Regulators Address the 2019 Baruch College Financial Reporting Conference

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*A*lways a fertile source of regulatory perspective, this year's Baruch College Financial Reporting Conference featured a future-oriented theme in remarks by Chief Accountant of the Securities and Exchange Commission Wesley Bricker and Public Company Accounting Oversight Board member Kathleen Hamm. Both speakers reflected on prior advancements in auditing and accounting, then offered insights into the future of financial reporting amidst a "rapidly changing society."

Beginning his speech with a look back, Mr. Bricker emphasized management's fundamental role as "the starting point for robust, accountable financial reporting," which is aided by effective board and audit committee oversight. Mr. Bricker went on to highlight improvements in the quality and reliability of financial reporting in the U.S. over time, citing "comprehensive efforts" that include "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."

For perspective, Mr. Bricker summarized measures undertaken by the SEC over the past four years to advance financial reporting, which measures have involved the following themes:

- Auditor talent and integrity;
- New accounting standards (e.g., revenue recognition, leases, current expected credit losses, hedging activities and investments in equity securities);
- Non-GAAP measures;
- Internal control over financial reporting (ICFR);
- Auditor independence;
- Audit regulation;
- Audit firm governance;
- Independent audit committees of public companies;
- International cooperation; and
- Technology, data and innovation.

Integral to the success of many of these undertakings, audit committees ultimately "set the tone for the company's financial reporting and the relationship with the external auditor," as Mr. Bricker observed. He also noted that "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." For audit committee members to improve their effectiveness, Mr. Bricker offered the following suggestions:

- Incorporate the audit firm's understanding of the company's business and audit risks into the audit committee's oversight of the auditor's expertise, incentives and, ultimately, appropriate performance in the conduct of the audit;
- Become familiar with research evidence relevant to the audit committee's responsibilities, offering academic research into the relationship between auditor tenure and audit quality as one such example; and
- Continue to provide voluntary, audit committee-related disclosures to investors and consider ways to make communication with investors more useful, including disclosures about how the audit committee met its responsibilities.

Looking forward more broadly, the charge for policymakers and practitioners, according to Mr. Bricker, is to "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." Some selected trends highlighted by Mr. Bricker include:

- The evolution of technology with data security and privacy concerns coming to the fore;
- Changes in investment strategies and the rise in institutional shareholdings from 7% of total US equity ownership in 1950 to about 80% for S&P 500 companies in 2017;
- The pace of small business formation and the "vital role" served by auditors in providing candid feedback to the small businesses they audit; and
- Potential differences in international accounting and auditing standards from US standards and changes to international standards that may not cause deleterious effects on investor and public confidence in the reliability of the auditor's report.

These trends touch on areas that have undergone significant change in recent years and present some opportunities for the accounting profession going forward.

Ms. Hamm also offered a reflective and prospective analysis of regulatory activities, focusing on the benefits and threats of advancing technologies. (See our February 23, April 9, April 30 and October 17, 2018 posts regarding recent cybersecurity regulatory developments) Highlighting cybersecurity as an emerging area for PCAOB oversight and cyber risks as a potential threat to financial reporting and capital markets, Ms. Hamm explored ways auditors can strengthen cybersecurity. Among other points in her discussion, Ms. Hamm commented that auditors should engage with audit committees and management about potential disclosure concerning any cyber-related incidents. She also noted that "even when a cyber-incident may appear not to be material to the financial statements, if the auditor becomes aware of a possible illegal act related to the incident, the auditor would need to assure themselves that the company's audit committee was adequately informed as soon as practical." Concluding that cybersecurity is "one of the most significant economic, operational, and national security threats of our time," Ms. Hamm urged that government, private institutions and individuals all share responsibility to defend against cyber threats.