

SEC Reporting & Compliance Alert

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SEC Chairman and Senior Staff Members Share Key Reminders for Audit Committees

In December 2019, U.S. Securities and Exchange Commission (SEC) Chairman Jay Clayton, SEC Chief Accountant Sagar Teotia and Division of Corporation Finance Director William Hinman jointly issued a [statement](#) (Statement) providing important reminders on the role and responsibilities of public company audit committees.

Acknowledging the vital role of audit committees in the financial reporting system through their oversight of financial reporting, including the internal control over financial reporting (ICFR) and the external, independent audit process, the Statement seeks to promote efficient and constructive dialogue among audit committees, management and independent auditors. The Statement also suggests that companies and independent auditors should be mindful of the considerations it outlines and ensure that audit committees have the resources and support needed to fulfill their obligations. Below is a summary of the reminders included in the Statement.

General Observations

Tone at the Top. The Statement encourages audit committees to focus on the “tone at the top” to create and maintain an environment that supports the integrity of the financial reporting process, the independence of the audit and clear and candid communications among the audit committee, management and the auditor. In addition, the Statement encourages audit committees to communicate proactively with the independent auditor to understand the audit strategy and status, and ask questions regarding any issues and understand their ultimate resolution.

Auditor Independence. The Statement reminds companies that the audit committee performs a “critical role in auditors’ compliance with the auditor independence rules.” The Statement encourages audit committees to consider periodically the sufficiency of the auditor’s and the company’s monitoring processes. The Statement explains that these processes should, among other things, address and facilitate timely communication with the audit firm of any corporate changes or other events that could affect auditor independence. These include changes or events that may result in new affiliate relationships, such as the company’s appointment of a new director or officer who is affiliated with the audit firm.

Generally Accepted Accounting Principles (GAAP). The Statement highlights the importance of the audit committee’s role in management’s successful implementation of new GAAP standards, such as the new revenue and leases standards. The Statement encourages

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audit committees to proactively engage with management and auditors in the implementation process of new accounting standards to understand management's implementation plan, including whether it provides for sufficient time and resources to develop well-reasoned judgments and accounting policies. The Statement also explains that audit committees should understand the management's internal control processes related to the adoption of, and transition to, new GAAP standards.

Internal Control Over Financial Reporting. Referencing the audit committee's responsibility for overseeing ICFR, the Statement observes that audit committees are most effective when they have a detailed understanding of identified ICFR issues and engage proactively to aid in their resolution. The Statement also explains that if material weaknesses exist in ICFR, the audit committee should 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 Independent Auditor. The Statement reminds audit committees of the year-end financial reporting processes required by the Public Company Accounting Oversight Board's auditing standard AS 1301, *Communications with Audit Committees*, 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. These communications may involve matters related to, among others, certain accounting policies and practices, estimates and significant unusual transactions. The Statement encourages audit committees to take into account this dialogue when fulfilling their oversight responsibilities.

More Specific Observations

Non-GAAP Measures. The Statement acknowledges that non-GAAP measures and other metrics, when used appropriately, can provide decision-useful information to investors. The

Statement encourages audit committees, however, to actively engage in the review of such non-GAAP measures and other metrics to understand how management uses them to evaluate performance, whether they are consistently prepared and presented from period to period and the company's related policies and disclosure controls and procedures.

London Interbank Offered Rate (LIBOR). The Statement notes that many companies may face material risks associated with the expected discontinuation of LIBOR. The Statement encourages audit committees to understand management's plan to identify and address the risks associated with reference rate reform and, specifically, the impact on accounting and financial reporting and any related issues associated with financial products and contracts that reference LIBOR. The SEC staff discusses additional considerations regarding the LIBOR transition in the July 2019 "[Staff Statement on LIBOR Transition](#)."

Critical Audit Matters (CAMs). Auditor reports for certain public companies are now required to include a section addressing CAMs. The Statement encourages audit committees to engage in a substantive dialogue with the auditor regarding the audit and expected CAMs in order to understand the nature of each CAM, the auditor's basis for the determination of each CAM and how each CAM is expected to be described in the auditor's report. In addition, the Statement explains that the discussion of CAMs in the auditor's report should capture and be consistent with the auditor-audit committee dialogue regarding those matters.

Next Steps

The Statement does not introduce any new concepts or requirements that would expand the scope of an audit committee's existing responsibilities or the disclosure obligations of public companies. Nevertheless, management and audit committees of public companies should take these observations and reminders into account, to the extent applicable, as part of their annual and ongoing reporting and communication requirements.

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