

## Center for Audit Quality Update

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*As prepared for delivery.*



Thank you, Fred [Frank], for that introduction. And thank you to Kimberly [Ellison-Taylor] for your inspiring remarks. We at the Center for Audit Quality are truly grateful for your leadership.

Hello to everyone, both in this room and those of you watching via webcast. I am pleased to update you today on how the CAQ and its member firms are working alongside policymakers, audit committees, investors, preparers, and other key stakeholders to enhance public company auditing and our capital markets.

My goal this morning is to (1) brief you on CAQ activities and (2) tee up our next session for our conversation with SEC Chairman Jay Clayton and SEC Chief Accountant Wes Bricker in our next session.

So let's set the stage and start with something critical: the state of investor confidence.

## Strong Investor Confidence

11<sup>th</sup> Annual Main Street Investor Survey, October 2017

Investor confidence in...	2017
US capital markets	85%
US public companies	83%
Audited financial information	78%
External auditors	84%

SEC and PCAOB Developments Conference



In the United States, investor confidence is strong. Retail investors—Main Street investors, or as Chairman Clayton calls them, "Mr. and Mrs. 401(k)"—have made it very clear that they hold positive views of our nation's markets.

Each year, the CAQ's Main Street Investor Survey measures investor confidence in four key areas: US capital markets, capital markets outside the United States, investing in public companies, and audited financial statements.

Our 2017 survey, which we published in late October, showed that investor confidence across the board is either holding steady or improving meaningfully. In some areas, confidence is even breaking records.

85 percent of "Main Street" investors expressed confidence in US capital markets. That's the highest level ever reached on that measure in the 11 years we've been conducting our survey

Eighty-three percent of investors expressed confidence in companies that are publicly traded. That's up from 70 percent in 2010.

Investors also showed robust confidence in audited financial statements, and they continue to see both independent auditors and audit committees as highly effective in their investor-protection roles.

One remarkable thing about the Main Street survey is that the numbers are not only relatively high—they are also fairly stable. Since we launched the survey in 2007, investors have experienced market volatility, political change, and global turmoil. Yet their core faith in US capital markets has been enduring. And this enduring faith is one reason, among many, why our capital markets are a marvel. They remain of the most powerful engines of opportunity and prosperity that the world has ever known.

So how do we keep this engine running smoothly? How do we honor the trust that investors place in all of us: auditors, preparers, boards, and regulators? How do we fortify their confidence, which has reached new highs?

In my remarks this morning, I will offer three critical ways.

**First, there must be robust collaboration and dialogue among key stakeholders across the financial reporting supply chain.**



**Robust Dialogue and Collaboration**

- **Collaborating** to fight financial reporting fraud
  - *Addressing Challenges for Highly Subjective and Complex Accounting Areas*
  - *LDC Cloud Systems Case Study*
  - Dec. 13 webcast on corporate culture: Register today!
- **Connecting investors** and audit committees
  - *2017 Audit Committee Transparency Barometer*

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If our capital markets are an engine, dialogue and collaboration are the motor oil that enables various parts to work together smoothly and effectively. That's why the public company auditing profession engages in steady dialogue on many fronts with important partners, including our regulators.

One of those fronts is the fight against financial reporting fraud.

Fraud deterrence and detection is without a doubt a shared responsibility. In that spirit, the CAQ teams up with its partners in the Anti-Fraud Collaboration: Financial Executives International, the National Association of Corporate Directors, and The Institute of Internal Auditors. Along with external auditors, these are groups who have a significant responsibility to combat financial reporting fraud.

In recent years, the Collaboration has also interfaced with the SEC's Financial Reporting and Audit Group on ways to combat fraud. One outgrowth of that interaction was a 2017 report titled, *Addressing Challenges for Highly Subjective and Complex Accounting Areas*. The report is available, like all CAQ resources, for free on our website. The report is based on two roundtables where participants included not only investors, board members, auditors, and preparers but also senior SEC and PCAOB officials.

Another hands-on anti-fraud resource from the Collaboration is the latest installment in our series of case studies. This series has been a great success, with teachings at firms, companies, and universities, both in the United States and overseas.

Our latest case study, *LDC Cloud Systems*, presents a story that revolves around a bribery allegation and questionable accounting practices within a fast-growing technology company. The case study is designed to foster understanding of how fraud situations can unfold, and how they can be addressed, including the importance of strong board oversight.

Speaking of board oversight, permit me to plug one more Anti-Fraud Collaboration resource. Next week, the Collaboration will hold a webcast on sound corporate culture, which is of course a critical part of deterring financial reporting fraud. We hope you can join us, and please spread the word about this webcast with your colleagues and others. It too is offered free of charge, with the opportunity to earn Behavioral Ethics CPE credit. For those unable to join the webcast, the archived webcast will be available at [AntiFraudCollaboration.org](http://AntiFraudCollaboration.org).

The fight against fraud is just one area of many where we see robust dialogue and collaboration. Exciting dialogue is also happening between investors and audit committees.

We see this connection at work in the area of audit committee disclosures to the marketplace. Earlier this year, SEC Chief Accountant Wes Bricker said, and I quote:

*"Audit committees can help increase investor understanding of the reliability and quality of financial reporting when they provide additional insights into how the audit committee has fulfilled its responsibilities."*

I'm happy to report that audit committees are providing more and more of these insights.

Each year, the CAQ teams up with Audit Analytics to benchmark how audit committees voluntarily are approaching the public communication of their oversight activities. We issue a report, titled the *Audit Committee Transparency Barometer*, which focuses on the robustness of proxy disclosures among companies in the S&P Composite 1500 index.

The 2017 Barometer, released last month, shows encouraging indicators. Consider:

- 63 percent of large-cap companies disclosed the length of the audit firm's engagement. That's up from just 47 percent three years ago.
- 27 percent of small-cap companies discussed their criteria for evaluating the audit firm. That's up from 15 percent in 2014.
- 14 percent of mid-cap companies discussed the role that the audit committee plays in audit partner selection. In 2014, just 1 percent did so.

At the CAQ, we will continue to track these trends, which are positive signs. They testify to our dynamic markets. They also support the idea that voluntary disclosure regimes are often an effective approach to getting investors and other stakeholder the information that they want and need. After all, voluntary disclosure allows for tailored disclosure. So we will continue to promote dialogue between investors and audit committees.

Yet we know that dialogue on its own is not sufficient to enhance investor confidence. We need sound controls, processes, rules, and standards—which leads me to a second point on how we maintain and build investor confidence.

**We must strive constantly to advocate for policies that work for investors and our markets.**

## Effective Policies

- **Engaging constructively**
- **Highlighting what works**
  - 15<sup>th</sup> anniversary of the Sarbanes-Oxley Act
- **Implementing the expanded auditor's report**
  - CAQ alerts

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One important takeaway from our Main Street Investor Survey is the degree to which public policy influences the confidence of investors. Confidence, in other words, isn't just a product of whether the Dow is up or down on any particular day.

It's more than that.

In fact, the US government is a top source of confidence for US investors. And the actions of Congress and the Administration are two of the most-cited factors by retail investors, when it comes to what affects their investment decision-making.

That's one reason why the public company auditing profession engages constructively with policymakers: to maintain a regulatory framework that is durable, effective, and flexible— to the benefit of investors and the markets.

A key part of our policy engagement is to highlight what works.

This past July, for example, was the 15th anniversary of the Sarbanes-Oxley Act. To mark that occasion, the CAQ teamed up with the SEC Historical Society to interview a wide range of stakeholders about that law's impact on today's markets. We spoke with investors, preparers, policymakers, educators, and others.

We presented their views in a set of videos that you can find on our YouTube channel. In one video, PCAOB Board Member Jeanette Franzel discusses how SOX restored the integrity of our capital markets. She says, and I quote:

*"We do not ever want to end up in the type of financial reporting and auditing crisis that we were in prior to the passage of SOX."*

We at the CAQ strongly agree with Board Member Franzel. That is why we stand by a strong and independent PCAOB—and by the mission of the PCAOB that SOX established. The PCAOB's strength and value to investors has been illustrated again this year by the approval of the expanded auditor's reporting model.

To take you down memory lane, the PCAOB started this project in earnest with a concept release issued in 2011. This past June, it adopted a final standard, which the SEC approved in October.

Between those 2011 and 2017 milestones, there was a journey of gathering input, fostering robust discussion, and refining policy proposals. The public company auditing profession engaged constructively and energetically. We hosted workshops with key stakeholders. We proactively field tested aspects of PCAOB proposals. And, of course, we submitted multiple comment letters.

Now the focus for all of us shifts to implementation of the expanded auditor's report. Through alerts and other communications, the CAQ will continue to keep our membership informed on the upcoming stages of this implementation. On Wednesday, the CAQ will publish a resource that will provide key considerations for audit committees on this issue.

As implementation proceeds, we urge the SEC and the PCAOB to continue their engagement with key stakeholders in the discussion. Such engagement will be critical as we head into a future of an expanded auditor's report.

Another critical implementation area for the profession is around the “New GAAP” standards going into effect in the next few years—most immediately revenue recognition, which becomes effective next year.

It's important to note that the internal controls related to both the transition and implementation are just as important as getting the day-one accounting right. Auditors, preparers and audit committees must be in the final stages for implementing the new standard and related disclosures.

And that leads me to my final point this morning on how we maintain investor confidence.

**We must innovate to respond to changes in our ever-evolving markets.**

**A Dynamic and Expanding Future**

- **Harnessing innovation** in the financial statement audit
- **Bringing to bear** the auditor's experience and values
  - AICPA Cybersecurity Risk Management Reporting Framework
  - Non-GAAP financial measures
- **Attracting top-tier talent** to public company auditing

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PCAOB Staff Addressing Cybersecurity Risk  
How the Auditing Profession Promotes Cybersecurity Resilience

The public company auditing profession is justifiably proud of its long history. Think of it - the AICPA traces its history back 130 years to 1887. Yet we are also excited about what lies ahead.

Our profession is dynamic and expanding. We see those dynamics at work in the innovative use of data analytics, artificial intelligence (AI), and other technology. Companies are changing the way they use data and AI. We as a profession are innovating to harness these advances to enhance work that auditors do.

And this is not just about the financial statement and ICFR audits. Outside those functions, we also see exciting developments emerging. These are areas where public company auditors can bring to bear their experience and their core values of independence, objectivity and skepticism. In doing so, they can enhance confidence in information that's provided to the market place.

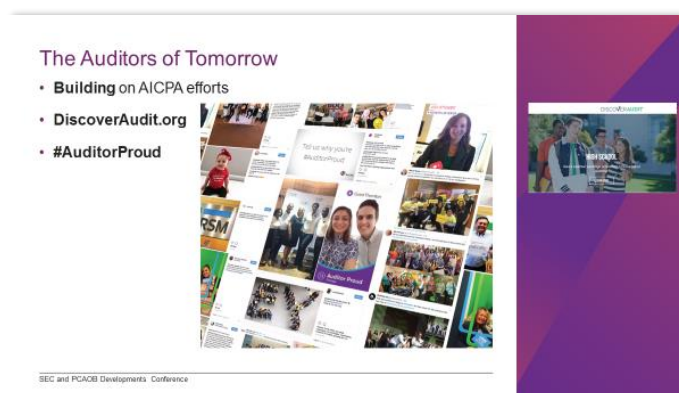
Cybersecurity is a great example. The AICPA is doing groundbreaking work to introduce a level of consistency in cybersecurity risk management that has not existed until now. The CAQ has been proud to work hand-in-hand with the AICPA on cybersecurity, and we will continue to interface on this issue with audit committees, investors, security experts, regulators, and other key groups across our markets.

Another example is non-GAAP measures. The CAQ has been exploring this complex topic at a set of roundtables bringing together management, audit committees, investors, lawyers, external auditors, and the AICPA Auditing Standards Board.

For their part, investors expressed their desire for consistency and comparability in the calculation of non-GAAP financial measures and key performance indicators, within a company and from company to company.

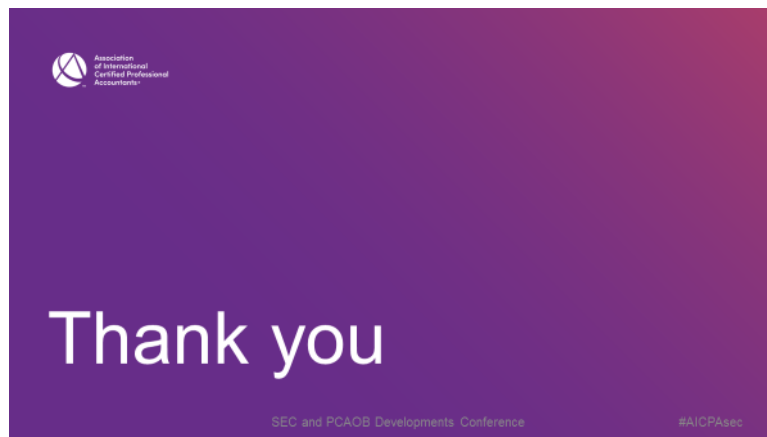
These ideas and others will shape our efforts as we continue to explore the non-GAAP issue. As it just so happens, we have another roundtable on the subject coming up next week. So, stay tuned for more.

Of course, the future of auditing isn't just about new controls or frameworks. It's about people: the auditors of tomorrow.



For many years, the AICPA has been hard at work on attracting top-tier talent to accounting and auditing. At the CAQ, we are joining the AICPA and putting a special focus on public company auditing as an excellent career choice. Our Discover Audit initiative has taken many forms, including conducting in-depth research, outreach to educators, and, of course, our #AuditorProud social media campaigns.

For our 2017 #AuditorProud blitz, thousands upon thousands of people—hailing from 482 cities in over 100 countries—posted messages that reached an audience of over five million. I invite you to visit the Discover Audit website to find resources and to learn more about these efforts.



In closing, let me return to where I began. US investors place extraordinary confidence in our capital markets, which are vibrant and sound.

We can never take these good things for granted. We must collaborate. We must work continually toward effective policies. And we must innovate, as we advance into an exciting future for auditors, investors, and the markets.

Now, we are fortunate to have a chance to discuss these matters and others with top leadership at the SEC. So thank you for your time today, and please join me in welcoming Chairman Clayton and Chief Accountant Bricker to the stage.