Testimony on Examining the Agenda of Regulators, SROs, and Standards-Setters for Accounting, Auditing, and Municipal Securities
by
Wesley R. Bricker
Interim Chief Accountant
U.S. Securities and Exchange Commission

Before the U.S. House of Representatives Committee on Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises

September 22, 2016

Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee:

I am Wes Bricker, Interim Chief Accountant of the United States Securities and Exchange Commission ("Commission"). I serve as the principal advisor to the Commission on accounting and auditing matters and lead the Commission's Office of the Chief Accountant ("OCA"). I appreciate the opportunity to appear before you today to testify on behalf of the Commission regarding current topics in the accounting and auditing profession that impact the capital markets and the related activities of OCA.

Financial Reporting Underpins Our Markets

The U.S. system of financial reporting has long been considered a major pillar of our capital markets that provides information to investors and other market participants. The objective of financial reporting is to provide accurate and credible information that is useful to investors for making decisions about investments. Thus, the reliability and credibility of financial reporting is critical to the proper functioning of our capital markets and for the investing public.

As the agency empowered by the federal securities laws to be the investor's advocate, maintain fair, orderly and efficient markets, and facilitate capital formation, the Commission has the authority and the responsibility to prescribe the methods to be used in preparing accounts and to specify the form and content of financial statements filed with the Commission. The federal securities laws also mandate that these public company financial statements be audited by an independent public accounting firm that will provide a report as to the reliability and integrity of the information presented.

OCA furthers the Commission's mission by working to enhance the foundation of our disclosure framework – the disclosure of reliable and accurate financial information to investors and other market participants. OCA is responsible for establishing and interpreting accounting policy to enhance financial reporting. OCA also works to improve the professional performance of public company auditors to ensure that financial statements are presented fairly and have credibility.

OCA leads the Commission's efforts to oversee two entities with key roles in the financial reporting process in the United States: the Financial Accounting Standards Board ("FASB") and the Public Company Accounting Oversight Board ("PCAOB"). The Commission has recognized the FASB's accounting and financial reporting standards as "generally accepted" in the U.S. for purposes of the federal securities laws. Financial statements filed with the Commission generally must be prepared in accordance with U.S. GAAP.[1] The PCAOB is responsible for overseeing the audits and auditors of public companies and registered broker-dealers. The staff of the Office of the Chief Accountant works closely with the staff and Boards of these two entities on accounting, financial reporting, and auditing matters. Among other things, OCA staff actively monitors the development and implementation of accounting standards, as well as identifying emerging accounting and auditing issues. I would like to summarize for the subcommittee some of the

[1] The Commission accepts from foreign private issuers in their filings with the Commission financial statements prepared in accordance with IFRS as issued by the IASB without reconciliation to generally accepted accounting principles as used in the United States.

important topics that we are focused on currently.

Current Accounting and Financial Reporting Activities

We continue to direct significant attention to three aspects of accounting and financial reporting:

- monitoring implementation activities for recently-issued accounting standards;
- monitoring future accounting standard-setting activities; and
- reinforcing the importance of internal control over financial reporting.

Implementation Activities for Recently-Issued Accounting Standards

The FASB has recently issued accounting and financial reporting standards concerning the measurement, reporting, and disclosure related to revenue recognition, leases, financial instruments, and credit losses of financial instruments. The FASB's standards in these areas reflect high quality accounting standards in areas identified as key convergence priorities in the 2008 Memorandum of Understanding between the FASB and the International Accounting Standards Board ("IASB").[2]

The FASB and IASB issued largely converged standards for how companies should report information about the nature, timing, and extent of revenue from customers. These new standards are intended to benefit investors' understanding of a company's financial performance by improving the measurement and reporting of revenue and enhancing the comparability of this critical metric across companies. The new jointly issued standards, which must be applied by U.S. public companies by 2018, is intended to improve existing revenue requirements by:

[2] The standards seek to improve financial reporting in the United States while also reducing inconsistencies in global financial reporting. The IASB, which is subject to oversight by the IFRS Foundation, is responsible for International Financial Reporting Standards ("IFRS") and establishes its own standard-setting agenda. For further information, see http://www.ifrs.org/About-us/Pages/IFRS-Foundation-and-IASB.aspx.

eliminating inconsistencies, including inconsistencies in industry-specific guidance; requiring additional disclosures to users of financial statements; providing a more robust framework for addressing revenue issues; and simplifying the preparation of financial statements. OCA staff has been actively monitoring implementation efforts, including the activities of the FASB's and IASB's joint revenue transition resource group. This group of financial statement preparers, auditors, and users has met publicly several times to discuss various questions that have arisen as companies prepare to implement the new standard. Those discussions have provided a forum for stakeholders to learn from the standard-setters and others involved with implementation. It has also provided the FASB and IASB with information for further improvements to the standards.

The FASB's and IASB's new standards on the measurement and reporting of leasing activities are the result of more than a decade of standard-setting due process and outreach, during which the standard-setters carefully considered input from stakeholders, including investors. This new standard will increase transparency and comparability among organizations that lease buildings, equipment, and other assets by recognizing on balance sheets the assets and liabilities that arise from lease transactions. This will enable investors to more readily and accurately understand the rights and obligations associated with these transactions. Under the implementation provisions of the standard, U.S. public companies are permitted to begin applying the standards immediately, but must do so by 2019.

Finally, the FASB and IASB have issued standards that will improve and simplify reporting for investments, loans, derivatives, and other financial instruments, so that investors have a more timely and representative depiction of a company's risks and obligations from its arrangements. The global financial crisis highlighted a need by investors for more timely reporting of credit losses on loans, investment securities, and other financial instruments held by banks, insurers, and others. The FASB and the IASB standards differ in several respects, such as the timing of recognition of an estimated credit loss, but both utilize an "expected credit loss" approach which, when implemented, will require companies to report credit losses on a more timely basis compared to the current standards. Both Boards have established a transition resource group to aid constituents with understanding the standards and inform the Boards about any areas for further enhancement. In the United States, the FASB's new credit loss standard will take effect in 2020 for U.S. public companies.

For all of the new standards, OCA has encouraged companies, their audit committees, and their auditors to assess the quality and status of implementation to ensure that the new standards meet the objective of better informing investors and other users. OCA also has emphasized the importance of disclosures by companies to investors of the impact that these recently issued standards will have when the standards are adopted in the future.

Importance of Internal Control Over Financial Reporting

Maintaining adequate internal accounting controls, representing annually to investors whether internal control over financial reporting ("ICFR") is effective, and, when required, having an independent accountant attest to the effectiveness of ICFR, promotes reliable financial reporting and encourages investment in our capital markets. Over the next several years, updating and maintaining internal controls will be particularly important as companies work through the implementation of the significant new accounting standards that I discussed earlier. Companies' implementation activities will require careful planning and execution, as well as sound judgment from management. And while internal controls cannot replace the need for sound professional judgment, well-designed, effective controls support the process by which those judgments are made and provide assurance that users of public companies' financial statements are consistently provided with relevant and reliable information reported in accordance with the applicable financial reporting framework.

OCA continues to work closely with our colleagues in the Divisions of Corporation Finance and Enforcement, as well as with the PCAOB, to help ensure that ICFR assessments continue to receive attention from management, audit committees, and external auditors. We also are committed to appropriately and timely addressing any emerging questions related to ICFR assessments and the application of the related guidance and standards of the Commission and the PCAOB. We and the PCAOB continue to engage with investors, auditors and representatives of public companies to proactively identify and address internal control issues that, if left unaddressed, could lead to lower-quality financial reporting and ultimately higher financial reporting restatement rates and higher cost of capital.

Current Audit and Professional Practice Activities

Independent auditors have been long-recognized as one of the key gatekeepers in our investor protection system, and the integrity of this system is supported by the PCAOB's oversight of the public company auditors. The credibility of public company financial reporting depends, in part, on thorough and objective audits performed by independent auditors. Recent PCAOB inspection results show promising signs of improvement in many audit firms' quality controls that are designed to ensure compliance with professional auditing standards as determined by the PCAOB. And while those improvements are not uniform across all firms or necessarily consistent within individual firms, and there is more work to be done, these findings do reflect the progress that has been achieved in improving audit quality since the passage of the Sarbanes-Oxley Act and the creation of the PCAOB.

The PCAOB's auditor inspections program has played an important role in improving the quality of independent public company audits. However, inspections alone cannot fully achieve their objective without the complement of rigorous and high-quality auditing standards that keep pace with the evolutions in financial reporting, the economic environment, and companies' business models.

The PCAOB continues to update and modernize the interim auditing standards that it adopted in 2003. For example, in 2014, the PCAOB adopted a new auditing standard setting out requirements for the auditor's evaluation of relationships and transactions between the company and its related parties, an area that has historically represented increased risks of material misstatement in company financial statements. Also, last December, the Board approved rules to require public accounting firms to disclose information about engagement partners and other key participants in audits of public companies. The PCAOB has also made significant progress on another major project of vital interest to investors—updating the standard auditor's report. The auditor's report has generally remained unchanged since the 1940s despite broad changes in the capital markets, financial reporting frameworks, and companies' business operations, and the goal of this project is to improve the informative value of the auditor's report to investors while retaining the traditional pass/fail opinion of the existing report upon which investors continue to rely.

Other important projects remain on the PCAOB's standard-setting agenda, including standards for auditing estimates and fair value measurements, the use of specialists by auditors, the use of the work of other audit firms, and firm quality control standards.

The PCAOB has also launched a post-implementation review program for its standards. This is responsive to requests from various stakeholder groups and another important element of the PCAOB's efforts to draw on past experiences to help continue to fulfill its statutory mission. I commend the PCAOB for its efforts and its commitment to high-quality auditing standards that have the potential to further enhance the credibility of financial reporting for the benefit of investors.

FY 2017 Budget Request

In furtherance of OCA's primary initiatives, goals and objectives, OCA's budget request for FY 2017 seeks to:

- Further its oversight of the FASB's, and monitoring of the IASB's, standard setting and implementation activities for new, comprehensive standards on revenue recognition, leasing, financial instruments and credit losses;
- Increase its oversight efforts of the PCAOB, especially given the growth of the PCAOB in recent years and the expansion of its authority;
- Further provide support for other division and office rule-making through consultation on significant accounting and auditing matters, training and advice on accounting and auditing matters to the Commission's Division of Corporation Finance in the context of their filing review program and to the Commission's Division of Enforcement in the context of enforcement of the federal securities laws; and
- Execute OCA-led rulemaking and policy initiatives.

C**onclusion**

In sum, there is a substantial activity in the financial reporting, accounting and auditing space. We will continue to oversee the efforts of the FASB and the PCAOB on these matters, guided by the Commission's mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation. Thank you, and I would be happy to answer your questions.