SEC Officials Issue Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities

Top officials at the Securities and Exchange Commission ("SEC") recently released the *Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities* ("Statement").[1] The Statement represents the views of the Chairman, Chief Accountant, and Director of the Division of Corporation of Finance, and is not a rule, regulation, or statement of the SEC, which traditionally has not opined on matters of corporate governance. That said, the Statement is important guidance for audit committees of public companies to consider.

The Statement places great emphasis on the importance of audit committees being active and proactive. According to the Statement, audit committees should focus on the "tone at the top" – meaning they should set a standard for clear and candid communications with both the auditor and management. Audit committees proactively should discuss audit strategy and status with the auditor. This includes the year-end financial reporting process under Public Company Accounting Oversight Board Auditing Standard 1301, which requires the auditor to communicate with the audit committee regarding certain matters related to the conduct of the audit and to obtain certain relevant information from the audit committee. When reporting and control issues do arise, audit committees are encouraged to ask the auditor specific questions about their resolution, and to keep management apprised of any ongoing concerns.

The Statement encourages audit committees to engage proactively with management and auditors in the adoption and implementation of generally accepted accounting principles ("GAAP") standards. Audit committees should have an understanding of management's process to establish and monitor controls and procedures over adoption of – and transition to – these new standards. Audit committees also are encouraged to consider periodically the sufficiency of the auditor's and the issuer's monitoring process to ensure auditor independence. These procedures should address corporate changes or other events that could affect auditor independence and facilitate the timely communication of these events and changes to the audit firm.

Internal controls are another important consideration. The Statement encourages audit committees to have a detailed understanding of any identified internal control over financial reporting ("ICFR") issues and to engage proactively in their resolution. This includes an understanding of management's remediation plans for any identified ICFR issue. Audit committees should communicate clearly that prompt, effective remediation is a high priority.

The Statement also addresses non-GAAP measures, which have been a focus of the SEC's Division of Enforcement in recent years. The Statement encourages audit committees to understand whether, how, and why management uses non-GAAP measures and performance metrics in their financial reporting, performance evaluation, and internal decision making. Audit committees should understand how these non-GAAP measures and metrics are utilized by management, whether they are consistently prepared and presented from period to period, and the company's related policies and disclosure controls and procedures.

The Statement also dives into the nuances of reference rate reform. Audit committees specifically are encouraged to understand management's plan to identify and address the risks associated with the expected discontinuation of LIBOR in the face of reference rate reform. Audit committees should

[1] *Available at* https://www.sec.gov/news/public-statement/statement-role-audit-committees-financial-reporting

understand the impact on accounting and financial reporting and any related issues associated with financial products and contracts that reference LIBOR.

Finally, the Statement addresses the importance of communication with auditors. For example, the Statement encourages audit committees to engage in substantive dialogues with their auditors regarding critical audit matters ("CAMs") that will be included in the auditor's report. Audit committees should maintain a dialogue with the auditor and seek to understand the nature of each CAM and how it is expected to be described in the auditor's report.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to call or email Bradley J. Bondi at 202.862.8910 or bbondi@cahill.com; Brock Bosson at 212.701.3136 or bbosson@cahill.com; Chérie R. Kiser at 202.862.8950 or ckiser@cahill.com; Joel Kurtzberg at 212.701.3120 or jkurtzberg@cahill.com; Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; John Papachristos at 212.701.3691 or jpapachristos@cahill.com; or Ross Sturman at 212.701.3831 or rsturman@cahill.com.