Views on Public Company Auditors:

Audit Committee Member and Institutional Investor Research Findings

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KRC RESEARCH

CAQ

About KRC Research

KRC Research is a global opinion research and insights consultancy that specializes in designing research to support effective public affairs, advocacy, engagement and communications initiatives. For over 30 years, we have helped nonprofits, governments, and corporations execute on their strategic imperatives and meet their organizational goals.

Our team draws from the worlds of global health, consumer and social marketing, journalism and academia, and public policy arenas. Not only are we passionate about the work we do for clients, but we also pride ourselves on being flexible, practical, creative, and knowledgeable, combining sophisticated research tools with real-world intelligence and communications experience.

We understand the needs and challenges of diverse target audiences and complex objectives. This breadth of experience and depth of knowledge positions KRC to deliver the highest quality insights needed to inform your organization's most pressing strategic decisions.

About the Center for Audit Quality

The Center for Audit Quality (CAQ) is a nonpartisan public policy organization serving as the voice of U.S. public company auditors and matters related to the audits of public companies. The CAQ promotes high-quality performance by U.S. public company auditors; convenes capital market stakeholders to advance the discussion of critical issues affecting audit quality, U.S. public company reporting, and investor trust in the capital markets; and using independent research and analyses, champions policies and standards that bolster and support the effectiveness and responsiveness of U.S. public company auditors and audits to dynamic market conditions.

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Introduction

Capital markets serve as an important engine for driving and maintaining our economic and societal well-being. For capital markets to operate efficiently, investors must trust the information they use to make investment decisions is accurate, transparent and reliable. As a result, investors need an independent third party to provide assurance on the information provided by company management. In their public interest role, public company auditors provide an independent assessment of company management's reporting that investors depend on when making investment decisions.

This research was commissioned to gather insights into how institutional investors, who utilize the work of public company auditors, and audit committees, who oversee the work of auditors, perceive them.

Objectives & Methodology

OBJECTIVES

As part of the CAQ's efforts to engage a broader array of stakeholders and serve as a prominent voice for the audit profession, KRC Research conducted qualitative research in the format of in-depth interviews with Institutional Investors and Audit Committee Members of publicly traded companies.

The research was designed to assess sentiment toward public company auditors, including:

+ Overall impressions, including recent trends.
+ The value, expertise, and independence of public company auditing.
+ The role public company auditors play in measuring GAAP and non-GAAP components of a business.
+ The role public company auditors play in evaluating environmental, social and governance (ESG) statements issued by publicly traded companies.

METHODOLOGY

+ KRC Research conducted 31 in-depth interviews with two audiences:
    - Fifteen interviews with Institutional Investors working at companies with a minimum of $500M in assets under management,
    - Sixteen interviews with Audit Committee Board Members of publicly traded companies who deal directly with public company auditing firms.
+ Interviews were conducted from February 2 to March 1, 2023.
+ Each interview was approximately one hour in length.

Key Findings

All audiences have a high level of confidence in public company audit firms to assure financial statements of publicly traded companies. They are known for being highly skilled, diligent, professional and an independent third party not influenced by company management.

The value of the audit is acknowledged by all because it brings trust and credibility to financial statements, which is critical to capital markets. Independence from company management was the most important attribute of audit firms to ensure an unbiased assessment of financial statements.

Leveraging technology for audits was the most cited trend in audit firms over the past few years. This includes using technology to enable increased remote work, digitizing the audit process, and applying machine learning to assess large datasets and identify risk. Use of technology is mostly seen as a positive trend because it allows for greater efficiency in the audit process.

Turnover is the most cited negative trend in public company audit firms. Board Members are seeing younger, less experienced auditors who don't fully understand the business they are auditing, which is critical in the audit process. This leads to a steep learning curve for new auditors, reduced efficiency, and increased costs.

Board Members and Institutional Investors expressed openness to audit firms assuring ESG statements. A majority of both audiences were positive toward audit firms assuring ESG statements because they believed their skills are transferable to attestation of ESG information. Those against audit firms performing ESG audits felt firms did not have the right skillset because auditing ESG is more subjective and the methodologies and metrics are undefined.

Detailed Findings

Attitudes Toward Public Company Audit Firms

POSITIVE PERCEPTIONS ARE DRIVEN BY:

+ Professionalism
+ Highly trained skillset
+ Diligence in auditing public company financial statements

Although not common, less flattering adjectives shared were: bureaucratic, risk averse, rigid, slow, and costly.

"

Public auditing firms make sure everyone is kept honest, all information is kept where it's been diligently audited. The first word that comes to my mind, is a positive overview of the company's wellness and the company's health, overall.

Board Member

Trends in Public Company Audit Firms

Board Members and Investors are seeing firsthand how trends that were initially adopted as a result of the pandemic remain prevalent across the industry.

Remote Work

Leveraging technology to perform audits remotely was initially an accommodation for the pandemic but is now a permanent reality. Most felt remote work was a positive because it can be done more efficiently, though some felt that in-person interactions provide better exposure to company information.

Use of Technology

Technology has affected not only the amount of work done remotely but also how audits are performed. Machine learning has created efficiencies in the auditing process and allowed auditors to better assess risk for their clients.

Turnover

Several Board Members perceive high staff turnover and feel there are younger and less experienced auditors. Similarly, many felt auditing firms are understaffed and auditors are overworked.

Increasingly Strict Regulations

Many Board Members and some Investors said they have observed increasingly strict measures put in place for auditors by the PCAOB. Many question whether these added regulations serve as useful measures that add value or if they merely create unnecessary work and costs that then must be passed along to clients.

> I see our auditors as partners because we all have the same goal. We want investors to have the best information. And, that's why I feel like we work together. It's great to have people again from the audit firms who work on a variety of mutual funds or hedge funds, whatever it may be. Their experience brings a lot there for us.
>
> **Board Member**

The Value of Public Company Auditing Firms to Society

Audit firms' value is derived from independence but is also viewed as a partnership.

Assurance

Both Board Members and Investors find value in public company auditing firms' **ability to provide assurance to a company and its stakeholders**. This high level of assurance confirms the reliability and transparency of a company's statements and instills shareholder trust.

Independence

Most Board Members and Investors cited the **independent nature of public company auditing firms**, which provides additional affirmation for a company and its stakeholders that all statements are accurate and accounted for.

Partnership

Although independence is key, many also highlighted that value can be derived from **the partnership role that public company auditing firms play**. Auditing firms have the company's best interest in mind and partner with them to ensure accuracy for all stakeholders.

> Safety, security, and assuring the stakeholders and stockholders everything is in line as it should be and complies with regulation and standard accounting practices.
>
> **Investor**

> The value it brings is assurance that the financial statements have been reviewed and annually audited by a qualified firm and can give the assurance to the investor as well as any public stakeholder that when they look at those financials they have comfort there is some certainty they're accurate.
>
> **Board Member**

Strengths & Weaknesses of Public Company Audit Firms

STRENGTHS

Expertise

Nearly all acknowledged that public company audit firms have deep expertise that allows them to not only accurately audit financial statements but also provide professional guidance on a company's audit processes to ensure accuracy and transparency in financial reporting.

Attention to detail

Public company audit firms are extremely detail oriented, which is important in auditing companies' financial statements, especially large, diverse multinational companies and complex investment vehicles. While some Board Members complained about audit firms "over auditing" or paying too much attention to less important processes, they still acknowledge the importance of being detail oriented to ensure the accuracy of financial statements.

Professional guidance

Board Members and some Institutional Investors specifically highlighted that audit firms' expertise allows them to provide guidance on audit and financial reporting processes and identify any risk factors related to processes.

Consistency

Given their expertise in GAAP, audit firms are very consistent in their work across companies, which is important to ensuring all firms are following the appropriate practices and processes that reduce errors and increase confidence in financial statements.

> The biggest advantage is just they provide an expertise, of working on results in a consistent and comprehensive fashion. I think that was the number one benefit.
>
> **Investor**

> Audit skills are one thing. You've got generally accepted auditing standards, GAAP, SOX. That's all fine, but the missing element here is really an understanding of how all of that applies in the business environment. There's a gap between those two things. The good auditors clearly have been able to bridge that gap and understand how these businesses operate.
>
> **Investor**

WEAKNESSES

Turnover and inexperienced, young auditors

Turnover, leading to younger and less experienced auditors who may not fully understand the business they are auditing, was a predominant theme for Board Members (and some Investors as well). Many elaborated on their concerns with the turnover they are witnessing among their auditors.

Industry knowledge

Most felt that to effectively audit a company, it is crucial to understand the industry and how it works. This included both the valuation of a company's assets and understanding the reporting risks common to a particular industry. For example, valuation of a pharmaceutical company's pipeline requires an auditor to be familiar with the industry and its research and development functions. Turnover, and younger, inexperienced auditors, exacerbates this situation as new auditors are constantly being assigned to a company's audit.

Risk averse

Because of the volume of regulations, many audit firms are seen as risk averse, leading audit teams to pay too much attention to minutiae or over auditing according to members of both audiences. Board Members and Institutional Investors, whose firms are also audited, commented that perceive that audit firms often pay too much attention to small and less important details.

Perceptions of Industry Regulation

OVERALL, BOARD MEMBERS AND INVESTORS FEEL THAT CURRENT REGULATIONS ARE APPROPRIATE.

Although a few Board Members felt that regulations are too strict, most Board Members and Investors believe **there is currently an appropriate amount of regulation in place for public company audit firms**.

They felt the critical nature of the audit function, as well as the need for independence and due diligence to ensure financial statements can be trusted, **offsets any current concerns about overregulation**.

“

There are some things the PCAOB has required audit firms to do that in my opinion are a bit over the top. It’s just sometimes you can use logic and logic should be something that gets you to the right answer instead of these check-the-box processes the PCAOB and now the auditors are required to do.

Board Member

“

PCAOB has put a lot of pressure on accounting firms, and the PCAOB has actually, in some respects, probably held the public accounting firms accountable where maybe in the past they weren’t so accountable. I know there is a sense it’s heavy of the PCAOB, but I actually think it’s necessary.

Board Member

Value of the Audit

VALUE OF THE AUDIT

All agreed that public company audit firms play a crucial role in bringing trust to capital markets by delivering high-quality audits of financial statements because investors and the public rely on their accuracy in investment decision-making.

That an audit functions as an **independent, objective third-party assessment** to provide assurance on the information provided by company management is a key component of providing trust in companies' financial statements.

Because auditors prioritize independence and focus on ensuring frameworks are adhered to, these characteristics are most likely to ensure the auditing function is performed effectively and financial statements can be trusted. Even those more critical of public company audit firms have a high level of confidence in the audit function.

Independence & Expertise

INDEPENDENCE

Independence of auditors and **avoiding conflict of interest** were most important to Board Members and Institutional Investors. There is broad agreement that changes because of the Sarbanes-Oxley Act (SOX) have been vital in addressing the conflict-of-interest issue that came to light through Enron.

Both Board Members and Institutional Investors also acknowledged the critical role of an independent audit committee that selects, hires, fires, and pays independent auditors. That audit committees are mostly independent members of the Board of Directors and the auditors are also an independent entity **minimizes the risks of conflicts of interests or undue influence being placed on auditors by a company's management team**.

EXPERTISE

Interviewees acknowledged the importance of the audit team's **ability to leverage multidisciplinary models to address complex business transactions**. Investors are quick to point out just being a CPA is not enough, and that a thorough understanding of the industry in which the business operates as well as the day-to-day operations of the business are important to assuring the accuracy and integrity of the audit.

Many focused on auditors bringing a level of expertise to the table that really allows them to understand not only the numbers but the business as a whole. This allows them to identify risks that may have otherwise been overlooked.

While GAAP is important, it is US focused and, given the global nature of our economy, international regulations are also an important area of expertise. Some worried about gaps that exist between the auditing standards and how they apply in an actual business environment. This concern ties back to the auditors bringing in the appropriate expertise that aligns with company operations.

> “It's comforting there is independence and the idea of the audit committee not being linked to the day-to-day operations of the company. That's greater credibility…and there is less ability to do anything other than report the truth.
>
> **Investor**

Role of the Auditor

There was **openness to public company accounting firms expanding into other areas such as cybersecurity and ESG**. There were three general reactions to the idea:

+ Cohort #1: This group was **not favorable to public company accounting firms also assuring a company's cybersecurity and ESG statements** for four reasons: 1) Lack of expertise, 2) erosion of independence, 3) reduced focus on financial statements, and 4) cost.

+ Cohort #2: Another group of Board Members and Investors was more **open to using public company accounting firms for nonfinancial assurance such as cybersecurity and ESG**. A few Board Members in the financial services industry said their accounting firms already perform some level of cybersecurity assurance because the risk of being hacked and losing customer information could result in significant financial losses.

+ Cohort #3: A third cohort was **open to the idea of using public company accounting firms for areas outside the financial audit, but this group did not think firms currently have the skillset, credentials, or expertise**. Credentialing and demonstrating skillset are critical to demonstrating public company audit firms should expand into other areas, particularly cybersecurity and ESG.

Institutional Investors and some Board Members had a more positive reaction to the role of auditors in non-GAAP information. Non-GAAP financial measures were seen as being more aligned with the skillset of auditing financial statements, an area where Investors are more skeptical of public company reporting.

> Would you trust a public company's ESG statement more if it were verified or assured by a public company accounting firm? I would trust it a lot more.
>
> **Investor**

> I think ESG is a little less quantitative in nature, a little more qualitative. I mean firms probably could develop a practice to do it but those skills are not quite as transferable. I think it would take a different set of skills to be evaluating environmental, governance, and social.
>
> **Board Member**

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