

January 7, 2020

Audit Committee Oversight of Financial Reporting

SEC Senior Staff Joint Statement Includes Observations and Reminders for Audit Committees on Oversight of Financial Reporting

SUMMARY

On December 30, 2019, SEC Chairman Jay Clayton, Sagar Teotia, Chief Accountant, and William Hinman, Director of the Division of Corporation Finance, issued a joint statement providing observations and reminders on a number of key areas of focus for audit committees as they approach the calendar year-end financial reporting season.¹ The statement includes a number of general observations about the audit committee's role in the oversight of financial reporting, followed by specific discussion on the audit committee's role in oversight of the use of non-GAAP financial measures, risks related to LIBOR reform and the implementation of critical audit matters. The statement stresses the significant oversight responsibility expected of independent audit committees.

GENERAL OBSERVATIONS

- ***“Tone at the Top.”*** Audit committees should set the tone for an issuer's financial reporting and the relationship with the independent auditor, including by actively communicating with the independent auditor to understand the audit strategy and status and to understand issues presented by the auditor and their ultimate resolution.
- ***Auditor Independence.*** Audit committees have an integral role in supporting the issuer and the auditor in the auditor's compliance with the auditor independence rules. Among other items, audit committees should consider corporate changes or other events that might affect auditor independence and timely communicate these events and changes to the auditor.
- ***Generally Accepted Accounting Principles.*** The statement encourages audit committees to promote an environment for management's successful implementation of new accounting standards, particularly in light of recently implemented standards, such as the new revenue and leases standards. Audit committees should regularly engage with management and understand the processes established by management to adopt and implement the new standards.

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- **ICFR.** Audit committees are responsible for overseeing internal control over financial reporting (ICFR), including in connection with their consideration of management's assessment of ICFR effectiveness and, when applicable, the auditor's attestation. If material weaknesses exist, audit committees must understand and monitor management's remediation plans and set an appropriate tone that prompt, effective remediation is a high priority.
- **Communications to the Audit Committee from the Auditor.** The statement reminds audit committees that under PCAOB AS 1301, *Communications with Audit Committees*, the auditor is required to communicate with the audit committee regarding certain matters related to the conduct of the audit and to obtain certain information from the audit committee relevant to the audit, including, among other items, matters related to certain accounting policies and practices, estimates and significant unusual transactions. Audit committees are encouraged to incorporate this dialogue in carrying out their responsibilities.

SPECIFIC TOPICS

- **Non-GAAP Financial Measures.** The statement reminds audit committees to be actively engaged in the review and presentation of the issuer's non-GAAP financial measures. The statement specifically notes that this obligation includes an understanding of how and why management is using particular non-GAAP financial measures. The audit committee should also ensure that non-GAAP measures are presented fairly and in compliance with all applicable rules and that they are consistently prepared and presented from period to period. The statement encourages audit committees to be involved in the company's disclosure controls and procedures relating to non-GAAP financial measures.
- **LIBOR Reform.** The statement encourages audit committees to assist management in identifying and addressing risks associated with LIBOR discontinuation, including specifically the impact on accounting and financial reporting and any related issues associated with financial products and contracts that reference LIBOR.²
- **Critical Audit Matters.** The statement encourages audit committees to continue ongoing efforts to understand the new standard for critical audit matters and to remain engaged with auditors during the implementation process.³

IMPLICATIONS

In light of prior and continued focus on the three specific topics described above, audit committees that have not already spent significant time on these matters may wish to consider including them on the agenda for their review of the year-end financial statements. More generally, audit committees should take the statement's general observations into account as they identify areas of focus and evaluate their processes and procedures for financial reporting oversight. Finally, management should also keep the statement's guidance in mind as management fulfills its role in providing audit committees with the resources and support they need in connection with their oversight responsibilities.

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ENDNOTES

- ¹ For the full text of the statement, please see, “Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities,” dated December 30, 2019, *available at* <https://www.sec.gov/news/public-statement/statement-role-audit-committees-financial-reporting>.
- ² For a detailed discussion of risks to consider associated with the expected discontinuation of LIBOR, please see our Memorandum to Clients, “Key Considerations for Fiscal Year 2019 Form 10-K and 20-F Filings” (Jan. 7, 2020) *available at* <https://www.sullcrom.com/files/upload/SC-Publication-Key-Considerations-for-Fiscal-Year-2019-Form-10-K-and-20-F-Filings.pdf>.
- ³ For a detailed discussion of items to consider with respect to the implementation of the critical audit matters requirement, please see our Memorandum to Clients, “Key Considerations for Fiscal Year 2019 Form 10-K and 20-F Filings” (Jan. 7, 2020) *available at* <https://www.sullcrom.com/files/upload/SC-Publication-Key-Considerations-for-Fiscal-Year-2019-Form-10-K-and-20-F-Filings.pdf>.

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CONTACTING SULLIVAN & CROMWELL LLP

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CONTACTS

New York

Ari B. Blaut	+1-212-558-1656	blauta@sullcrom.com
Robert E. Buckholz	+1-212-558-3876	buckholzr@sullcrom.com
Whitney A. Chatterjee	+1-212-558-4883	chatterjee@sullcrom.com
Catherine M. Clarkin	+1-212-558-4175	clarkinc@sullcrom.com
Donald R. Crawshaw	+1-212-558-4016	crawshawd@sullcrom.com
Robert G. DeLaMater	+1-212-558-4788	delamaterr@sullcrom.com
Robert W. Downes	+1-212-558-4312	downesr@sullcrom.com
John E. Estes	+1-212-558-4349	estesj@sullcrom.com
William G. Farrar	+1-212-558-4940	farrarw@sullcrom.com
Joseph A. Hearn	+1-212-558-4457	hearnj@sullcrom.com
John P. Mead	+1-212-558-3764	meadj@sullcrom.com
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
Rebecca J. Simmons	+1-212-558-3175	simmonsr@sullcrom.com
William D. Torchiana	+1-212-558-4056	torchianaw@sullcrom.com
Benjamin H. Weiner	+1-212-558-7861	weinerb@sullcrom.com

Washington, D.C.

Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com
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Los Angeles

Patrick S. Brown	+1-310-712-6603	brownp@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com

SULLIVAN & CROMWELL LLP

Palo Alto

Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
John L. Savva	+1-650-461-5610	savvaj@sullcrom.com

London

Chris Beatty	+44-20-7959-8505	beattyc@sullcrom.com
Kathryn A. Campbell	+44-20-7959-8580	campbellk@sullcrom.com
Oderisio de Vito Piscicelli	+44-20-7959-8589	devitopiscicellio@sullcrom.com
John Horsfield-Bradbury	+44-20-7959-8491	horsfieldbradburyj@sullcrom.com
John O'Connor	+44-20-7959-8515	oconnorj@sullcrom.com
Evan S. Simpson	+44-20-7959-8426	simpsons@sullcrom.com

Paris

William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
----------------------	-----------------	--

Frankfurt

Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
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Sydney

Waldo D. Jones Jr.	+61-2-8227-6702	jonesw@sullcrom.com
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Tokyo

Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com
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Hong Kong

Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
Michael G. DeSombre	+852-2826-8696	desombrem@sullcrom.com
Ching-Yang Lin	+852-2826-8606	linc@sullcrom.com
Chun Wei	+852-2826-8666	weic@sullcrom.com

Beijing

Gwen Wong	+86-10-5923-5967	wonggw@sullcrom.com
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