Speech

Remarks before the AICPA National Conference on Banks & Saving Institutions

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Introduction

Good morning and thank you for the kind introduction. I am honored to have the opportunity to share my thoughts with you. As a group, this audience is instrumental in strengthening the quality of financial reporting of our financial institutions, which is critical to the effective functioning of our economy.

One cornerstone of our capital markets continues to be companies supplying high-quality financial information that enables investors, lenders, and other providers of capital to make better-informed decisions. Said another way, as CFOs, controllers, analysts, treasurers, auditors, and others, you help drive the information that is ultimately included in many shareholder and creditor communications. These communications, when made with appropriate care and candor, build public trust and help sustain the ability of banks and others businesses to raise the capital they need to grow and compete.

I want to thank my team in the Office of the Chief Accountant for their work and acknowledge the help I received in preparing today's remarks from Rachel Mincin, Matt Hodder, and Tom Collens. In addition to my comments, today you will also hear from some of my colleagues in OCA including Marc Panucci, Sagar Teotia, and Michael Berrigan, as well as Stephanie Sullivan and John Nolan from the Division of Corporation Finance.

This morning my remarks will focus on several topics that I believe will be important to financial institutions in the years to come. Specifically, I would like to share thoughts on:

- Implementation of the CECL standard[1];
- Digital asset activities; and
- Expanded audit reports.

Implementation of the CECL Standard

Accounting standards are written to provide investors, lenders, and others with information that is clear, useful, and relevant to their needs in making decisions about providing resources to the entity, while considering whether the anticipated benefits of that information justify the costs of producing and using it.[2] Standard setting entails a deliberative process that includes soliciting broad input to improve the quality and usefulness of the final standards.

Last year at this conference, I spoke to the private-sector-led outreach in developing the CECL standard and the FASB's bases for concluding that CECL is sensibly designed to provide information for an investor to understand management's estimate of expected credit losses.[3] I believe implementation of CECL can result in financial reporting that better reflects management's expectations and an institution's credit risk information.

There are aspects of CECL with which you might already have experience. For example, within many organizations, individuals have some experience making business and investment decisions based on an assessment of the amount of cash flows expected to be collected (and not) over the life of a financial asset. For example, the evaluation of a potential merger or acquisition of a financial institution or the pricing of a significant credit exposure frequently involves an analysis of both the buyer's and the seller's view of expected cash flows over the remaining life of the financial assets. As with CECL, the evaluation done today frequently incorporates forward-looking information based on relevant, available information.

Let me turn to implementation activities. An essential part of our work is monitoring the implementation of accounting changes. Our initiatives include:

- Participating in educational forums, such as the FASB's Transition Resource Group;[4]
- Helping companies and their auditors interpret the standards, such as through our voluntary consultation process;[5] and
- Monitoring the FASB's decisions to make any necessary clarifications to the standards to address unintended consequences, if any.

In other words, the issuance of a standard by the FASB is a continuation of our and the FASB's work, not the end of it. To implement the standard requires the active engagement of and collaboration amongst all stakeholders both before and after issuance of the standard.[6] Moreover, I'm pleased that this collaboration is occurring, including with groups such as the AICPA Depository Institutions Expert Panel and Financial Reporting Executive Committee.[7]

Companies also are active, which I support. Companies need a process and controls in place to assess and implement accounting changes. They also need to understand the potential impacts. Change in accounting standards is easier said than done—but as we saw with the revenue recognition standard, it can be accomplished with sufficient planning and consistent communication among management, the audit committee, and the external auditor.

Adoption plans for CECL should also consider requirements under the federal securities laws[8] and expectations set forth in Commission guidance [9]for preparers to:

- Make and keep books, records, and accounts that accurately and fairly reflect the transactions and dispositions of assets of the issuer;
- Devise and maintain a system of internal accounting controls sufficient to provide reasonable assurance that, among other things, transactions are recorded in conformity with GAAP or any other criteria applicable to such statements; and
- Document a systematic methodology to be employed each period in determining the amount of loan losses to be reported and rationale supporting each period's determination.

As I have previously discussed, the underlying principles in the SEC staff guidance included within SEC Staff Accounting Bulletin (SAB) 102 will continue to be relevant, even after being updated to align the concepts to an expected loss measurement that incorporates reasonable and supportable forecasts.[10] These principles include maintaining documentation and supporting evidence to facilitate the review, validation, and audit of that estimate.

I want to emphasize the positive impact an audit committee has on implementation when it understands management's implementation plans and the status of progress, including any required updates to internal control over financial reporting.[11] The audit committee plays a vital role in overseeing a company's financial reporting, including the implementation of new accounting standards.

Anticipated impacts of the standard may need to be communicated externally as well. Nobody likes surprises. Transition disclosures[12] enable investors to understand the anticipated effects of the new standard. Drawing from experience with IFRS 9 transition reports,[13] I believe the following concepts can help investors understand the anticipated effects:

- Easy to understand explanation of new terms and key concepts;
- Specific descriptions of the methodology and significant judgments made by management;
- Tabular presentation of the economic assumptions utilized; and
- Quantified effects of moving from incurred to expected credit losses, disaggregated by lending portfolio.

Innovations in Technology and Commerce: Digital Assets[14]

Let me now turn to recent innovations[15] in technology and commerce: digital assets. It is critical that we keep ourselves informed about emerging technologies so that the accounting profession can continue to perform the essential gatekeeper function for issuer compliance related to financial reporting.

As we do so, it is essential to keep in mind that innovations in technology can be the ally of a company's business and financial reporting activities, not their opponent. It follows that changes in technology need not work against investors and the public capital markets. Moreover, companies must continue to maintain appropriate books and records—regardless of whether distributed ledger technology (such as blockchain) smart contracts, and other technology-driven applications are (or are not) used. Likewise, the auditor of an issuer, broker-dealer, or investment adviser is required to determine the nature and extent of the audit procedures to perform based on the circumstances of the entity and the auditing standards applied.

In addition to understanding innovations in distributed ledger technology and digital assets, companies should take what is learned and then act appropriately within the parameters of the existing requirements of the federal securities laws, such as those relating to books and records, internal accounting controls, internal control over

financial reporting ("ICFR"), and custody. Distributed ledger technology and digital assets, despite their exciting possibilities, do not alter this fundamental responsibility.

Let me illustrate with a few examples, none of which are exhaustive.

Illustration #1: Financial Statement Assertions; Books and Records; Internal Accounting Controls

As a general matter, when preparing financial statements, management makes implicit (if not explicit) assertions that the assets on the balance sheet exist, are complete, and are supported by rights that provide the ability to benefit from and control others' access to them, among others.[16]

Before undertaking digital asset activities, companies should consider their policies and the expertise of their accounting staff to support the preparedness for compliance with the federal securities laws to make and keep detailed and accurate "books, records, and accounts" along with related internal accounting controls to record such transactions or balances.[17]

The goal of the books and records provision is to: (1) accurately and fairly reflect the issuer's transactions, and the disposition of its assets, (2) protect the integrity of the independent audit of issuer financial statements, and (3) promote the reliability and completeness of financial information that issuers are required to file with the Commission or disseminate to investors.[18]

In other words, maintaining complete and accurate books and records, along with maintaining related internal accounting controls, is not just a good practice, it is a regulatory requirement. Management and others should understand these requirements and have a crucial role to play in helping prevent, detect, and deter mischief in our public capital markets.

Also, the context of my reference here is for issuers of securities—companies that are required to file reports with the SEC or that have securities registered with the SEC. Please note that in addition to public companies, there are also books and records requirements for investment advisers, broker-dealers, and other companies as just examples.

Illustration #2: Fair Value Measurement[19] and Related Party Disclosures

Another illustration arises from structural characteristics of current distributed ledger technology. Transactions in digital assets on distributed ledgers can be public, but the identification of the owners and recipients of these transactions generally are not. Transactions are associated with alphanumeric codes known as "public keys," which provide for a high degree of anonymity and possible mischief.

Transaction records generally do not include information to identify related parties or transactions.

The identification of related parties, transactions with related parties, and any resulting balances is necessary for purposes of preparing disclosures required by Regulation S-X[20], GAAP[21] , and IFRS.[22]

For example, a fair value measurement assumes that the asset is exchanged between market participants, who are buyers and sellers who are *independent of the reporting entity; that is, they are not related parties of the reporting entity*. [23] Of course, there are many other valuation considerations.

Related party relationships and transactions also may require disclosure in the financial statements. The information is useful because of the nature of the relationships. The relationship between two related parties may enable one of the parties to exercise a degree of influence over the other such that the influenced party may be favored or caused to subordinate its independent interests.

Said another way, related party transactions may be the result of the related party relationship and without the relationship may not have occurred or may have occurred on different terms. As a result, related party transactions may not reflect competitive, arm's length transactions between market participants.

Digital asset developers sometimes, for example, "pre-mine" or accumulate a given digital asset and therefore hold an overwhelming concentration of the digital assets. Then, later, these digital assets can make their way to market, with an effect on the supply and demand for the digital asset, and impact the prevailing price.

Thus, identification of related parties, their transactions, and balances can be useful disclosures for investors to receive.

Illustration #3: Loss contingencies

Digital asset activities may expose the company to litigation, claims, and assessments, for which management should consider the necessity of accrual or disclosure (or both). [24]

An aspect worthy of attention is that the circumstances to be considered for accrual or disclosure may be broad, and include unasserted claims and assessments. For example, management should consider possible private claims that often follow from an investigation by a governmental agency, when enforcement proceedings have been or are likely to be instituted.

The basis for the determination would include the opinions or views of competent legal counsel and other advisers. But also, it is necessary to consider the company's own

experience and experience of other companies. Information available in this regard includes (though certainly is not limited to) the numerous statements, letters, educational bulletins and enforcement cases available from the SEC's website, state securities regulators, and others such as FINRA that outline experience with (or expectations regarding) the effects of a company's activities that fail to comply with the securities laws.

Illustration #4: Dealing with potential illegal acts

The remaining illustrations have particular relevance to external auditors.

Auditors serve a vital role, enhancing the public's confidence in the credibility of the financial statements they audit. Auditors function as critical gatekeepers in the area of issuer reporting and disclosure. They practice under regulations, professional codes of conduct, and auditing standards, and are required to be independent of the entities they audit. It is essential that auditors continue to adhere to these, including in circumstances where a company has digital asset holdings or transactions, perhaps for the first time. In these circumstances, external auditors need to appropriately consider their ability to carry out their professional responsibilities in connection with digital assets during their client acceptance and continuance processes.[25]

As a starting point, I believe auditors should consider in any client acceptance or continuance:

- Relevant laws and regulations, including applicable securities regulations;
- The tone at the top in the company, including the commitment to integrity, compliance, and competency;
- The company's commitment to an effective control environment, including compliance with books and records requirements, internal accounting controls and ICFR[26]; and
- The auditor's competencies to adequately identify and assess risks, design, and execute appropriate audit procedures and obtain sufficient, appropriate audit evidence.

It is worth noting that auditors also have a long-standing obligation to deal with potential illegal acts that have a direct and material effect on the determination of the financial statement amounts.[27] Potential illegal acts may arise from violations under the federal securities laws in connection with digital asset activities.

Section 10A[28] of the Exchange Act generally requires that the auditor of a company whose stock is registered include in its annual audit, among other things, procedures regarding the detection of illegal acts that have a direct and material effect on the determination of the financial statement amounts.

Section 10A also requires that where certain illegal acts are detected, the auditor must report its findings to company management, assure that the audit committee or board is adequately informed as to the illegal act, and, under certain conditions, that the SEC be informed of such illegal acts as well.[29]

Of course, the potential for an auditor's reporting to the SEC of potentially illegal acts often provides an incentive for management and the audit committee to address the circumstance.

For this and other reasons, the PCAOB and SEC will continue to monitor audit activities in this area.

Illustration #5: Audit Committee Considerations

Audit committees have a role too in connection with their financial reporting oversight responsibilities, including considerations to initially select and subsequently retain their external auditor. I encourage audit committees to:

- Review an auditor's qualifications, including access to legal and technology specialists in the area of digital assets;
- Consider information about the audit firm's regulatory and litigation experience, including concerning audits of companies with digital assets;
- Develop expectations for communications regarding information to be provided to the audit firm, such as analyses of compliance with laws and regulations; and
- Consider the impact of circumstances in which an auditor declines or is unable to issue an audit report with an unqualified audit opinion.

Changes in the Auditor's Report: The Auditor's Reporting Model and Critical Audit Matters (CAMs)

Let me close with a brief comment on the status of implementation of the PCAOB's new auditing standard for auditor reports and, in particular, the pending inclusion of critical audit matters (or CAMs) within the auditor's report.

The goal of the new standard is to make the auditor's report more informative and relevant to investors and other users of the financial statements.[30] As I've said previously,[31] to achieve this, ongoing dialogue among auditors, audit committees, management, and others, will be critical.

I was pleased to see the PCAOB staff's update to its guidance for applying the auditor reporting standard and, if needed, encourage the PCAOB to consider further updates as it relates to critical audit matters.[32] I am also pleased with the level of dialogue

including through dry-runs between auditors, audit committees, and management. These dry runs can help auditors and audit committees plan for meaningful information specific to the audit to be included in the audit report. Please consider sharing your experiences with the PCAOB staff and with us at the SEC as we monitor the implementation of critical audit matters.

Conclusion

In closing, I want to thank you for the work you do to advance high-quality financial reporting, including within the banking industry. Whether it is in the adoption of new accounting and auditing standards or the development of new markets, each of us has a responsibility to continue to apply the core financial reporting concepts that contribute to our robust markets. Your attendance at this conference demonstrates your commitment. Thank you, and I look forward to taking your questions.

[1] Accounting Standards Update No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.*
[2] We look to the Financial Accounting Standards Board, a private sector body, to lead in this work, which they do, among other necessary priorities such as considering both the need to keep standards current in order to reflect changes in the business environment, and the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors.

[3] See Wesley R. Bricker, Chief Accountant, U.S. Securities and Exchange Commission, *Remarks before the AICPA National Conference on Banks & Savings Institutions* (Sept. 11, 2017), *available at* https://www.sec.gov/news/speech/speech-bricker-2017-09-011

[4] See https://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176168064055

[5] See Guidance for Consulting with the Office of the Chief Accountant at https://www.sec.gov/info/accountants/ocasubguidance.htm.

[6] See Wesley R. Bricker, Interim Chief Accountant, U.S. Securities and Exchange Commission, *Remarks before the AICPA National Conference on Banks & Savings Institutions* (Sept. 21, 2016), *available at* https://www.sec.gov/news/speech/bricker-remarks-aicpa-national-conf-banks-savings-institutions.html

[7] See https://www.aicpa.org/press/pressreleases/2018/aicpa-releases-working-drafts-accounting-issues-credit-loss-standards.html.

[8] See Sec. 13(b)(2) of the Securities Exchange Act of 1934 (“Exchange Act”).

[9] See Codification of Financial Reporting Policies 401.09.b (FRR 28, subsection b), Procedural Discipline in Determining the Allowance and Provision for Loan Losses to be Reported.

[10] See Wesley R. Bricker, Chief Accountant, U.S. Securities and Exchange Commission, *Remarks before the AICPA National Conference on Banks & Savings Institutions: Advancing High-Quality Financial Reporting in Our Financial and Capital Markets* (Sept. 11, 2017), *available at* https://www.sec.gov/news/speech/speech-bricker-2017-09-011

[11] *See* Wesley R. Bricker, Chief Accountant, U.S. Securities and Exchange Commission, *Remarks before the University of Tennessee's C. Warren Neel Corporate Governance Center: Advancing the Role and Effectiveness of Audit Committees* (Mar. 24, 2017), *available at* https://www.sec.gov/news/speech/bricker-university-tennessee-032417.

[12] See Staff Accounting Bulletin (SAB) Topic 11.M, Disclosure of the Impact that Recently Issued Accounting Standards will have on the Financial Statements of a Registrant when Adopted in a Future Period, *available at* https://www.sec.gov/interps/account/sabcodet11.htm#M. See also FASB ASC paragraph 250-10-S99-6 for a September 2016 SEC staff announcement.

[13] See International Financial Reporting Standard 9, *Financial Instruments*

[14] To level-set, for purposes of this discussion, I am using the term "digital asset" broadly to include assets that commonly use labels such as "cryptoassets", "digital tokens", "digital coins","cryptocurrencies", "virtual currencies", and/or other digital types of value that may be a security, a commodity, a security-based or commodity-based instrument such as a future or swap, and/or may be substitute for currency of legal tender. It also includes digital coins and tokens offered in an initial coin offering (ICO) or pre-ICO.

[15] See additional speeches from Wes Bricker addressing the topics of technology and innovation, e.g., Wesley R. Bricker, Chief Accountant, U.S. Securities and Exchange Commission, Remarks to the Institute of Management Accountant's 2018 Annual Conference and Expo: "Advancing the Purpose and Promise of Those Involved in Financial Reporting", and Remarks to the Institute of Chartered Accountants in England and Wales: "The intersection of financial reporting and innovation".

[16] For example, if a balance sheet shows digital assets with an amount of $5 million, management is asserting that:

- The digital assets recognized exist at the period end;
- The reporting entity owns or controls those digital assets;

- The digital assets are reported accurately according to an appropriate measurement basis; and
- All such digital assets owned and controlled are included within the amount of $5 million.

The reporting entity's financial statement preparation and related books and records take into account the integrity and security of the records, circumstances involving loss of a key or password to access the digital assets, theft, as examples.

[17] See Sections 13(b)(2)(A) and (B) of the Exchange Act.

[18] See SEC v. World-Wide Coin Investments Ltd., 567 F. Supp. 724, 747 (N.D. Ga. 1983)

[19] Fair value may be the primary measurement attribute, as is in the case of the specialized accounting for investment companies under GAAP. Other entities may be required to apply intangible asset accounting.

[20] See Regulation S-X Rule 4-08(k) for required disclosures pertaining to related party transactions.

[21] See ASC Subtopic 850-10-50 for additional related party transaction disclosures required by GAAP.

[22] See IAS 24, Related Party Disclosures, paras. 13-24 for required disclosures pertaining to related party transactions.

[23] See ASC paragraph 820-10-30-3a for a discussion of consideration of related party transactions.

[24] See ASC paragraph 450-20-55-10 for guidance on determining whether accrual and/or disclosure are required with respect to pending or threatened litigation.

[25] See PCAOB Interim Quality Control Standards "QC" Section 20, System of Quality Control for a CPA Firm's Accounting and Auditing Practice, paras. 14-16.

[26] Obtaining an understanding of the control environment includes the auditor assessing management's philosophy and operating styles for promoting effective ICFR, integrity, and ethical values as well as the effectiveness of the board and audit committee effectiveness related to its oversight responsibilities for financial reporting and internal control. See AS 2110, Identifying and Assessing Risks of Material Misstatement, paras. 23-25.

[27] See AS 2405, Illegal Acts by Clients, para. 7.

[28] See Sec. 10A of the Exchange Act.

[29] See id. In particular, Section 10A(b)(2) indicates that If management does not take timely and appropriate remedial actions to address the material illegal acts, and the failure to take such remedial actions is reasonably expected to warrant that the auditor either resign from the engagement or not be in a position to issue an audit report with an unqualified audit opinion, the auditor is required to directly report its findings to the company's board of directors. Ultimately, Section 10A then requires the board of directors to inform the SEC of the auditors' findings or, if it fails to do so, the auditor to inform the SEC.

[30] *See* PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*, page 1

[31] *See*, e.g., Wesley R. Bricker, Chief Accountant, U.S. Securities and Exchange Commission, Remarks before the Financial Executives International 36th Annual Current Financial Reporting Issues Conference: "Effective Financial Reporting in a Period of Change", *available at* https://www.sec.gov/news/speech/speech-bricker-2017-11-14

[32] *See* PCAOB Staff Guidance, *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15. 2017 (Updated as of August 23, 2018)*