discussion of four papers that suggest issues on which audit committees should focus in 2025. See What Should be on the Audit Committee's 2025 Agenda?, December 2024 Update. An additional paper is now available. In early January, the Deloitte Center for Board Effectiveness released On the Audit Committee's Agenda: Looking Ahead to 2025 setting forth its suggestions.

Deloitte observes that serving on an audit committee in 2025 "might be daunting" and that "the number and complexity of new issues and concomitant responsibilities" audit committees face is likely to grow. With the caveat that "a complete list of such issues would be far longer than can be addressed in this publication," Deloitte focuses on four areas:

- Regulation. Audit committees should anticipate significant changes in regulatory priorities, financial reporting, and corporate governance due to the changes in Presidential and SEC administrations. While the future of the SEC's climate change disclosure rules is uncertain, it may not be feasible for companies to delay developing controls to comply with the rules, particularly because of the need to comply with other climate disclosure regimes, such as those of the EU and California. Recent SEC enforcement has emphasized internal controls and disclosure controls, but audit committees should follow the new SEC chair's priorities to understand where future enforcement actions may focus. The priorities of the PCAOB may also shift, and audit committees should be alert for developments, such as the future of the PCAOB's NOCLAR proposal. Audit committees should engage with their independent auditor regarding the results of any PCAOB inspection of the company's audit and the firm's overall inspection results. Audit committees should also ensure that the company's proxy statement provides adequate disclosure about auditor selection and oversight.

- Technology. GenAI and cybersecurity will continue to be important audit committee challenges. Artificial intelligence impacts areas for which audit committees have responsibility, such as risks associated with AI use, especially for financial reporting and internal control purposes. Cyber-security will continue to be a top priority considering "the proliferation of breaches, the extent to which nation-state actors have become more active hackers, the greater consequences of a breach or a ransomware attack, and the regulatory environment," including SEC disclosure requirements.

- Enterprise Risk Management. Many audit committees are taking a fresh look at ERM programs to assess whether they are still effective due to the proliferation of new risks (e.g., those associated with GenAI), increased geopolitical risk, the complexity and increased inter-relationships of various risks, or simply because ERM programs may become stale or perfunctory. Audit committees might consider regularly revisiting ERM – preferably quarterly -- to be sure that management is continuously refreshing the program.

- Audit Committee Effectiveness. Audit committees should consider how they can be more efficient and effective. Deloitte suggests prioritizing items on meeting agendas and using "consent" agendas to act on routine matters without discussion. Audit committees should also consider "which matters properly reside with the audit committee and, in appropriate circumstances, pushing back on responsibilities that others seek to place on the audit committee agenda."

The report concludes with a list of questions to guide board consideration of whether to modify committee structure or the matters assigned to particular committees.

California Will Go Easy on Enforcement of GHG Emissions Reporting in 2026.

The California Air Resources Board (CARB) has announced that it will not take enforcement action during the first reporting year against companies that fail to make complete greenhouse gas (GHG) emissions disclosure as required under California Senate Bill 253. In an Enforcement Notice issued on December 5, 2024, CARB stated that it will "exercise its enforcement discretion such that, for the first report due in 2026, reporting entities may submit scope 1 and scope 2 emissions from 'the reporting entity's prior fiscal year' that can be determined from information the reporting entity already possesses or is already collecting at the time this Notice was issued." This relief is conditioned on a reporting entity's demonstration of good faith efforts to comply with the law. CARB says its objective is to support entities actively working toward full compliance.

Senate Bill 253, the Climate Corporate Data Accountability Act, requires U.S. public or private entities with annual global revenue exceeding $1 billion that do business in California to report their Scope 1, Scope 2, and Scope 3 GHG emissions. See California Outflanks the SEC on Climate Disclosure, October 2023 Update. The first reports are due in 2026 (on a date yet to be established by CARB) and cover Scope 1 and Scope 2 emissions during the reporting entity's 2025 fiscal year. Last Fall, the California legislature made minor changes to the law but declined Governor Newsom's request to postpone the reporting deadline. See California Tweaks its Climate Disclosure Law But Reporting Deadlines are Unchanged, November 2024 Update.

A second California law, the Climate-Related Financial Risk Act, requires U.S. public or private entities with annual global revenue exceeding $500 million that do business in California to disclose their climate-related financial risks and the measures they have adopted to reduce and adapt to those risks. The first reports under this law are due on or before January 1, 2026, That deadline has not been extended.

Audit committees that have not already done so should discuss with management whether the company is subject to the California climate disclosure requirements and, if so, whether it has processes in place to collect the information needed to comply. Audit committees and managements of companies subject to the GHG emissions disclosure requirement should also consider whether the company can fully report Scope 1 and 2 GHG emissions for FY 2025 and, if not, how it would demonstrate good faith efforts to work toward full compliance.

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For further information, please contact:

Daniel L. Goelzer
301.288.3788
dangoelzer@gmail.com

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