ACCOUNTING AND AUDITING RULEMAKING

Two Mini-case Studies

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Agenda

- About the Office of Investor Advocate

- Mini-case Study 1: FASB and the Definition of Materiality

- Mini-case Study 2: PCAOB’s Audit Reporting Model
The Office of Investor Advocate

Core Functions

- To Provide a Voice for Investors
- To Assist Retail Investors
- To Study Investor Behavior
- To Support the SEC’s Investor Advisory Committee

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Mini-case Study 1:

FASB and the Definition of Materiality
Definitions of Materiality

FASB Concepts
Statement Number 8

Information is material if omitting it or misstating it could influence decisions that users make on the basis of the financial information of a specific reporting entity.

[Emphasis added]

Supreme Court

“An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. …

Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the “total mix” of information made available.”

-- TSC Industries Inc. v. Northway Inc.
[Emphasis added]
FASB’s 2015 Proposed Update

Materiality is a legal concept. In the United States, a legal concept may be established or changed through legislative, executive, or judicial action. The Board observes but does not promulgate definitions of materiality.

Currently, the Board observes that the U.S. Supreme Court’s definition of materiality, in the context of the antifraud provisions of the U.S. securities laws, generally states that information is material if there is a substantial likelihood that the omitted or misstated item would have been viewed by a reasonable resource provider as having significantly altered the total mix of information.

[Emphasis added.]

Fundamental Questions

- The securities anti-fraud context vs. the financial reporting context

- Does FASB have authority to define materiality?

- Authoritative guidance needed to apply the materiality definition
1980
FASB Concepts
Statement No. 2
(Con 2)

1999
SEC Staff
Accounting
Bulletin 99
(SAB 99)

2010
FASB
Concepts
Statement
No. 8
(Con 8)

2015
FASB
Proposed
Updates
Mini-case Study 2:

PCAOB’s Audit Reporting Model
Determining and Communicating Critical Audit Matters ("CAMs")

Conclusion

- Policymaking: striking the right balance
- Reducing informational asymmetries for investors
- The importance of accounting professionals

*When accountants do their jobs well by producing high-quality financial information, that information energizes our capital markets, enabling… companies… to… grow…, creating investment opportunities, jobs and other benefits for the U.S. economy….*

*Investors, issuers, and the markets all depend on the work you do and the judgments you make…*

—SEC Chief Accountant Wesley Bricker