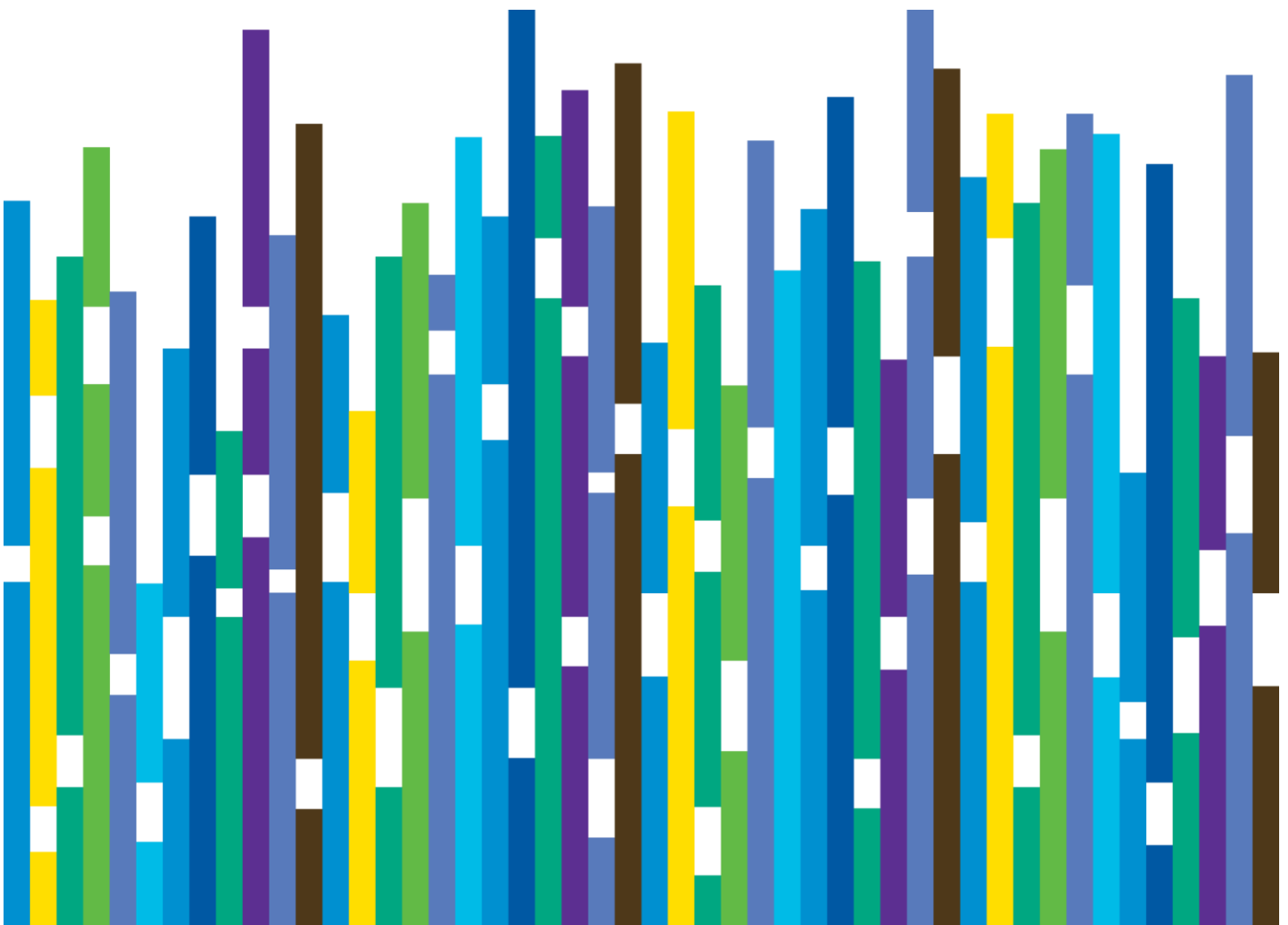




CFA Institute

REGULATORY OVERSIGHT AND THE INDEPENDENT AUDIT SURVEY REPORT

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REGULATORY OVERSIGHT AND THE INDEPENDENT AUDIT SURVEY REPORT

Contents

About the Survey

Background and Purpose..... 3
Methodology..... 3

Survey Results

Quality of the Audit..... 4
Current Regulatory Oversight and Enforcement..... 5
Transparency of Inspection Reports 6
Independent Auditor’s Report 7

Comments

To what extent do you agree or disagree that regulatory oversight and enforcement of the independent audit improves the quality of the audit? 8
To what extent do you agree or disagree that current regulatory oversight and enforcement of the independent audit is effective? 8
In your opinion, do inspection reports issued by regulators of audit firms need to be more transparent? Yes – please explain 8
In your opinion, do inspection reports issued by regulators of audit firms need to be more transparent? No – please explain why not 10
In your opinion, should risk factors associated with measurement uncertainties in an entity's financial statements be included in the independent auditor's report? 10

Additional Comments 12
Survey Questionnaire 14

About the Survey

Background and Purpose

CFA Institute collected member feedback on the regulatory oversight function and whether risk factors associated with measurement uncertainties in an entity's financial statements should be included in the independent auditor's report. Member feedback will be used to inform the International Forum of Independent Audit Regulators (IFIAR) as they deliberate proposed changes to the audit process and discuss investor perceptions and preferences for expanded transparency in both audit regulation and independent auditor reporting.

Methodology

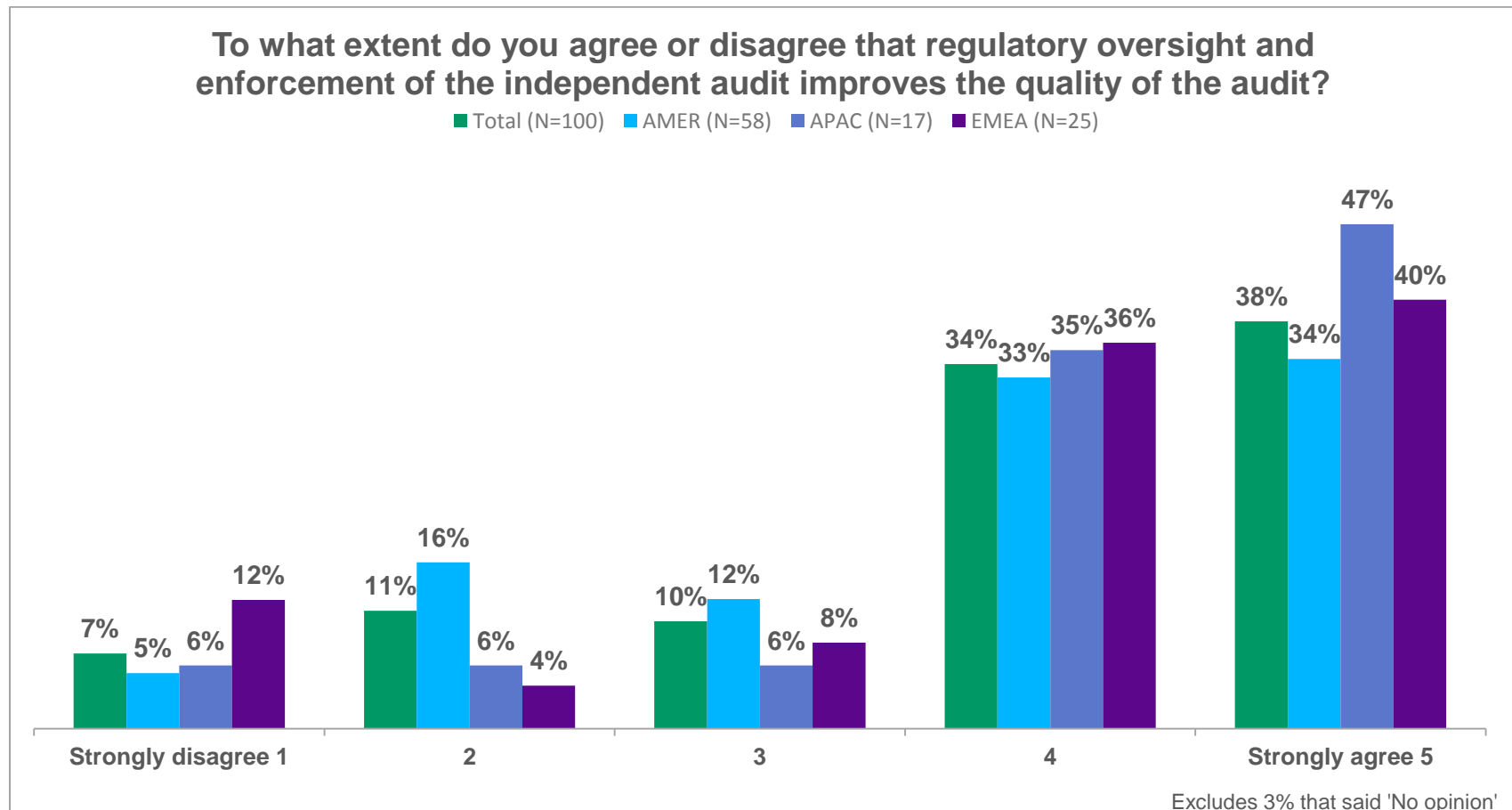
On 19 September 2012, the 498 CFA Institute members comprising the Financial Reporting Survey Pool were invited to participate in the online survey. One reminder was sent to non-respondents on 24 September, and the survey closed on 25 September 2012. 104 members responded for a response rate of 21% and a margin of error of $\pm 8.5\%$ at the 95% confidence level.

Survey Results

Quality of the Audit

Overall, 72 percent of respondents agree that regulatory oversight and enforcement of the independent audit improves the quality of the audit.

A higher proportion of those in APAC (47 percent) strongly agree than those in AMER (34 percent) and EMEA (40 percent).

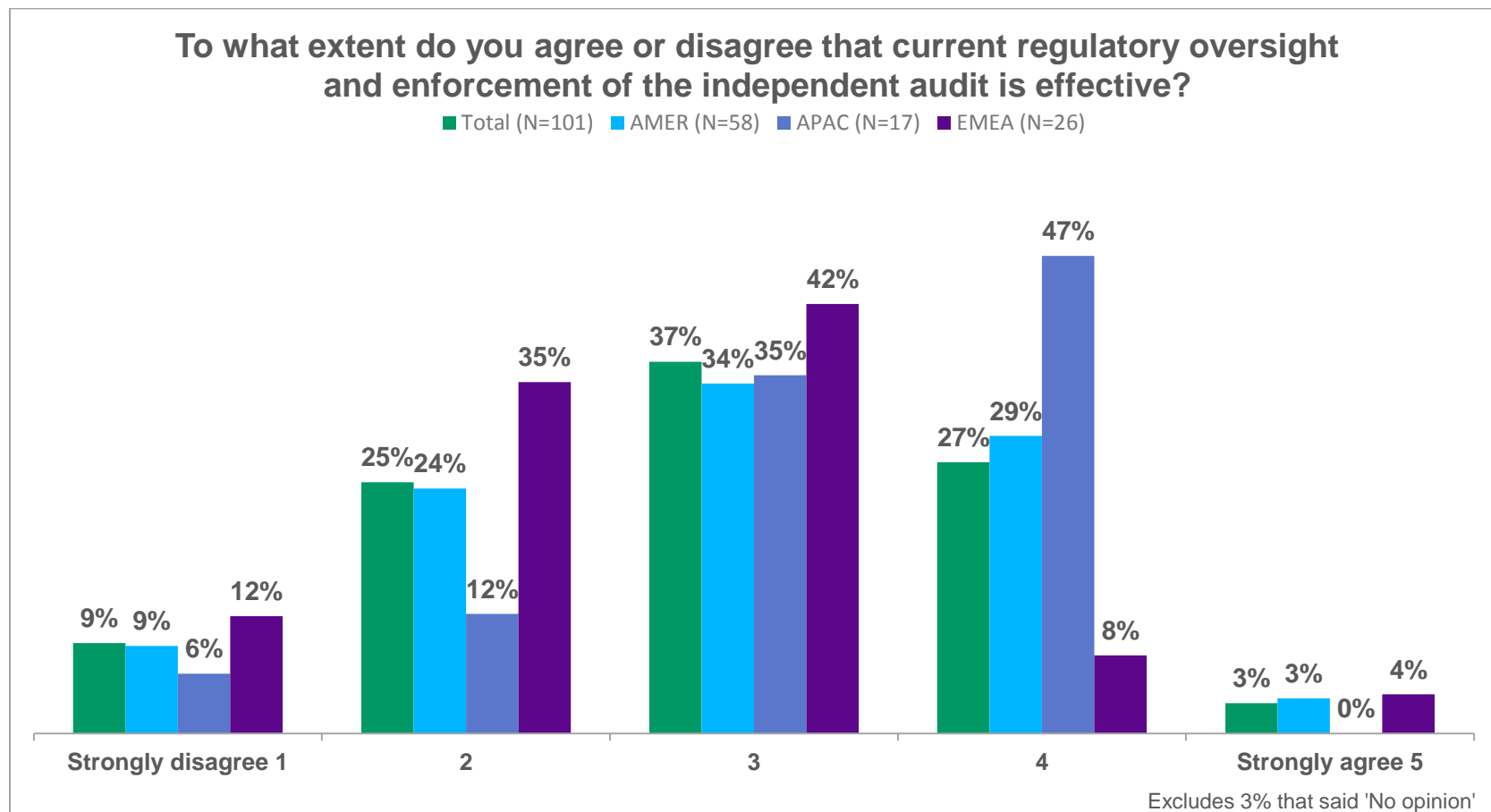


Current Regulatory Oversight and Enforcement

Overall, 30 percent agree that current regulatory oversight and enforcement of the independent audit is effective.

34 percent disagree with a higher proportion of those in EMEA (47 percent) than AMER (33 percent) and APAC (18 percent).

37 percent of respondents neither agree nor disagree.

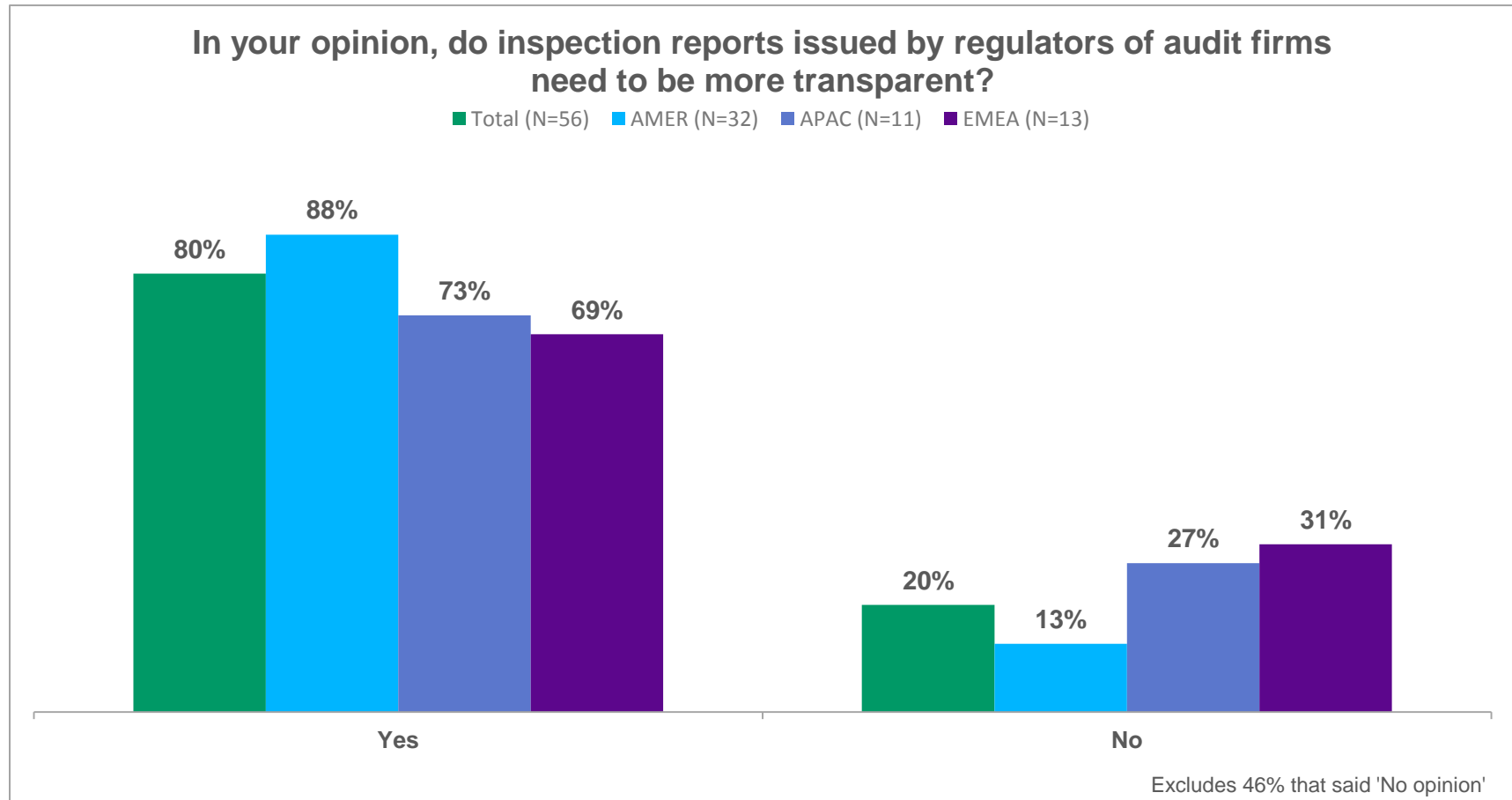


Transparency of Inspection Reports

Overall, 80 percent of respondents think inspection reports issued by regulators of audit firms need to be more transparent, with a higher proportion of those in AMER (88 percent) than in APAC (73 percent) and EMEA (69 percent).

20 percent do not think inspection reports need to be more transparent.

46 percent had no opinion.

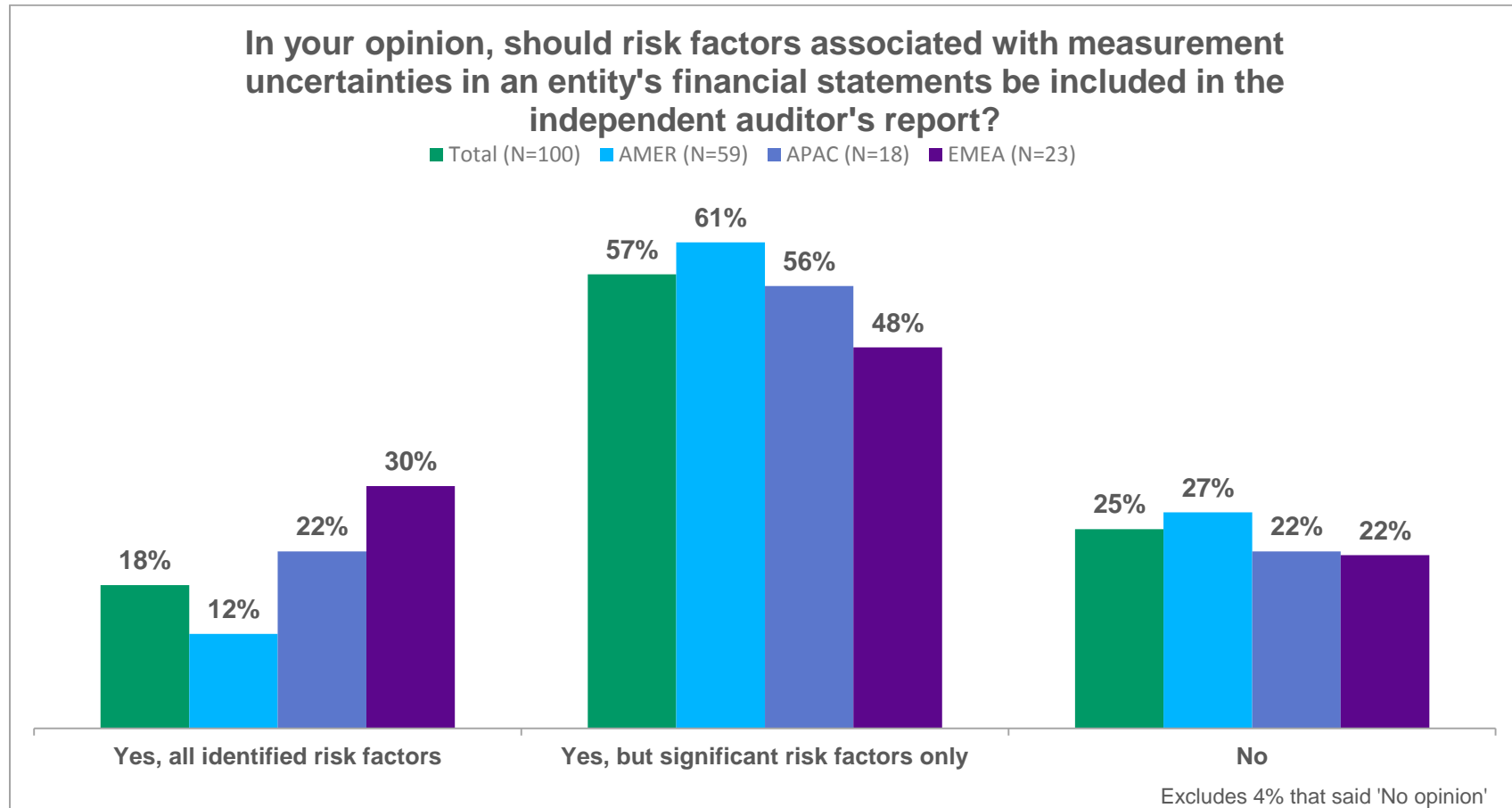


Independent Auditor's Report

57 percent of respondents think only significant risk factors associated with measurement uncertainties in an entity's financial statements should be included in the independent auditor's report.

18 percent think all identified risk factors should be included with a higher proportion of those in EMEA (30 percent) than AMER (12 percent) and APAC (22 percent).

25 percent do not think risk factors should be included in the independent auditor's report.



Comments¹

To what extent do you agree or disagree that regulatory oversight and enforcement of the independent audit improves the quality of the audit?

- Having worked on any number of accounting fraud cases, regulatory oversight is not likely to deter defalcations or other errors. (Americas)
- If oversight is strong then company or management can't play with the auditor. (EMEA)
- It might have a minor impact. (Americas)
- The accounting profession has (in most instances) always been a self-regulating body. Adding additional layers of regulation will not add anything to this structure. (Asia Pacific)
- The audit process seems to be working fine. (Americas)
- The quality of the audit is more influenced by the quality & integrity of the auditor and firm as well as the threat of personal liability. (Americas)

To what extent do you agree or disagree that current regulatory oversight and enforcement of the independent audit is effective?

- Enforcement / assessment of audit is fundamentally based on the same processes upon which audits are based, and are therefore subject to the same flaws. (EMEA)
- I believe sometimes they overemphasize on areas that are not real risk areas and not focused on big picture areas of concern. (Americas)
- I still think there are many areas where companies apply GAAP differently to the point of confusion to investors and the audit firms and PCAOB okay it. (Americas)
- It provides some assurance, but focuses on issues that the SEC doesn't see as very important -- quality of work papers, procedures in confirming receivables. It is too much in the weeds rather than making a broader assessment of whether the auditor evaluated key risks properly. (Americas)
- Just a couple examples: Chinese reverse merger company financial fraud epidemic; finance firms w/ investment grade credit rating given clean bill of health then blowing up a short time later... (Americas)
- PCAOB needs more resources so that it can do a better job of overseeing accounting practices in public companies. In particular, it needs greater power to impose compliance with Section 404 of Sarbanes-Oxley. Exempting smaller companies from complying with Sec. 404 was just the opposite of what we needed. It is those smaller companies that have the weakest internal controls in the first place. They're the ones that need 404 the most. If any group should have been exempted, it should have been the biggest companies. If the small companies think that 404 compliance is too expensive then let them go private. They can't have it both ways. (Americas)
- SOX should be amended to make PCAOB enforcement actions public. (Americas)
- We haven't seen any significant problem, so assume it is working. (Americas)

In your opinion, do inspection reports issued by regulators of audit firms need to be more transparent? Yes – please explain

- More detail about which office of which firm has been flagged for deficiencies. (Americas)
- Plain English (Americas)
- Full disclosure of most recent reports issued by inspector should be made available. (Americas)
- They should be available to the public (Americas)

¹ In some cases the respondent comments were edited to improve readability and understanding.

- Current audit reports generally only express an unqualified or qualified opinion with insufficient explanation for qualified opinions. (Americas)
- I do this full-time and I didn't even know I could access these (Americas)
- Should make the quality control part of the PCAOB report public. (Americas)
- Should provide summary of findings and conclusion as to whether these were considered material or not (Americas)
- Mandatory rotation of auditors (Asia Pacific)
- Make them public. (Americas)
- The reports as currently written are of very little use for investors. According to the PCAOB, none of the audit firms can properly perform an audit. If that's actually the case, then our entire financial system is built on a foundation of sand. (Americas)
- The information should be easier for everyone to get and share. (Asia Pacific)
- Yes, the public could learn of high risk areas from these disclosures, even if on a no-name basis (Americas)
- Yes need to be more transparent because in current environment there is doubt in experts' mind regarding effective functions of regulators (EMEA)
- So the public will have a basis in valuing the firm (Asia Pacific)
- Important for users to understand the extent and nature of findings (Americas)
- Name names, not just of the audit firms, but of the partner(s)-in-charge of a deficient audit (Americas)
- Apply greater transparency to audits/auditors of large public filers (Americas)
- All significant findings should be disclosed. (Americas)
- Transparency increases the incentive for auditors to maintain standards, and disclosure enables others to learn from 'mistakes' (EMEA)
- Transparency is the key in making an informed decision. (Americas)
- Part 2 (Americas)
- Naming of responsible persons (EMEA)
- Reason for opinion (Americas)
- To allow users to understand better the regulator's view (Asia Pacific)
- Detail methodology of review and explain findings (Asia Pacific)
- In order to see and understand potential conflict of interests it is necessary to have more transparent reports (EMEA)
- There shouldn't be confusion created from the inspection reports (Americas)
- Should be more timely (Americas)
- The audit firms are not independent from management therefore they lack transparency (EMEA)
- More widely disseminated (Americas)
- Will improve auditor selection decisions (Americas)
- Issue sooner and name deficient audits and involved partners (Americas)
- Auditors are like the lumber at home depot -- warped. Jerry Garcia was straighter than many audit partners. (Americas)
- Statements made do not refer to the exact nature of deficiencies uncovered (Asia Pacific)
- I have never come across such regulator's report. (Asia Pacific)
- Include basis of inspection (Asia Pacific)
- Should be relevant to the situation and also immediate for the period under review. (EMEA)
- At the least they should be easily available preferably on a website (EMEA)
- Need to be more specific so meaningful comparisons between audit forms can take place (EMEA)
- It would be helpful to have company names on the report, like the SEC is transparent. (Americas)
- Hard to determine the level of audit quality from private reports (Americas)

In your opinion, do inspection reports issued by regulators of audit firms need to be more transparent? No – please explain why not

- Review of audit firms is usually conducted through peer review and overseen by the practice standards bodies within the accounting institute. If issues are found, these results are published already (if significant) (Asia Pacific)
- Could unfairly limit a CPA firm's business... (Americas)
- Regulators' findings do not add value to external investors who do not have full understanding of the auditing standards and practices. They focus on issues only and do not provide an objective picture of particular firm's quality of services. Issues identified should be followed up by regulators, but should not be provided to general public in all details. (EMEA)
- Already detailed (EMEA)
- It has no impact at the end. (EMEA)

In your opinion, should risk factors associated with measurement uncertainties in an entity's financial statements be included in the independent auditor's report?

- Auditing is about a lot more than numbers. The complexity imposed by complying with GAAP obscures the level of risk at both industry and company levels. Auditors need to have a broader view than just GAAP, and requiring them to disclose all risk factors that enhance the uncertainty of measurement would provide additional useful information and context to investors and other consumers of audit information. (Americas)
- Auditors seldom have any insight into measurement uncertainties which would be of value to the user of the financial statements. This inclusion would only antagonise clients, and further weaken relationships. (EMEA)
- But should be categorized by high/medium/low risk. (Asia Pacific)
- Companies will be punished by any negative inferred from the auditors. (Americas)
- It is already intimated that in a risk based audit, that all identified risks are being addressed. What is the purpose of adding more verbiage? (Asia Pacific)
- It's the company's responsibility to explain risk factors in its disclosures. Seems like it would be easier to have the audit opinion cover the other parts of the Form 10-K than to make the auditors repeat the same items. (Americas)
- Management needs to make the representation, not auditors. Auditors are there to audit, not create. (Americas)
- Measurement uncertainties should already be identified in key assumptions and estimates sections of the financial statements - perhaps need expanding on. As worded your suggestion would lead to boiler plate wording in audit reports. Better would be discussion of matters reported to audit committees and specifically areas of disagreement between the auditor and management. (EMEA)
- Not sure. Investors don't often read the report other than to check if qualified, etc. (EMEA)
- Risk factors are already reported in the 10K -- if measurement uncertainties are material, they should be mentioned by management in the 10K. (Americas)
- Risk factors should be identified by management and described in the financial statements. It's not appropriate to shift this responsibility to a party independent of the entity which is clearly not in the best position to do so (EMEA)
- Significant risks should be listed but not in boiler plate language. Don't just give notice that there is a risk but try to quantify the size/significance and the probability. (Americas)
- The financial statements are currently littered with too much junk like corporate governance reports, standard accounting policies and the financial risks section is completely over the top. (Asia Pacific)

- There is simply too much room for people to fudge what is considered significant. And auditors being paid by companies to produce the audit have an inherent conflict of interest that makes them willing to play that fudge. (Asia Pacific)
- This needs to be addressed through accounting standards-setting and/or SEC regulation in audited footnotes to GAAP financial statements. The auditor attests to management's information - be careful about asking the auditor to supplement or explain audited material. (Americas)
- This would be nearly impossible to achieve. (Americas)
- Yes, because this is an area where there can be significant variability based on management judgment and measurement subjectivity. By limiting the risk factors to significant factors only, I have hope that the information would not be boilerplate. (Americas)

Additional Comments

- Audit quality and auditor independence are very important and in need of improvement. (Americas)
- Auditor is a consultant who is paid by the client. Risk of measurement is included in the price of audit. The reliability of client's data is responsibility of client and should be guaranteed by the regulator. Investors can only 50% rely on the audit and 50% rely on the regulator. (Asia Pacific)
- Auditors are doing a poor job because the audited pays the auditor. / A vendor will not issue negative comments about their customer. (Americas)
- I don't know what inspection reports by the regulators are--I've never seen one. (Americas)
- I don't think investors actually read the inspection reports, however, if there are major issues with an audit firm's work, then, yes, that information should be discussed transparently in the inspection report. (Americas)
- I have come to the conclusion that regulators are incompetent and cannot be trusted to provide any useful information under any circumstances. (Americas)
- It's tempting to try to "get the auditor to say what they really think" publicly - but there's a danger in that kind of approach. It could muddy responsibility for financial statements (which should lay fully on management). Auditors should be responsible for their attestation. If we want additional risk information suggest do that through accounting footnote disclosure, which is audited, and standards-setting. That said I'm not against all public discussion of audit methods by the auditor, and can see a possibility of requiring additional auditor information for large public firm auditors, but it needs to be done carefully to balance legal risks against other considerations. (Americas)
- More government is not the efficient solution to many financial reporting problems -- nor is complexity. Audit Committees already make a report to shareholders. I suggest that critical risk issues identified in the 10K be referenced in the Audit Committee reports so that investors know what the Audit Committee deems important to reported results. (Americas)
- No one really understands what the inspection reports say since information is buried somewhere, more transparency is absolutely needed. (Americas)
- PCAOB is the best thing that's happened to the audit profession in my lifetime. Though I prefer responsible self-regulation to the heavy-handed government kind, the audit profession, locked arm-in-arm, as it was, with its shills at the AICPA, long ago proved itself incapable of regulating responsibly. I believe that we need greater personal accountability in the audit process. Therefore, I favor requiring the partner(s)-in-charge of a particular audit to sign the audit opinion personally. That conveys greater responsibility and personalizes that responsibility in a way that the audit firm's signature by itself does not. Finally, I favor prohibiting firms that provide audit services to public companies from offering any other services. Period. Auditing needs to be their sole sustenance. That will eliminate the subsidies that are now available to audits through higher prices for tax and consulting work. Auditors need to be as pure as the driven snow. They should have thoughts of providing nothing but audit services. Anything else detracts from the audit effort and puts it at risk. The investing public deserves better, and PCAOB can help us achieve that by limiting the services that audit firms offer their public-company clients to auditing only. (Americas)
- Regulating the auditors does not help to improve the quality of the financial statements of companies. It's the companies that need to have the quality and knowledge to produce proper financial statements. / If someone wants to cheat or to commit a crime, you won't be able to stop them, and even more the external auditors won't be able to stop them. Regulating them more and more only increases the administration costs with no real benefit for the shareholders and investors. (EMEA)
- The real problem about "independent audit" is that audit firms can never be independent as long as the source of their revenue streams is the audit fees paid by their audited clients. / / The regulators should really change the compensation structure of audit firm, e.g. by creating a pool,

partially funded by fixed due levied to audited companies, and partially funded service fee charged to investors. Auditors then don't get direct revenue from their audit target. But there are still motivation and competition among auditors to do better job in order to attract investors and win more clients (The pool can simply design a compensation structure like pay by the size of the client and by the number of audited clients). (Americas)

- The regulators have demonstrated time and time again that they have a very difficult time effectively regulating nearly every aspect of the financial system. The audit firms are no different. The PCAOB is an inconsistent regulator that constantly moves the goalposts on the audit firms. From what I can tell, the minute the audit firms correct a shortcoming (as defined by the PCAOB), the regulators make the standards even more difficult to meet. The audit firms are caught between a rock and a hard place. (Americas)
- Too many details would just make audit firms more defensive in debating regulators on the improvements needed, rather than actually helping quality. In fact, it would slow down the process to a crawl.(Americas)
- Unless people end up in handcuffs, corporate charters get revoked or fines are multiples of damages (instead of fractions thereof), any regulatory oversight is literally toothless. (Americas)

Survey Questionnaire

1. To what extent do you agree or disagree that regulatory oversight and enforcement of the independent audit improves the quality of the audit?

Scale: Strongly disagree 1, 2, 3, 4, Strongly agree 5, No opinion

Comments (optional): [text box]

2. To what extent do you agree or disagree that current regulatory oversight and enforcement of the independent audit is effective?

Scale: Strongly disagree 1, 2, 3, 4, Strongly agree 5, No opinion

Comments (optional): [text box]

3. In your opinion, should risk factors associated with measurement uncertainties in an entity's financial statements be included in the independent auditor's report?

- a. Yes, all identified risk factors
- b. Yes, but significant risk factors only
- c. No
- d. No opinion

Comments (optional): [text box]

4. In your opinion, do inspection reports issued by regulators of audit firms need to be more transparent?

- a. Yes (please explain): [text box]
- b. No (please explain why not): [text box]
- c. No opinion

5. Additional comments:

[text box]