A New Era for Auditing After Sarbanes-Oxley

The US regulatory framework for the public company auditing profession helps to support audit quality and investor confidence.

In July 2002, the US public company auditing profession entered a new era. With the enactment of the Sarbanes-Oxley Act of 2002 (SOX), the profession was subject to a new regulatory framework, one designed to increase the reliability of financial reporting and to improve audit quality. That framework, which the profession has embraced, has been an extraordinary success, as shown by improvement in key measures such as investor confidence and trends in financial restatements. It's important to understand and highlight this regulatory success story, which is often overlooked by critics of the profession.

SOX Ushered in a New Regulatory Era for Public Company Auditing

The vote counts for SOX were extraordinary: 99-0 in the US Senate, and 423-3 in the House of Representatives. In broad terms, the landmark law made important advances, including the following.

- **Greater executive accountability:** Under SOX provisions, chief executives and chief financial officers would have to certify financial reports.
- **Independent audit committees:** The law required that public companies have audit committees that are independent of management. SOX also made audit committees, not management, responsible for hiring, compensating, and overseeing the external auditor.
- **Enhanced auditor independence:** SOX established rules such as lead engagement partner rotation, as well as the prohibition on certain non-audit services to audit clients.

Perhaps the most significant aspect of SOX was that it provided a new oversight framework for public company audits through the establishment of the Public Company Accounting Oversight Board (PCOAB). For the first time in US history, external auditors had a dedicated regulatory agency overseeing their work. Previously, the profession had been self-regulated. The PCAOB has a broad set of responsibilities, including the following:

- Registering public company accounting firms (as well as firms that audit securities brokers and dealers);
- Setting auditing, quality control, independence, ethics, and other standards applicable to the preparation of audit reports;

- Inspecting public company auditing firms; and
- Enforcing compliance by firms with their obligations relating to audit reports.

SOX Was a Catalyst for Continual Improvement

With this new framework in place, stakeholders across the private and public sectors began working individually and together as never before to improve financial reporting and audit quality. To take just one example, the Center for Audit Quality (CAQ) was created in 2007 in part to help the profession respond to and implement new standards and other policy initiatives from the PCAOB and other regulators. The CAQ has joined forces with other organizations in collaborative efforts aimed at fighting financial reporting fraud and enhancing the vital work of audit committees.

In the Post-SOX Era, Investor Confidence Has Been High and Steady

So how do we know that this new regulatory framework has been a success? One measure is investor confidence. Since 2007, the CAQ has commissioned an annual survey of US "Main Street" investors. In 2016, In 2016, 79 percent of investors expressed confidence in US capital markets, and 81 percent have confidence in investing in US public companies.

Additionally, the CAQ's Main Street Investor Survey asks respondents how much confidence they have in several entities when it comes to effectiveness in looking out for investor interests. For six consecutive years, independent auditors have topped this list.

Since SOX Implementation, Financial Restatements Have Trended Downward

Another important data set is the number of financial restatements by public companies. Research from Audit Analytics shows that overall restatement levels are down significantly from a post-SOX high in 2006 (after implementation of SOX Section 404 internal control reporting).

The Profession Will Continue to Play a Constructive Role

These positive metrics do not mean work to enhance audit quality is over. The public company auditing profession will continue to engage constructively with the PCAOB and other policymakers and standard setters, develop resources, collaborate with key partners and stakeholders, and foster academic research on auditing topics. All these activities will serve to enhance audit quality and increase investor confidence in our markets.

About the Center for Audit Quality

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs. For more information, visit www.thecaq.org.