

10. 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.

10.1 CAQ background

The CAQ is an autonomous public policy organization that was launched in 2007 and counts more than 600 U.S. public company auditing firms as members. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants (AICPA). The CAQ works to make public company audits even more reliable and relevant for investors in a time of growing financial complexity and market globalization. It also has undertaken research, offered recommendations to enhance investor confidence and the vitality of the capital markets, issued technical support for public company auditing professionals, and helped facilitate the public discussion about modernizing business reporting.

The CAQ's activities include:

- Bringing together stakeholders to discuss the future of the capital markets and audit quality;
- Conducting research on the perceptions of market participants to recommend enhancements to the auditing process that advance investor confidence and the vitality of capital markets;
- Assisting its more than 600 member public company audit firms in their pursuit of audit quality by providing technical alerts, white papers and webcasts on key issues and topics; and
- Acting as the public company auditing profession's liaison with policymakers.

The CAQ receives strategic guidance from a 12-person Governing Board composed of CEOs of public company auditing firms and the AICPA and includes three members independent from the public company accounting profession.

The CAQ's Executive Director is Cindy Fornelli. In 2011, Fornelli was honored for the third time by Directorship magazine as one of the 100 most influential people on corporate governance and in the boardroom, and Accounting Today named her one of the 100 most influential people in accounting for the fifth consecutive year. Fornelli currently serves as a member of the Financial Accounting Standards Advisory Council and the Securities and Exchange Commission Historical Society's

Board of Trustees, Class of 2014. She previously served on the National Association of Corporate Directors' (NACD) 2010 Blue Ribbon Commission on the Audit Committee and the NACD 2009 Blue Ribbon Commission on Risk Governance. Prior to becoming the Center's Executive Director, Fornelli was the Regulatory and Conflicts Management Executive at Bank of America. Before joining Bank of America, Fornelli was Deputy Director of the Division of Investment Management of the U.S. Securities and Exchange Commission.

10.2 Investor Education

In an effort to narrow the expectation and information gaps regarding public company auditing, the CAQ developed a series of film-noir style videos to introduce the people, laws and requirements that help ensure that the financial reporting process protects investors' interests. The CAQ created a dedicated website for the videos, CAQForInvestors.org, which contains additional CAQ materials of interest to investors.

The first video, "The System of Investor Protection," explains the roles of the external auditor, the audit committee chair, the chief financial officer, the internal auditor, and regulatory agencies. The 3-and-a-half minute video introduces those with key responsibilities in the financial reporting system: Ledger Lines, an external auditor with a granite chin, who explains the roles and responsibilities of Lotta Charts, a CFO and a whiz with the books; Indy Pendent, the chair of the independent audit committee and a man of integrity; Ida Figures, an internal auditor who's tough on the numbers; and Johnny Law, the cop on the beat who makes sure that everyone is playing by the rules.

The second video, "The Financial Statement Audit," features external auditor Ledger Lines explaining the audit process, including the risk assessment, selection of the audit team, collection and documentation of evidence, and issuance of a written audit opinion as to whether the financial statements, as a whole, are free of serious or material misstatement.

The CAQ's third investor education video spotlights the role of the audit committee and features Indy Pendent, the chair of the audit committee.

10.3 Individual Investor Survey

Since its inception in 2007, the CAQ has conducted the Main Street Investor Survey, an annual survey of individual investor confidence in the capital markets, publicly traded companies and audited financial information. In October, 2011, the CAQ released its 5th Annual Main Street Investor Survey. According to the survey results, 70% of individual investors indicated that they have at least some confidence in investing in U.S. public companies. While this represents a decline of five percentage points from 2010, a solid majority of American investors continue to express confidence in these companies. The investing public's confidence in U.S. capital markets dropped as well, but stands at a reasonably solid 61 percent (down from 68 percent in 2010). The results of the CAQ's 6th Annual Main Street Investor Survey will be released in fall 2012.

10.4 The Role of the Auditor

The CAQ launched an initiative on the Evolving Role of the Auditor to explore potential changes to the role of the auditor in light of changing market practices and investor information needs. The initiative began with a series of roundtables in Dallas, New York, San Francisco, Chicago and Toronto between May and July 2011. Investors, the public company auditing profession, regulators, standard setters and other stakeholders were asked whether there is more that auditors can do to help investors better understand the key financial risks within a company. Participants discussed how the auditor's role might evolve to improve financial reporting beyond the boundaries of the audit of financial statements and internal control over financial reporting.

The results of the roundtable discussions were released in the 2011, *Observations on the Evolving Role of the Auditor: A Summary of Stakeholder Discussions*. The report states that participants believe the audit is valuable and should not go away. Participants also want auditors to retain the attest function and not expand their reach into the realm of management by asserting new information about a company. Nevertheless, the participants observed that there is more that all participants in the financial reporting process, including independent auditors, can do to make corporate reporting more relevant for investors.

The CAQ continues to explore this issue through continued dialogue with stakeholders and policymakers and is committed to the goal of investor confidence in our financial reporting system and the checks and balances that underlie that system.

In March 2012, the CAQ held a workshop to further explore the observations made during the roundtable series over the course of 2011 on the evolving role of the public company auditor. More than 30 workshop participants gathered in New York on March 12 to consider how the public company auditor's role might change to meet the needs of investors. Over half of the workshop participants were investors and buy-side analysts; the remainder was a mix of audit committee members, preparers, auditors and others.

Workshop participants explored key areas that had been flagged at the roundtables, including the benefits of auditor involvement with financial information disclosed by management outside of the audited financial statements; specifically, Management's Discussion and Analysis (MD&A), earnings releases, and key performance indicators (KPIs).

Summary of Workshop on the Evolving Role of the Auditor, a report on the results of the Workshop, was released in May 2012. Workshop observations include: • Non-GAAP disclosures are important to investors' decision making processes, although audited financial statements provide a baseline; • More consistency and comparability is warranted in the use of KPIs in MD&A and earnings releases; • Investors want to hear directly from management; auditor involvement with information outside the financial statements could add an unwanted "filter"; and • Some investors would like to see a requirement that the auditor read and discuss the earnings release with the audit committee or perform a limited review.

10.5 Anti-fraud initiative

The CAQ Anti-Fraud Initiative endeavors to increase collaboration and communication among members of the financial reporting supply chain – audit committees, company management, internal auditors and external auditors – to help advance efforts to lessen fraud risk. In 2010, the CAQ released *Deterring and Detecting Financial Reporting Fraud – A Platform for Action*, which concluded that increased collaboration and communication among members of the "financial reporting supply chain" can greatly advance efforts to lessen fraud risk.

With the release of *Deterring and Detecting Financial Reporting Fraud*, the CAQ announced that it had joined with Financial Executives International (FEI), the National Association of Corporate Directors (NACD) and The Institute of Internal

Auditors (The IIA) in a collaborative partnership to develop of tools and best practices to help mitigate financial reporting fraud.

In 2011, FEI, in conjunction with the collaborative partners, released a new Fraud Literacy Quiz. The quiz, which is open to the public, comprises a series of questions designed to assess an individual's knowledge on topics related to deterring and detecting financial reporting fraud. In addition, a feature article in the November issue of Financial Executive magazine is available online.

In 2012, the collaborative partnership is unveiling several new products designed to mitigate the risk of financial reporting fraud. These materials will be made available on each partner organization's website.

10.6 Fair value accounting

The CAQ strongly defended fair value (or mark-to-market) accounting standards against calls for suspending the practice in the aftermath of the economic crisis in 2008 and 2009. CAQ Executive Director Cindy Fornelli sent a September 2008 letter to members of Congress stating that proposals to suspend fair value "are not in the best interest of investors or the capital markets and should be rejected."

The CAQ collaborated with investor groups, including the Council of Institutional Investors, CFA Institute and Consumer Federation of America, to oppose calls for suspending fair value accounting. In a joint letter in February 2009, the four organizations applauded Congressional efforts to restore investor confidence in the U.S. capital markets, but cautioned against a retreat from fair value.

In March 2009, Fornelli urged members of the House Financial Services Committee's Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises to reject calls for suspending fair value accounting during a March 2009 hearing.

10.7 Independent Standard-Setting

In November 2009, the CAQ joined with the Council of Institutional Investors, the Investment Company Institute and the United States Chamber of Commerce Center for Capital Market Competitiveness in a letter to discourage leaders of the House Financial Services Committee from taking actions that would potentially impact the independence of accounting standard-setting.

In May, 2010, the CAQ joined with the AICPA, the CFA Institute, the Council of Institutional Investors, Financial Executives International, the Investment Company Institute and the U.S. Chamber of Commerce on a letter to U.S. Senate leadership voicing concern over possible amendments that would legislate accounting standards.

10.8 IFRS

The U.S. Securities and Exchange Commission continues to explore whether to incorporate international financial reporting standards (IFRS) into the U.S. financial reporting system. The CAQ supports the adoption and universal application of a single set of high quality global accounting standards and that IFRS is best positioned to be that single set of standards.

On February 24, 2010, the U.S. Securities and Exchange Commission approved a statement that makes clear that the Commission continues to believe that a single set of high-quality globally accepted accounting standards would benefit U.S. investors and directed SEC staff to execute a Work Plan by 2011 to determine whether to incorporate international financial reporting standards (IFRS) into the U.S. financial reporting system.

In July 2012, the SEC released a staff report on the IFRS Work Plan. In Response to the staff report, the CAQ issued a statement that read, “While staff recommendations of specific approaches or dates for the possible incorporation of IFRS into the U.S. financial reporting system was beyond the scope of the staff’s Work Plan, we hope the information in the report will facilitate an SEC determination on incorporation of IFRS in the near future.”

In July 2009, the CAQ released its Guide to IFRS in the interest of an informed public discussion about possible U.S. transition to IFRS. The purpose of the Guide is to provide investors, policymakers and other capital market stakeholders a timely, accessible and objective introduction to the current debate over a single set of high quality global accounting standards.

10.9 Research

The CAQ facilitates research initiatives and provides independent funding of scholarly research projects to address new or significant issues relating to public company auditing and the capital markets.

10.9.1 Academic Research Funding

Since 2009, the CAQ through its Research Advisory Board, has annually funded independent academic research projects on auditing-related topics, including audit quality, professional judgment, professional skepticism, and the value of the audit.

The CAQ announced the most recent funding awards in May 2012. The following projects were chosen for funding:

- “Field Evidence of Auditor’s Views on Audit Quality and Earnings Quality” by Brant Christensen, Marjorie Shelley and Thomas C. Omer, Texas A&M University, and Steven M. Glover, Brigham Young University
- “A Field Investigation of Coordination and Communications in Globally Dispersed Audit Teams” by Denise Hanes, Bentley University
- “Field Study Examination of How Auditors Evaluate Internal Control over Financial Reporting: Implications for Practice and Research” by Jay Thibodeau, Bentley University, Jeffrey Cohen, Boston College, Jennifer Joe, Georgia State University, and Greg Tompeter, University of Central Florida
- “Learning More about Auditing Estimates Including Fair Value Measurements” by Mark Taylor and Yi-Jing Wu, Case Western Reserve University, and Steven M. Glover, Brigham Young University
- “Evaluating the Intentionality of Misstatements: How Auditors Can Better Differentiate Errors from Fraud” by Erin Hamilton, University of South Carolina

The CAQ’s research funding continues to provide opportunities for doctoral students. Three 2012 funding recipients, Texas A&M’s Christensen, Bentley’s Hanes and South Carolina’s Hamilton, are in accounting doctoral programs.

10.9.2 Research Symposium

The CAQ’s Research Symposium brings together senior audit partners and academic researchers to facilitate a dialogue on areas where research can enhance audit practice. The Symposium provides a unique opportunity for senior practice leaders from the public company audit firms and academics to discuss auditing issues. The 4th Annual Research Symposium was held in August 2012, in Washington, DC.

10.10 Publications

Summary of Workshop on the Evolving Role of the Auditor highlights findings from a March workshop in New York on the ideas most frequently identified for further exploration during the CAQ's 2011 outreach on how the public company auditor's role might evolve to meet the needs of investors (Observations on the Evolving Role of the Auditor). The report highlights workshop discussions on the benefits of auditor involvement with Management's Discussion and Analysis, earnings releases, and key performance indicators.

Observations on the Evolving Role of the Auditor explores the continued value of the audit and the role of the auditor going forward. In 2011, the CAQ convened a series of events with the full range of financial reporting stakeholders – CEOs, CFOs, board and audit committee members, investors, auditors, former regulators, attorneys and academics – to discuss responsible changes to the auditor's reporting model and the role of the auditor. Observations on the Evolving Role of the Auditor summarizes observations made during these discussions.

10.10.1 In-Depth Guide to Public Company Auditing

The In-Depth Guide to Public Company Auditing: The Financial Statement Audit is designed for investors and those interested in understanding the external audit process for public companies and role the audit plays in our capital markets. The In-Depth Guide to Public Company Auditing provides more detail about the audit process than the Guide to Public Company Auditing, which is an introduction and overview of public company auditing.

10.10.2 Guide to Public Company Auditing

The Guide to Public Company Auditing illustrates for capital market stakeholders the vital role public company auditors play in providing transparency in the markets. The publication serves as an introduction to, and overview of, the key processes, participants and issues related to public company auditing. Presented in a straightforward, easy-to-use format, the Guide to Public Company Auditing demonstrates to investors the important role public company auditing plays in preserving the strength and stability of U.S. capital markets.

10.10.3 Guide to International Financial Reporting Standards

The Guide to International Financial Reporting Standards (IFRS) is an overview of the issue of global accounting standards to provide investors, policymakers and other capital market stakeholders an accessible and objective introduction to the current debate over a single set of high quality global accounting standards. In the spirit of educating stakeholders, the CAQ developed the Guide to IFRS to help facilitate an informed discussion among interested parties.

10.11 Membership and structure

The CAQ is self-supporting and entirely funded by member dues. Membership in the CAQ is open to U.S. accounting firms registered with the Public Company Accounting Oversight Board (PCAOB). Associate membership is available for U.S. accounting firms not registered with the PCAOB. The CAQ also offers international firm subscriptions.