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PODCAST EPISODE

Chief Accountant Kurt Hohl: Building Trust in Our Capital Markets

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In Episode 4, Chairman Paul Atkins and the SEC's Chief Accountant, Kurt Hohl, discuss how accounting and auditing strengthen investor confidence. They also discussed artificial intelligence, the importance of materiality in financial reporting, and efforts to align global accounting standards.

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U.S. Securities and Exchange Commission



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Transcript

The following transcript has been lightly edited for readability. Please review the episode audio before quoting from this transcript and reach out to SEC staff with any questions.

<Intro Music and Highlight Reel>

Kurt Hohl: Investors want information, but there's a difference between investor wants and investor needs.

The question is what's really material? And that underpins our financial reporting model that we follow here at the Commission.

Chairman Atkins: Artificial intelligence. It's taken the world by storm.

Kurt Hohl: This Commission encourages innovation and how innovation can change and better our marketplace.

No matter what companies do, management is ultimately responsible for their financial statements, and they need to understand the risks associated with that.

Alexander Hamilton. He built a financial system on trust, and that continues to be the mission of the SEC today.

<Material Matters Logo>

Chairman Atkins: Hello and welcome to another episode of Material Matters. Today I'm delighted to sit down with Kurt Hohl, the SEC's Chief Accountant. Now, this is not Kurt's first tour at the SEC. He was the Associate Chief Accountant in the Division of Corporation Finance in the late 1980s and 1990s, serving under three different Chairmen and Chief Accountants during that time.

Now, as our principal adviser to the Commission on accounting, auditing, and controls-related standards for public financial reporting purposes, Kurt plays an invaluable role in fulfilling our mission of protecting investors, ensuring fair and orderly markets, and facilitating capital formation.

Today, we'll explore many ways in which the work of his office impacts companies and investors around the globe.

So, let's get started. Kurt, thank you very much for joining me today here on Material Matters. Now, you know, as I mentioned a bit there, accounting and auditing underpin investor confidence in the integrity of companies' disclosures and our capital markets at large.

It's one of the essential things that the SEC has done really since its inception back in 1934. And so, your office is really critical in maintaining trust in our markets and in upholding our agency's mission of investor protection. So, maybe you could tell us a little bit about the role of the

Chief Accountant within the SEC and how you interact with the Commission.

Kurt Hohl: Great. Thank you for having me here. I think back on the formation of the American capital markets all the way back in the late 1700s under Alexander Hamilton. He built a financial system that was built on trust, that people could have faith in the capital markets, we would honor our obligations. And that continues to be the mission of the SEC today.

And, the Office of the Chief Accountant, or we like to refer to as “OCA”, plays a role, an important role, in that, because, as you know, financial statements and the auditing of financial statements play an integral role in our financial system today. So, the Office of the Chief Accountant, one of the oldest offices in the Commission. I was told it's the oldest, continuously named office in the Commission, dating back to 1935.

And we play, like you said, an important role in protecting investors, making sure that there's trust in the financial markets through the preparation of financial statements, the controls over the financial statements, and the audits of those financial statements. So, we serve as like you indicated, the principal advisor to the Commission.

We work with all the divisions on issues related to accounting and auditing, whether it be rulemaking or interpretive guidance. The Office of the Chief Accountant serves a vital role for issuers in terms of providing guidance and what can sometimes be very complex accounting standards as they relate to public companies.

So, we take pride in the fact that we work with issuers and registrants before they file with the SEC to make sure they get it right, because getting it right helps investor confidence in the marketplace. We don't want companies to file with the SEC and then have us taking a look at filings and say, nope, we disagree with you and you have restatements.

We also play a very important role with standard setters, whether they be the Financial Accounting Standards Board or FASB. We oversee their standard setting agenda, making sure that their standards are relevant for investors and timely in terms of providing guidance on developing issues.

We also work very closely with the Public Company Accounting Oversight Board, or PCAOB, in terms of their oversight of the auditing profession. That's something that was new, wasn't there when I was here the first time. It's been around for 20 some years, but it serves an important role and function for the financial markets and the underpinning of the financial markets.

And then we also interact fairly significantly with international standard setters and international regulators due to the pervasiveness of foreign companies entering our markets.

So, we have we have a lot of touchpoints. I like to say we're a small office in size, but we're fairly large in stature.

Chairman Atkins: Well, you can go on the website, and you can see how there are some accountants in other divisions of the SEC, including Corporation Finance and Enforcement and elsewhere. So, how do you interact with them and how does your role differ from what goes on in the divisions?

Kurt Hohl: Right. So, we work with those other Chief Accountants in the divisions on a daily basis. So, obviously our office is responsible for the ultimate determination of an accounting or auditing issue, because we're the primary advisor to you and the rest of the Commission. But they're the experts. They're working with within the divisions to analyze issues that are pertinent and developing in that particular area.

So, while they work closely and liaise with the accountants and lawyers within the division, if there's any significant accounting issues, they'll bring them to our attention. So, for example, if Corp Fin [Corporation Finance] is reviewing a filing, they see an accounting issue, they're not quite sure on the accounting, they'll refer to our office. Similarly, with the Division of Enforcement, if there's a question about well, you know, is there a misconduct here by an auditor or an accountant? They'll ask us for advice and whether to proceed with a particular case. So, they serve an important function of staying close to the directors in the particular divisions and offices.

Chairman Atkins: Okay, great. Well, so one of the major things that underpins corporate financial reporting is the concept of materiality, which

is, you know, obviously in our title here of our podcast. So, what does that actually mean? In the last several years under the prior administration, there was a departure from a strict adherence to financial materiality with respect to rulemaking and some other things.

And there were some phrases that cropped up like “decision-useful” and maybe not as complete replacement but seemed to be chipping away at that concept. So, what is your approach to materiality, how has it materialized in your office?

Kurt Hohl: This is a question that comes up a whole lot, right? Investors want information. But there's a difference between investor wants and investor needs. The investor needs are the material information, financial materiality information.

And the way we approach it in our office is we look to the Supreme Court definition. You know, what is material information for someone to buy, sell, or hold a security. If you don't do that, and you focus on other interests that may be of interest to investors, then you get into social issues. You get into other types of issues, and you'll get a stack of disclosures within a particular document, and you lose the whole meaning of the financial disclosure documents that we monitor and oversee, and no one will read them. And we lose at the end.

So, we're primarily focused on financial statement materiality, financial materiality. What are those critical financial issues that are relevant to investors. And we take that to our activities when we deal with standard setters. So, we go to the Financial Accounting Standards Board when they're developing a standard.

You need to be focused on issues that are relevant to the financial reporting market. You need to focus on those disclosures that are material to understanding how a company operates from a financial perspective, and you need to do cost benefit analysis associated with doing that as well. You can't just keep adding disclosures on disclosures without taking into consideration the cost of providing those disclosures and the financial statement materiality.

We carry that view throughout our oversight of some of these regulatory bodies, like the PCAOB and some of the international standards setting

bodies. Again, focused on what's material? Because if you get to, I want this information. Everybody wants information, right? There's no there's no information you wouldn't want to get.

The question is, what's really material? And that underpins our financial reporting market model that we follow here at the Commission.

Chairman Atkins: Right. And I think that's an important point. And which the Supreme Court recognized that investors aren't monolithic, and no one size fits all. But the standard set, it was actually Thurgood Marshall in 1976, so 50 years ago, he set out, it's the reasonable investor, meaning — it's a legal term — but meaning an objective investor from an objective test, not a subjective one.

Not what you think or I think. Not we take a poll of all the investors in the United States and 51.2% think this is material. That's not the way that means. It's to look at the objective test, from a judge's perspective, and would an investor consider it important for him or her to make an investment decision. So that's carried the whole jurisprudence forward over and over.

The Supreme Court has emphasized that as a test. And it's not just three out of the five commissioners what they think at any one time. That's important. So, I'm glad that you all are pushing that forward.

Well, just a few minutes ago, you were talking about the Public Company Accounting Oversight Board, or PCAOB for short. And the SEC's oversight over the PCAOB comes out of a statute that was passed by Congress, enacted back in 2002, I believe, the Sarbanes-Oxley Act. And so, the statute mandates that we oversee the PCAOB and appoint its board and that sort of thing. And so earlier this year, we ushered in a new day at the PCAOB with a new board.

And your office works regularly with them, especially with the Chairman. So, maybe you can share some of how your office interacts with them and your impressions of it.

Kurt Hohl: So, Sarbanes-Oxley did a lot to change how the audit profession operates. So, the PCAOB serves an important role there. The statute says the SEC has the oversight of the PCAOB. And a recent

Supreme Court case kind of confirmed that. So, we play a very, almost like, partner role with the PCAOB.

We work with them every day in our office because our office has the delegated authority to deal with the PCAOB on a day-to-day basis. The Commission doesn't have the time to deal with all the myriad of things that we deal with for them. What's important about the PCAOB is how it's funded. It's funded through assessments by public companies and broker dealers.

Chairman Atkins: Like a wealth tax on public companies.

Kurt Hohl: So those costs are ultimately borne by investors. So, we take an investor oversight perspective when we deal with the day-to-day operations. The key activities that we focus on, obviously, is selecting the board. We assisted the Commission in making a selection of the new board and making sure that those people were qualified under the statute, and we thought would make a meaningful change in the PCAOB organization. Because, again, the organization has been around for 23, 24 years.

Not a lot of change in terms of how it approaches certain things. So, what's important is that regulatory bodies change with the environment, change with changes in innovation in the marketplace. So, from a day-to-day activity, we're focused on matters such as the budget and governance. That's a really important part.

We need to make sure that they're fiscally responsible with the monies that they collect from issuers, and that the governance is there to make sure that one, they have the proper resources, but those resources are deployed in an appropriate way, meaning they're efficient. They're effective at carrying over their responsibility under Sarbanes-Oxley.

They also have a standard setting responsibility, meaning they set audit standards for accountants of public companies in the United States. So, when they are developing rules, we work with them very closely on the development of those rules, and then we'll advise the Commission on the adoption of those rules, because the Commission has to approve the rules that are adopted by the PCAOB.

They also are involved in probably one of the most important, certainly the largest aspect of the PCAOB is their inspection program. So, they inspect auditors. The majority of their resources go to the inspection process, which really hasn't changed much in the last 20 or so years. Coupled with that is the reporting, the inspection reporting, under the statute, they have to report do a public report on the firms that they inspect.

And if you talk to audit committee members or other users, there's a lot of confusion about what the report says. So, if you're going to be an effective regulator, you're going to have an effective oversight, and the inspection program is an important aspect of that, you need to make sure that you clearly communicate material matters or material deficiencies of the auditors to make sure that the public understands the quality of the work that's being conducted by registered audit firms. And then lastly, but not certainly, to be diminished, is the PCAOB has an enforcement function. So does the SEC.

So, we want to make sure that we're working very closely together to focus on material matters. Not necessarily what some people have referred to as parking tickets in the past. We're focused on material misconduct by auditors, to make sure we take bad actors out of the space. So, we work very closely with the Division of Enforcement on pursuing auditor cases and working very closely with the PCAOB on enforcement matters.

Chairman Atkins: Great. Well, let's move to artificial intelligence and the Office of Chief Accountant. Obviously, that's of huge interest to the marketplace and to people even in their ordinary day-to-day lives. It's taken the world by storm to say the least. And it's being rapidly adopted by companies far and wide.

And the efficiencies to come out of that are pretty exciting to think about. With, of course, some people are afraid of the possibilities as well. But so as artificial intelligence then moves into financial reporting and auditing work, can you share some of the ways that we're advising registrants and auditors in that regard?

Kurt Hohl: Yeah, I can't help but when you talk about this topic to think back when we were here the first time in the late 80s and early 90s, the

new technology at that time was the internet. And if you think about it today, how could we function without the internet? That's part of our day-to-day lives, and I see artificial intelligence probably having a more significant impact on businesses financial reporting on everything that we do going forward.

So right now, our office is very inquisitive about it. Obviously, whenever we have discussions with public companies, audit committees, auditors, we ask them about how artificial intelligence is changing what they do. And what we're seeing is, companies are experimenting with artificial intelligence in the financial reporting process, whether it be determining disclosures, reviewing massive data sets, and determining what disclosures might be necessary through synthesizing that data set.

So, in the past, maybe they've done it manually and had someone look through, you know, thousands of leases, maybe. Now you can load all that data set into a database, you can process and say, here's the information that's relevant to this financial statement disclosures. And I see a day when, you know, many of the financial disclosures might be initially computed or maybe solely computed or determined based on use of artificial intelligence and the many tools.

We're in the fact gathering stage. We want to encourage innovation. This Commission encourages innovation and how innovation can change and better our marketplace. So, we're focused on not curtailing that, but gathering facts because, you know, no matter what companies do, management is ultimately responsible for the financial statements, and they need to understand the risks associated with that.

So, when I have discussions with audit committee members, I say, look, this is a big area for you all. Do you understand how companies are using it? Does the company understand they're using it? Maybe they buy a tool or a product that's using artificial intelligence and maybe they don't even know it. So, making sure people are mindful of how it's being used, there's appropriate oversight that we address the risks that might be presented from companies' use of artificial intelligence.

Auditors — this is a big change in the audit environment because, as you know, there's a lot of menial, manual tasks that take place. And auditors

are using AI to develop tools that will streamline a lot of the products that were made. So, I remember the day back when I started in auditing 40 some years ago, we went through and we used a ten-key to hand sort each sheet.

Now you can load a data set in, and you can look at an entire general ledger for an entire year, synthesize things out of the general ledger, look for anomalies. So there's a potential for extreme benefits to improve audit quality through use of artificial intelligence. But again, we're in the learning mode trying to figure out how auditors are using it.

Are they using it responsibly? Is it producing the desired outcome? And then working very closely with the Public Company Accounting Oversight Board, who has oversight of the audit profession to make sure that those people there are knowledgeable in how artificial intelligence is being used in the audit profession to make sure that they execute their oversight responsibility.

Chairman Atkins: Right. Well, so another topic that many people might not think about is that the SEC is really, and especially your office, is really engaged with international accounting and auditing standards setting bodies. We're not an island, obviously, we have American companies that have subsidiaries and operations abroad and then foreign companies that come here.

So, the questions that come to you all, you know, are pretty cutting edge and pretty interesting, especially how to align U.S. GAAP with IFRS or not. You know, however that works. So maybe you can explain a little bit about the current global landscape and why alignment between domestic and international standards is so important to what we're doing here.

Kurt Hohl: Yeah, happy to do that. So, people ask me all the time, why are you guys focused on some of these international issues? Well, it's for a number of reasons, one, there's a lot of market capitalization of foreign companies that list in our markets and are subject to our jurisdiction. Somewhere between \$10 and \$15 trillion of market cap of companies that list in the United States use international accounting standards.

Okay. So, it's important, since we're the guardians of financial presentation at the SEC, we have to make sure that the standards that are being

developed are fair and proper. Similarly, and most people don't know this either, is that the International Standards on Auditing serve as the baseline for audit methodologies for most of the firms that practice before the Commission.

In fact, they're even used by the AICPA on private companies. So international auditing standards are equally as important to the Commission, because we want to make sure that the audit rules that are being followed are robust and that it will yield high-quality audits.

If I think about it, in my old days as a client service partner working for global companies too, if you're reporting in the United States, you have your teams that are working throughout the world, working on a 10-K, and they're working under U.S. accounting principles, U.S. Generally Accepted Accounting Principles.

And then they go do their local audits, their statutory audits, and they're done under international accounting standards. So, what this presents is a unique challenge for businesses and for us, is how to get those two standards, either on the accounting side or the auditing side, as close to as possible to one another for the following reasons. One, investor confidence. If investors are confused by which standard am I applying to which entities, how do you make a comparison between one company that's using international standards and one that's using U.S. standards, so, to the extent that they're closer together, investors benefit. Companies also benefit from this because of the costs associated with having to have knowledge base in both standards.

And then from an auditor's perspective, the audit firms have to develop, make sure that they have resources globally for global clients or global issuers that can serve on SEC auditors. They have the knowledge and expertise, and if that's a small piece of their business, and there's significant differences between the two, that adds cost to an audit firm's basis, which gets passed on to companies, which ultimately gets passed on to investors.

Right now, there is a significant funding challenges for international standards setting bodies. That's particularly acute on the audit side. Unlike our market, where we charge a fee for the PCAOB, which I mentioned,

which also goes to the Financial Accounting Standards Board for the development of accounting standards, there's no similar mechanism internationally. So, they're dependent wholly on voluntary contributions from interested parties, which is mostly reliant on the accounting profession. There's also a very complex and obtuse governance structure over the auditing standard setting body that probably needs to be modernized.

So, we're working with the other international regulators and other key stakeholders, including investors and auditors and accountants to make sure that we can put in place accounting standards that are as close to one another as possible and that investors can have trust in the financial information that they're relying on.

It's a significant initiative. Very difficult to operate in the international environment. But we're confident that working with other regulators around the world, we're going to be able to solve this problem because it's been kicked, the can has been kicked down the road for a number of years, and it's time to fix it.

Chairman Atkins: Great. Well, I'm glad you're working on that. And that's a huge project to deal with. So, with that, thank you very much for participating in yet another episode of Material Matters. And I look forward to continuing to work hard with you on behalf of American investors. Thank you, Kurt.

Kurt Hohl: Thank you for having me.

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