Remarks before the 2019 Baruch College Financial Reporting Conference: Aiming toward the future

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I. Introduction

Thank you, Dean Huss, for the kind introduction. I'm grateful for the opportunity to visit Baruch College's Zicklin School of Business and speak at the annual financial reporting conference for the fourth time. Many students who were starting their collegiate work here when I first spoke at this conference are now members of the graduating class.

I could use other examples in tracking changes to make the same point: the world stops for no one. Financial reporting is not exempt from change. This conference also provides an opportunity to talk about current issues in financial reporting and to peer into the future together and explore the role of financial reporting in a rapidly changing society. I'll use a four-year timeframe to describe changes.

Next week is National Small Business Week. It's a week when the U.S. Small Business Administration takes the opportunity to highlight the impact of outstanding entrepreneurs, small business owners, and community members from all 50 states and U.S. territories.

This year also marks the launch of a new office at the Securities and Exchange Commission ("SEC" or the "Commission"), the Office of the Advocate for Small Business Capital Formation, with the mission of advocating for the interests of small businesses and small business investors.[1] It's a good time for all of us to consider ways to do more for small businesses and their investors in the area of financial reporting.
Before I continue, let me remind you that the views expressed today are my own and not necessarily those of the Commission, the individual Commissioners, or other colleagues on the Commission staff.

Let me also express my gratitude to my colleagues in OCA for continuing to provide thoughtful advice to the Commission regarding accounting and auditing matters and acknowledge in particular the assistance of Ying Compton and Carlton Tartar in preparing me to make today's remarks.

My ambition today is to provoke thought about 1) where we have been over time and 2) several trends and ideas to incorporate in planning for the future of financial reporting.

In doing so, I will use as an essential starting point, an understanding of the overall financial reporting structure – the blueprint – which I introduced last year with a video.[2] Management is the starting point for robust, accountable financial reporting, along with effective board and audit committee oversight. Regular, reliable, and independent audits enhance investors' confidence in the quality and reliability of financial statements. Over time, the quality and reliability of the overall U.S. financial reporting structure has been strengthened through comprehensive efforts – including requirements for public companies to strengthen audit committees, evaluate the effectiveness of internal control over financial reporting, make directors and officers liable for accuracy of financial statements, and financially support the Financial Accounting Standards Board ("FASB") and Public Company Accounting Oversight Board ("PCAOB"), among many other things.

We all go to work every day recognizing the enormous responsibility that we and others have to foster decision-useful financial reporting for investors— including sophisticated institutional investors and, importantly, Main Street investors. Our work has the far-reaching impacts in our society: in 2018, almost 45 percent of U.S. households owned some type of registered fund.[3]Many of these people are saving for a home, retirement, or school; they are parents, veterans, teachers, and first responders.

While I remain optimistic about the long-term role of financial reporting in the United States and the world, the backdrop is complex. In my view, we face a long term trend of less overall trust and confidence in virtually all institutions, from corporations to audit firms. This trend must be reversed, and we must all work to do so. The future must be met with all of us involved in financial reporting being clear-minded, evidence-based, courageous, and frank regarding the objectives, responsibilities, and sensible expectations for each involved in financial reporting. Confusion or lack of action in this regard undermines purpose, trust, quality, confidence, and ultimately increases costs borne by shareholders.

II. Financial Reporting and Our Work in Advancing It

Confidence in financial reporting is essential to a healthy economy, including in the capital markets. However, financial reporting is a means to an end; it is not the end. Its purpose is to measure, reflect, describe, interpret, or otherwise disclose business events that have taken place in a decision-useful manner. High-quality, general-purpose financial statements are designed to help investors make well-informed investment decisions.

A company's control environment is a pervasive and vital aspect of getting reporting done right, acknowledging the inherent limitations of any financial reporting process.[4] Ultimately, I believe, it is self-defeating for management to issue materially misstated financial statements, or an auditor to certify those financial statements. For instance, materially misstated financial statements that create false expectations of future results could increase the pressure on management to continue to engage in improper accounting practices when the business performance does not turn around. Unless management addresses the issue, the position becomes untenable and can eventually lead to a restatement. The costs of financial reporting failure can be substantial. While most professionals are doing the right thing, instances of financial statement fraud, though relatively infrequent, do occur. When they occur, they can have profound effect on investors. Thus, it helps policymakers and practitioners alike to ask the question, how can we analyze previous failures, understand the root causes, learn from them, and find effective and efficient ways to limit failure while restricting burdens and costs on honestly- and well-run companies? In answering this question, it is also essential that the correct lesson be learned by the party with the corresponding responsibility to limit failure: management is responsible for preparing financial statements, subject to board and audit committee oversight; the independent external auditors then evaluate the fair presentation of these financial statements in relation to a financial reporting framework.

Work in advancing financial reporting

Our work over the past four years has emphasized several well-established themes:

#1. Talent and integrity. Perhaps the biggest challenge and focus area facing the auditing profession, and to some extent accounting more generally, is an apparent decline in the attractiveness of auditing, particularly to students. The decline has been influenced by issues of understanding the purpose and meaning (the "why") of auditing, education requirements, compensation, heavy workloads, and a perception that other career opportunities are more exciting and rewarding.
We all have an opportunity to inspire the future generation of accountants –convincingly demonstrating the worth of careers in accounting and audit that serve a vital role in society, incorporate technology, and provide a basis for developing other specialized skills. We also need to focus on the diversity of background, perspectives, and thinking.

This is an effort that will require intense collaboration among audit firms, professional societies, government, and the academic community. It is in everyone's interest that the "best" people enter the profession, excited and ready to contribute. To achieve that, we should be asking if our best accounting practitioners and educators are exciting students and stimulating minds? Similarly, do seasoned practitioners inspire less tenured ones to see the purpose and importance of their work and how it is meaningful to the financial well-being of millions?

We also look to accountants and others who participate in our capital markets to act with the highest level of integrity and accountability. While the vast majority of accountants meet our high standards, the Commission will continue to protect investors from the minority of individuals who do not meet their professional responsibilities using all tools available. Relatedly, any efforts to subvert a Commission or PCAOB process are unacceptable. In the past several years, the PCAOB brought several actions where attempts to manipulate workpapers in advance of inspections reached the highest levels of a firm.[5] Also, just last year, the Commission brought charges against six certified public accountants – including former staffers at the PCAOB and former senior individuals at KPMG– arising from their participation in a scheme to misappropriate and use confidential information relating to the PCAOB's planned inspections of KPMG.[6] Such alleged behavior has no place in our markets.
#2. Accounting standards ("New-GAAP"). Necessary to the reliability and comparability of financial information is the maintenance of a set of accounting standards and practices that are oriented to the needs of

investors. Investors are now receiving (or soon will receive) financial statements based on several comprehensive new standards, including many that have largely converged with International Financial Reporting Standards ("IFRS"). Since 2015, the FASB has issued significant updates including enhancements in the following areas:

- revenue recognition,
- leases,
- current expected credit losses,
- targeted improvements to hedging activities, and
- investments in equity securities.

These new standards are at various stages of implementation. I believe they have enhanced and will continue to enhance financial reporting.

#3. Non-GAAP. Non-GAAP is a form of voluntary reporting, designed to supplement (and must be reconciled to, though not supplant, with presentation not more prominent than,) the comparable GAAP numbers. When done properly, the reporting can add critical insight for investors to the company's performance from management's perspective.
Investors benefit from understanding business performance from various perspectives: financial measures of GAAP and non-GAAP and operational measures. When taken together, these perspectives can establish a strong foundation for decision-making. When taken in isolation, however, insights into business performance is limited.

Operational measures are generally the direct results of actions, although they are not necessarily direct measures of economic value. Financial measures are historical, generally-accepted measures of economic value, integrated across a company's financial position, performance, and cash flows. Thus, it can be useful for investors to receive a mosaic of information – to receive operational and financial measures as a signal of activity and value.

Integrity and consistency in the non-GAAP and key operational figures are essential characteristics. In 2016, the SEC staff released new and revised guidance on the use of non-GAAP financial measures to address the concern regarding practices seen as potentially misleading. The SEC staff also has emphasized the essential role of appropriate and effective disclosure controls and procedures, which should be designed to provide timely information to management to allow for timely decisions regarding required disclosures.

#4. Internal Control over Financial Reporting ("ICFR"). ICFR fosters reliability in the financial reporting process and has benefited from time and attention. In 2015, concerns were raised regarding how companies and auditors should address requirements to maintain effective ICFR.[7] My colleagues at the SEC and I have worked diligently, together with the PCAOB and others, in an accessible manner, to communicate to companies, audit committees, and auditors about resources, such as the COSO's 2013 framework,[8] the SEC's interpretative guidance on management's report,[9] and other available publications.[10]
The SEC also announced settled enforcement actions relating to the requirements to maintain ICFR and evaluate its effectiveness.[11] The SEC has also issued a Report of Investigation pertaining to the statutory requirement to devise and maintain internal accounting controls that reasonably safeguard companies and, ultimately, investor assets from cyber-related frauds.[12] Separately, the disclosure of material weaknesses in ICFR does not obviate the need to remediate those weaknesses in a reasonable period of time.
#5. Auditor independence. Independence is fundamental to the credibility of audit reports and investor confidence in them. The judgments auditors make in the course of their audit work must be objective and impartial.
The auditor independence rules and standards must be reviewed over time to ascertain whether they meet the needs of evaluating auditor independence in a changing environment. In May 2018, the Commission proposed amendments to the Commission's auditor independence rules to refocus the analysis that must be conducted when an auditor has a lending relationship with certain shareholders of an audit client.[13] Issuance of final rules is on the Commission's agenda for 2019.[14]
Also, in this area, I understand that auditors are being asked with some frequency in the fund industry to consider providing permissible tax services to the fund, subject to pre-approval. Auditors and independent audit committees, of course, must take care to adhere to the law in both the process and conclusions.[15] In doing so, attention should be given to avoiding scope creep into prohibited services, such as bookkeeping or other services related to the accounting records or financial statements.
#6. Audit regulation. Auditors are subject to a system of public regulation, self-regulation, and controls that, taken as a whole, constitutes the regulation of the profession. Attention in this area is premised in the role of an

auditor as a vital gatekeeper in financial reporting.[16] Preserving and enhancing confidence in the quality of audit services is essential to the public interest and all Americans.
The independent auditor helps to build confidence in financial statements. As of December 31, 2018, there were 1,862 public accounting firms registered with the PCAOB, which means that they are authorized to audit U.S. public companies.[17]
The SEC appointed five new Board members to join the PCAOB in 2018, the first time five new members joined the Board in the same year since the PCAOB was established. The appointments provided a significant opportunity—a chance for the PCAOB to learn from the fresh and diverse thinking of the new Board members, to innovate, and ultimately to enhance its oversight of the auditing profession in an increasingly dynamic and demanding environment.

The PCAOB's work has been substantial over time, including with:

- improvements to the transparency of audits – requiring disclosure of certain audit participants on a new PCAOB form, and establishing *AuditorSearch*, a public database of engagement partners and audit firms participating in audits of U.S. public companies; and
- changes to the auditor's report– some of the most significant amendments in 70 years.

#7. Audit firm governance. Last year at this conference I mentioned that the leaders of many of the largest, most complex audit firms, had earlier appointed (or would be appointing) independent directors or independent advisory council members with meaningful governance responsibilities.[18]Those remarks provide context for these comments on the same topic.
Five of the six largest U.S. firms have added valuable outside perspectives.[19] The purpose of adding outside views in those roles is to strengthen monitoring and to enhance advising to foster audit quality; this, in turn, will bolster public confidence and trust in the firm, its network, and the audit profession generally.
This year, I would like to provide my personal views on how to advance the thinking with some suggestions for U.S. firms:

- Outside members should be strong and steadfast, independent of mind and willing to challenge each other and firm leadership constructively.
- Each member should clearly understand their responsibilities and stake in the firm's long-term performance in delivering quality audit services.
- Each member should make active and substantive contributions including, for example, by providing input into setting the board's or council's agenda.
- Members should provide input to the firm's annual transparency or audit quality report (which is voluntary in the U.S.), especially regarding the board's or council's charter, work, and outcomes.[20]

#8. Independent audit committees of public companies. Audit committees of listed public companies have become well-recognized and essential in the governance of listed public companies and increasingly of entities in other countries. In the U.S., they have financial reporting and external auditor oversight authority and responsibility. They set the tone for the company's financial reporting and the relationship with the external auditor.
In my experience, some of the more important drivers of audit committee effectiveness are the independence of the members, the time invested in the oversight functions, the quality of the committee's information and communication from management and the auditors, and the committee members' training and experience relevant to their oversight responsibilities. I encourage audit committees and their advisors to think along these dimensions to increase effectiveness. In addition, an audit committee should incorporate the audit firm's understanding of the company's business and audit risks into its oversight of the auditor's expertise, incentives and, ultimately, appropriate performance in the conduct of the audit.

As relevant information for the audit committees' oversight, I believe it is also essential for the committee members to familiarize themselves with relevant research evidence. For example, existing academic research has not been conclusive on the relationship between an auditor's tenure and either audit quality or auditor independence. Some studies document that mandated rotation may worsen an auditor's efforts to be skeptical and may mask company "opinion shopping." There is also some evidence suggesting that professional skepticism can, in some cases, benefit from a long-term auditor-client relationship.[21]
Audit committees work in the interest of shareholders, and they have a clear information advantage over outside shareholders. As such, I have encouraged voluntary audit committee-related disclosures, which are increasing. I am heartened by the momentum over the past several years, recognizing there is always more that could be done.

For example, in a survey of proxy statement disclosures by Fortune 100 companies relating to audit committees in 2018:[22]

- sixty-two percent of companies disclosed the factors used in the audit committee's assessment of the external auditor's qualifications and work quality, while in 2012 the percentage was 18%, and
- eighty-nine percent of companies disclosed that the audit committee considers non-audit fees and services when assessing auditor independence, up from 12% in 2012.

I encourage audit committee members of listed companies to continue to consider ways to make their communication with investors more useful, including communicating *how* the audit committee met its responsibilities.

#9. International cooperation. The business environment continues to reflect the extensive cross-border reach of companies and the markets they serve. OCA is actively engaged in promoting comparability among public company financial reporting and audit activities on the global front as well.

Over the past year, I have participated in the work of the Monitoring Group. The Monitoring Group is a group of regulatory and international financial organizations committed to advancing the public interest.[23] The Monitoring Group's work is done in view of promoting international audit quality in order to strengthen confidence in the audit of financial statements, in particular, those of public companies.[24] Given the importance of international standards to the U.S. capital markets, I was honored to be appointed to serve in the roles of vice chair, now co-chair, and in a few weeks will assume the role of chair of the Monitoring Group.

The approach I have taken over the past year has been, and will continue to be *collaboration* with and among Monitoring Group members, including exchanging views on ways to strengthen the effectiveness of the structure and governance of setting international audit-related standards. This collaborative spirit is also consistent with the Monitoring Group's main mode of decision-making: *consensus*, which helps incorporate each member's view.

I have also urged *continuous improvement* as a parallel, current, and an ongoing responsibility of all the organizations involved in the overall structure for setting international audit-related standards, including the standard setting boards, the International Federation of Accountants (IFAC), the Public Interest Oversight Board (PIOB), and the Monitoring Group. It is the responsibility of each organization to identify and respond to necessary changes in a timely manner, even in addition to and apart from the Monitoring Group's ongoing effort at developing recommendations to strengthen the structure and governance of international audit-related standard setting.

Having said that, the effectiveness of standard setting also depends on the human factor. I look forward to working with the chairs and leaders of the PIOB, IFAC, and the standard setting boards to better understand whether behaviors — at the individual, group and organizational level — are calibrated and aligned in such a way that the entire system works smoothly and effectively.

On a separate front of international cooperation and coordination, though significant progress has been made, obstacles to the flow of information from foreign jurisdictions to U.S. regulators remain, hindering regulatory oversight of U.S.-listed companies. Last December, Chairman Clayton, Chairman Duhnke and I communicated such concerns to the market in a statement. We highlighted impediments to the SEC's and PCAOB's regulation, supervision, and enforcement resulting from restrictions on the access to books and records maintained in China, and the PCAOB's inability to inspect the audit work of PCAOB-registered accounting firms with respect to U.S.-listed companies with operations in China. Such limited oversight as a result of barriers to information access, combined with limited enforcement tools, could allow bad actors to hide fraud more effectively and do so without meaningful consequence, including the inability of defrauded investors to recoup losses. This state of affairs undermines confidence in all China-based companies.[25] It is important for investors, advisors, securities analysts, index publishers, and others to be aware of the impact of limitations in this area.

As we noted in December, depending on various facts and circumstances, including company-specific considerations, if significant information barriers persist, remedial actions involving U.S.-listed companies may be necessary or appropriate. In the past, remedial measures have included, as examples, requiring affected companies to make additional disclosures and placing additional restrictions on new securities issuances. Companies need to consider how these circumstances could affect their initial or periodic disclosures.

#10. Technology, data, and innovation. Not a day goes by without illustrations of the profound effects of technology on the economy. Technological developments are changing business and financial reporting, and consequently how effective audit approaches take advantage of technology and data.

Among other work, we engage with market participants on innovative ideas and technological developments. As an example, we collaborate with the SEC staff's FinHub (Strategic Hub for Innovation and Financial Technology) to help reduce regulatory barriers to innovation that benefits investors and the markets. The Commission also has supported the expansion of the role of structured data, tagging, and related

systems to provide investors with new and efficient ways to consume and analyze the information in our markets.

These are examples of changes just in the past four years, many of which were planned years ago and benefited from multiple years of development. The changes have strengthened the structure for financial reporting.

III. Some Currently Observed Outcomes

The financial reporting structure is supported by clear responsibilities for and certifications from management; requirements to devise and maintain sufficient internal accounting controls; requirements to have independent, expert audit committees or others charged with governance; clear accounting and reporting standards issued by a reliable, well-resourced standard setter; strong audit firms; a well-resourced audit regulator; and timely, prevention-first (among other essential) regulatory approaches.

The following observations also buttress my belief in the current strength of the U.S. financial reporting structure:

- While our collective work is never done and the inherent risks of financial reporting failure are always present, restatement rates in the most recent past have been at the lowest level in about two decades.[26] A survey of investors indicates a high degree of confidence in financial reporting.[27]
- Companies with ineffective disclosure controls (242 in 2018) have decreased for the second year in a row, after peaking in 2015 (275), with IT-specific controls being the most frequently identified deficiency.[28]
- During 2018, there were 209 new engagements and 186 departures among the major global and national audit firms, suggesting that audit committees can and do change audit firms.[29]
- Similar to restatements, while our collective work to reduce defect rates is never done, auditor inspection findings in the U.S. are on the decline, particularly among the largest of registered firms, both in frequency and severity.

Although these points are anecdotal, I believe they are consistent with an emphasis on maintaining a high-quality financial reporting structure, a structure that fosters investor confidence, promotes efficient capital allocation, and ultimately makes the U.S. more competitive in the global marketplace.

IV. Aiming Toward the Future

We should not rest on our laurels. We must peer into the future and plan. I will discuss two broad areas that have gone through significant changes and identify opportunities for the accounting profession.

Economic trends

As context for my perspective, the SEC oversees over $97 trillion in securities trading annually on U.S. equity markets and the activities of over 27,000 registered market participants, including investment advisers, mutual funds, exchange-traded funds (ETF), broker-dealers, municipal advisors, and transfer agents.[30]
The SEC is responsible for selectively reviewing the disclosures and financial statements of almost 8,000 reporting companies, of which approximately 4,300 are exchange listed.[31] Of the top 100 publicly traded companies in the world, 81 are subject to the SEC's reporting requirements.[32]

Evolution of technology

Technology is a prominent force that has been a catalyst of profound changes to business models, business process, accounting, and auditing.

The technology sector has attracted substantial amounts of capital investment and represents a significant share of the economy. Since its invention in 1989, the World Wide Web has exponentially expanded the reach of information technology and has transformed the world and business. For example, as of March 2019, the S&P 500 index included 68 companies belonging to the Information Technology sector,[33] representing 21% of S&P 500 companies' total market capitalization.[34]
These statistics are significant, yet they understate the impact of technology in a sense because they do not capture the effect of technology in transforming how companies in other sectors do business.[35] They also illustrate the pervasive and fast pace of change in technology, which also affects how investors and other users access and process financial information.
The SEC itself demonstrates the impact of technology as its IT systems provide a critical service to the markets. On a typical day, investors and other market participants access disclosure documents through the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system 41 million times. Again, that's a single day!

The opportunities and benefits of technology provide also come with risks and complexities. For example, data security and privacy concerns are coming to the fore. How we respond to these challenges will have a profound

effect on our capital markets. As such, we need to understand these changes through the lens of our capital markets, particularly in their impact on financial reporting. Adequately preparing the next generation of the accounting profession for such challenges will be critical to that understanding.

Investment strategies

On the investing side, retail investors are and have been critical to our capital markets. Over the past four decades, they have been increasingly relying on financial intermediaries to help them make investment decisions. For example, almost 45 percent of U.S. households owned funds (generally ETFs or mutual funds) in 2018, a sharp increase from about only six percent in 1980.[36]

As a result of innovative, valuable institutional services, the U.S. issuers' equity securities markets have been increasingly intermediated, although further separating companies from their ultimate, retail investors. For example,

- In 1950, institutional shareholdings accounted for only 7% of total U.S. equity ownership; this percentage rose to 28% in 1979, and over 50% in 1999.[37]
- For S&P 500 companies, the rate of institutional shareholdings increased to about 80% in 2017.[38] A change that has fueled this trend is the growing shift from actively-managed to passively-managed funds. In every year since 2005, actively-managed U.S. domestic equity mutual funds experienced outflows, while index domestic equity mutual funds had inflows and index domestic equity ETFs had positive net share issuance.[39]

These shifts can impact how accounting and audit information serves investors. For example, passive investors are not necessarily passive owners. Their governance and trading decisions rely on the consumption of high-quality, consistent, comparable financial information and other metrics, in part, because it reduces their trading and monitoring costs.[40]

Also, passive investing relies on the efforts of active investors whose buying and selling activities determine share prices. Transparent financial disclosures are essential for active investors to set informationally efficient prices.

Thus, there exists a strong demand for extensive, refined financial data for corporate managers and investment advisors, both of whom manage shareholder capital. Opportunities go to those who identify the changes affecting the market participants and how needs for financial data used by investors might change.

Small business

Another broad economic influence is the pace of small business formation. While attention is sometimes focused on large corporations, the growth and reporting of small businesses are vital to our economy.

I want to discuss two broad observations I have had related to small businesses.

First, auditors serve a vital role in providing candid feedback to the small businesses they audit, in either a financial statement only audit or an integrated audit. They can and should engage in two-way communications with the companies they audit because such communications help the auditor elicit useful information from management and improve audit quality.

The auditor has certain communications that are required to be made to the audit committee in all audits conducted under PCAOB standards, such as the communication of uncorrected and corrected misstatements[41] and significant deficiencies and material weaknesses identified during the audit[42]. In addition to these required communications, the auditor has ongoing two-way communications with management and the audit committee regarding matters about internal controls, complex accounting matters and other matters impacting the audit. The auditor's feedback in these areas can help the company gain a better understanding of the related audit decisions and lead to corresponding improvements. I believe auditors can effectively serve this role within the boundaries of the independence rules. It is essential for auditors to have processes and controls to help mitigate the occurrence of a violation of the independence rules.

Audit firms can provide both audit and permissible other services to the same public audit client and serve the public and shareholder interests of strengthening companies and their financial reporting, while also in many cases benefitting audit quality. Relative to large and mature companies, small businesses likely have shorter history and hence less experience in building up robust internal control systems, so they may particularly benefit from objective, seasoned feedback regarding the role and consequences of useful information.

We are all better off when auditors fully embrace their role in providing audit feedback and other services, which facilitates improvement to financial reports prepared by management, and increases the effectiveness of the audit committee's oversight.

Second, it is essential to note that mandates for disclosures always come at a cost, and such cost could be disproportionately burdensome on small businesses. In my view, the experience with graduated disclosures or phased implementation has been positive.

As an example of graduated disclosures, public companies referred to as Emerging Growth Companies ("EGC's") or as Smaller Reporting Companies are permitted to present two (instead of three) years of financial statements and MD&A. The JOBS Act also allows EGCs to elect to use private company transition dates for accounting standards.[43]
Phased effective dates have been applied recently to the PCAOB's new auditor reporting standard – auditors of companies that are not large accelerated filers will have an additional 18 months to implement the requirements for critical audit matters. This approach can apply to other standard-setting activities as well. Phased implementation enables all involved in the implementation of new or revised standards to monitor the experiences of earlier adopters, including consideration of any unintended consequences. Phased implementation can facilitate more timely and effective post-implementation reviews, and provide support for regulatory or standard setting changes, education, and coordination, where necessary.

International trends

Let me now transition to several international trends.

Today's companies both operate and seek capital globally. There has been extensive international cooperation to promote convergence, where possible, between domestic and international accounting and audit standards, and work against fragmented regulation. The SEC has for decades considered accounting convergence, as an example.[44]
It is crucial to identify similarities and differences in financial reporting and auditing standards across countries and reconcile them where possible. Differences in these standards and their applications contribute to uneven financial reporting quality and audit quality; this, in turn, manifests in additional costs that investors bear in acquiring and processing information about foreign companies relative to domestic companies and imposes significant costs on foreign companies seeking cross-listing.[45] Overcoming such information barriers is vital for companies and their investors to realize the benefits of cross-border capital flows and a diversified investor base.[46]
Given the nature and size of our capital markets,[47] I would expect the U.S. to set a benchmark in the quality of financial reporting and audit services, in no small part due to coordinated, intensely collaborative, and informed thinking regarding the overall financial reporting structure.
I also recognize that countries around the world have different legal, governance, capital markets systems, and regulatory approaches. For example, regarding regulating the audit market, the U.K. has recently issued several reports with varying objectives. In my view, some recommendations have limited use in a U.S. and international context; they might, in fact, present risks to audit quality and investor interests in those contexts.

For example, one report[48] includes a recommendation that the governance regime for an audit firm's business should include a board comprising "a majority of non-executive directors" that reports to a new regulator. Non-executive appointments should "be approved" by the new regulator. This regulator would be charged with establishing wider public interest responsibilities that run even beyond investors' interests.[49]
An effective and efficient global capital market depends on high-quality financial information that is reliable and comparable, regardless of country of origin. Continually advancing the goal of disclosure of information across borders requires the cooperative efforts of all participants in the capital raising and financial reporting processes, including national governments, regulators, the international business community, international financial institutions, accounting and audit standard setters, and audit firms.

I am concerned about national approaches that structurally intertwine private sector and public sector responsibilities –blurring the lines of responsibilities and accountabilities of each and adding additional undefined, and multilayered, incentives. For example, the path of embedding within a private-sector audit firm's chain of command a board answerable to the regulator can undermine and impair the auditor's independence – its objectivity and impartiality – with deleterious effects on investor and public confidence in the reliability of the auditor's report. A regulatory process that lacks transparency and consistency can risk placing other interest well ahead of investors' interests; it is our obligation to put investors' interests — notably their long term interests — first.

The example, although an important one, is one of the many ideas and recommendations being considered in different national markets that relate to audit and financial reporting. It illustrates the importance of thoroughly examining the root causes of failures in domestic markets, assumptions that underpin recommendations, and the possible consequences of proposals – both intended and unintended. In doing so, it is crucial to understand the starting points for audit and financial reporting in the analysis – a country-level profile of the cultural, legal, and

reporting environments – and the aspects in which those starting points are similar and different from other countries and international contexts.

More broadly, it illustrates the essential responsibility for all of us – policymakers, practitioners, investors, academics, in contributing to the work of problem identification, root cause analyses, and ultimately informative evidence and other comprehensive data gathering on the audit market and audit quality to inform the policy-making process.

V. Conclusion

My colleagues and I firmly believe a bright future beckons. But, it is not a certainty. Even as we advance high-quality information in the capital markets, it is critically important to understand and maintain focus on the core principles that will move us forward and to continue to act by them.

Having fair, orderly, and efficient capital markets that facilitate capital formation while protecting investors is a pillar of the U.S. economy, and the quality and performance of the U.S. economy supports and promotes many of America's other strengths, as well as public policy initiatives.

The future belongs to those with the energy to lead and the imagination to make things better.

Thank you.