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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 of the company's relationship with its auditor.

In This Update:

PCAOB Staff Previews 2018 Inspections Results

One of the challenges in understanding the implications of the PCAOB's inspection program is that inspection reports are frequently not issued until several years after the engagements reviewed were performed. In fact, the Board has not yet issued all the inspection reports resulting from its 2017 large firm inspections (which generally reviewed FY 2016 audits). See PCAOB 2017 Inspections Status Report in this Update.

One of the PCAOB's stated objectives is more timely communication. Apparently as a step in that direction, on May 6, the PCAOB staff released Staff Preview of 2018 Inspection Observations. This document provides a high-level summary of the findings of the 2018 inspection cycle, even though the underlying inspection reports have not yet been published. The staff states that the Preview may be useful to auditors as they plan and perform current audits and to audit committees as they engage with their auditors.

In 2018, the PCAOB inspected more than 160 firms and reviewed portions of approximately 700 public company audits. These inspections were performed in the U.S. and 30 other jurisdictions. The Preview provides the staff's observations as a result of these inspections in three areas – good practices to improve audit quality; common audit deficiencies; and a group of additional topics, including audit committee communications.

Good Practices to Improve Audit Quality

The PCAOB has sometimes been criticized for focusing only on deficiencies and failing to note "good practices" observed in its inspections. The Preview responds to this criticism by listing six practices identified in the 2018 inspections "that we believe influence continued improvement in audit quality."

- Expanding accountability for audit quality beyond the lead engagement partner. The staff notes that some firms have established programs to reward or penalize engagement partners, engagement quality reviewers, and others in leadership roles "depending on whether the audits in which they participated are found by external or internal inspections to have deficiencies."

- Developing and refining guidance to help auditors identify and assess risks of material misstatement.

- Revising training programs. Training programs that favorably impressed the inspections staff included those that "use real-world examples to more effectively illustrate where things might go wrong in an audit."

- Providing additional support from experienced personnel not assigned to the audit.

- Establishing a network of specialized professionals to address emerging risks. For example, some audit firms have established a group of cybersecurity experts that can be deployed if an audit client experienced a cybersecurity incident.

- Providing new or enhanced audit tools in areas of significant judgment. This includes furnishing engagement teams with examples illustrating the nature and extent of evidence necessary to audit accounting judgments effectively.

Common Audit Deficiencies

Not surprisingly, deficiencies observed in 2018 are consistent with those identified in prior inspection cycles. See, e.g., PCAOB Staff Highlights 2016 Inspection Findings, November-December 2017 Update. The Preview highlights four areas in which 2018 inspections found audit deficiencies.

- Internal Control over Financial Reporting. Two recurring issues in ICFR auditing are failure to sufficiently test the design and operation of controls that include a review element (e.g., failure to obtain an understanding of activities performed and factors considered when the control owner reviews the reasonableness of estimates) and failure to select controls for testing that address specific assessed risks of material misstatement.

- Risk Assessment and Revenue. The staff cites as examples of deficiencies in this area failure to test whether invoices agreed to the terms of the underlying contract; failure to obtain evidence that invoiced services or products were actually delivered; and limiting testing to revenue transactions exceeding a certain amount or recorded near year-end without considering the need to test the remainder of the population.

- Accounting Estimates. The Preview states that estimates often involve "unobservable inputs, complex valuation models, and/or subjective judgments." Many of the deficiencies identified in this area involve inadequate evaluation of the assumptions underlying valuation models. Auditing of allowances for loan and leases losses, accounting for business combinations, and financial instrument valuations are areas in which such deficiencies were observed.

- Engagement Qualify Review. In every public company audit, a partner not involved in performing the engagement is required to review the audit team's judgments and sign off before the audit report is issued. This individual is referred to as the engagement quality reviewer (EQR). The Preview states that many of the deficiencies identified by inspectors were missed by EQRs and that

"EQRs may have placed too much reliance on discussions with the engagement team" or may have "limited their review by reading summary memos that did not provide sufficient detail to allow for a review with due professional care."

Observations on Technology, Implementation of New Standards, and Audit Committee Communications

The Preview also describes staff observations in four other areas. Except for the comments on audit committee communications, these observations focus more on trends in auditing than on deficiencies.

- Cybersecurity Risk. In approximately 10 percent of the 2018 engagement inspections, the company had experienced a cybersecurity incident. The staff observes that "auditors generally considered the cybersecurity incident in their risk assessments and modified their audit procedures, as needed, to address the potential impact on relevant controls and the data generated by the company's information technology systems."

- Software Audit Tools. The staff observed the use of data analytics as part of risk assessment. However, while firms are "actively considering" the application of artificial intelligence and robotic process automation to auditing, inspectors did not see AI or RPA in use during 2018 inspections.

- Implementation of New Standards and Rules. Firms have revised their audit methodologies and conducted training in preparation for adoption of new accounting standards related to revenue, leases, current expected credit losses, and financial instruments. Firms have also been performing pilot testing and creating methodologies to identify and communicate critical audit matters in their reports. (See PCAOB Staff Dives into CAM Reporting in this Update.) However, as to the new requirement that the audit firm file a report on Form AP listing the engagement partner and any other accounting firms that participated in the audit, inspectors found that some smaller firms failed to comply.

- Audit Committee Communications. In its inspections of smaller firms, the staff found deficiencies in compliance with the PCAOB's audit committee communications requirements.

  > "* * * [W]e continue to identify deficiencies related to auditors failing to communicate to the audit committee significant risks identified in the audit, including changes to those risks throughout the audit. Some of these deficiencies arose because the auditor failed to communicate the fraud risks related to management override of controls. Communicating significant risks to audit committees is required by PCAOB standards and assists audit committees in exercising their oversight responsibilities. Such communications may also help audit committees better understand the external and company-specific factors considered by the auditor in assessing whether all significant risks have been identified."

Comment: The Preview provides insight that may be useful to audit committees in understanding what areas of the company's audit are likely to attract the attention of the PCAOB's inspection staff. The PCAOB's recent Outlook for Audit Committees, outlining the objectives of its 2019 inspections program is also helpful in this regard. See We're From the PCAOB and We're Here to Help You: 2019 Staff Inspections Outlook for Audit Committees, March 2019 Update. The Preview may also aid audit committees in understanding their auditor's risk assessments and resource allocations. For example, from the auditor's perspective, obtaining an in-depth understanding of how review controls operate is a necessary response to a common PCAOB inspection finding.

With respect to the staff observation regarding audit committee communications, this appears to be an area on which the PCAOB is focusing. Two weeks prior to the publication of the Preview, the PCAOB sanctioned an auditor for failure to comply with the audit committee communications requirements. The case involved the understatement of the allowance for loan losses by a bank holding company that was a major mortgage originator. According to the PCAOB's order (entered by consent as part of a settlement), the engagement partner was aware of defects in the manner in which the allowance was determined. He also learned, shortly before issuing the audit opinion, that the allowance may have been understated by at least $30 million (about 15 percent). The PCAOB's standards require that auditors communicate to the audit committee matters that are significant to the oversight of the company's financial reporting process, including "complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention." The engagement partner did not communicate any concerns regarding the allowance to the audit committee. The PCAOB found that he violated the communications requirements (along with numerous other violations) and barred him from future public company auditing. See In the Matter of Timothy M. Kosiek, PCAOB Release No. 105-2019-010 (April 26, 2019).

CAQ on CECL: Help for Audit Committees on Oversight of New Credit Losses Accounting Standard Implementation

Many public companies – particularly financial institutions – are currently struggling with implementation of the new accounting standard on credit losses. The new standard shifts from an incurred loss model, which values financial assets based on losses actually incurred at the time of measurement, to a current expected credit losses (CECL) model, which requires the company to forecast losses that are likely to occur over the life of the asset. Unlike the incurred loss model, CECL is forward-looking and seeks to provide insight into a portfolio's future risks. For public companies, the standard is effective for fiscal years (and interim periods within those years) beginning after December 15, 2019.

The Center for Audit Quality has issued Preparing for the New Credit Losses Standard: A Tool for Audit Committees to assist audit committees in overseeing implementation of the new standard. The CAQ's publication provides examples of questions audit committees may want to ask management and the auditor concerning the company's CECL implementation efforts. A brief overview of the CAQ's guidance appears below.

Understanding the Standard

The new standard applies to most financial assets that are not measured at fair value through net income. Most debt instruments (other than available-for-sale debt securities), trade receivables, lease receivables, reinsurance receivables, financial guarantee contracts, and loan commitments will be subject CECL. The model must be applied at the initial recording of the asset, based on consideration of current conditions and forecasts that are reasonable and supportable to estimate expected credit loss over the life of the asset. In estimating lifetime credit losses, the company must segregate financial assets into pools based on similar risk characteristics. The CAQ's tool includes a list of twelve points audit committees should be aware of regarding the new standard.

Evaluating the Company's Impact Assessment

While the new standard will affect most companies, the degree of impact will depend on company-specific factors. Management may perform an impact assessment which can guide the implementation plan, including consideration of resource needs. The CAQ suggests five areas of audit committee inquiry to aid the committee in evaluating management's impact assessment:

1. How has the standard's impact on the company been assessed?

2. Were all relevant parties involved in assessing and understanding the potential impact of the standard, such as accounting, tax, communications, financial reporting (including internal control over financial reporting), financial planning and analysis, investor relations, risk, credit, operations (data retention for forecasting), treasury, and information technology?

3. What factors were considered in management's impact assessment? (This question includes a list of specific factors that may – or should have been – considered.)

4. How has management assessed the potential impact that the new standard may have on the following: a) Planning and analysis forecasting? b) Investor relations and communications? c)

Regulatory compliance (including systems, processes, and controls)? d) Accounting for taxes? e) Impact on financial statements of borrowers?

5. When will management provide pro forma financial statements, including disclosures, and investor communications to the audit committee to demonstrate the expected impact of the new standard on the financial statements (including multiple scenarios based on potential economic environmental impacts)?

Evaluating the Implementation Plan

The core of the CAQ's tool is a list of 41 questions that audit committees should consider asking regarding management's implementation plan. The questions fall into eight categories, listed below, along with examples of the questions.

The Implementation Plan

- How will the audit committee be apprised of status? Audit committees may want to consider requesting a quarterly progress report from management.

- How does the company's implementation plan compare to other companies and best practices based on the audit committee members' experience, if applicable?

Culture and Resources

- Does the implementation team have adequate levels of experience and company knowledge to understand the new standard's impact? Will significant judgments about implementation be made and approved centrally (e.g., at corporate headquarters) or throughout the company (e.g., at a business-unit level)?

Systems and Data

- Is a new system or improvements to existing systems needed? What is the status of the system implementation, if applicable?

Controls

- Is management appropriately designing and testing controls related to the standard's adoption? How will internal controls related to disclosure of the adoption impact be documented and tested?

Accounting Policy and Significant Accounting Judgments

- Who has reviewed significant assumptions and judgments? Have significant judgments been documented and communicated to the audit committee? Has management considered alternative assumptions or outcomes? If so, why did management reject them?

Modeling and Assumptions

- How do significant modeling methodologies and assumptions used compare to other business units within the company, to peers, and to competitors? What controls has management put in place to evaluate internal consistency where appropriate? If not consistent, has management documented why?

Involvement of Stakeholders

- How has an internal communication plan been established (such that key stakeholders are aware of how the new standard will impact the company)? Are key decision makers aware of the judgments and process/control changes that need to be made at a business-unit level?

Questions for the External Auditor

- How does the company's external auditor view the company's impact assessment? How has the external auditor been involved and what are the auditor's views on the impact of adopting the standard, changes to critical accounting policies and practices, and the company's overall readiness?

- What is the external auditor's view as it relates to the implementation plan? Will it satisfy the auditor's plan and timeline to complete the audit in a timely manner?

Other Important Implementation Considerations

The CAQ identifies three additional issues on which audit committees should focus and suggests questions the committee may wish to raise with respect to each.

- Transition method (include internal controls over transition adjustments).

- Disclosures.

- Impact on statutory reporting, reporting under other accounting frameworks (e.g., IFRS), and impact on regulatory reporting.

Comment: Many companies still have a long way to go in order to be ready to implement the CECL standard next year. Financial institutions will be the most effected. In fact, while the likelihood of passage seems low, legislation has been introduced in Congress to delay the effectiveness of the new standard for banks and credit unions until regulators study and report on the impact on bank lending. See S. 1564, introduced in the Senate on May 21, 2019.

Regardless of the nature of the company's business, audit committees should be aware of the impact that CECL will have on the company and of management's implementation plans. The CAQ's publication provides an excellent roadmap for fulfilling that responsibility. As the CAQ tool discusses, audit committees should also focus on the company's compliance with its obligation to make pre-effective date public disclosure concerning new accounting requirements. SEC Staff Accounting Bulletin 74 requires companies to disclose the impact that adoption of a new accounting standard is expected to have on the company's financial statements, unless the impact is not known or reasonably estimable. It appears that many companies are behind in making this disclosure. A survey of the S&P 500 conducted in February by PwC found that 44 percent of S&P companies had made no CECL impact disclosure, while 43 percent disclosed that they had not determined the impact. Of the remaining 13 percent, 2 percent said the impact would be material, and 11 percent said it would be immaterial to their financial reporting.

PCAOB Staff Dives into CAM Reporting

On May 22, the PCAOB staff added to its guidance on new auditor reporting requirements by releasing Implementation of Critical Audit Matters: A Deeper Dive on the Communication of CAMs. The new guidance includes seven FAQs to assist auditors in drafting their discussion of critical audit matters (CAMs) in the auditor's report. While not intended specifically for audit committees, these FAQs may be helpful in understanding what auditors are required to disclose and considerations that will influence CAM drafting.

As described in detail in earlier Updates (see, e.g., PCAOB Staff Issues New Guidance on CAM Reporting, March, 2019 Update), beginning for large accelerated filers with fiscal years ending on or after June 30, the auditor's report will include a discussion of CAMs identified during the audit. A CAM is defined as any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that relates to accounts or disclosures that are material to the financial statements and involved especially challenging, subjective, or complex auditor judgment. For each CAM, the auditor's report must:

- Identify the CAM.
- Describe the principal considerations that led the auditor to determine that the matter is a CAM.
- Describe how the CAM was addressed in the audit.
- Refer to the relevant financial statement accounts or disclosures that relate to the CAM.

The guidance notes that CAM disclosure should provide a summary that is useful to investors and not recite details of the auditor's response to the issue. Further, "[l]anguage that could be viewed as disclaiming, qualifying, restricting, or minimizing the auditor's responsibility for the CAMs or the auditor's opinion on the financial statements is not appropriate and may not be used." The guidance also reiterates that the PCAOB does not expect the auditor to disclose information about the company that has not been made public by the company itself "unless such information is necessary to describe the principal considerations that led the auditor to determine that a matter is a CAM or how the matter was addressed in the audit."

Some key points in the FAQs include:

- If the auditor describes audit procedures as part of communicating how a CAM was addressed, the description should be specific to the CAM and the audit. "General statements about procedures that would likely be performed in most audits or in relation to most significant areas of the audit * * * typically do not, by themselves, provide useful information * * *."
- The CAM discussion should not imply that the auditor is providing a separate opinion on the CAM or on the accounts or disclosures to which it relates.
- CAM communications should describe why the auditor decided that a matter was a CAM and how it was addressed in the audit. Therefore, CAM discussions should not duplicate company disclosures.
- Some CAMs may recur from year to year. Even if a CAM was previously disclosed, the auditor should consider the specific facts and circumstances during the current audit, and tailor the CAM communication as necessary.
- There is no requirement that CAMs be listed in any particular order in the auditor's report. Auditors may consider ordering based on relative importance or the order of presentation of the underlying issue in the company's financial statements.

Comment: The new guidance, along with earlier PCAOB staff statements on CAM reporting (see PCAOB Staff Issues New Guidance on CAM Reporting, March, 2019 Update), provide a useful overview of the new requirement. None of these documents are lengthy or complex and reviewing them will aid audit committees in understand the auditor's approach to identifying and describing CAMs.

SEC and PCAOB Cases Against Accountants Decline, While Accounting Class Actions Near Record Highs

A Cornerstone Research report finds that SEC and PCAOB enforcement cases involving accountants "fell sharply" in 2018. But another Cornerstone report finds that the value of 2018 settlements of securities law class actions alleging public company accounting violations nearly quintupled over 2017 and that the number of new accounting class action filings "remained at uncharacteristically high levels."

Actions Involving Accountants

According to the first report, Regulatory Actions Involving Accountants—2018, the SEC and the PCAOB combined finalized 45 enforcement actions involving accountants in 2018. This compares to 75 actions in 2017. (For these purposes, accountants include CPAs employed by SEC registrants, individual auditors, and audit firms.) There were 67 respondents in these 45 cases, 32 of which were subject to monetary sanctions totaling about $3.3 million.

Looking only at the 2018 SEC cases, the number of final actions involving accountants declined by 20 percent from 2017 (from 40 cases to 32 cases). There were 44 respondents in these SEC cases (8 firms and 36 individuals). In contrast, the average annual number of accountants charged in SEC enforcement cases was 57 during the period from 2013 to 2017. Much of the decline resulted from a decrease in actions involving CPA employees of SEC registrants.

As to the types of accountant conduct that attracted SEC attention:

- Nearly one-third of the SEC cases involved a financial statement restatement.
- Ten percent of the actions against individuals included insider trading allegations.
- Nearly half of the actions involving auditors or audit firms related to engagement quality reviews (EQR) -- the second partner review required before an audit report is filed with the SEC. Over one-third alleged violations arising from auditing of related party transactions.

At the PCAOB, 2018 enforcement actions declined 63 percent (from 35 in 2017 to 13); the number of 2018 final actions was the lowest since 2013 when only 11 cases were finalized. There were 23 respondents in the PCAOB's 2018 cases – 12 individuals and 11 firms. (All PCAOB cases are necessarily against either individual auditors or accounting firms.)

Like the SEC, the PCAOB focused on EQR and on related party transactions, but, unlike the SEC, restatements were not a significant enforcement trigger: More than two-thirds of the PCAOB's final actions involved EQR, and nearly one-third involved auditing of related party transactions; only one case arose from a restatement. Almost half of the PCAOB's cases didn't involve public company auditing at all – 46 percent of its final actions dealt with audits of SEC-registered securities broker-dealers.

Accounting Class Actions

While accounting enforcement is declining, class actions against public companies alleging accounting violations are booming. A separate Cornerstone report, Accounting Class Action Filings and Settlements—2018 Review and Analysis, found that, while the number of new accounting class actions filed declined slightly, it remained high and that the value of accounting class action settlements mushroomed from $883 million in 2017 to almost $4.5 billion in 2018.

In 2018, 143 new accounting class actions were filed, compared to 165 in 2017. While a decrease from 2017, this level of new filings was nearly 86 percent higher than the 2009-2017 average.

- Cases challenging merger and acquisitions transactions on accounting grounds have become common in recent years, and 79 of the 143 new 2018 cases were M&A-related. These actions typically allege a failure to reconcile a non-GAAP measure to a GAAP measure and are often brought by attorneys seeking a quick settlement involving a disclosure correction and payment of attorney's fees. See Accounting Class Actions Rise, But Settlements Fall, April-May 2018 Update.)

- Sixty-four "core accounting cases" (i.e., cases not involving M&A transactions) were filed in 2018, an increase of 10 percent from 2017. The market capitalization losses alleged in these cases, as measured by the change in the defendant company's market capitalization during the class period, was $53.9 billion, the highest level in 10 years. In three of the newly filed cases, market capitalization losses were $5 billion or greater.

- One in five of the core accounting cases involved restatements. Three-quarters of the restatement cases included allegations of internal control weaknesses.

The number of accounting class action settlements declined from 49 in 2017 to 41 in 2018, but both the aggregate and the median settlement value increased:

- The total settlement value of accounting cases settled in 2018 was $4.48 billion. Since 2009, aggregate accounting cases settlements have only been larger in one year – 2016.

- Five settlements exceeded $100 million. All five involved alleged internal control weaknesses, and four involved alleged GAAP violations. Three involved restatements.

- The median settlement amount for cases involving GAAP allegations rose from $5.5 million in 2017 to $10 million in 2018.

- By dollar amount, the energy sector accounted for almost 70 percent of all accounting settlements in 2018, although only ten percent of the settled cases were against energy sector defendants. The number of accounting cases settled in the technology sector increased by 55 percent over the 2009-2017 average.

Comment: As noted in Securities Law Class Actions are Mushrooming, But More Cases are Being Dismissed and the Survivors are Settling for Less, March 2018 Update, the risk that a public company will be named in a securities law class action is increasing, particularly for companies engaged in M&A activity. Even outside of M&A litigation, accounting issues remain a significant line of attack for the plaintiff's bar, and the cost of settling accounting cases is again rising, after an earlier decline. The best protection against litigation is diligence and care in overseeing the company's financial reporting.

Who Would Have Guessed? Opinion Shopping Compromises Audit Quality

Academic research that reviewed the financial reporting of distressed U.S. companies between 2004 and 2012 finds that companies that switched auditors in hopes of avoiding a going concern qualification – or merely investigated the possibility of switching – often ended up with poorer auditing and financial reporting. The authors of the study, Opinion Shopping to Avoid a Going Concern Audit Opinion and Subsequent Audit Quality, conclude that their findings "provide important implications for investors and audit committees by suggesting that both audit opinion credibility and financial reporting quality can be hampered by auditor switching through opinion shopping."

The opinion shopping research study was authored by Jong-Hag Choi of Seoul National University, Heesun Chung of Sejong University, Catherine Heyjung Sonu of Korea Open National University, and Yoonseok Zang of Singapore Management University. Their paper appears in the May issue of the American

Accounting Association's Auditing: A Journal of Practice and Theory, and is summarized in a May 7 AAA press release. Study findings include:

- An estimated 57 percent of the distressed companies in the study sample shopped opinions. Of these companies, 16 percent received going concern opinions, compared to 28 percent of the companies that did not opinion shop. (For these purposes, opinion shopping refers to seeking an independent assessment of the company from a third-party auditor, regardless of whether the company changed auditors. It appears that, even without an auditor change, opinion shopping may cause the incumbent auditor to refrain from issuing a going concern opinion.)

- Of the 142 companies in the study that filed for bankruptcy, 45 percent of the opinion-shoppers had received clean opinions, compared to only 19 percent of the non-shoppers. Thus, opinion shopping seems to prevent investors from receiving potentially valuable earlier warning information concerning the company's financial outlook.

- Opinion shopping is a predictor of financial reporting misstatements. The incidence of misstatements was "significantly higher" among firms that engaged in opinion-shopping than among those that did not. Interestingly, this disparity was entirely attributable to opinion-shoppers that actually changed auditors. Companies that contacted other firms but ended up retaining the incumbent were no more likely to restate than non-shoppers. (The study theorizes that "incumbent auditors under non-switching opinion-shopping can be more resistant to client pressure, as they have recovered the start-up costs partly or fully from previous audit service.")

- Audit firms that have more opinion shoppers as clients have poorer audit quality than firms with fewer such clients. These firms tend to be those "whose reputational capital is weak, [whose] pocket for litigation damages is not deep and…[who] are more likely to accept switching opinion-shoppers despite the higher litigation risk associated with accepting these clients."

- The passage of the Sarbanes-Oxley Act in 2002 and the creation of the PCAOB do not appear to have had any long-term effect on opinion shopping. While opinion-shopping declined from 2004 to 2006, it subsequently returned to pre-PCAOB levels.

Comment: As a result of the Sarbanes-Oxley Act, any decision to change auditors would, of course, be made by the audit committee. The research study suggests that audit committees should avoid the temptation (and management requests) to look for a more accommodating auditor as a tactic to avoid a going concern opinion. Opinion shopping is likely to result in financial reporting misstatements and reduced auditor credibility.

Large Company Sustainability Reporting Inches Up Still Further

On May 16, the Governance & Accountability Institute (G&A), a sustainability consulting firm, released the results of its eighth annual analysis of sustainability reporting by S&P 500 companies. G&A found that 86 percent of companies in the index published a sustainability or corporate responsibility report in 2018—one percent more than in 2017. See Sustainability Reporting and Responsibility are Becoming Part of Corporate Culture, March 2018 Update. The popularity of voluntary sustainability reporting has increased dramatically during the past eight years. According to G&A, in 2011, only about 20 percent of S&P companies released such reports; 53 percent did so in 2012, 72 percent in 2013, and 75 percent in 2014.

G&A also reported that the industry sectors with the highest percentage of reporting companies were Utilities and Materials; all the companies in both sectors issued sustainability reports. Consumer Staples came in third with 91 percent reporting (30 out of 33 companies). At the other end of the spectrum, the industry sectors with the lowest percentages of companies issuing reports were Communication (8 non-reporters/36.3 percent of the sector), Real Estate (8 non-reporters/25 percent of the sector), and Information Technology (13 non-reporters/36 percent of the sector).

In the "flash report" announcing the survey results, Louis Coppola, G&A's Executive Vice President and Co-Founder, stated: "Many more institutional and retail investors are expecting and even demanding greater corporate ESG disclosure today. This trend has been on a steady trajectory upward and we see the response by S&P 500 companies in our research from 2011 reporting through to 2018."

Comment: As noted in prior Updates, sustainability reporting is rapidly becoming the norm for large public (and many smaller and private) companies. Most companies face some level of investor, customer, and/or supplier demand for more transparency concerning a variety of ESG issues, particularly those related to its supply chain integrity and climate change response. Over time, sustainability disclosures of various types may become mandatory, either as a result of the application of traditional securities law materiality to ESG issues or through direct regulatory or statutory disclosure mandates. For audit committees, these types of disclosures will pose oversight challenges involving compliance with new reporting requirements and controls and procedures to assure the accuracy and reliability of non-traditional disclosures.

PCAOB 2017 Inspections Status Report

The PCAOB 2017 Inspections Status Report is unchanged since Update No. 51. The PCAOB has released the public portion of the 2017 inspections reports with respect to the U.S. affiliate of four of the six global network accounting firms. (The Global Networks are described on the PCAOB's website.) No 2017 report has yet been issued for the U.S. affiliate of BDO International or Ernst & Young Global. The table below summarizes the results of the 2017 inspection of the firms for which inspection reports are available.

2017 Inspections of U.S. Affiliates of Global Networks (Reports Made Publicly Available in 2019)

Firm	Report Date	Engagements Inspected	Part I Deficiencies*	Percentage
Deloitte & Touche	December 20, 2018	55	11	20%
Grant Thornton	March 21, 2019	34	6	18%
KPMG	January 24, 2019	52	26	50%
PwC	February 28, 2019	55	13	24%

* The PCAOB describes deficiencies that are included in Part I of an inspection report as "of such significance that it appeared to the inspection team that the firm, at the time it issued its audit report, had not obtained sufficient appropriate audit evidence to support its opinion."

Comment: Audit committees should discuss the results of the firm's most recent PCAOB inspection with their engagement partner. If the company's audit is mentioned in either the public or nonpublic portion of the inspection report, the audit committee should understand the reasons for the reference to the audit and how it will affect the engagement in the future. If the company's audit is not cited in the report, the audit committee should explore with the auditor how deficiencies identified in other audits might have affected the company's audit and how changes in the firm's procedures might affect future audits. Audit committees should also understand how the firm intends to remediate quality control deficiencies described in the nonpublic portion of the report.

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Prior Updates issued after January 1, 2019 are available here.