"Center for Audit Quality Update"

Cindy Fornelli
Executive Director
Center for Audit Quality

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Thank you, Melanie [Dolan], for that introduction, and thank you to the SEC Regulations Steering Committee. I'm very pleased to have a chance to provide an update for this distinguished audience, both those in this room, and those who are watching in remote locations.

I'd like to start by saluting Tommye Barie and wishing her the very best during her AICPA chairmanship.

As we know from Tommye's eloquent remarks just now, she is one serious athlete. And, like any good athlete, she knows that sports teach us lessons that go well beyond the playing field—or, in Tommye's case, the kite-board.

Today, inspired by Tommye, I'd like to frame my remarks with a piece of sports wisdom. This one comes from football.

The great Vince Lombardi, who led the Green Bay Packers to five NFL Championships, once made this observation: "Perfection is not attainable. But if we chase perfection, we can catch excellence."

Now, of Vince Lombardi's many memorable quotes, I think this one is particularly suitable for accountants and auditors.

Investors, who rely on public company auditors, expect them to carry out their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public.

Investors’ expectations are high, so our profession sets a high bar for itself accordingly. We never assume our own perfection, yet we chase it constantly.

We strive to improve for the sake of investors but also for the companies in which they invest, as well as for our markets, the economy, and the public at large.

In this pursuit of perfection, we must understand and acknowledge our imperfections.

And there are a few markers of public company audit “imperfections.” Perhaps the most visible are those shared by the PCAOB, through its inspection findings.

Just last week, PCAOB Chairman James Doty shared a few statistics on inspection reports for the four largest U.S. firms during the 2013 cycle. Of 219 public company audits selected for inspection—based on an assessment of risk—inspectors deemed that 85 audit opinions, or 39 percent, should not have been issued.
Now, as Chairman Doty was quick to point out, that doesn’t mean the financial statements were materially wrong. But rather it means inspectors were unable to confirm that sufficient work had been done to issue the audit report.

Still these numbers are sobering. They should spur us all into action.

Beyond audit inspection findings, we have another public measure in our chase for perfection: financial restatements by public companies.

While restatements have fallen significantly in recent years, they still occur, and sometimes with a heavy impact on investors.

Of course, as we hear news of restatements, we must keep the big picture in mind. This year, to illustrate that big picture, the CAQ published an in-depth study on financial restatements, authored by Susan Scholz of the University of Kansas.

Professor Scholz found that the number of U.S. restatements declined significantly from 2006 to 2012—a finding confirmed through 2013 by Audit Analytics. Professor Scholz also found that the number of accounting issues underlying each restatement has dropped, as have restatement reporting periods.

While these findings are encouraging—some might even say “excellent”—they too should spur us into action.

What other metrics should propel us in our pursuit of perfection?

Another important data set is polling on investor confidence.

In October, the CAQ released our Eighth Annual Main Street Investor Survey. This survey gauges confidence of U.S. retail investors in a handful of key areas.

The findings in our survey this year are by and large positive—again, some might say “excellent.”

As the slide indicates, 73 percent of Main Street investors expressed confidence in U.S. capital markets. That’s the highest level since 2009. We’re also heartened to see the steady and robust confidence that investors have in U.S. publicly traded companies.

Finally, as this next slide shows, investors put public company auditors at the top of the list of entities who they see as looking out for their interests. Audit committees, who of course stand in the shoes of investors, rank a close second.

We can take pride in these numbers. I have certainly enjoyed discussing them with the media and others. But now is definitely not the time to spike the football. Instead, we should ask ourselves a few questions.

Question one: if 75 percent of investors view public company auditors as effective in looking after their interests, why doesn’t the other 25 percent share that confidence?

Question two: Four-fifths of investors have confidence in U.S. public companies, but what about the other fifth?

Question three: Investor confidence in capital markets is up, but why hasn’t it recovered to the high levels it reached in 2007?
I don't have the answers to these questions for you today. But I will repeat, these questions—like the data I've discussed—should spur us into continued action.

So if taking action is so important, let's have a closer look at what the Center for Audit Quality and the public company auditing profession are doing. How are we chasing perfection to catch excellence?

As Tommye mentioned, one of our top initiatives is our work with our members to develop audit quality indicators. Across the globe, there is widespread interest in audit quality indicators among regulators, investors, and audit committees.

Last year, the PCAOB announced plans to pursue a project to define key elements of audit quality, and Board members have suggested that a concept release is forthcoming in the very near future.

For our part, the CAQ has been working on an AQI project since early 2012. This past April, we released an in-depth paper that sets forth our thoughts on an approach to AQIs, along with a set of potential AQIs.

Our approach recognizes the vital role that the audit committee plays in providing oversight of the audit and the importance of a robust dialogue between the audit committee and the engagement team. Thus, we recommend that communications of AQIs be directed at audit committees.

Second, we suggest that communication of audit quality indicators focus largely on engagement-level indicators, with a few firm-wide metrics to provide context.

We think that this approach could assist the audit committee in evaluating the effectiveness of the engagement team and the audit firm.

To see how our approach performs in practice, several of our member firms are undertaking an AQI pilot-testing program that will finish up early next year, with the completion of the 2014 audit cycle.

We are looking forward to seeing—and sharing—the results of the pilot testing.

The Center for Audit Quality is also collaborating more than ever with key stakeholders.

For the CAQ, a top effort is our work with the Anti-Fraud Collaboration, a group of organizations representing the key players in the financial reporting supply chain.

Last month, the Collaboration released a comprehensive publication entitled, *The Fraud-Resistant Organization*. Drawing on a wealth of recent research, the report provides valuable information about the conditions that might make an organization more susceptible to fraud—and how to mitigate those conditions.

Another key project for this Collaboration is its set of case studies. These are a series of hypothetical fraud scenarios, which are modeled on the Harvard Business School case method.

We released our second case study this past February, and a third case study is slatted for release in 2015, focusing on financial institutions.

Feedback reveals that the case studies have been put to good use by companies, academics, and auditors across the globe, from Canada to Kenya. They've also been used for two prominent university case study competitions in California and Georgia.
For the public company auditing profession, a key part of the pursuit of perfection lies in the policy process itself. As this conference embodies, we must engage constructively with our regulators, taking action to help build an effective regulatory framework.

Focusing on effective regulation is important, because regulation has the potential to disrupt, in both positive and negative ways.

Investors are certainly aware of this potential. In our Main Street Survey this year, we asked investors about their concerns, particularly regarding risk.

On the one hand, 73 percent of investors view government regulation as a threat to their portfolios. But on the other hand, our survey revealed that the U.S. government is also driving investor confidence in U.S. markets.

So how can we reconcile this apparent paradox? One way is to focus intently on policy that works.

At the CAQ, a focus on making rules and standards effective and operational is core to what we do.

For example, in early 2014, working through the CAQ, CAQ member firms extensively field tested the PCAOB’s 2013 proposal to enhance the auditor’s reporting model. Through a publicly filed comment letter, we shared results from that field testing with the PCAOB in June. We look forward to seeing a revised proposal from the PCAOB next year, which we hope will be responsive to our field-testing findings.

Which leads me to my final point on our chase for perfection: While we work constructively with regulators, we cannot wait for them to act. Where possible, we must voluntarily respond to the ever-changing needs of the markets and investors.

Such voluntary efforts are central to the CAQ’s work with audit committees. A principal channel for us here is the Audit Committee Collaboration, formed in 2012.

In November of last year, the Collaboration launched a major project with a new publication, titled Enhancing the Audit Committee Report: A Call to Action. In simple terms, the Call to Action urges audit committees to provide more insight to investors and others about the important work they are doing. The document highlights leading audit committee disclosure practices at companies like General Electric and Pfizer.

We're pleased to say that in the year since its release, the Call to Action has generated a positive response and stimulated a broad and ongoing conversation. To take just one example, Professor Charles Elson, Director of the Center for Corporate Governance at the University of Delaware, has said he applauds the Call to Action, as it is, "all about effective disclosure, rather than just more disclosure that may not be truly beneficial to investors."

As this conversation unfolds, and as the SEC readies its concept release in this area, the CAQ is continuing its research.

Recently, we’ve examined emerging practices around audit committee disclosure at small-cap, mid-cap, and large-cap companies. Last week, we released our Audit Committee Transparency Barometer, which has established a baseline to track these emerging practices.
This work, which we did in partnership with Audit Analytics, is just one example of staying proactive. I would also cite a number of our member alerts on top issues such as the role of the auditor in cybersecurity, audits of broker-dealers, and emerging issues in the forthcoming audit cycle.

Finally, on the matter of financial disclosure, we have taken up SEC Chair White's challenge to rethink how to make disclosures more effective. We have convened key investor and financial groups to explore this issue and possible recommendations.

We also completed an innovative initiative, in partnership with The George Washington University School of Business. Under this initiative, teams of graduate students competed to find new ways that 10-K filings might be made more useful for investors.

The rigor and creativity brought by these graduate students were truly inspiring and a testimony to the importance of staying proactive.

I'm as eager as all of you to hear from the SEC's new Chief Accountant, Jim Schnurr.

But in closing, let me say that the Center for Audit Quality, spurred on by research and data, will continue to take action. We will do so proudly as part of a profession that serves a critical role in our markets.

After all, there are many ways that all public company auditing firms chase perfection, including some ways that aren’t visible to the public. Whether through their quality control processes, root cause analyses, internal inspections, or training and education—to name just a few—the firms and the men and women that comprise the profession pursue perfection each and every day on each and every engagement.

And, while there is no finish line or final whistle, true to Vince Lombardi's words, they also catch excellence—to the benefit of companies, investors, and economy.

Thank you.