Speech

Keynote Address at the 2015 AICPA National Conference: "Maintaining High-Quality, Reliable Financial Reporting: A Shared and Weighty Responsibility"

Chair Mary Jo White

Washington, DC

Dec. 9, 2015

Good morning. Thank you, Bridgette [Hodges], for that kind introduction.

It is a pleasure to be here to speak to you about our shared and weighty responsibility to maintain high-quality, reliable financial reporting. This audience – preparers, auditors, audit committee members, and their advisors – is a very important one for the SEC. Investors, issuers, and the markets all depend on the work you do and the judgments you make – and how well you do both. You, together with the standard setters and the regulators, have a vital stake in ensuring that our capital markets remain the safest and strongest in the world – and we all share the responsibility.

Key to our mutual success is maintaining high-quality reporting of reliable and relevant financial information that investors can use to make informed investment decisions. If there is even one weak link in the financial reporting chain, investors and the integrity of our markets suffer. We must all work together in order to fulfill the high expectations investors rightly set for financial reporting.

This morning, I will talk about our respective responsibilities and some challenges I see for each of us. In the course of my remarks, I will touch on some of the current work we are doing at the SEC, including our disclosure effectiveness review, our concept release on audit committee disclosure, and the status of the Commission's consideration of the further use of International Financial Reporting Standards (IFRS). Over the next three days, our Chief Accountant Jim Schnurr, Director of Corporation Finance Keith Higgins, and Director of Enforcement Andrew Ceresney – and members of their staffs – will address each of the topics I cover in more detail.

The Responsibility of Preparers

Let me start with the role of preparers because you really are the lynchpin of high-quality, reliable financial reporting. You are the ones who make the often difficult and nuanced decisions and judgments required to meet the objectives and principles of U.S. Generally Accepted Accounting Principles (GAAP) or IFRS – from revenue recognition to impairments to fair value determinations. We rely on those of you in the trenches of finance and internal audit to press and challenge management on questions you have on transactions, judgments, and risk areas. It is not an easy job, and we all need to do whatever we can to support you – whether through strong external audits; through standard setters and Commission staff providing clarity in the implementation of new standards; or through our Whistleblower Office protecting you if you do find and report violations to us.

Preparers must recognize that management's ability to fulfill its financial reporting responsibilities significantly depends on the design and effectiveness of internal control over financial reporting (ICFR) – controls designed to provide reasonable assurance that the company's financial statements are prepared in accordance with GAAP.[1] While some initially questioned the value of such controls, we now generally hear from stakeholders – especially following new guidance and auditing standards issued in 2007[2] – that the ICFR requirements of the Sarbanes-Oxley Act have resulted in improved controls and financial reporting. And we see the improvement ourselves.

But, as you know, debate persists about whether companies and auditors are being required to perform documentation and testing of controls that is unnecessary – and, if so, the reasons why. There are useful, ongoing discussions about these issues among the Public Company Accounting Oversight Board (PCAOB), investors, the audit profession, and preparers, which the SEC staff has been keenly observing. I will not get ahead of those discussions, but I will say that it is hard to think of an area more important than ICFR to our shared mission of providing high-quality financial information that investors can rely on. We need to be frank about any challenges in the operation and assessments of ICFR and address them to the extent appropriate. But at the end of the day, ICFR must remain the strong bulwark of reliable financial reporting that it has become.

Another financial reporting topic of shared interest and current conversation is the use of non-GAAP measures. This area deserves close attention, both to make sure that our current rules are being followed and to ask whether they are sufficiently robust in light of current market practices. Non-GAAP measures are allowed in order to convey information to investors that the issuer believes is relevant and useful in understanding its performance. By some indications, such as analyst coverage and press commentary, non-GAAP measures are used extensively and, in some instances, may be a source of confusion.

Like every other issue of financial reporting, good practices in the use of non-GAAP measures begin with preparers. While your chief financial officer and investor relations team may be quite enamored of non-GAAP measures as useful market communication devices, your finance and legal teams, along with your audit committees, should carefully attend to the use of these measures and consider questions such as: Why are you using the non-GAAP measure, and how does it provide investors with useful information? Are you giving non-GAAP measures no greater prominence than the GAAP measures, as required under the rules? Are your explanations of how you are using the non-GAAP measures – and why they are useful for your investors – accurate and complete, drafted without boilerplate? Are there appropriate controls over the calculation of non-GAAP measures?

The Responsibility of Auditors

Preparers, of course, are not solely responsible for maintaining the strength of financial reporting. It also depends on thorough and objective audits performed by independent, knowledgeable, and skeptical public accountants. Indeed, while preparers are the lynchpin of high-quality financial reports, auditors are the key gatekeepers for those reports, protecting shareholders by ensuring that issues are promptly identified and addressed. As with other parts of the chain in financial reporting, there is both encouraging news and also some areas of concern.

In the encouraging column, investor confidence in audited financial statements and independent auditors is high.[3] We have also seen a general reduction in the number and severity of restatements of financial statements since the implementation of the Sarbanes-Oxley Act, although there are some specific areas that could benefit from a redoubling of efforts.[4] The positive signs are attributable, at least in part, to improvements in audit quality and the enhanced role that auditors generally now discharge in providing an essential check in the financial reporting process.

Significant credit for the increase in audit quality should be given to the PCAOB's inspection program and the enhancements it has made to some of the auditing standards. The PCAOB's inspection findings on individual audit engagements and firm quality controls have resulted in many audit firms making significant improvements, which in some cases included structural or systems changes beyond the specific remedial actions required.

In the worrisome column, we still observe too many instances where companies and their auditors have not discharged their responsibilities adequately under the securities laws and professional standards. Recent PCAOB inspections, for example, have found significant deficiencies in auditing the effectiveness of ICFR; assessing and responding to risks of material misstatement; auditing accounting estimates; and work performed by audit firms other than the signing firm in cross-border audits.[5] And as I will discuss later, we have also just recently brought two enforcement cases against national accounting firms and their partners for missing or ignoring red flags. Such failures are totally unacceptable.

The Responsibility of Audit Committees

The audit committee is another critical gatekeeper in the chain responsible for high-quality, reliable financial reporting. Listing requirements and SEC rules, as well as how companies address various enterprise risks, are placing heavy demands on audit committees. We must all ensure that they have the tools and the abilities to perform their important functions.

As I have said before, being a director of a public company is not "for the faint of heart." [6] Members of audit committees particularly need to be strong. Having served on the audit committee of a public company, I know first-hand how much work and responsibility the job requires. And, since my service, even more is being demanded, with many audit committees now being charged with overseeing additional risks, including incredibly important areas such as cybersecurity.

I have growing concerns about the amount of work required of some audit committees. The increasing workload may dilute an audit committee's ability to focus on its core responsibilities: selecting and overseeing the independent auditors; internal controls and auditing; setting up an appropriate system for the receipt and treatment of complaints about accounting; and reporting to shareholders.[7] And when directors serve on multiple boards, including multiple audit committees, we must question whether they can do the job effectively.

Companies and directors should carefully choose who serves on their audit committee, selecting only those who have the time, commitment, and experience to do the job well. Just meeting the technical requirements of financial literacy may not be enough to fully understand the financial reporting requirements or to challenge senior management on major, complex decisions. Nor is experience necessarily transferable. While independent directors should have diversified backgrounds, a director with financial reporting experience limited to manufacturing firms, for example, may not be able to adequately oversee the reporting of a large financial services firm.

Audit committees of every company must be entirely committed to their oversight of financial reporting. They must, for example, be able to adequately review how management is designing and implementing ICFR and how it is using non-GAAP measures. They must ask questions about their auditor's work and satisfy themselves of the job the auditors are doing, particularly when it is time to select the right auditor and recommend to shareholders that they ratify the company's choice.

Audit committees must also take seriously their reporting to shareholders, a critical responsibility on which the SEC is closely focused. Deputy Chief Accountant Brian Croteau will discuss the responses we have received on the concept release we issued in July on possible revisions to audit committee disclosure requirements. My only observation for now is that the audit committee report serves as a place for engaging with shareholders on important subjects, and the report must continue to meet the needs of investors as their interests and expectations evolve with the marketplace.

The Responsibility of Standard Setters

Let me now turn to the importance of standard setters to high-quality, reliable financial reporting. In a fundamental sense, good financial reporting cannot occur without strong, first-rate accounting standards established by independent standard setters. The quality and value of financial reporting would be seriously diminished if based on – and audited against – subpar accounting standards.

Confidence in financial reporting cannot exist without confidence in the underlying accounting standards and how and for what purpose they were developed. Accounting standards, with their potentially significant ramifications for companies, are often the subject of intense debates among policymakers, companies, investors, and other market participants. Setting a standard must be informed by all relevant viewpoints, but the standard must ultimately provide objective, accurate, and credible information about relevant economic activities useful for investor decisions, without regard to how it might change the behavior of market participants or regulators.

As you know, while the Commission retains the ultimate standard-setting authority for financial reporting in the United States, it has consistently looked to the private sector for leadership in establishing and improving high-quality accounting standards. Since the 1970s, the Financial Accounting Standards Board (FASB) has been the private sector standard setter for GAAP, and its structure and operations have been designed to preserve its independence and maintain a focus on strong standards.[8]

Since 2002, the FASB has also worked jointly with the International Accounting Standards Board (IASB) to develop converged, high-quality globally accepted accounting standards.[9] While several priority projects did not result in a common standard, the two boards have made significant progress in converging GAAP and IFRS in several major areas and are continuing to cooperate on other important projects. Too often, these successes are not sufficiently recognized, with the public discussion emphasizing instead the differences between GAAP and IFRS.

The new revenue recognition standard that Deputy Chief Accountant Wes Bricker will be talking about, for example, addresses one of the most fundamental financial statement metrics for investors. It is a prime example of how the cooperation between the two boards can produce high-quality standards that now will be globally consistent. Other success stories include reporting for business combinations and fair value measurements.

As both boards shift to agendas not dominated by joint projects, I urge them to continue, wherever possible, to build on these successes and maintain their commitment to collaboration in support of the objective of a single set of high-quality, globally accepted accounting standards.

I want to pause here to briefly mention the question of the use of IFRS by domestic issuers in the United States. As you know, since 2007, the Commission has permitted foreign private issuers to include financial statements prepared in accordance with IFRS, as issued by the IASB, in filings with the SEC without requiring reconciliation to U.S. GAAP.[10] And today, over 500 issuers representing trillions of dollars in aggregate market capitalization report to the Commission using IFRS. The Commission staff monitors and reviews the application of those standards in filings with the SEC in the same manner that it monitors and reviews the application of GAAP, making IFRS very much a focus in the SEC's work.

With respect to the issue of possible further use of IFRS in the United States, as I have said in the past, I believe it is important for the Commission, as a Commission, to make a further statement about its general views on the goal of a single set of high-quality global accounting standards – a topic that the Commission itself has not spoken on since 2010.[11]

At this conference last year, Jim Schnurr discussed the possibility of allowing domestic issuers to provide IFRS-based information as a supplement to GAAP financial statements without requiring reconciliation.[12] This proposal has the potential to be a useful next step, and the staff has now developed a recommendation for the Commission's consideration, which staff will be discussing with all of the Commissioners so that we can determine the path forward.

The Responsibility of Regulators

I will finish today with a brief discussion of the role of regulators. As with the other parties I have addressed, our vigilance and commitment too is essential for preserving high-quality, reliable financial reporting.

Let me first return briefly to the PCAOB. We work closely and collaboratively with the board to achieve our shared goals on behalf of investors and it is an extraordinarily important partnership.

One of my responsibilities since becoming Chair has been to attend board meetings of the International Organization of Securities Commissions (IOSCO), which oversees a number of important workstreams, including one dedicated to audit quality. Discussions around that workstream return again and again to how strong a contributor the PCAOB is in the United States to raising audit quality – through their inspections, standard setting, enforcement, and other initiatives. That is certainly my view, and I want to commend Chairman Doty and the PCAOB board and staff for the important work they have done – and continue to do – in raising the bar for auditors and audit quality.

For the Commission's part, our staff works closely with the PCAOB and all of the parties in the financial reporting chain to ensure that reports continue to serve to protect investors and build confidence in our markets. This work, of course, reflects the work of our Office of the Chief Accountant, expertly led by Jim Schnurr, who you will hear from shortly, and includes the extensive and very impressive work of the Division of Corporation Finance in reviewing and commenting on the financial reports of over 4,000 registrants each year. It also includes a strong enforcement program that prioritizes financial reporting cases.

One important area of mutual interest is the staff's work on its disclosure effectiveness initiative. As you know, at my direction, the Division of Corporation Finance is spearheading a comprehensive review of our disclosure regime, beginning with a review of Regulations S-K and S-X. In September, the Commission issued the first public product from that review – a request for comment on certain Regulation S-X requirements.[13] I anticipate further output in the coming year on Regulation S-K, as well as on various technical changes related primarily to financial statement disclosures and improvements to the presentation of information and tools on sec.gov.

There is also news from Congress on this front. Last week, a transportation bill was enacted that contained a number of SEC-related provisions, including one for disclosure modernization and simplification.[14] Among other provisions, the Commission is required to study the requirements in Regulation S-K, report the findings to Congress, and issue a proposed rule to implement the recommendations of the study.

Momentum on disclosure effectiveness is also occurring at companies. We have seen concrete progress by companies working to make disclosures clearer and more understandable, in particular by removing redundancies or unnecessary information.

But there is more work to do, both from our perspective and yours. The goal of the staff's initiative is to make disclosure more effective, which is not only about reducing volume and complexity, but also considering whether investors need more information in certain areas. While in some cases it may be beneficial to reduce volume and complexity to help investors better focus on important matters, you will hear from our staff in Corporation Finance that there are other areas – foreign tax disclosure is one – where the staff believes that more disclosure would help investors. The staff is considering all of these issues in its review, and I encourage companies to continue to undertake their own efforts to enhance disclosures for the benefit of their investors.

One of the ultimate tools to ensure high-quality, reliable financial reporting is strong enforcement when the rules are not followed. Since I became Chair in April 2013, the staff has reinvigorated its investigative and enforcement efforts in this area, with a focus on issuers and gatekeepers. The Commission has more than doubled the number of issuer reporting and disclosure actions it has brought – from 53 actions in fiscal year 2013 to 114 actions in fiscal year 2015, not counting cases based on delinquent filings and follow-on proceedings.

We have also been closely scrutinizing the gatekeepers of financial reporting, continuing to hold accountants, auditors, and audit committees accountable in appropriate circumstances. In the fiscal year that just ended, the Commission charged 76 respondents – 57 individuals and 19 firms – under Rule 102(e) of the Commission's Rules of Practice. In September, we also charged a national audit firm for dismissing red flags and issuing false and misleading audit opinions about the financial statements of an audit client.[15] This was the Commission's first non-independence case against a national audit firm since 2009,[16] and the first case where we obtained admissions from a national audit firm.

Just last week, a second national audit firm admitted wrongdoing, and the firm and two of its partners agreed to settle charges that they ignored red flags and fraud risks while conducting deficient audits of two publicly-traded companies that wound up facing accounting-related enforcement actions.[17] In the past fiscal year, we also charged a former audit committee chair for substituting his incorrect interpretation of SEC rules requiring the disclosure of executive perks for the views of experts the company had hired, resulting in incomplete disclosures.[18]

The financial reporting area will continue to be a high priority for our enforcement program. Investors depend on comprehensive and accurate financial reporting, and so our fundamental objective is to raise the bar of compliance by issuers and their auditors and we will use all of our tools to do so.

Conclusion

Let me conclude on that note. In our time this morning, I have tried to give you an overview of how the SEC views our shared responsibility for strong financial reporting and to highlight some of the reporting issues that have our attention. Senior staff will talk more about these and other issues over the next three days.

As you listen to the discussion of specific financial reporting issues, it is important to keep in mind that regulators are not just preaching to you, although it may seem like that at times. What we are trying to do is engage proactively with you on our shared responsibility for high-quality, reliable financial reporting. It is a weighty responsibility that constantly requires the very best efforts of all of us. Investors and our capital markets deserve and demand no less.

Thank you.

[1] *See* Section 404 of the Sarbanes-Oxley Act of 2002, Securities Exchange Act Rules 13a-15 and 15d-15 and Item 308 of Regulation S-K.

[2] *See Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934,* Release No. 33-8810 (June 20, 2007), *available at* https://www.sec.gov/rules/interp/2007/33-8810.pdf and AS 2201: *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, *available at* http://pcaobus.org/Standards/Auditing/Pages/AS2201.aspx (originally adopted in June 2007 as Auditing Standard No. 5).

[3] *See* The Center for Audit Quality's Ninth Annual Main Street Investor Survey, Investor of the Future (September 2015), *available at* http://www.thecaq.org/docs/default-source/reports-and-publications/caq2015mainstreetinvestorsurvey.pdf?sfvrsn=4.

[4] *See* Center for Audit Quality, "Financial Restatement Trends in the United States: 2003-2012," *available at* http://www.thecaq.org/docs/reports-and-publications/financial-restatement-trends-in-the-united-states-2003-2012.pdf .

[5] *See* Audit Committee Dialogue, PCAOB Release No. 2015-003 (May 2015), *available at* http://pcaobus.org/sites/digitalpublications/Documents/AuditCommitteeDialogue.pdf.

[6] Mary Jo White, Chair, U.S. Securities and Exchange Commission, *A Few Things Directors Should Know About the SEC* (June 23, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370542148863.

[7] *See Standards Relating to Listed Company Audit Committees,* Release No. 33-8220 (April 9, 2003), *available at* https://www.sec.gov/rules/final/33-8220.htm.

[8] *See Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter*, Release No. 33-8221 (April 25, 2003), *available at* https://www.sec.gov/rules/policy/33-8221.htm.

[9] The FASB's objective for participating is to increase the international comparability and the quality of standards used in the United States. *See* http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1218220079468.

[10] *See Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP,* Release No. 33-8879 (December 21, 2007), *available at* http://www.sec.gov/rules/final/2007/33-8879.pdf.

[11] Mary Jo White, Chair, U.S. Securities and Exchange Commission, Remarks at the Financial Accounting Foundation Trustees Dinner (May 20, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370541872065.

[12] James Schnurr, Chief Accountant, U.S. Securities and Exchange Commission, Remarks before the 2014 AICPA National Conference on Current SEC and PCAOB Developments (December 8, 2014), *available at,* http://www.sec.gov/News/Speech/Detail/Speech/1370543609306.

[13] *See Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant,* Release No. 33-9929 (September 25, 2015), *available at*http://www.sec.gov/rules/other/2015/33-9929.pdf.

[14] *See* the "Fixing America's Surface Transportation Act", or "FAST Act," *available at* http://transportation.house.gov/uploadedfiles/fastact_xml.pdf.

[15] Press Release No. 2015-183, *SEC Charges BDO and Five Partners in Connection With False and Misleading Audit Opinions* (September 9, 2015), *available at* http://www.sec.gov/news/pressrelease/2015-184.html.

[16] Press Release No. 2009-271, *SEC Charges Ernst & Young and Six Partners for Roles in Accounting Violations at Bally Total Fitness* (December 17, 2009), *available at* http://www.sec.gov/news/press/2009/2009-271.htm.

[17] Press Release No. 2015-272, *SEC: Grant Thornton Ignored Red Flags in Audits* (December 2, 2015), *available at* http://www.sec.gov/news/pressrelease/2015-272.html.

[18] Press Release No. 2015-179, *SEC Charges Sports Nutrition Company With Failing to Properly Disclose Perks for Executives* (September 8, 2015), *available at* http://www.sec.gov/news/pressrelease/2015-179.html.

Modified: Dec. 9, 2015