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Center for Board Effectiveness

On the audit committee's agenda

Aligning the disclosure committee in the era of disclosure

As discussed in our January 2024 update "Looking ahead: The audit committee agenda in 2024," disclosure continues to be a critical topic for the audit committee in the coming year, and likely beyond.

While disclosure has been an important topic for the audit committee, three factors differentiate this period:

- The frequency and speed at which new disclosures are being adopted and/or proposed by regulators;
- The expanding scope of disclosures, going beyond financials, and the new accounting methods used as the basis of these disclosures; and
- The prevalence of voluntary disclosures, companies using these as a competitive edge, and the lack of standardization in industry-driven, unregulated reporting.

The release of the US Securities and Exchange Commission's (SEC) much anticipated rule titled The Enhancement and Standardization of Climate-Related Disclosures for Investors (the "Climate Disclosure Rule") is the most recent regulatory event to affect the direction of disclosures (see Deloitte's *Heads Up* publication with detailed analysis of the rule). For many companies, the Climate Disclosure Rule may prompt an expansion of the disclosure committee's scope as new disclosure controls and procedures will likely be required.

However, the Climate Disclosure Rule is not the only regulatory shift companies are navigating; companies are implementing new rules on cyber, executive compensation clawbacks; trading by insiders; special-purpose acquisition companies (SPACs); and preparing for rule proposals on human capital and board diversity. At the same time, companies are also adjusting to a heightened enforcement environment.

Given the volume of large-scale new and/or updated disclosures and other types of information being reported, and the SEC's focus on disclosure enforcement in the midst of adaptation, the audit committee may contemplate how to effectively leverage the tools at its disposal for overseeing this disclosure landscape. At such a pivotal moment, consideration should be given to focusing on disclosure committee activities and understanding whether any refresh is needed. Companies that do not currently have a disclosure committee may take this opportunity to establish one.

As disclosure committees align to the evolving disclosure landscape, leading practices and operational enhancements, such as charter updates, membership refresh, and committee procedures, should be considered.

SEC rule resources

Deloitte's rule-specific resources

- **Climate disclosure**
- **Cyber**
- **Executive compensation clawbacks**
- **SPACs**

Audit/disclosure committee resources

- **Deloitte's Audit Committee Guide**
- **Deloitte's sample audit committee charter**
- **SEC's sample disclosure committee charter**

What is the disclosure committee?

While not mandated by the SEC, disclosure committees rapidly became common from 2002 on with the adoption of SEC rules under Section 302 of the Sarbanes-Oxley (SOX) Act. This provision and the SEC rules required CEOs and CFOs to not only certify the accuracy of SEC disclosures, but also the existence of adequate disclosure controls. For many companies, disclosure committees have served as one such disclosure control. In the commentary accompanying Securities Exchange Act rule 13a-15, prompted by Section 302, the SEC recommended that companies establish a management-level committee responsible for "considering the materiality of information and determining disclosure obligations" and reports to the CEO and CFO "who bear express responsibility for designing, establishing, maintaining, reviewing and evaluating the issuer's disclosure controls and procedures."

The purpose of disclosure committees is to assist the CEO and CFO in preparing SEC-required disclosures for the audit committee's review and approval, and to facilitate appropriate and properly implemented disclosure controls. Likewise, disclosure committees can support the accuracy, completeness, timeliness, and fairness of company filings. They can set parameters for and determine the appropriateness of disclosures in all publicly disseminated information.

The objectives of many disclosure committees are to:

- Review draft SEC filings, recommend edits and provide comments, and confirm that edits have been incorporated before submitting the filing;
- Provide integrity and completeness relating to internal controls over financial reporting; and
- Support the certification requirements of Sections 302, 404, and 906 of the SOX Act.

Management is responsible for maintaining adequate internal control over financial reporting (ICFR) as well as disclosure controls and procedures (DCPs) for items disclosed in Exchange Act reports and evaluating the effectiveness of ICFR. The audit committee is responsible for overseeing the financial reporting process and for doing so effectively. The audit committee should be familiar with the processes and controls that management has established and determine whether they are designed and operating effectively. By enhancing the credibility of the information presented by the CEO and CFO, the disclosure committee supports the audit committee in meeting this objective.

As the number of topics that are required to be disclosed or voluntarily disclosed has increased, the disclosure committee's mandate may expand to oversee a broader range of disclosures. This may involve coordinating with other management committees that lead different reports, such as the risk management and newly developed sustainability management committees.

Considerations for disclosure committee refresh

To continue to formalize and enhance disclosure committees, we identified three possible opportunities for disclosure committees to consider in this time of transition.

1. Maintain and update a formal disclosure committee charter

Though the disclosure committee has been a widely adopted organizational practice for more than 20 years, some companies evidence its existence and performance through meeting materials, not a formalized charter. The SEC suggested the importance of a charter in the commentary accompanying the adoption of Securities Exchange Act rule 13a-15 and later with its release of a sample charter.

Among the topics in the SEC's sample charter are:

- **Committee purpose**—the committee's mission statement;
- **Responsibilities**—the scope of the committee's purview, including reviewing and monitoring disclosure controls and public filings;
- **Disclosure control considerations**—factors that will inform the disclosure committee's assessment of controls;
- **Membership and chair**—how is the committee organized and led; and
- **Meetings and procedures**—how often does the committee meet, how, and on which agenda topics.

As discussed in the *Audit Committee Practices Report*, the audit committee's role continues to grow as more and more hot button issues are added to its agenda. Two recent developments emphasize the disclosure committee's role in this broadening agenda:

- **Focus on materiality**—In a recent enforcement action, the SEC imposed a $35 million fine on a company for failing to disclose material information pertaining to its workforce.[1] Specifically, the SEC noted that the company should have ensured that this information was provided to the disclosure committee.
- **Voluntary disclosures**—Companies are increasingly providing voluntary disclosures to meet stakeholder expectations, maintain pace with peers, build credibility through transparency, and distinguish themselves in the marketplace. Though the Climate Disclosure Rule encompasses many disclosures that were previously voluntary, companies may continue to provide voluntary disclosures beyond the rule. Recent voluntary disclosures have been driven by environmental, social, and governance (ESG) trends, but also include data on risk management, operations, suppliers, privacy, and health and safety.

[1] US Securities and Exchange Commission (SEC), press release, February 3, 2023.

Given the additional compliance considerations these trends have for disclosure committees, it is important for them to clearly define their role to make sure they have appropriate access to information while also managing mission creep.

When refreshing its charter (or drafting a charter, if it does not already have one), the disclosure committee should do so in alignment with the audit committee charter, which typically references its responsibility for disclosure oversight (see our sample audit committee charter here).

2. Reassess disclosure committee owner(s) and membership

The disclosure committee charter should designate a committee chair who can drive meetings, agendas, and action items. Chairs or owners often include finance or legal; in some cases, it may be helpful for more than one function to co-own committee leadership. As disclosure requirements and trends continue to target more specific domains, more disclosure committees may consider expanding membership to include additional subject-matter experts (e.g., executives/managers in sustainability, cyber, technology, and human resource roles).

As a first step in a membership refresh, disclosure committee leadership may consider inventorying all disclosures the committee is responsible for (see below), and assessing whether all relevant data is owned by current committee members. As the data included in disclosures continues to broaden, it is strategic to expand disclosure committee expertise as well.

With a rapidly changing disclosure environment and addition of new committee members, disclosure committees may consider adopting onboarding procedures. New members will likely need to understand the committee's function, and existing members should receive regular briefings on new/modified committee procedures and required disclosures.

3. Enhance disclosure committee procedures, particularly those pertaining to memorialization of committee operations

In the same case action discussed earlier—the SEC pursued enforcement action against the company even though the SEC found no disclosure violations. Disclosure committees may safely interpret this as a sign of disclosure scrutiny to come and might consider revisiting committee procedures, paying particularly close attention to understanding if relevant topics are included in each agenda and documenting disclosure committee reviews.

Inventory of disclosures

Many companies publish other publicly available reports that are not necessarily included in SEC filings (e.g., subject-specific reports on sustainability; supplier responsibility; diversity, equity, and inclusion; human rights). As the volume of corporate reports has increased, so has the risk that the content could contradict each other or even include false or misleading information. The Climate Disclosure Rule might add an additional layer of complexity as data previously reported in non-SEC publications will likely need to be included in SEC filings.

The disclosure committee can play a critical role in coordinating with other management committees that lead these reports (often risk and sustainability committees) and helping to synchronize data that is reported in multiple disclosures as well as on a company website or communicated internally and externally by leadership. Even if not squarely within the disclosure committee's purview, it is important for committees to understand the full scope of "disclosures" published by the company. Voluntary reporting can still expose a company to SEC enforcement or shareholder litigation for fraud or even cost the company stakeholder trust.

At a minimum, the disclosure committee should have the opportunity to review any disclosures it does not own to make sure there is alignment between its contents and any current or expected SEC filings. If a disclosure committee has the capacity and expertise, it may be well positioned to help serve as the centralizing oversight body for all reporting, required and voluntary.

For many companies, the Climate Disclosure Rule and cyber rule will require adoption of new DCPs. The disclosure inventory can help companies identify any gaps in DCPs and opportunities for DCP enhancement.

Meeting agendas

While many disclosure committees review the same topics from quarter to quarter and year to year, the expansion of the audit committee's scope as referenced above may prompt disclosure committees to make sure their meeting agendas include sufficient time for topics beyond review of specific filings (e.g., a deep dive on a particular disclosure or control, planning for anticipated or expected regulatory changes).

Checklists

A standardized checklist may also be useful to help the disclosure committee stay on track with the disclosures and controls in its purview that need to be addressed or reviewed at any given meeting. Additionally, records of draft filing markups may be made more robust if accompanied by a checklist showing how the review was performed.

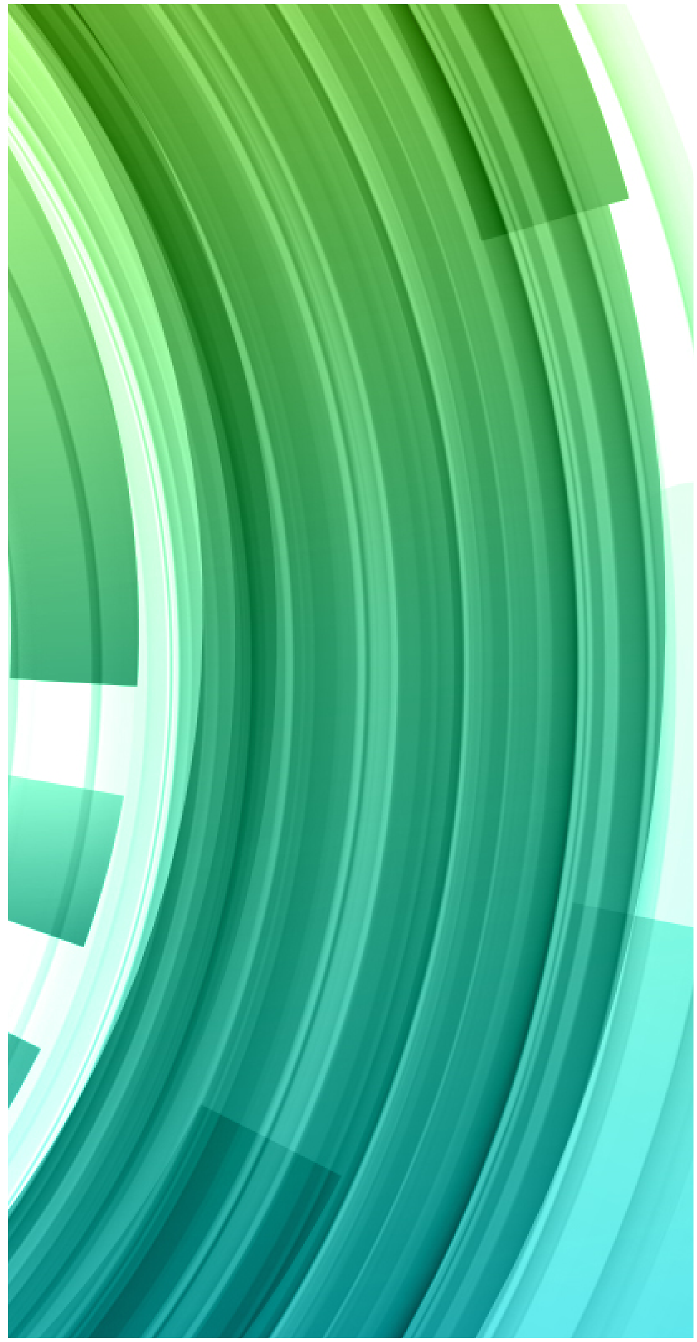
Documentation

Should a company be challenged on its controls and procedures, evidencing the scope and quality of the controls evaluation with robust documentation from disclosure committee meetings may be beneficial. Evidence can take several forms depending on available resources and records management policies. As part of any refresh of disclosure committee procedures, disclosure committee leadership should consult counsel to determine a documentation procedure that aligns with any legal risks or risk appetite specific to the company.

Some disclosure committees maintain formal minutes of meetings, but there are documentation alternatives, including:

- Maintaining records of agendas and calendar appointments to evidence that the meetings occurred;
- Maintaining records of financial report drafts marked up for the committee meeting to illustrate the nature of the review;
- Maintaining records of checklists utilized by the disclosure committee to demonstrate the scope of review; and/or
- Memorializing in audit committee minutes that the disclosure committee provided a report and any relevant details presented.

Specifically with respect to the Climate Disclosure Rule and cyber rule, what companies disclose will likely be largely determined by each company's assessment of what data/events are material. Companies may consult counsel to consider whether it is appropriate to document the rationale for potentially reportable data/events deemed immaterial.



Conclusion

The increased demand for disclosure from regulators, investors, and stakeholders is likely to continue, as will the complexity of the data reported, regulatory expectations, and legal risk. Fortunately for boards, the disclosure committee is well positioned to help, but it may require greater time and diligence to make sure the disclosure committee is a well-equipped first line of defense.

Questions for the audit committee

The disclosure committee is a management-level committee that supports the audit committee. We recommend three key areas where disclosure committees may consider revisiting their readiness for a changing disclosure landscape. Some audit committees may want to be closely involved in this refresh. The following questions can help guide this process.

- If we do not have a disclosure committee, should we consider establishing one?
- Does the disclosure committee have a charter, and if so, does it accurately reflect the breadth and depth of disclosures the committee is currently responsible for?
- Is the disclosure committee composed of representatives from all relevant business functions so that all disclosure data is reviewed by an expert?
- Are all disclosure committee members, whether new or experienced, adequately familiar with the committee’s role and their responsibility as a member?
- Does the disclosure committee agenda reflect all relevant topics?
- Is the disclosure committee effectively documenting the completion and quality of its disclosure reviews?
- How does the disclosure committee coordinate with the risk management committee (if applicable) and/or the sustainability committee (if applicable)?

The Climate Disclosure Rule: An enterprise-wide effort

Implementation of the Climate Disclosure Rule will for many companies be an enterprise-wide effort (see our summary in our publication *The SEC climate rule is here*). We have identified the following considerations for companies as they begin to set their implementation plan:

- Define board-level governance and management oversight for developing quality and transparent disclosures
- Streamline strategic goals by integrating financial reporting and climate-focused capabilities with overall enterprise strategy
- Quantify the impacts on financial statements
- Evaluate reporting technology, data architecture, and relevant controls over climate-related information
- Prepare for assurance
- Implement technology and tools that connect climate and reporting data to achieve quality and transparency at scale

These actions will likely require significant cross-business collaboration. For some companies, the disclosure committee may be an effective forum for streamlining the company’s approach to this large-scale endeavor.

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