

**EXAMINING THE AGENDA OF REGULATORS,
SROs, AND STANDARDS-SETTERS FOR
ACCOUNTING, AUDITING, AND
MUNICIPAL SECURITIES**

HEARING
BEFORE THE
SUBCOMMITTEE ON CAPITAL MARKETS AND
GOVERNMENT SPONSORED ENTERPRISES
OF THE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
ONE HUNDRED FOURTEENTH CONGRESS
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**EXAMINING THE AGENDA OF REGULATORS,
SROs, AND STANDARDS-SETTERS FOR
ACCOUNTING, AUDITING, AND
MUNICIPAL SECURITIES**

Thursday, September 22, 2016

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS AND
GOVERNMENT SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:01 p.m., in room 2128, Rayburn House Office Building, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Neugebauer, Huizenga, Hultgren, Schweikert, Poliquin, Hill; Maloney, Sherman, Perlmutter, Scott, Himes, Ellison, and Murphy.

Ex officio present: Representative Hensarling.

Chairman GARRETT. The Subcommittee on Capital Markets and Government Sponsored Enterprises will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "Examining the Agenda of Regulators, SROs, and Standards-Setters for Accounting, Auditing, and Municipal Securities."

Thanks, members of the panel, for being here. And I will begin by recognizing myself for 5 minutes for an opening statement.

So since 2011, one of the primary objectives of this subcommittee and of the full Committee of Financial Services has been to hold regulators and other governmental bodies accountable to the American public who, lest we forget, ultimately, we are the ones that pay the cost and have to contend with rules and regulations that are issued out of here, out of Washington.

In the last 3 years, our subcommittee has received testimony from the heads of a number of offices within the Securities and Exchange Commission, SEC, including our most recent hearing that was just back in April, when we heard from the chief economist, the Office of Compliance and Inspection, the Office of the Whistleblower, and the Office of Credit Ratings. These hearings that we have held have allowed our subcommittee to take a deeper dive, as we call it, into the regulatory apparatus of these various agencies so that we can better understand how they operate and what their agenda is so to ensure that they are actually carrying out their statutory missions.

So if someone wants to step back, we may have a bit of a Noah's Ark here on the panel in terms of the breadth of the issues that we will be able to cover between the ones I listed, municipal security regulations as well as accounting and auditing. In all of that, I am particularly pleased that we are able to hear from the PCAOB and FASB today. It has been, as you know, a while since you have last testified, and there are a number of areas within your jurisdiction that I think members will be interested in.

In the time that I have left, let me just highlight a few areas of particular interest I am looking forward to hearing from you today, although certainly this is not an exhaustive list.

The first one is related to enforcement. As members are aware, the subcommittee has spent a great deal of time examining and also criticizing the lack of due process protections that exist for respondents who are the subject of an administrative proceeding at the SEC and other agencies. There are few issues that are more important to Congress than upholding the rights of Americans to defend themselves when the government brings a charge against them.

But in today's enforcement world, there exists an anomaly in that proceedings initiated by the PCAOB are held in private and are only made public if they are then later on referred to the SEC. This obviously contrasts sharply with practices over at the SEC or FINRA, where charges against an individual or a firm are made public as soon as they are brought.

Even as someone who has long been concerned about government overreach, I can't bring myself to find a good reason for why an enforcement proceeding against an auditor should be treated any differently. Well, then again, it is a proceeding against a broker-dealer or a proceeding against an investment advisor.

Seems that investors have a right to a certain level of transparency. If an auditor of a company they have invested in has serious charges brought against them, that seems to be important information. Certainly, that auditor should be granted every single right possible to defend themselves. But keeping a proceeding quiet means and makes our market less transparent and is potentially harmful to the investor.

Second issue I would like to discuss is what related to the hearings the subcommittee held just yesterday. There we discussed the topic of materiality, with regard to SEC filings, of course. Companies, of course, make decisions on what to disclose based off the questions whether they are material to the investors or not. And as we heard from our witnesses yesterday, the long-held definition in this country of materiality has worked well and therefore should not be changed. While it seems that the SEC and FASB are working towards a common definition that would provide certainty to preparers and to issuers and investors, what is less certain is the role that the PCAOB is playing and whether they are coordinating there properly with both the SEC and FASB.

The third and final issue that—and I don't think this will come as a surprise to anyone in this room—is the issue of cost-benefit analysis. This committee has made cost-benefit analysis a top priority, not just for the regulators, but for the SROs and the standard-setters as well.

I understand that some of the organizations represented on our panel this afternoon have made efforts to improve economic analysis. And this committee and myself appreciate that. But as in many things, the devil is always in the details. So I am looking forward to hearing how each one of your organizations or offices incorporate cost-benefit analysis into either your rulemaking or your standard setting.

And with that, I yield back the remainder of my time, and I yield 3 minutes to the gentlelady from New York, the ranking member of the subcommittee, Mrs. Maloney.

Mrs. MALONEY. I am speaking for 1 minute and yielding 3 minutes to Mr. Sherman and 1 minute to Mr. Perlmutter, who have a great deal of interest in this subject matter.

This hearing will cover a range of topics from auditing and accounting standards to the municipal bond market, the oversight of broker-dealers. And as a former city council member, I know firsthand the importance of municipal bonds. They allow cities and States to finance infrastructure, build schools, pave roads. This is a huge market with more than \$3.8 trillion in bonds outstanding. And as we look forward to the next Congress, an infrastructure package is supported by both Presidential candidates. And municipal bonds are an important part of that.

The other main topic of this hearing is accounting and auditing. Accurate and transparent financial statements are absolutely critical to maintaining investor confidence in our markets. And I have always said markets run much more on confidence than they do on capital. And I also want to make sure that we are not needlessly undermining confidence in our own financial system. I understand the concern that the PCAOB has about firms dragging out disciplinary proceedings. But I am also concerned that by making these proceedings public, we may be unnecessarily harming the reputation of a firm before any official action is taken.

I look forward to the and listening to everyone's testimony. And I reserve my time for Mr. Sherman, 3 minutes, and Mr. Perlmutter for 1 minute.

Chairman GARRETT. Mr. Sherman, you are recognized now for 3 minutes.

Mr. SHERMAN. I thank the gentlelady for the generosity in granting the time.

FASB exercises tremendous government power. It is funded by a tax. If you don't follow its rules, you go to jail. Yet it gets little attention and is not subject to the cost-benefit analysis requirements suggested by our chairman, nor to the FOIA requirements, Open Meetings Act, or Senate confirmation of its members. That would all be okay if they didn't make one really bad decision. And that was the requirement to write off research expenses.

Research is critical to our Nation. Congress determined that when we passed a tax law last year providing \$11 billion every year to incentivize research by private companies. How many refugees could you feed? How many veterans could we provide better care for? But we have decided it is that high a priority. But our \$11 billion to incentivize research is virtually wiped out in its effect by an unheralded decision made I think 30 years ago by FASB to say that we are going to violate all accounting theory and instead

require companies to write off research expenses. Now, if we had that rule for inventories, if you bought inventory for your store, you had to show that as an expense, retailers couldn't carry inventories. But we say that you match the expenditure with the revenue it generates. So you recognize the inventory as an expense when you sell it.

With research, instead of writing off that cost as the research is used, as the patent expires, you write it off all the way. That is a system designed to discourage research. And as I say, wipes out \$11 billion of Congressional effort. It is a clear violation of everything that you learn about accounting theory. It is done solely for convenience.

And FASB has been resisting reviewing this for the 20 years I have been in Congress, saying: Oh, we will get to it. Oh, the Europeans are doing something. We will catch up to them maybe. Oh, we will deal with development expenditures. Development expenditures are not our focus here. It is research and experimentation, which is the focus of Congress' \$11 billion of credit.

So I look forward to FASB coming up with better decisions. And if they don't, then maybe they need a better process. Senate confirmation, FOIA, open meetings, cost-benefit analysis. Because the power that they have to control—to really to be the arbiter that determines what publicly traded corporations do. Because they will do what is necessary to show higher earnings per share. That amount of power shouldn't be hidden in Norwalk, Connecticut.

I yield back.

Chairman GARRETT. The gentleman yields back.

And for the final 1 minute, Mr. Perlmutter.

Mr. PERLMUTTER. Thank you, Mr. Chairman. And thank you, Ranking Member Maloney.

Today, it is my hope that our witnesses will focus some of their remarks on how the current regulatory regime impacts small broker-dealers. Since 2011, we have seen a 12.5 percent reduction in the number of registered broker-dealer firms from about 4,400 down to 3,900. Small firms are being forced to consolidate, merge, or sell in order to achieve economies of scale to compete in today's environment.

This committee spends a lot of time discussing the important role independent community banks play in our towns and States. We have considered several regulatory relief proposals targeted at community banks, including tailoring for risk and size, yet we rarely focus on the role of small broker-dealers. Small firm broker-dealers in my district tell me the regulatory pressures are squeezing them, especially the costs associated with a PCAOB audit and supervision requirements on activities happening away from their firms and not as part of their firms.

So I would ask our panelists to please discuss those particular issues that seem to be troubling small broker-dealers.

Thanks, Mr. Chairman. I yield back.

Chairman GARRETT. The gentleman yields back.

We now turn to the panel. And I appreciate all the members of the panel being with us today. Some of you have been here before, and some have not.

We will now recognize each of you for 5 minutes for an oral presentation of your testimony. And without objection, your complete written statements will be made a part of the record.

For those of you who have not been here before, I always begin by saying that in front of you should be a lighting system, a timing system. You will be recognized for 5 minutes. The green light goes on initially, and then yellow is a 1-minute warning to you to begin to wrap up, if you would, please. And then the red is the conclusion of your time.

So we will begin to my left, with the SEC interim Chief Accountant, from the Office of the Chief Accountant over at the SEC. Mr. Bricker, you are recognized for 5 minutes. Welcome.

STATEMENT OF WESLEY R. BRICKER, INTERIM CHIEF ACCOUNTANT, OFFICE OF THE CHIEF ACCOUNTANT, U.S. SECURITIES AND EXCHANGE COMMISSION

Mr. BRICKER. Thank you very much. And good afternoon, Chairman Garret, Ranking Member Maloney, and members of the subcommittee. It is a pleasure to be here. I appreciate the opportunity to appear before you today to testify on behalf of the Commission regarding current topics in accounting—in the accounting and auditing profession that impact the capital markets and the related activities of the Office of the Chief Accountant, or OCA.

The reliability and the credibility of financial reporting is critical to the proper functioning of our capital markets. As the agency empowered by the Federal securities laws to be the investor's advocate to maintain fair, orderly, and efficient markets and facilitate capital formation, the Commission has the authority and the responsibility to specify the form and the content of financial statements filed with the Commission. Also, the Federal securities laws mandate that public company financial statements be audited by an independent public accounting firm that will provide a report as to the credibility and the reliability of the information presented.

OCA furthers the Commission's mission by working to enhance the foundation of our disclosure framework, which is the disclosure of reliable and accurate financial information to investors and other market participants. OCA is responsible for establishing and interpreting accounting policy to enhance financial reporting. OCA also leads the Commission's efforts to oversee two entities with key roles in the financial reporting process, which are the Financial Accounting Standards Board, or FASB, whose accounting and financial reporting standards the Commission has recognized as "generally accepted" for purposes of the Federal securities laws, also the Public Company Accounting Oversight Board, or PCAOB, which is responsible for overseeing the audits and auditors of public companies and registered broker-dealers.

Currently, OCA has been directing significant attention to monitoring implementation activities for recently issued accounting standards. First, the FASB and the International Accounting Standards Board, or IASB, issued largely converged standards for how a company should report information about revenue from customers, which is generally intended to improve existing requirements by eliminating inconsistencies, requiring additional disclosures, and simplifying the preparation of financial statements.

Second, the FASB and the IASB's new standards on the measurement and reporting of leasing activities will increase the transparency and comparability among organizations, thereby enabling investors to more readily and accurately understand the rights and the obligations associated with lease transactions.

Finally, the FASB and the IASB have issued new credit loss standards that will improve and simplify reporting for loans, investments, and other financial instruments. These new standards should improve financial reporting within the United States and reduce country-by-country disparity in financial reporting.

OCA is also focused in the area of internal controls over financial reporting. Maintaining adequate internal accounting control promotes reliable financial reporting and encourages investment in our capital markets. Updating and maintaining internal controls will be particularly important as companies work through the implementation of significant new accounting standards that I discussed earlier.

Now I would like to say a few words about the importance of auditors and our oversight of the PCAOB. Independent auditors have been long recognized as one of key gatekeepers in our investor protection system. And the integrity of this system is supported by the PCAOB's oversight of public company auditors. Recent PCAOB inspection results show promising signs of improvement in many audit firms' quality controls that are designed to ensure compliance with the professional auditing standards as determined by the PCAOB.

However, inspections alone cannot fully achieve the objective without the complement of rigorous and high-quality auditing standards that keep pace with the evolution and financial reporting, the economic environment, and companies' business models. The PCAOB has continued to update and modernize its interim auditing standards that it adopted in 2003. For example, the PCAOB has made significant progress on a major project of vital interest to investors, which is improving the informative value of the standard auditor's report upon which investors rely.

I commend the PCAOB for its efforts and its commitment to high-quality auditing standards that have the potential to further enhance the credibility of financial reporting for the benefit of investors.

Thank you again for the invitation today, and I am happy to respond to any questions.

[The prepared statement of Mr. Bricker can be found on page 33 of the appendix.]

Chairman GARRETT. Thank you.

And speaking of the PCAOB, Mr. Doty, you are recognized, and welcome, for the next 5 minutes.

**STATEMENT OF JAMES R. DOTY, CHAIRMAN, PUBLIC
COMPANY ACCOUNTING OVERSIGHT BOARD**

Mr. DOTY. Chairman Garrett, Ranking Member Maloney, and members of the subcommittee, it is a pleasure to be here today. Thank you for the opportunity to appear.

As chairman, I want to highlight a few key themes and priorities of the PCAOB. First, I believe the PCAOB is a vital resource pro-

tecting investors and fostering economic resilience by advancing reliable, informative, and independent audits.

Second, accurate and transparent financial audits are a key to promoting investor trust and investment that grows capital markets and drives a healthy economy.

Third, experience tells us that the PCAOB's role is essential, and our standards and oversight programs are making a real difference on behalf of investors and companies.

Fourth, it is critically important that PCAOB remain vigilant and independent because persistent economic pressures can threaten the integrity of audits.

Finally, going forward, a rapidly changing landscape will require that the PCAOB sustain our investment in innovation to meet the needs of investors and enable public companies in our markets to benefit from a lower cost of capital.

When investors lose confidence in financial reporting, it becomes more difficult and more expensive to finance the businesses on which our economy depends. Moreover, inaccurate financial reporting can mask poor business strategies or fraud that, if left uncorrected, may result in the misallocation of capital, business failures, and job losses.

The PCAOB promotes audit quality through its inspection and enforcement programs, its standard setting, coordination with other regulators, domestic and foreign, and an important investment in economic analysis we have made in recent years.

The PCAOB also benefits from extensive outreach to investors, preparers, and audit committees, academics, auditors, and others. As we speak, representatives of PCAOB are conducting a forum in Jersey City for auditors of small businesses and brokers and dealers.

In the PCAOB's 14 years, our inspections have found many examples of high-quality auditing, including evidence of auditors requiring companies to change their accounting or improve their internal controls over production of financial reports. These auditors are the unsung heroes who avert the scandals that don't happen.

But our inspectors have also found and reported instances in which firms' audit reports should not have been issued. These instances include audits of some of the largest companies in the world, as well as midsize and smaller companies. What this points to is smart regulation and accomplishments that are changing the landscape.

Inspections have improved audits and changed firms' attitudes and execution. Emerging research on our inspections indicates that when we find audits that are deficient, the engagement teams raise their game without a commensurate increase in fees, but with a statistically significant reduction in restatements. Issuance of regular inspection reports provides meaningful information that didn't exist before. And that helps all parties, including investors, audit committees, and companies that make better decisions. Enforcement has helped root out bad apples and fosters trust in the system.

We have issued clearer and better audit standards and have made progress in improving the relevance and transparency of audits. Markets will soon have useful information to differentiate

auditors on the basis of track records for quality. Awareness of our role and mission is now firmly established, and emerging research suggests that this is helping build public confidence in investing.

The PCAOB has helped foster global recognition of the importance of cooperation. Our joint inspection with counterparts around the world have proven to be both effective and efficient. The PCAOB has established a center for economic analysis headed by Luigi Zingales of the University of Chicago, to further incorporate meaningful economic analysis in all aspects of our work. I firmly believe that through these accomplishments, the PCAOB has played a part in helping our economy and capital markets be resilient and grow.

As we go forward, we must continue to invest in staff skill sets, information technology, and analytics. The audit of the future will need to take advantage of big data. And we will need to stay ahead of that curve. Our 2017 budget is still under development in consultation with the Commission, which must ultimately approve it. I should point out that by law, our budget is funded primarily by public companies, brokers, and dealers.

In order to adequately address priorities, the PCAOB needs to at least maintain the current budget level. I do anticipate the need for a small increase over our \$257.7 million budget for 2016. This would be for the cost of living, annual merit increases, as well as expected expenses for travel, particularly for inspections, information technology, including cybersecurity, and facilities. But we do have a keen sense of stewardship. It is my goal to accomplish our objectives through careful and continuous assessment with the best use of our resources without a significant increase.

In conclusion, I appreciate the subcommittee's continued interest in our work and I will be happy to answer questions. Thank you.

[The prepared statement of Mr. Doty can be found on page 48 of the appendix]

Chairman GARRETT. Thank you.

From FASB, Mr. Golden, thank you for being with us. You are recognized for 5 minutes.

STATEMENT OF RUSSELL G. GOLDEN, CHAIRMAN, FINANCIAL ACCOUNTING STANDARDS BOARD

Mr. GOLDEN. Chairman Garrett, Ranking Member Maloney, and members of the subcommittee, good afternoon. My name is Russell Golden and I am the chairman of the Financial Accounting Standards Board.

Established in 1973, the FASB operates under the oversight of the Financial Accounting Foundation, a private sector nonprofit organization. Through authority established by Congress, the SEC has recognized the FASB as the designated accounting standard-setter for public companies.

The objective of financial reporting is to neutrally depict the economics of a transaction and thus provide financial information that is useful to existing and potential investors, lenders, and others. Accounting standards, however, are not intended to drive behavior in a particular way. Rather, they seek to present financial information so that users can make informed decisions about how to best deploy their capital. U.S. GAAP is essential to the efficient func-

tioning of the U.S. economy because investors, creditors, donors, and other users of financial reports rely heavily on the information that they contain. The FASB's goal is to improve financial information that is useful to investors and other financial statement users in making capital allocation decisions.

It is important to note that although the FASB has the responsibility to set accounting standards, it does not have the authority to enforce them. That falls to regulators like the SEC and the PCAOB. An independent standard-setting process is integral to producing high-quality accounting standards. The FASB sets accounting standards through processes that are open and that encourage input from all stakeholders. This involves, among other things, proactively requesting meetings with stakeholders, including a wide range of investors, auditors, and issuers. These meetings help us to assess whether the proposals or existing standards will lead to better information as well as to assess the related costs.

Our comprehensive procedures permit timely, thorough, and open study of financial accounting and reporting issues. Because we understand that the FASB's actions affect so many stakeholders, the procedures also encourage broad public participation throughout the standard-setting process.

The FASB supplements its direct outreach by meeting regularly with numerous advisory groups and with staff of the SEC, the PCAOB, and banking regulators. This broad consultation provides the opportunity for the FASB to hear and consider all stakeholder views and to identify unintended consequences. The FASB is keenly aware of the need to balance compliance costs with the benefits investors and other users of financial reports gain from the improved information. The FASB's broad and inclusive process helps us to assess these factors and strike appropriate balances. The FASB exercises its judgment after considering relevant research, analyzing stakeholder views, and carefully deliberating issues.

The FASB's role does not stop when a standard is issued. An important part of the FASB's mission is to monitor implementation and assisting preparers and other practitioners in their understanding and ability to consistently apply a new standard. Further, we ensure that stakeholders have sufficient time to transition to a new standard, and our goal is to be in a position to help them facilitate a smooth transition.

The FASB recently completed a number of amendments to U.S. GAAP designed to improve transparency and overall usefulness of information provided in financial reports, as well as reduce complexity. The most significant amendments are related to the recognition of credit losses and lease accounting. The FASB has a number of ongoing projects, including a disclosure framework project in materiality continued to increase the utility of information disclosed in a financial statement. Stakeholders have also prompted us to look at four financial reporting areas of concern, namely, intangible assets, including research and development, pensions, and other postretirement benefit plans, distinguishing liabilities from equity, and reporting performance.

In conclusion, I would like to emphasize that the objective of financial reporting is to neutrally depict the economics of a trans-

action, and it is important for Members of Congress and the American public to know that the FASB's accounting standard-setting process is robust, transparent, and accountable. Thank you for the opportunity to provide this brief overview of the FASB and its priorities for the year. I would be pleased to answer any questions.

[The prepared statement of Mr. Golden can be found on page 62 of the appendix]

Chairman GARRETT. Thank you.

Moving next to the Director of the Office of Municipal Securities at the SEC, Ms. Kane, welcome. And you are recognized for 5 minutes.

STATEMENT OF JESSICA KANE, DIRECTOR, OFFICE OF MUNICIPAL SECURITIES, U.S. SECURITIES AND EXCHANGE COMMISSION

Ms. KANE. Good afternoon, Chairman Garrett, Ranking Member Maloney, and members of the subcommittee. Thank you for inviting me to testify on behalf of the U.S. Securities and Exchange Commission regarding the activities of the Office of Municipal Securities.

The office supports the Commission's mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation by overseeing the municipal securities market, administering the Commission's rules pertaining to municipal securities brokers and dealers, municipal advisors, investors in municipal securities, and municipal issuers, and coordinating with the MSRB on rulemaking and enforcement actions.

The Commission created the office as an independent office that reports directly to the SEC Chair as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The office's current activities generally fall within the following three areas: First, municipal advisors. Second, market structure and disclosure initiatives. And third, regulatory coordination.

The Dodd-Frank Act required municipal advisors to register with the SEC and to comply with MSRB rules. The Commission adopted final rules for municipal advisor registration in September 2013. The office has significant responsibilities relating to the implementation of the municipal advisor registration rules, including providing interpretative guidance to market participants, reviewing and processing MSRB rule filings related to municipal advisor regulation, and overseeing the registration of over 650 municipal advisory firms.

The office also consults with the Commission's Office of Compliance, Inspections, and Examinations regarding municipal advisor examinations, and coordinates with the MSRB and FINRA to help promote fair and uniform application of new rules to municipal advisors.

With respect to market structure and disclosure initiatives, the Commission issued a report on the municipal securities market in July 2012 that recommended a number of possible actions to improve the municipal securities market in these two areas. In a June 2014 speech, Chair White discussed three of the report's market structure recommendations with respect to the fixed income markets, and steady progress has been made on these initiatives.

First, the Commission approved the MSRB's proposed rule change to require brokers, dealers, and municipal securities dealers to seek best execution of customer transactions in municipal securities. And the MSRB and FINRA issued guidance on their respective best execution rules. Second, the MSRB and FINRA have filed proposed rule changes with the Commission to require broker-dealers to disclose markups and markdowns to retail customers on certain principal transactions for municipal, corporate debt, and agency securities. And third, the office continues to work with the Division of Trading and Markets to consider ways to enhance the public availability of pretrade pricing information for municipal and corporate bonds.

The Division of Enforcement's Municipalities Continuing Disclosure Cooperation Initiative, a program for municipal issuers and underwriters to self-report Federal securities law violations, has focused significant attention on compliance with the continuing disclosure requirements of rule 15c2-12 and disclosure practices more generally. The self-reported violations have provided the office with valuable information as to how rule 15c2-12 is working, and will help us determine where best to channel our efforts going forward.

The office regularly coordinates with other regulators in the municipal securities market. The office is responsible for reviewing and processing all MSRB rule filings on behalf of the Commission. The office also regularly meets with the MSRB to discuss rule-making, examination, and enforcement activities in the municipal securities market. And the office leads the semiannual meetings with the MSRB and FINRA as required by the Dodd-Frank Act.

In addition, the office also works with the municipal securities industry to educate State and local governmental officials and conduit borrowers about the Commission's rules.

Thank you again for having me here today. And I would be happy to answer any questions.

[The prepared statement of Ms. Kane can be found on page 105 of the appendix.]

Chairman GARRETT. Thank you, Ms. Kane.

I now recognize Ms. Kelly, the executive director of the MSRB. Ms. KELLY. Thank you.

Chairman GARRETT. Welcome, and you are recognized for 5 minutes.

**STATEMENT OF LYNNETTE KELLY, EXECUTIVE DIRECTOR,
MUNICIPAL SECURITIES RULEMAKING BOARD**

Ms. KELLY. Thank you. My name is Lynnette Kelly, and I am the executive director of the Municipal Securities Rulemaking Board. On behalf of the MSRB, which regulates the \$3.8 trillion municipal securities market, I appreciate the opportunity to testify today.

Since the enactment of the Dodd-Frank Act in 2010, and the 2012 release of an SEC report on the municipal securities market, the MSRB has made significant strides in fostering a municipal securities market that provides investors and State and local government issuers with an unprecedented level of transparency. In 1975, Congress created the MSRB under the Securities Exchange Act of 1934 as an SRO with the mandate to regulate the activities of

broker-dealers and bank dealers that buy, sell, and underwrite municipal securities.

We are a 501(c)(6) organization governed by a 21-member board of directors with a majority of public members. The MSRB is overseen by both Congress and the SEC, and our rules generally must be approved by the SEC before becoming effective. Our mission is to protect investors, State and local government issuers, other municipal entities and the public interest in promoting a fair and efficient municipal securities market. The MSRB is unique amongst SROs in that it does not examine for compliance with or enforce our rules. But we do play a supporting role for those organizations that do, including the SEC, FINRA, and the bank regulators.

Congress expanded the MSRB's authority under Dodd-Frank to include the regulation of municipal advisors, those professionals who act as fiduciaries to State and local governments. Congress also expanded our original mandate to protect investors, to include the protection of State and local government entities. MSRB Chair Nat Singer wrote to this committee earlier this week detailing the MSRB's progress in advancing this expanded authority through its establishment of our core regulatory framework for municipal advisors.

The MSRB is also working to enhance market transparency through three avenues: rules for financial professionals informed by economic analysis and regulatory efficiency measures; improved access to market information through enhancements to our EMMA website, which provides free public access to municipal disclosures and data; and education for issuers on their disclosure responsibilities.

First, we are improving transparency with rules intended to ensure that retail investors in this market have a more detailed view of the market, including dealer compensation. A new MSRB rule proposal on that topic requires dealers to disclose markups and markdowns to retail customers on certain principal transactions. This and other MSRB rules benefit from a 2013 MSRB policy to formally integrate economic analysis into our rulemaking efforts. In addition, the MSRB has undertaken a multiyear initiative to review the totality of our rule book with the result of streamlining, clarifying, and modernizing a number of rules.

Secondly, the MSRB has greatly enhanced municipal market transparency through new tools and resources on our EMMA website to improve retail investor access to important market information. EMMA also offers tools and features that support issuers in making full and timely disclosures to the market. This is a topic we underscore through our third avenue for enhancing transparency, education.

When State and local governments issue most types of municipal securities, the issuer or obligated person generally must agree to provide ongoing or continuing disclosures. We have consistently called for better disclosure, better quality, and more timely disclosure through market education initiatives, including disclosure of bank loans and other direct purchase debt which is not currently subject to SEC disclosure requirements.

More generally, the MSRB highlighted for the Congressional Task Force on Economic Growth in Puerto Rico principles and

practices that any municipal issuer should consider to ensure timely and complete disclosures to the market. Attached to my written testimony is a comprehensive MSRB report card that shows the progress that we have made on numerous initiatives aligned with those recommendations contained in the 2012 SEC report.

I would be pleased to provide this committee with further detail on these and other initiatives, and again very much appreciate the opportunity to testify today.

[The prepared statement of Ms. Kelly can be found on page 113 of the appendix.]

Chairman GARRETT. Thank you.

And Mr. Colby, chief legal officer of the Financial Industry Regulatory Authority, you are recognized for 5 minutes.

**STATEMENT OF ROBERT L.D. COLBY, CHIEF LEGAL OFFICER,
FINANCIAL INDUSTRY REGULATORY AUTHORITY**

Mr. COLBY. Chairman Garrett, Ranking Member Maloney, and members of the subcommittee, I am Bob Colby, chief legal officer of the Financial Industry Regulatory Authority, or FINRA. Thank you for the opportunity to testify today.

As you have now heard twice before, the municipal securities market is overseen via a well-developed collaborative relationship between the MSRB, FINRA, and the SEC. The MSRB has responsibility for adopting rules relating to the municipal securities market. FINRA serves as the examination, surveillance, and enforcement authority for its regulated firms. And the SEC oversees the activities and approves the rules of both FINRA and the MSRB.

Effective coordination among these regulatory bodies is achieved through both leveraging of resources and collaborating on many financial, operational, and business conduct topics. FINRA examines for and enforces compliance with the Federal securities laws and rules by broker-dealers engaging in municipal securities transactions. In addition, since the passage of Dodd-Frank, FINRA has examined its broker-dealers' activities as registered municipal advisors. In doing so, we coordinate closely with the SEC and the MSRB, and we have a specialized team that acts as a central point of contact with the SEC and the MSRB.

As part of this coordination, FINRA requests interpretative guidance from the MSRB regarding its rules and provides information to the MSRB about FINRA's municipal securities market examinations and enforcement actions. FINRA also participates in formal periodic meetings with the MSRB and the SEC to discuss timely issues arising from current examinations.

Each year, FINRA and the MSRB collaborate on municipal securities regulatory priorities leveraging, among other things, regulatory intelligence gathered from current year examinations, new rules, rule interpretations and emerging issues. FINRA then performs a qualitative and quantitative risk assessment of each municipal broker-dealer and municipal advisor to determine its municipal dealer exam priorities. FINRA conducts on average about 500 municipal broker-dealer and 60 municipal advisor examinations annually.

In recognition of the unique characteristics of the municipal securities market, FINRA operates specialized exam teams for the larg-

est most complex municipal broker-dealers and municipal advisors. We also conduct market surveillance of municipal securities transactions using a risk-based approach.

FINRA worked closely with the SEC and the MSRB to develop regulation for the fixed income market that is consistent yet calibrated to reflect the unique regulatory needs of each market. In particular, FINRA works with the SEC and MSRB and focuses on initiatives designed to enhance transparency and promote better execution quality in the fixed income markets. One of these initiatives, which has been mentioned already, involves proposals that the FINRA and MSRB recently filed with the SEC that would require additional pricing information to customers on their trade confirmations. Putting additional pricing information in the hands of customers will better enable them to evaluate the cost and quality of the services that firms provide. FINRA and the MSRB also jointly conducted investor testing to evaluate the potential benefits of the proposed disclosures.

We look forward to evaluating the comments that will no doubt be received on the proposal and coordinating with the MSRB on this and other issues. I appreciate the opportunity to testify today and would be happy to answer any questions you may have.

[The prepared statement of Mr. Colby can be found on page 42 of the appendix.]

Chairman GARRETT. Thank you. Thank you very much.

So I said at the—I will recognize myself for 5 minutes.

I said at the outset that our hearing today is examining the agenda of regulators, SROs, standard-setters for accounting, auditing, and municipal securities. We were saying that this—and being done through one panel, it really could have been two, but let's delve into it. And I guess I will start off with PCAOB.

Mr. Doty, reading through your testimony and hearing you today, as you know, you mention in your testimony that—you know, and I mentioned in my comments, PSAOB enforcement proceedings are somewhat of an anomaly, right, in that they are held out of the public eye unless, what, both parties consent? Essentially, I guess you would say, grants a—what do you call it, veto power, if you will, before that gets out. And this contrasts with other folks here, with the SEC, FINRA, and other agencies.

And as you are aware, the subcommittee has been as I—I have been one of the critics when it comes to the way in which the SEC and FINRA conduct their enforcement proceedings, and particular a lack of due process. And you have probably seen some of my comments on that. But no point of our examination of their practice they would say, you know what, let's just make all of them private and out of the public eye.

So just from a practical sense, and I think you will probably agree, if you were an investor in a public company and that company's auditor had a charge brought against them, if you are that investor in that company, wouldn't you want to know whether that charge was brought against them?

Mr. DOTY. Absolutely, Chairman Garrett. If you are an audit committee making a selection of an audit firm—

Chairman GARRETT. Right.

Mr. DOTY. —you might want to know. And our strong hope for this—the change that you are describing is that the present situation as an anomaly creates harm. It harms—when we go after the bad apples, they continue to practice, they continue to issue bad audit opinions. They compete with the vast majority of good auditors who are doing conscientious work. And we think that is unfair.

Chairman GARRETT. That is true. And I wasn't even thinking about it from the audit committee perspective, but just the investor. But that is true.

And I have said it, but does this type of enforcement secrecy exist anywhere else, that you are aware of, within the whole regulatory framework, certainly not right here, but elsewhere, particularly within the banking securities area? The secrecy aspect.

Mr. DOTY. We see no reason why auditors—

Chairman GARRETT. Yes, but you don't see it anyplace else.

Mr. DOTY. No. No, we don't. It is a general practice in Federal agencies and administrative law and other areas that the public knows when we have made a determination that auditor conduct is sufficiently egregious, and an extreme departure from professional standards, that we have brought charges.

Chairman GARRETT. Okay. And that is interesting. And so under the Grassley-Reed Senate bill, you mention that in your testimony, I will be introducing a version of that over here, the investigation portion of it, however, would still remain private. Correct?

Mr. DOTY. It would. Absolutely.

Chairman GARRETT. And this was an argument made up years ago, but—a while back, but I assume you will agree here: Do broker-dealers and investment advisors operate in an environment where reputation and trust matters? And the answer, of course, is yes. And is there anything inherently different between those folks and auditors?

Mr. DOTY. Other professionals who rely on the trust of the public are subjected to public proceedings where they are derelict.

Chairman GARRETT. Right. Thanks.

Moving next to Mr. Golden. My time is going by quick. I understand that FASB has been working on the disclosure framework, you mentioned it in your testimony, to improve the effectiveness of disclosures. We had a discussion on that about disclosure. Were you watching our hearing yesterday by any chance? Did you tune in?

Mr. GOLDEN. No, I did not.

Chairman GARRETT. You missed it. It was exciting. It was the whole issue of materiality. One of the most fascinating hearings we have held to date and—no. And I want to follow up in my last minute on, last fall, FASB issued guidance that would revise the definition of materiality for financial statements, though it is based on a legal concept that the Supreme Court has articulated. Can you explain briefly FASB's logic behind that updated guidance and the importance of following the materiality standard articulated by the Supreme Court?

Mr. GOLDEN. Sure. And thank you for that question. Our intention in the project was to align the existing definition with that of the PCAOB and the SEC, and remove a change that the board made in 2010 to have the same words as that of the IASB. We

thought it was important that the conceptual definition of the FASB align with the SEC, the PCAOB, and the laws of this country.

Chairman GARRETT. And let me just jump back to Mr. Doty. So there is some degree I hear as far as confusion as far as where you guys are and where they are. Are you consulting as you are coming up with your—with definitions of materiality?

Mr. DOTY. We do consult. And Chairman Golden is correct that we have continued to observe the law, as we understand it, on materiality under the Exchange Act.

Chairman GARRETT. And be willing to make—

Mr. DOTY. Supreme Court decisions.

Chairman GARRETT. Yes, but my understanding is there some discord or confusion at this—

Mr. DOTY. Our—we do consult, and we will be looking to be sure that auditors are auditing in accordance with the legal standard for disclosure policy that the SEC and the FASB established.

Chairman GARRETT. And since—this is off page, but Ms. Kelly, you raised one issue. I know my time is over. But you brought up the aspect of some degree of materiality. Is your standards—this is just for my information. I just don't understand this. The materiality issue that you were raising near the end of your testimony. Right? Are you with me? Ms. Kelly?

Ms. KELLY. I am sorry, sir.

Chairman GARRETT. At the end of yours talking about disclosure regimes and materiality issues. Is there—no?

Ms. KELLY. Well, the disclosure regime in the municipal market does—is based on a materiality standard.

Chairman GARRETT. And is that all—this is my learning education period—different definition here? Because you were saying—you were going into some of the other areas that needed to be disclosed and some of issues that are being brought out there. Right? By your testimony. So is that something that I need to understand better, I guess I do, as far as the materiality definition over here versus where in your market? Either one? Are you with me?

Ms. KELLY. Well, I can say during the MCDC initiative, there were certainly market participants that did ask for further clarity on the definition of materiality.

Chairman GARRETT. Okay.

Ms. KELLY. And that wouldn't be something that is within the MSRB's—

Chairman GARRETT. Per your authority, but—okay. With that uncertainty that I still have in my head on that point—I will circle back with you—I now yield 5 minutes to the gentlelady from New York.

Mrs. MALONEY. I thank the gentleman for yielding, for calling this important meeting, and for all of your testimony. I have been called to a confidential briefing on the bombings that—the terrorist attacks in our country, one of which took place in my district.

But before I leave, I wanted to ask Mr. Colby about the proposed rule to require the reporting of—FINRA's reporting of Treasury trades. Certainly, our Treasury market is the deepest and most liquid in the world, and tremendously important to the financial markets, and very, very important to the financing of government. So

I wanted to ask you, where does this rule stand? When will it be completed? What is the status of it? What can you tell us about this important rule?

Mr. COLBY. Thank you, Congresswoman. We have filed a proposal to require our members to give us information for purposes of an audit trail of Treasury securities. It is with the Commission. There have been a round of comments. We are about to respond to those comments, and we are hopeful the Commission will approve it shortly.

Mrs. MALONEY. And so you think it will be shortly. Okay. What do you think of the argument that some people have put forward that the Treasury trades should be reported publicly rather than just to regulators? And do you think there is a risk that public reporting could potentially in some way hurt or disrupt the market?

Mr. COLBY. Well, we believe that the question about dissemination of the Treasury data is primarily a question for the Treasury Department and the SEC. We responded to their requests for us to develop an audit trail. We have made public data with respect to corporate and agency securities, and we heard these same arguments in that context. And so we went through a very methodical process where we put out in the public sphere the most liquid of the security transactions and assessed the impact of those before moving on to other transactions.

Mrs. MALONEY. Well, I would like to address this question also to Jessica Kane and to you. And would each of you describe the types of enforcement actions you have brought in the municipal market, both with the SEC and with FINRA, and any emerging threats that you see either to municipalities or investors, and how are you addressing them? First, Ms. Kane and then Mr. Colby, if I could.

Ms. KANE. At the Commission we have a specialized unit within the Division of Enforcement. It is the Public Finance Abuse Unit, the PFAU, and their current efforts focus on investigating and pursuing enforcement actions in four primary categories: Offering and disclosure fraud, broker-dealer abuses, public corruption, and municipal advisors.

Earlier, Ms. Kelly referenced the MCDC initiative. I would say the lack of compliance with continuing disclosure obligations was one area that we saw a potential for abuse and the Enforcement Division, noting this area, brought the MCDC initiative.

Mrs. MALONEY. Mr. Colby?

Mr. COLBY. Our efforts are focused on broker-dealers and municipal advisors that are members. We have brought a range of cases covering both market transactions and customer transactions. In the customer area, we focused on suitability issues, the sort of recommendations that are made to customers and whether they are appropriate for that sort of customer. In the transactions area, we have brought cases on markups where excessive undisclosed markups were charged to customers; also for failure to report transactions that should have been reported under the municipal reporting system.

Mrs. MALONEY. Thank you.

And my time is almost up, but I would like to ask James Doty. It is my understanding that the PCAOB does not currently have

a budget request for 2017 because of a unique timeline. Could you explain what the timeline is and discuss, in general terms, what your views are on your expected budget request?

Mr. DOTY. Yes. Ranking Member Maloney, we are in the process of formulating our budget. That happens as a bottom-up assessment of each program's needs. It occurs with extensive discussions that begin in the spring. We receive some—a lot of feedback and discussion from SEC staff here, which acting—which Acting Director Bricker has referred to. We normally—we will submit a preliminary budget for examination and review at the end of July, which we have done, and that will receive a lot of work, both with the SEC and ourselves pitching in and meeting frequently. It will culminate with a final budget request on November 30. That will then be the subject of a hearing by the Commission.

Mrs. MALONEY. Thank you. My time has expired. Thank you.

Chairman GARRETT. Thank you. The gentlelady yields back.

The gentleman from Arizona is recognized for 5 minutes.

Mr. SCHWEIKERT. Thank you, Mr. Chairman. And this is one of those hearings where you sort of get to ask those sort of questions that have bounced around in the back of your head.

A decade ago, I was the treasurer of a very large county. And so this is going to be to Ms. Kelly. I signed a lot of bonds in that time. I mean, lots. I mean, the type where you have the hand cramp. But I remember a number of occasions where we were doing a defeasance, a refinance. And typically, my job was just, you know, the official of the county putting our name on it, saying, you know, the school district or whatever the taxing district was, and I got loose with some of the fees and costs. And in digging into them, I realized that the legal fees, the rating fees, everything else that goes into that cost stack of this refinance was actually almost as much as the savings on the instrument was going to have to the taxing district.

Is there a standard that is articulated that you don't walk in and convince, say, a school district, someone else saying we want you to refinance your bonds because we are going to make a bunch of legal fees on it, but over the next decade, we are going to save you five grand? I mean, what is the proper etiquette or rules, and has that changed in the decade since I was doing that?

Ms. KELLY. Thank you. The MSRB rules apply to broker-dealers and municipal advisors, and we have rules for each, fair dealing and fiduciary duty rules, for both of those types of professionals that prohibit the charging—

Mr. SCHWEIKERT. Yes, but you already—because it was not—there was no municipal advisors involved in this.

Ms. KELLY. Right.

Mr. SCHWEIKERT. And someone handed you a note; you might want doublecheck that. Look, we all rely on our experts. Because in this particular case, there seem to be some extraordinary legal fees rolled into this defeasance.

Ms. KELLY. Right.

Mr. SCHWEIKERT. And, you know, I know that is sometimes uncomfortable, but when we looked at the entire stack of costs, from the rating to, you know, the analysis, this, that, there was really

very little savings happening here. Does the entire cost stack get looked at?

Ms. KELLY. Not by the MSRB. We have no direct authority over bond attorneys at all, but there are certain activities at the State level that seek to really make cost of issuance on a bond issue more transparent. So for example, the State of California just adopted a bond disclosure law that would require very detailed information about all of the professionals and the costs that they were—or the fees that they were paid per bond transaction.

Mr. SCHWEIKERT. Okay. And this is for anyone on the panel. Has anyone ever seen a State municipal government or even a national organization that says, hey, we have a very simple online disclosure when someone walks in and wants your road district, your sewer district, your school district, whatever, you know. In Maricopa County we have, what, 3,300 taxing districts, and I think 25 percent of those have the right to do some type of bonding. Here is our cost. And any taxpayer can log in, see it, and it is a nice, simple, looks like the back side of a yogurt carton, of here is our legal costs, here is our rating costs, here is our research costs, here is our certification, here is our—and to see that, and particularly in the occasion of a defeasance where, you know, you are moving from one to the other and assuming that you are saving the taxpayers money.

Does anyone know of something like that? Because I am thinking of the elected officials who may not be from our world of doing finances. How do they get a quick understanding of the cost?

Ms. KELLY. What is fair, what is not. I am not aware—

Mr. SCHWEIKERT. No. What is rational.

Ms. KELLY. I am not aware of—well, there certainly is no national database that requires municipal bonds.

Mr. SCHWEIKERT. Wouldn't that be a lot easier than a fairly large regulatory statement?

Ms. KELLY. Sure.

Mr. SCHWEIKERT. Like as you were mentioning California, which I am a little familiar with, which has, you know, what, a couple dozen line items—

Ms. KELLY. Right.

Mr. SCHWEIKERT. —and categories in it, and just make it, hey, this is it.

Ms. KELLY. Again, there are certain States that do require disclosure at the State level. I am not aware of whether or not that information is publicly available, but I take your point.

Mr. SCHWEIKERT. Okay. If anyone ever comes across something like that, I would love to read more about that.

And with this I yield back, Mr. Chairman.

Chairman GARRETT. The gentleman yields back.

Mr. Scott is recognized now for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman.

As a co-lead sponsor on Dodd-Frank a few years back, I was happy that the law elevated the attention needed to the municipal securities market by creating the Office of Municipal Securities at the SEC. It has been a long time, indeed, since this committee itself has even had a hearing on municipal securities. So I wanted to ask the panel, especially you Director Kane, if you could provide

us with an update of any emerging threats, any emerging threats that you see today, either to the municipalities themselves or to the investors? And I am particularly interested in this because municipal bonds have been getting a lot of attention in my own district in Georgia, in Cobb County, lately because of our brand-new spanking Atlanta Braves stadium. So it is of particular interest to me to make sure things are going to be going smoothly, and so I would like to know, do you see any threats on the horizon to either municipalities themselves or to investors, or do we see smooth sailing along the way?

Ms. KANE. I am happy to start that off.

Mr. SCOTT. Yes, if anybody else would like to comment, I certainly would like to cover the waterfront so all of us will know. And we are on C-SPAN, so people across the country will know if everything is fine.

Ms. KANE. Well, I think I would like to talk about two issues in particular. The Dodd-Frank Act required municipal advisors to register with the Commission and to comply with MSRB rules. These are important rules that the Commission promulgated in September 2013. The MSRB has rolled out a suite of conduct rules applicable to municipal advisors, and these rules were really designed with the idea of protecting municipalities—

Mr. SCOTT. Let me ask you one thing. I think I just missed you. Who would register with the Commission again?

Ms. KANE. Municipal advisors.

Mr. SCOTT. Okay.

Ms. KANE. These are persons who would provide advice on the issuance of a bond or municipal financial products or would solicit a municipal entity or obligated person. So the SEC does have authority over municipal advisors with respect to registration, examination, and enforcement. As Ms. Kelly mentioned, the MSRB has recently completed a suite of conduct rules applicable to municipal advisors, including a fiduciary duty rule. So advisors to municipalities are now subject to SEC registration, examination, and oversight, as well as to MSRB conduct rules. These are important rules designed to protect municipalities from conflicted advice and from unregistered financial advisors advising them on transactions without the municipalities' best interests at heart.

Another area that we have been focusing on at the SEC is compliance with continuing disclosure obligations. The 2012 report that the SEC Commission put out noted that there were widespread failures to comply with continuing disclosure obligations on the part of municipal issuers. To correct that widespread activity, the PFAU, the Public Finance Abuse Unit, in the Commission's Enforcement Division launched the MCDC program. This is a voluntary self-reporting program whereby issuers and underwriters could self-report violations of the Federal securities laws. It has been an incredibly successful program from the perspective of my office in terms of focusing compliance by municipal issuers and underwriters on continuing disclosure obligations and ensuring that investors get the information that they need.

Mr. SCOTT. So let me ask you this too. Also in my State, at the same time we are building the new Atlanta Braves stadium on municipal bonds in the area, downtown in Atlanta we are building the

new Falcons stadium in municipal bonds. And there was some concern about is this too much in one area, and particularly because municipal bonds now are becoming the favorite way of building these huge mega stadiums now.

Do you all see any threat in that? I mean, we are doing well given we are doing them all at the same time. We got both stadiums supposed to come on in 2017, so that will be interesting. But is that a threat? Is that something communities need to be aware of, not to overload?

Ms. KANE. The decision to incur debt is a decision that is made at the State and local government levels. The SEC has authority over municipal advisors, municipal securities brokers and dealers. The SEC also enforces the antifraud provisions of the Federal securities laws with respect to disclosures made by issuers to investors.

Mr. SCOTT. Right. So we are safe.

Chairman GARRETT. The gentleman's time has expired.

Mr. SCOTT. Thank you.

Chairman GARRETT. Thank you.

The gentleman from Texas is recognized for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. Thanks for holding this hearing.

One of the things I wanted to talk about a little bit is the municipal bond market and the transparency in that market. And, Ms. Kelly, I think I will start with you. You recently put out a new proposal that would require the dealer to disclose the markup. Kind of walk me through kind of where you are with that process and what are some of the plusses and the minuses of that proposal.

Ms. KELLY. Certainly. The MSRB worked, actually, very closely with FINRA so that there could be a uniform standard for disclosure across the fixed income markets. There were over 2 years of notice and comment on various kinds of disclosure proposals, including price reference, you know, a reference price on a confirm, which eventually evolved into a markup disclosure requirement. This is a great example of where a really thorough independent economic analysis worked, and it was pretty clear that the price reference standard didn't make sense from an economic analysis perspective.

So fast forward, in the last 2 months, both FINRA and the MSRB filed rule proposals with the SEC. They are in public comment right now, public comment directly to the SEC, which MSRB and FINRA will respond to. And it is expected that there will be an effective date possibly as long as 12 months. The effective date, if approved, has not been set yet. This kind of disclosure requires some very significant technological changes and confirmation disclosure changes, so we want to make sure that the industry has enough time to implement those requirements.

Mr. NEUGEBAUER. The interesting thing to me is the technology in the securities area has, you know, been 4X, but it seems like the municipal bond market has trailed that. And I think one of the things that concerns me about the municipal bond market is that—kind of the lack of information from an investor's standpoint. I think most sophisticated investors understand that municipal bonds can be less liquid than other types of securities. But if we had more information, then as investors we would actually know

how illiquid that is, and for example, the last time that bond traded, for example.

Ms. KELLY. Certainly.

Mr. NEUGEBAUER. And what you can find out on the Web right now, you can find the ask, but you can't find really information on what maybe the current bids for those securities are or what was the last trade in—the last trade date. So are those some of the things that are being considered or what—kind of give me some insight into that.

Ms. KELLY. Certainly. An equally important activity at the MSRB, equal to rulemaking, is transparency in the market. And in 2009, the MSRB launched the EMMA website, which is the central location available for free and really geared to the retail investor that has information on over 1.3 million individual municipal securities. That includes offering documents, ongoing disclosures, trade data, short-term interest rate resets, market information, as well as other tools and information useful to better understand the market.

You are right that municipal bonds generally don't trade very frequently. We have a price discovery tool which allows a retail investor to ascertain similar securities and look at their trading patterns to get a better sense of the value of their security. Perhaps we need a little bit more of a marketing budget, but it is really a game changer for the market. And what we have found out with the age of the traditional municipal retail investor happens to be, you know, in the 60 to 80 range, they are not as likely necessarily to embrace technology and to do research on their own. The market generally still is a buy-and-hold market, but we are very confident that, you know, as the new investors come into the market, that they will be much more self-directed.

Mr. NEUGEBAUER. And one last question. In your cost benefit analysis that you have done on this particular rule—

Ms. KELLY. On the what rule?

Mr. NEUGEBAUER. The liquidity issues, did that come up? In other words, if I have to start disclosing, you know, what my mark-up is, I may not want to inventory certain bonds, and so that might create some liquidity issues. Was that something that was discussed?

Ms. KELLY. Yes, sir. We certainly invite a dialogue with the industry about the costs and the benefits of each regulatory proposal that we issue. Many times we have quantitative information, and sometimes we don't, in which case we would have to rely on a more qualitative assessment. So that question absolutely is part of the analysis.

Mr. NEUGEBAUER. Thank you.

Chairman GARRETT. The gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. Let me first focus on the PCAOB. It has been thought that we should publicize every time they do an investigation. I would point out that nobody in the room is an accounting firm, but we are all citizens, and as far as I know, none of us have been indicted, but none of us know whether we have ever been, you know, talked about in a grand jury. I don't think it would make

sense to publish everyone whose name is mentioned in a grand jury. That is why we keep them private.

I will ask our witness from the PCAOB, if it was announced that you were investigating a firm, that would punish the firm. That would hurt the firm's position in the community. It would cost them clients. Would you be reluctant to investigate a firm if you didn't know that they had done any wrongdoing and you knew that by merely announcing the investigation, you were punishing folks that may be blameless?

Mr. DOTY. Mr. Sherman, we would not identify witnesses or even announce the fact of an investigation.

Mr. SHERMAN. Oh, I know that is your current policy. What if Congress said that you couldn't investigate anybody until you published the fact that you were investigating them? Would that interfere with your work?

Mr. DOTY. Our investigations should be confidential. And as with other law enforcement agencies, including the SEC, we would not seek the authority to announce and do not seek the authority to announce the commencement of investigations or the participants, no more than we would identify the identity of companies that we audit or we have findings in an audit report or where we have an investigation. That should be confidential. We are seeking only the ability to publicize the facts when we get to the point of filing charges.

Mr. SHERMAN. And then if you file charges, that is public, and there could be, in effect, a public trial or hearing before the SEC?

Mr. DOTY. Well, there would be a hearing at the PCAOB in which those persons charged would be entitled to all of the protections of due process that government agencies, including the right to counsel

Mr. SHERMAN. So a secret grand jury and a public trial. Sounds familiar. That sounds like how we do business in this country. We don't punish somebody because we want to investigate them.

I want to go on to Mr. Golden. Well, the chairman believes in cost-benefit analysis with regulations. You say that accounting standards are not intended to drive behavior, and they are not, but when you violate every accounting principle for the convenience of accountants and provide tens of billions of dollars of punishment to those companies that choose to do research, can you ignore that you are driving behavior?

Mr. GOLDEN. I have enjoyed the conversations we have had over the number of years regarding the accounting for research and development. As we have completed a number of standards this year, we began to plan our future agenda, and a few months ago we issued for—

Mr. SHERMAN. If I can interrupt. I talked to your predecessor. I talked to your predecessor's predecessor. I talked to your predecessor's predecessor's predecessor. I talked to your predecessor's predecessor's predecessor's predecessor. And they have all promised to look at this and they have all done absolutely nothing, and you sound just like them. So telling me that you are going to finally go back to good, solid accounting of matching—of expensing and expenditure when it generates revenue, you know you are not going

to do that. I know you are not going to do that. It is pretty clear that your decisionmaking process is broken. Please proceed.

Mr. GOLDEN. A few months ago we issued for public comment four very important issues that have been raised by a number of stakeholders. One of those was the accounting for intangible assets, including research and development. We plan to seek feedback throughout the fourth quarter and have a public discussion with our stakeholders as to whether or not we should change the accounting for intangible assets, including research and development, and I look forward to talking to your office as that process continues.

Mr. SHERMAN. I look forward to a situation in which—you can't build a two-story apartment building in my community without a public hearing, Freedom of Information Act request, and people paying attention. But you can do damage to the entire state of science and research for decades, and as long as your ruling comes out of Norwalk, Connecticut, nobody pays any attention. There is no Senate confirmation. There is no freedom of information. There is no cost-benefit analysis, and there is no open meetings act. Just because accounting is boring doesn't mean it is not important.

I yield back.

Mr. POLIQUIN [presiding]. Thank you, Mr. Sherman.

Mr. HULTGREN from Illinois.

Mr. HULTGREN. Well, I do want to express my appreciation to Chairman Garrett for holding this series of oversight hearings on our capital market. I especially want to thank Chairman Bruce Poliquin for doing such a great job chairing this committee. And I hear Maine is beautiful this time of year. All of you, grateful that you are here. This is important.

Mr. Colby, if I can address my first question to you. As you might be aware, Chair White stated last week that the Commission is close to finalizing amendments on rule 15b9-1 that would require more firms to register with FINRA. I am hearing concerns about the impact on the options markets if the rule is finalized without changes. Can you tell me why expanding FINRA supervision over these new registrants would improve option markets?

Mr. COLBY. The purpose of this rule is to extend FINRA oversight to entities that are trading outside of specific markets and to make sure that they are included in the broader audit trail that FINRA currently operates. And so we have been in discussions with a number of the participants for the options markets trying to identify their concerns. We have a filing that is going to go in that is going to have specific changes to our fees that apply to trading, which we know that they support, and we hope to respond to their concerns in other ways through these discussions.

Mr. HULTGREN. I would share their concerns. I mean, I do think from at least an initial look, the proposal scope is maybe broader than intended and really could do, as oftentimes happens up here, harm when we want to do good. Mr. Colby, if I can follow up. I am also co-chairman—not follow up but change a little bit here.

I am co-chairman of the Municipal Finance Caucus. I am especially interested in assuring that we have a highly competitive municipal securities market. I have heard of some unscrupulous marketing practices that would suggest States and local governments

are required to retain the services of municipal advisors despite the statute and rule being quite clear that this is not necessary. I recently introduced the Municipal Advisor Choice Act to address this issue.

Is this an issue you have encountered in your surveillance of the municipal securities market, and would you agree that Congress should take all steps necessary to clarify its intent?

Mr. COLBY. I certainly support Congress clarifying its intent. We have seen situations where—and brought cases where a firm has acted both as advisor and as underwriter in a situation, contrary to the law.

Mr. HULTGREN. Okay. Well, I hope we will be able to clarify it and make our intent crystal clear.

Let me switch over to Ms. Kane real quick, if I could. As you are aware, Dodd-Frank requires the SEC to promulgate rules to make reforms to money market funds, which will go into effect next month. A significant portion of the \$3.7 trillion in outstanding muni debt is held by money market funds. According to a September 16 story in the Financial Times, assets in tax-exempt funds have dropped by nearly 50 percent since standing at \$266 billion at the beginning of this year, and the cost of borrowing for issuers to States and local governments is already beginning to increase significantly. What cost-benefit analysis did your office conduct on this rule and how did you contemplate the increased cost in borrowing for issuers and how did you weigh this with investor protection?

Ms. KANE. So I am aware of the issue that you referenced. The Office of Municipal Securities monitors the municipal securities market and current developments in that market. The Commission's Division of Investment Management is responsible for administering the Commission's rules on money market funds. I am generally familiar with their 2014 amendments, which I think is what you are referencing, and would note that these amendments are not yet effective. They are scheduled to become effective in October of this year. There are many factors investors may be considering in their determinations in how to allocate capital. The current low interest rate environment may be one of those factors that investors are considering currently.

Mr. HULTGREN. We may follow up, if that is okay, and find out who we should direct a question to directly of just, again, looking at cost-benefit analysis, certainly seeing higher costs and concern in the significant decrease this year.

I just have a few seconds left. Let me address my last question to Ms. Kelly, if I may. You note in your written testimony that the MSRB advances transparency of the municipal securities markets in three ways. One, through rulemaking; two, through your website, the Electronic Municipal Market Access; and, three, by encouraging timely disclosures. I wonder if you could please discuss briefly some of your initiatives in this space. I am sure we can all agree that market transparency is a crucial thing.

Ms. KELLY. Thank you. Yes, on transparency, again, it is really a fundamental activity that we find to be certainly as important as rulemaking. This year, the board of directors has approved making third-party yield curves available on EMMA, adding a new issue

calendar, enhancing the EMMA user experience for various types of users for the EMMA system, and we are also exploring whether or not there are certain kinds of pretrade information that might be helpful, especially for retail investors. We want to study the impact of our regulatory framework continuing our retrospective rule review. And finally, on the education front, we have recently launched our Muni Ed Pro system, which is a learning management system that we are making available to all market participants and including investors and issuers with courses over this year. We really want to empower market participants to really understand the market to make the decisions and to know what kinds of questions to ask their market professionals.

Mr. HULTGREN. Okay. Thank you.

Chairman Poliquin, you have been very generous, and I appreciate that so much. I yield back to you.

Mr. POLIQUIN. Well, it is the fall in Maine. You are very welcome, Mr. Hultgren.

Mr. Ellison from Minnesota is recognized for 5 minutes.

Mr. ELLISON. Thank you, Mr. Chairman.

My first question is directed to Mr. Doty, chairman of the Public Company Accounting Oversight Board. Section 404 of Sarbanes-Oxley Act is a cornerstone in providing public confidence in financial statements. Section 404 requires firms to include information concerning the scope and adequacy of the internal control structure and procedure for financial reporting in their annual report.

What are the benefits of section 404(b) to investors?

Mr. DOTY. I am sorry, sir?

Mr. ELLISON. What are the benefits of section 404(b) to investors?

Mr. DOTY. Well, it is a fundament of good accounting, we believe, that there be good internal controls. Good internal controls have proven over time, Congressman, to be the best tool we have for early detection of problems and the prevention of fraud.

Mr. ELLISON. Thank you. And since Sarbanes-Oxley was passed in 2002, have costs for the implementation gone down? And if we roll this back to cover fewer and fewer companies, what would be the impact?

Mr. DOTY. The cost has gone down, as you rightly point out, because companies, I think, have gotten better and auditors have gotten better at working with companies to spot earlier the improvements in internal controls that are needed. We would like to think that as the process continues to evolve, that without regard to the very largest companies or the midsize or even smaller companies, there is an advantage to adopting and implementing the best internal control system that you can find.

I am quite aware of the fact that there is a statutory issue here, and I don't want to suggest that we have disregarded the JOBS Act and the position of emerging growth companies, which have a different and competing statutory purpose.

Mr. ELLISON. Are you concerned at all that if section 404(b) covered fewer and fewer companies, that some of the internal controls that are so important—as you correctly point out, in my opinion—are you concerned that some of those controls will be relaxed and we could introduce more risk into the system?

Mr. DOTY. Congressman, we do see a change in the view of audit committees and boards, and there is a perception spreading in corporate America, which I think is very healthy, that if you are on a board of directors, you want to know they have good corporate—good internal controls. One of the achievements of Sarbanes-Oxley, I think, might be that over the time that we have had it, and over the 14 years of the PCAOB's existence, the advantages of internal controls for the board of directors as well as the stakeholders is becoming apparent. And so many of the people on audit committees to whom we speak—and we meet with businessmen and audit committee people all the time—we continually hear this said, that most responsible directors would not consider going on a board of directors now that did not have an integrated audit of internal controls.

Mr. ELLISON. Well, I just want to say that there is a lot of criticism in this institution of Congress about regulation, but Sarbanes-Oxley didn't come about because everything was going great. And if we relax those requirements, I am concerned that, you know, some of the trouble that we saw back then could return. That is just my own view.

Let me ask you this also, Mr. Doty, regarding the issue of technology. I think technology has always had and will continue to have a transformative impact on the financial statement audit. And I am eager to see the SEC implement Inline XBRL, eXtensible Business Reporting Language, and I have opposed efforts from certain of my colleagues to reduce XBRL coverage.

When it comes to audits, we know that the ability to analyze vast amounts of data, access it remotely, and create digital audit trail will change the audit forever. How will technology impact the accounting profession and the PCAOB?

Mr. DOTY. We are keenly aware, Congressman, of the need to maintain our cutting edge and our investment in innovation. It will be incumbent on us to understand the tools of technology that are being used by audit firms to appreciate the extent to which they can meaningfully contribute to a better audit. That is a project the firms have now that will go on for a long time, and it will be important for us to recognize that, to adjust to it, to be able to evaluate how good their tools are and how competent they are at using their tools. That will be a technical challenge for us. We will have to maintain investment in technical skills and the data ourselves to do that.

Mr. ELLISON. Well, I have run out of time, so allow me to thank the panel.

And I yield back.

Mr. POLIQUIN. Thank you, Mr. Ellison.

I recognize myself for 5 minutes.

Ms. Kane, you run the Municipal Securities area at the SEC?

Ms. KANE. That is correct. I am the director of the Office of Municipal Securities.

Mr. POLIQUIN. Yes, ma'am. When I was the State treasurer up in Maine, I came from the private sector and we were trying to do things quite differently to save as much money as we could for our taxpayers. And one of the things that was a big surprise to me when I arrived, Ms. Kane, was the history in our State of using negotiated bond sales instead of competitive bond sales. And I always

found this quite unusual, especially when we were dealing with a plain vanilla offering, a general obligation offering from State treasury, in that when the legislature would come to us and say, you know, we need to build a new road or we need to build a new bridge, or what have you, or when some of our smaller rural communities needed to pool their offerings and raise money that way.

And I know if the credit is a little bit unusual and negotiated sale makes a lot of sense, but what we used to do, Ms. Kane, for the first time, is introduce a competitive process and such that we would get all the information to all of the investment houses out and say, we are going to market on Tuesday at 10:30. We would push the button. We would sit behind the computer and we would watch the bids come in. And I remember when we would get a dozen or so many or so bids, we would drive down the interest rates in a very transparent way, no hidden cost. And we saved the taxpayers a boatload of money.

Now, my question to you is, in the work that you do over at the SEC, are States required—or municipalities required to employ the services of independent advisors with respect to this function? Because we did. We had a very small staff at State treasury and we didn't have the depth of personnel that we needed to to get this done. But what I found, it was very refreshing when you had an independent set of eyes and set of experience that could advise the folks that were borrowing the money for the taxpayers of Maine to build the roads and bridges. It was helpful to say, you know, Mr. Treasurer, I think we can do very well with a competitive bond sale here instead of a negotiated one here and not succumb to the pressures of Wall Street.

What are your thoughts about that?

Ms. KANE. Well, the decision to incur debt at the State and local level is a State and local government decision. The decision to hire market professionals is a State and local government decision. The SEC does have authority over municipal securities brokers and dealers and municipal advisors. Certainly, the municipal advisor registration rules bring a new class of SEC registrant into SEC registration exams and enforcement.

One of the benefits, as you pointed out, of hiring a municipal advisor by a municipal entity is that that municipal advisor owes a fiduciary duty to the municipal entity client and can help the municipal entity client evaluate the advice coming in from other transaction participants, can help evaluate conflicts of interest. It is someone standing next to the municipal entity advising them, acting in their best interests.

Mr. POLIQUIN. I always found in our work at Maine State Treasury, Ms. Kane, that in a negotiated sale, there tended to be a lot of hidden fees, you know, the cost of issuance, where a lot of things could be in there that wouldn't be clear to the taxpayers who are eventually paying for all this. And have you found in your work at the SEC that there have been surprises or abuses in that regard with respect to that type of sale?

Ms. KANE. With respect to negotiated versus competitive?

Mr. POLIQUIN. Yes, in the cost of issuance.

Ms. KANE. I would have to take that back to our Office of Compliance Inspections and Examinations, but I am happy to get back to you on that.

Mr. POLIQUIN. Would you mind? And we look forward to that, and I thank you very much.

Mr. Golden, I know that in the work that you folks do you try to always assess the cost and the benefit with respect to dealing with the space that you are in. Do you folks have a very rigorous process, not only to look at specific companies, but also in aggregate, look at whole different sectors of the economy when it comes to assessing the cost and the benefit of your regulations?

Mr. GOLDEN. We do have a very robust and transparent due process. All of our board meetings are in public and all of our discussions are communicated in a basis for conclusion. We do meet with a number of companies. For example, in our recently completed project on expected credit losses, we met with over 200 users and over 100 different companies and received over 3,000 comment letters. What we were trying to do is to understand what is the cost that the company will incur upon transition and what is the cost it will incur over time. We then compared that to the benefit that the investor will receive with respect to more information.

Mr. POLIQUIN. Great. Thank you very much. My time has expired.

I don't believe there are any more individuals here looking to ask questions of our witnesses today.

I would like to thank all the witnesses today for your testimony.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And without objection, this hearing is adjourned.

[Whereupon, at 3:36 p.m., the hearing was adjourned.]

A P P E N D I X

September 22, 2016

“Examining the Agenda of Regulators, SROs, and Standards-Setters for Accounting, Auditing, and Municipal Securities”
Hearing of the Subcommittee on Capital Markets and Government Sponsored Enterprises
Thursday September 22, 2016 at 2 pm

Statement for the record of Congressman Bill Foster

This Committee’s oversight of financial regulators is a crucial component of its charter. The work that the regulators do to ensure accuracy in the financial statements of publicly traded companies is fundamental to a functioning, efficient market. It is important that we carefully consider the structure for governance of accounting and auditing standards and for enforcement of those standards. The Public Company Accounting Oversight Board has a legitimate interest in trying to proceed swiftly to resolution of investigations, often leading to settlement, but I am concerned that changes to the current practice could needlessly expose firms and individuals to reputational damage before any finding of misconduct. I believe the process needs to be fact-driven and designed to protect the due process rights of the firms and individuals subject to any inquiry. While investors can benefit from knowledge of a finding of wrongdoing, candor in the process and certainty in the conclusion can be furthered by confidence. Any changes to the current system should be carefully studied to ensure they further public interest and protect individuals.

**Testimony on Examining the Agenda of Regulators, SROs, and Standards-Setters for
Accounting, Auditing, and Municipal Securities**
by
Wesley R. Bricker
Interim Chief Accountant
U.S. Securities and Exchange Commission

**Before the U.S. House of Representatives Committee on Financial Services
Subcommittee on Capital Markets and Government Sponsored Enterprises**

September 22, 2016

Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee:

I am Wes Bricker, Interim Chief Accountant of the United States Securities and Exchange Commission (“Commission”). I serve as the principal advisor to the Commission on accounting and auditing matters and lead the Commission’s Office of the Chief Accountant (“OCA”). I appreciate the opportunity to appear before you today to testify on behalf of the Commission regarding current topics in the accounting and auditing profession that impact the capital markets and the related activities of OCA.

Financial Reporting Underpins Our Markets

The U.S. system of financial reporting has long been considered a major pillar of our capital markets that provides information to investors and other market participants. The objective of financial reporting is to provide accurate and credible information that is useful to investors for making decisions about investments. Thus, the reliability and credibility of financial reporting is critical to the proper functioning of our capital markets and for the investing public.

As the agency empowered by the federal securities laws to be the investor’s advocate, maintain fair, orderly and efficient markets, and facilitate capital formation, the Commission has the authority and the responsibility to prescribe the methods to be used in preparing accounts and

to specify the form and content of financial statements filed with the Commission. The federal securities laws also mandate that these public company financial statements be audited by an independent public accounting firm that will provide a report as to the reliability and integrity of the information presented.

OCA furthers the Commission's mission by working to enhance the foundation of our disclosure framework – the disclosure of reliable and accurate financial information to investors and other market participants. OCA is responsible for establishing and interpreting accounting policy to enhance financial reporting. OCA also works to improve the professional performance of public company auditors to ensure that financial statements are presented fairly and have credibility.

OCA leads the Commission's efforts to oversee two entities with key roles in the financial reporting process in the United States: the Financial Accounting Standards Board ("FASB") and the Public Company Accounting Oversight Board ("PCAOB"). The Commission has recognized the FASB's accounting and financial reporting standards as "generally accepted" in the U.S. for purposes of the federal securities laws. Financial statements filed with the Commission generally must be prepared in accordance with U.S. GAAP.¹ The PCAOB is responsible for overseeing the audits and auditors of public companies and registered broker-dealers. The staff of the Office of the Chief Accountant works closely with the staff and Boards of these two entities on accounting, financial reporting, and auditing matters. Among other things, OCA staff actively monitors the development and implementation of accounting standards, as well as identifying emerging accounting and auditing issues. I would like to summarize for the subcommittee some of the

¹ The Commission accepts from foreign private issuers in their filings with the Commission financial statements prepared in accordance with IFRS as issued by the IASB without reconciliation to generally accepted accounting principles as used in the United States.

important topics that we are focused on currently.

Current Accounting and Financial Reporting Activities

We continue to direct significant attention to three aspects of accounting and financial reporting:

- monitoring implementation activities for recently-issued accounting standards;
- monitoring future accounting standard-setting activities; and
- reinforcing the importance of internal control over financial reporting.

Implementation Activities for Recently-Issued Accounting Standards

The FASB has recently issued accounting and financial reporting standards concerning the measurement, reporting, and disclosure related to revenue recognition, leases, financial instruments, and credit losses of financial instruments. The FASB's standards in these areas reflect high quality accounting standards in areas identified as key convergence priorities in the 2008 Memorandum of Understanding between the FASB and the International Accounting Standards Board ("IASB").²

The FASB and IASB issued largely converged standards for how companies should report information about the nature, timing, and extent of revenue from customers. These new standards are intended to benefit investors' understanding of a company's financial performance by improving the measurement and reporting of revenue and enhancing the comparability of this critical metric across companies. The new jointly issued standards, which must be applied by U.S. public companies by 2018, is intended to improve existing revenue requirements by:

² The standards seek to improve financial reporting in the United States while also reducing inconsistencies in global financial reporting. The IASB, which is subject to oversight by the IFRS Foundation, is responsible for International Financial Reporting Standards ("IFRS") and establishes its own standard-setting agenda. For further information, see <http://www.ifrs.org/About-us/Pages/IFRS-Foundation-and-IASB.aspx>.

eliminating inconsistencies, including inconsistencies in industry-specific guidance; requiring additional disclosures to users of financial statements; providing a more robust framework for addressing revenue issues; and simplifying the preparation of financial statements. OCA staff has been actively monitoring implementation efforts, including the activities of the FASB's and IASB's joint revenue transition resource group. This group of financial statement preparers, auditors, and users has met publicly several times to discuss various questions that have arisen as companies prepare to implement the new standard. Those discussions have provided a forum for stakeholders to learn from the standard-setters and others involved with implementation. It has also provided the FASB and IASB with information for further improvements to the standards.

The FASB's and IASB's new standards on the measurement and reporting of leasing activities are the result of more than a decade of standard-setting due process and outreach, during which the standard-setters carefully considered input from stakeholders, including investors. This new standard will increase transparency and comparability among organizations that lease buildings, equipment, and other assets by recognizing on balance sheets the assets and liabilities that arise from lease transactions. This will enable investors to more readily and accurately understand the rights and obligations associated with these transactions. Under the implementation provisions of the standard, U.S. public companies are permitted to begin applying the standards immediately, but must do so by 2019.

Finally, the FASB and IASB have issued standards that will improve and simplify reporting for investments, loans, derivatives, and other financial instruments, so that investors have a more timely and representative depiction of a company's risks and obligations from its arrangements. The global financial crisis highlighted a need by investors for more timely reporting of credit losses on loans, investment securities, and other financial instruments held by

banks, insurers, and others. The FASB and the IASB standards differ in several respects, such as the timing of recognition of an estimated credit loss, but both utilize an “expected credit loss” approach which, when implemented, will require companies to report credit losses on a more timely basis compared to the current standards. Both Boards have established a transition resource group to aid constituents with understanding the standards and inform the Boards about any areas for further enhancement. In the United States, the FASB’s new credit loss standard will take effect in 2020 for U.S. public companies.

For all of the new standards, OCA has encouraged companies, their audit committees, and their auditors to assess the quality and status of implementation to ensure that the new standards meet the objective of better informing investors and other users. OCA also has emphasized the importance of disclosures by companies to investors of the impact that these recently issued standards will have when the standards are adopted in the future.

Importance of Internal Control Over Financial Reporting

Maintaining adequate internal accounting controls, representing annually to investors whether internal control over financial reporting (“ICFR”) is effective, and, when required, having an independent accountant attest to the effectiveness of ICFR, promotes reliable financial reporting and encourages investment in our capital markets. Over the next several years, updating and maintaining internal controls will be particularly important as companies work through the implementation of the significant new accounting standards that I discussed earlier. Companies’ implementation activities will require careful planning and execution, as well as sound judgment from management. And while internal controls cannot replace the need for sound professional judgment, well-designed, effective controls support the process by which those judgments are made and provide assurance that users of public companies’ financial statements are consistently

provided with relevant and reliable information reported in accordance with the applicable financial reporting framework.

OCA continues to work closely with our colleagues in the Divisions of Corporation Finance and Enforcement, as well as with the PCAOB, to help ensure that ICFR assessments continue to receive attention from management, audit committees, and external auditors. We also are committed to appropriately and timely addressing any emerging questions related to ICFR assessments and the application of the related guidance and standards of the Commission and the PCAOB. We and the PCAOB continue to engage with investors, auditors and representatives of public companies to proactively identify and address internal control issues that, if left unaddressed, could lead to lower-quality financial reporting and ultimately higher financial reporting restatement rates and higher cost of capital.

Current Audit and Professional Practice Activities

Independent auditors have been long-recognized as one of the key gatekeepers in our investor protection system, and the integrity of this system is supported by the PCAOB's oversight of the public company auditors. The credibility of public company financial reporting depends, in part, on thorough and objective audits performed by independent auditors. Recent PCAOB inspection results show promising signs of improvement in many audit firms' quality controls that are designed to ensure compliance with professional auditing standards as determined by the PCAOB. And while those improvements are not uniform across all firms or necessarily consistent within individual firms, and there is more work to be done, these findings do reflect the progress that has been achieved in improving audit quality since the passage of the Sarbanes-Oxley Act and the creation of the PCAOB.

The PCAOB's auditor inspections program has played an important role in improving the quality of independent public company audits. However, inspections alone cannot fully achieve their objective without the complement of rigorous and high-quality auditing standards that keep pace with the evolutions in financial reporting, the economic environment, and companies' business models.

The PCAOB continues to update and modernize the interim auditing standards that it adopted in 2003. For example, in 2014, the PCAOB adopted a new auditing standard setting out requirements for the auditor's evaluation of relationships and transactions between the company and its related parties, an area that has historically represented increased risks of material misstatement in company financial statements. Also, last December, the Board approved rules to require public accounting firms to disclose information about engagement partners and other key participants in audits of public companies. The PCAOB has also made significant progress on another major project of vital interest to investors—updating the standard auditor's report. The auditor's report has generally remained unchanged since the 1940s despite broad changes in the capital markets, financial reporting frameworks, and companies' business operations, and the goal of this project is to improve the informative value of the auditor's report to investors while retaining the traditional pass/fail opinion of the existing report upon which investors continue to rely.

Other important projects remain on the PCAOB's standard-setting agenda, including standards for auditing estimates and fair value measurements, the use of specialists by auditors, the use of the work of other audit firms, and firm quality control standards.

The PCAOB has also launched a post-implementation review program for its standards. This is responsive to requests from various stakeholder groups and another important element of

the PCAOB's efforts to draw on past experiences to help continue to fulfill its statutory mission. I commend the PCAOB for its efforts and its commitment to high-quality auditing standards that have the potential to further enhance the credibility of financial reporting for the benefit of investors.

FY 2017 Budget Request

In furtherance of OCA's primary initiatives, goals and objectives, OCA's budget request for FY 2017 seeks to:

- Further its oversight of the FASB's, and monitoring of the IASB's, standard setting and implementation activities for new, comprehensive standards on revenue recognition, leasing, financial instruments and credit losses;
- Increase its oversight efforts of the PCAOB, especially given the growth of the PCAOB in recent years and the expansion of its authority;
- Further provide support for other division and office rule-making through consultation on significant accounting and auditing matters, training and advice on accounting and auditing matters to the Commission's Division of Corporation Finance in the context of their filing review program and to the Commission's Division of Enforcement in the context of enforcement of the federal securities laws; and
- Execute OCA-led rulemaking and policy initiatives.

Conclusion

In sum, there is a substantial activity in the financial reporting, accounting and auditing space. We will continue to oversee the efforts of the FASB and the PCAOB on these matters, guided by the Commission's mission of protecting investors, maintaining fair, orderly, and

efficient markets, and facilitating capital formation. Thank you, and I would be happy to answer your questions.

Testimony of

**Robert L.D. Colby
Chief Legal Officer
Financial Industry Regulatory Authority**

**Before the Subcommittee on Capital Markets and Government Sponsored Enterprises
Committee on Financial Services**

U.S. House of Representatives

September 22, 2016

Chairman Garrett, Ranking Member Maloney and Members of the Subcommittee:

On behalf of the Financial Industry Regulatory Authority, or FINRA, I would like to thank you for the opportunity to testify today about FINRA's role in overseeing the municipal securities markets.

FINRA

Before I address municipal securities market oversight, I'd like to provide a brief overview of FINRA and its regulatory programs. FINRA plays an integral role in overseeing broker-dealers and the U.S. securities markets and regulating broker-dealer firms and brokers that sell securities in the United States. FINRA oversees nearly 4,000 brokerage firms and more than 600,000 registered brokers. FINRA supervises most aspects of the broker-dealer business—from registering individuals to examining securities firms; writing rules and enforcing those rules and the federal securities laws; informing and educating the investing public; providing trade reporting and other industry utilities; and administering the largest dispute resolution forum for investors, broker-dealer firms and individual brokers.

This monitoring plays an important role in enabling us to detect and fight fraud. In addition to our own enforcement efforts, each year we refer hundreds of fraud and insider trading cases to the Securities and Exchange Commission (SEC) and other agencies. FINRA regularly shares information with other regulators, leading to important actions that can prevent further harm to investors.

FINRA, directly and through our regulatory service agreements with exchanges, monitors approximately 99 percent of all trading in U.S. listed equities markets and 70 percent of the options markets. In fact, FINRA's market surveillance systems process approximately 50 billion market events on average each day to closely monitor trading activity in equity, options and fixed income markets in the United States.

In addition, FINRA operates and regulates over-the-counter (OTC) market transparency facilities that provide the public and professionals with timely quote and trade information on publicly traded equity and debt securities. They are the primary source for regulatory data on these transactions, and provide FINRA-registered firms with tools to comply with reporting

obligations in secondary-market activity in fixed income and equity securities. In this role, we are continually evaluating and identifying areas where enhanced transparency can benefit investors and the markets.

Finally, FINRA believes that an essential component to investor protection is investor education. More than 10 years ago, FINRA established the FINRA Investor Education Foundation to support innovative research and educational projects aimed at improving the financial capability of all Americans. Together with the Foundation, FINRA is committed to providing investors with information and tools they need to better understand the markets and basic principles of investing—and to help them protect themselves from financial fraud. As part of this effort, FINRA offers dozens of free online resources about investing and avoiding fraud, including online calculators and investor alerts. FINRA's BrokerCheck® allows investors to research the professional backgrounds of current and former FINRA-registered brokerage firms and brokers.

Regulatory Oversight Framework for the Municipal Securities Markets

In the municipal securities market, pursuant to Sections 15A and 15B of the Securities Exchange Act of 1934 (Exchange Act), FINRA plays an instrumental role in examining for and enforcing compliance with the federal securities laws, SEC rules and regulations and the Municipal Securities Rulemaking Board (MSRB) rules by FINRA-regulated broker-dealers engaging in municipal securities transactions. In addition, since 2013, as a result of amendments to the Exchange Act by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) to require municipal advisors to register with the SEC and expand the MSRB's regulatory authority to municipal advisors, FINRA examines regulated firms' activities as registered municipal advisors and enforces compliance by such firms with the federal securities laws, SEC rules and regulations, and MSRB rules applicable to municipal advisors. Currently, there are approximately 1,440 municipal broker-dealers and municipal advisors that are FINRA members. In contrast, currently fewer than 30 municipal bank broker-dealers are overseen by the Federal Reserve, Office of the Comptroller of the Currency or the FDIC. A small number of these bank dealers are also municipal advisors.

The municipal securities market is overseen via a well-developed, collaborative relationship among: (1) the MSRB with its responsibility for adopting rules relating to the municipal securities market; (2) FINRA as the examination, surveillance and enforcement authority for its regulated firms; and (3) the SEC with its responsibilities for overseeing and approving the rules of FINRA and the MSRB. Effective coordination among these regulatory bodies is achieved through both leveraging of resources and collaborating on many financial, operational and business conduct topics, as well as with respect to implementing risk-based regulatory programs.

A memorandum of understanding (MoU) between FINRA and the MSRB sets out the terms of the relationship in a number of areas, including information and data sharing; referrals of potential rule violations from the MSRB to FINRA; types and frequency of meetings; confidentiality; fine sharing; MSRB assistance with rule interpretation and enforcement; and FINRA support of MSRB professional qualifications testing.

FINRA's Municipal Securities Coordination

FINRA coordinates closely with the SEC and MSRB in the oversight of municipal securities professionals. To this end, FINRA dedicates specialized staff that act as a central point of

contact with the SEC and the MSRB regarding the regulation of municipal securities broker-dealers and municipal advisors that are FINRA-regulated firms.

As part of this coordination, FINRA requests interpretive guidance from the MSRB regarding its rules and provides information to the MSRB about FINRA's municipal securities market examinations and enforcement actions. This sharing of information with the MSRB enables the MSRB to provide assistance to FINRA with its examination and enforcement actions and to evaluate the ongoing effectiveness of the MSRB's rules. FINRA also participates in formal, periodic meetings with the MSRB and SEC, including bi-monthly meetings with the MSRB and semi-annual meetings with the SEC and MSRB as required by the Exchange Act. In addition, we also participate in informal, monthly meetings with the SEC and MSRB to discuss timely issues arising from current municipal broker-dealer and municipal advisor examinations.

Examinations and Surveillance

Within the last five years, amendments to MSRB Rule G-16 have allowed FINRA to shift from mandatory two-year cycle examinations of municipal broker-dealers to a risk-based approach that better ensures the allocation of resources to the protection of investors and market integrity. While the smallest municipal broker-dealers may now be examined once every four years, FINRA visits the largest, most complex municipal broker-dealers annually. That's because a firm's business and risk profile—meaning transaction volume, product type, business model, customer profile and other risk factors—determine how frequently we examine firms and on what we focus during those examinations.

FINRA and the MSRB collaborate on municipal securities regulatory priorities each year leveraging, among other things, regulatory intelligence gathered from current year examinations, new rules, rule interpretations and emerging issues. FINRA then performs a quantitative and qualitative risk assessment of each municipal broker-dealer and municipal advisor. The assessments include analyzing relevant data about each firm—much of which is obtained from the MSRB under our MoU—such as transaction data, underwriting filings, revenue, news and disciplinary history to determine each firm's examination frequency and inspection scope.

FINRA conducts, on average, about 500 municipal broker-dealer and 60 municipal advisor on-site examinations per year. In recognition of the unique characteristics of the municipal market, FINRA operates specialized municipal examination teams assigned to examinations of the largest, most complex and highest risk municipal broker-dealers and municipal advisors. Separately, FINRA also reviews firms' financial and operational conditions for compliance with, among other things, SEC net capital and customer protection regulations. These examinations incorporate municipal securities as well, including reviews of municipal short positions, inventory valuations, haircuts and other financial prudential regulations.

In addition to periodic examinations, FINRA also conducts ongoing monitoring of regulated firms. We review a variety of information, including monthly balance sheets and income statements, position data and relevant news. We also meet periodically with firms that exhibit a large footprint in the municipal securities space outside of the routine examination cycle.

Market Regulation

FINRA's fixed income surveillance program for municipal securities, like FINRA's other market regulation programs, uses a risk-based approach, focusing on firms that demonstrate a pattern and practice of non-compliance for customer protection and transaction reporting reviews. FINRA receives municipal security transaction information reported to the MSRB's Real-time Transaction Reporting System (RTRS) and currently conducts surveillance based on 18 distinct patterns for municipal securities.

Once alerted to the existence of a potentially problematic pattern, FINRA applies certain thresholds to identify instances where further investigation is warranted. FINRA's selection thresholds for customer protection and transaction reporting alerts are designed to take into consideration the absolute number of violations, compliance rates, impact to the municipal securities market, and the potential harm to investors, among other factors. FINRA's alert review for potentially manipulative behavior is designed to identify conduct that may impact the integrity of the municipal securities market and bring provable actions that will effectively deter future misconduct.

Disciplinary Actions

In response to violations of MSRB rules, FINRA takes both formal and informal actions to enforce these rules. For formal matters, FINRA has action and settlement options such as Minor Rule Violation letters; Acceptance, Waiver and Consents; Formal Complaints; and suspensions, bars and monetary sanctions. FINRA can also caution firms in writing for less significant violations.

FINRA has successfully prosecuted a number of important municipal securities cases—with invaluable assistance from the MSRB. The MSRB has given FINRA access to data and information that better positions us to address a wide range of novel, problematic conduct. As an example, the MSRB's support enabled us to quickly link two firms—Cantone Research Inc. and Lawson Financial—through their shared association with Christopher Brogdon, an individual who had been barred from the securities industry decades earlier. Through our ability to connect MSRB and FINRA information, we were able to bring fraud charges against both firms and their owners for failing to disclose to investors material information known to them about bond issues they underwrote, including the likelihood that the obligors would be unable to repay the debt. We also made referrals to other authorities regarding conduct beyond FINRA's jurisdiction. It is unlikely that FINRA would have been able to so quickly connect these firms and discover the extent of their misconduct without such a collaborative relationship with the MSRB.

Regulatory Policy Coordination

FINRA works closely with the SEC and MSRB to develop regulation for the fixed income markets that is consistent yet calibrated to reflect the unique regulatory needs of each marketplace. In particular, FINRA's work with the SEC and MSRB has focused on initiatives designed to enhance transparency and promote better execution quality in the fixed income markets. These initiatives are tied together by a common thread—strengthening investor protection with a data-driven approach that accounts for recent, current and anticipated developments in fixed income market structure. FINRA's work with the MSRB in these areas has also been informed by SEC efforts in recent years. Transparency and execution quality

were key subjects in the SEC's 2012 Report on the Municipal Securities Market, and they were again highlighted in recommendations made by Chair White in her 2014 speech on the fixed income markets more broadly.

One of these initiatives involves proposals that FINRA and the MSRB recently filed with the SEC to require that additional pricing information be provided to customers on their trade confirmations in corporate and agency debt and municipal securities. As FINRA and the MSRB state in the respective proposals, putting additional pricing information in the hands of customers will better enable them to evaluate the cost and quality of the services firms provide and encourage communications between firms and their customers about their fixed income transactions. As part of our coordination efforts, FINRA and the MSRB also jointly conducted investor testing to evaluate the potential benefits of the proposed disclosure. FINRA looks forward to evaluating the comments it receives on the proposal and continuing its coordination with the MSRB on any interpretive issues raised in connection with the proposals.

Similarly, in recognition of the significant changes that have occurred in the fixed income market, FINRA consulted with the MSRB as each organization published guidance on firms' best execution obligations relating to transactions in fixed income securities. FINRA's guidance for non-municipal debt securities, among other things, reiterated firms' overall best execution obligations and emphasized the importance of evaluating the accessibility of electronic systems and how such systems can provide benefits to firms' customer order flow to ensure customers receive the best prices reasonably available.

Educational Efforts

Joint Regulatory Training

FINRA operates several educational programs to further train regulatory staff working on municipal securities matters, including hosting municipal securities training events, co-hosting joint training seminars with the MSRB and SEC for FINRA and SEC examiners, and developing in-depth written examination content on municipal securities and their regulatory framework for examiners.

Guidance for Firms

As is true for many issues, FINRA issues Regulatory Notices and guidance to assist firms with their compliance efforts. For municipal securities issues, FINRA and the MSRB sometimes issue joint notices.

In addition, FINRA analyzes data obtained from the MSRB to create industry compliance reports and tools that address concerns arising from FINRA examinations, such as the timeliness of underwriting filings, disclosures of material information, sales of bonds below the minimum denomination and underwriter due diligence. These reports are created on a monthly basis and are available to firms as well as to examiners.

FINRA conducts a biennial fixed income conference, and co-hosts a biennial joint SEC-FINRA-MSRB Municipal Advisor Compliance Outreach Conference. These events are live and webcast to allow nationwide participation.

Guidance for Investors

FINRA, the SEC and the MSRB all provide investor education materials, information and alerts relative to investing in municipal securities. Recent FINRA alerts have covered topics including important considerations for municipal bond investors, bond liquidity and duration, and the impact of interest rate changes on bond portfolios.

Conclusion

FINRA appreciates this opportunity to discuss its role in the oversight of the municipal securities market with the subcommittee. FINRA remains committed to working closely with other regulators, this subcommittee and the full committee as we continue to work toward our dual mission of protecting investors and safeguarding market integrity.



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Statement of James R. Doty
Chairman
Public Company Accounting Oversight Board

at a Hearing on

Examining the Agenda of Regulators, SROs, and Standard-Setters for
Accounting, Auditing and Municipal Securities

Before the

United States House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets
and Government Sponsored Enterprises

2128 Rayburn House Office Building
September 22, 2016



Statement of James R. Doty
Chairman
Public Company Accounting Oversight Board

Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee:

Thank you for the opportunity to appear before you today on behalf of the Public Company Accounting Oversight Board ("PCAOB" or "Board") to testify on the work of the PCAOB. I appreciate the Subcommittee's continued interest in high quality audits for public companies and SEC-registered broker-dealers.

I. Introduction

U.S. public securities markets provide a reliable funding mechanism for American and foreign businesses. Our economy is resilient, in part because millions of savers continue to be willing to invest in business enterprises to fuel growth, growth that results in more workers, more savings and more investment. This cycle promotes economic wealth, but it relies on the system of accurate financial disclosures by public companies to the investors who entrust capital to them.

As Chairman, I believe the PCAOB is a vital resource that protects investors and fosters economic resiliency by advancing reliable, informative and independent audits. Accurate and transparent financial audits are a key to promoting investor trust and investment that grows capital markets and drives a healthy economy. Experience tells us the PCAOB's role is essential and our standards and oversight programs are making a real difference on behalf of investors and companies. It is critically important that the PCAOB remain vigilant and independent because persistent economic pressures can threaten the integrity of audits. Going forward, a rapidly changing landscape will require the PCAOB to invest in innovations to meet the needs of investors and enable public companies in our markets to benefit from a lower cost of capital.

I believe that the PCAOB, and the accounting firms that we oversee, play a critical role in enabling markets to provide investors with reliable information upon which to make their own investment decisions. The financial audit is the linchpin for investor confidence in that information, and a reliable audit is one led by an auditor that is independent, objective, and skeptical, and applies the diligence needed to meet PCAOB standards.

If investors lose confidence in financial reporting, they will demand prohibitively high returns as a condition of investing or they may withdraw from the capital markets altogether. The result would be to make it more difficult and expensive to finance the businesses on which our economy depends. Moreover, inaccurate financial reporting can mask poor business strategies or fraud that, if left uncorrected, may result in the misallocation of capital, business failures, and job losses.



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The PCAOB is focused on taking appropriate steps in its inspection and enforcement programs in order to improve audit quality and enhance protection of the investing public. The PCAOB is also using information gained in inspections and investigations, along with information received from investors, audit committee members, auditors and others, to improve auditing and related professional practice standards.

The PCAOB is a non-profit institution established by the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"). It is designed to bring expertise and a variety of perspectives to the task of setting appropriate standards and overseeing the practice of auditing public companies and SEC-registered broker-dealers. By law, all of the PCAOB's responsibilities are discharged under the oversight of the U.S. Securities and Exchange Commission ("SEC"). Chair Mary Jo White, the Commissioners, and Interim Chief Accountant Wes Bricker have taken a deep interest in the PCAOB's work. I am grateful for their support and for the strong working relationship they have fostered between our organizations.

II. Current PCAOB Activities and Priorities

A. Inspections

The Sarbanes-Oxley Act requires the PCAOB to conduct a continuing program of inspections of registered accounting firms. There are currently 2,062 accounting firms registered with the Board. The Board's statutory inspection authority relates to audits of issuers, brokers, and dealers. The Board does not inspect firms that perform no such work, although many such firms have chosen to register anyway.

During an inspection, the PCAOB assesses the auditor's compliance with applicable laws, rules and professional standards. As part of an inspection, PCAOB inspectors evaluate the design and effectiveness of the audit firm's quality control system as well as the quality of its work in the portions of audits selected for inspection.

1. Inspections of Public Company Audits

Registered firms that issue audit reports for more than 100 issuers are required to be inspected by the PCAOB annually. In 2015, the last complete cycle of our inspection program, the PCAOB inspected 10 such firms. As part of these inspections, PCAOB inspectors examined portions of approximately 320 audits performed by these firms.

Registered firms that issue audit reports for 100 or fewer issuers are, in general, inspected at least once every three years. The PCAOB inspected 205 such firms in



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2015, including 63 non-U.S. firms located in 29 jurisdictions.¹ In the course of those inspections, PCAOB staff examined portions of 493 audits.

The selection of issuer audits for review is influenced by a number of factors. The selection can be based on the risk that an issuer's financial statements could be materially misstated; characteristics of the particular issuer or its industry; the audit issues likely to be encountered; considerations about the firm, a particular practice office or an individual partner; prior inspection results; or other factors.

The PCAOB prepares a report on each inspection and makes portions of that report publicly available, subject to statutory restrictions on public disclosure. The Board issued 218 inspection reports in 2015.

If an inspection report includes criticisms of or identifies potential defects in a firm's system of quality control, those criticisms are initially kept nonpublic, as required by the Act. The firm has 12 months from the issuance of the inspection report to address the criticisms to the Board's satisfaction. If it does so, the criticisms remain nonpublic. If it does not do so, then, subject to the firm's right to seek SEC review of the Board's determination, the Board publicly discloses those criticisms.

In the PCAOB's 14 years, inspectors have found many examples of high quality work, including evidence of auditors requiring companies to change their accounting or improve their internal controls over the production of financial reports. They are the unsung heroes who avert the scandals that don't happen.

But our inspections have also found and reported numerous instances in which firms' audit reports should not have been issued. These instances include audits of some of the largest companies in the world, as well as mid-size and smaller companies.

Emerging research on our inspections indicates that when we find deficient audits, the engagement teams raise their game – without a commensurate increase in fees but with a statistically significant reduction in restatements.

¹ Based on bilateral protocols we have established, we conducted many of these non-U.S. inspections jointly with our foreign counterparts. Earlier this year, the European Commission issued a new Adequacy Decision covering the next six years, double the term set in the two previous Adequacy Decisions covering our work which supports continued joint inspections with local European audit regulators.

Today, our inspectors can conduct required inspections in all relevant jurisdictions except Belgium, Italy, Ireland, Portugal and China. We have made significant progress toward concluding cooperative agreements with the first four of these jurisdictions. We are actively engaged with our counterparts in all of those jurisdictions to establish cooperative arrangements.



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Our joint inspections with counterparts in Europe and elsewhere are another new paradigm, and have proven to be both effective and efficient. We are tearing down impediments to audit quality in the global network firms that the leaders of those firms had not focused on prior to our efforts in this area.

2. Interim Program for Inspections of Firms that Audit Broker-Dealers

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") expanded the PCAOB's inspection, enforcement, and standard-setting authority to include the auditors and audits of brokers and dealers and authorized the PCAOB to develop an inspection program for auditors of brokers and dealers. The PCAOB has implemented this new authority thoughtfully. We quickly established an interim inspection program in 2011, with the stated objective of developing a permanent program that, with the benefit of experience in the interim program, would reflect informed judgments about cost-effective ways to design the program, including through the consideration of the use of exemptions and frequency provisions.

Under this interim pilot program, the PCAOB plans to conduct 75 inspections of broker-dealer auditors this year, covering portions of approximately 115 audits. This number includes 5 firms that audit more than 100 broker-dealers, 13 firms that audit 21 to 100 broker-dealers, and 57 firms that audit 1 to 20 broker-dealers.

The PCAOB has not issued any firm-specific inspection reports as part of the interim inspection program. Instead, to keep the public informed, the Board has published an annual report on the overall results of the inspections during the interim program. That report is also intended to help auditors understand identified deficiencies and applicable requirements. The fifth such annual progress report was issued last month.

Based on information gathered through the interim inspection program, we are now conducting careful economic analysis of potential approaches to a permanent program. The permanent program will be established by rule, after notice, public comment and, as is the case with all our rules, SEC approval.

In order to maintain a constructive dialogue with these auditors, the PCAOB has conducted numerous forums with broker-dealer auditors around the country. Since 2011, we have held 18 such Forums for Auditors of Broker-Dealers with more than 2,700 attendees. Indeed, on the date of the Subcommittee's hearing, representatives of the PCAOB are scheduled to conduct a Forum in Jersey City, New Jersey, where we expect approximately 330 people from 120 firms to attend. We plan to continue such



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forums going forward, as well as via webinars. We have held three such webinars during the past two years and plan to expand the use of such Web-based, interactive communication tools, in order to be accessible to as many auditors as possible.

C. Enforcement

The Board has authority to impose sanctions on registered firms and associated persons that have violated applicable laws and standards. Disciplinary cases that have become public recently have focused on audit failures related to both U.S. and non-U.S. issuers; violations of applicable standards on quality control and auditing; and auditors' failures to comply with the Board's processes and rules.

The PCAOB made public 44 settled disciplinary orders in 2015, providing for sanctions on auditors ranging from censures to monetary penalties to revocations of registration and bars on association with registered accounting firms. So far in 2016, the PCAOB has made 30 settled disciplinary orders public.

Also in 2015, the Board determined for the first time not to commence disciplinary action against an audit firm based on credit given for the firm's extraordinary cooperation with the PCAOB, including self-reporting and remedial actions, under the terms of a policy statement issued by the Board in April 2013. The Board also issued its first order in which a settling respondent admitted to a disciplinary order's facts, findings and violations.

The PCAOB has also stepped up enforcing compliance with our audit standards and other requirements by registered non-U.S. firms. Recently PCAOB staff have also uncovered evidence suggesting the possibility that registered firms, including some affiliates from large global networks, may have improperly deleted, added to, or altered documents provided to PCAOB inspectors without informing the inspectors of the alterations. Addressing these matters continues to be a high priority for the Enforcement division. To this end, earlier this year, the PCAOB issued a Staff Audit Practice Alert on *Improper Alteration of Audit Documentation*, which reflects the staff's concern about auditors improperly altering audit documentation in connection with a PCAOB inspection or investigation. As the Alert pointed out, "[i]mproperly altering audit documentation is also inconsistent with an auditor's professional duty to act with integrity and as a gatekeeper in the public securities markets."²

The PCAOB closely coordinates its enforcement efforts with the SEC. In certain instances, the PCAOB investigates the auditor's conduct and the SEC focuses its

² See PCAOB Publishes Staff Audit Practice Alert on Improper Alteration of Audit Documents, April 21, 2016.



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investigation on the public company, its management, and other parties. In other cases, upon request of SEC investigators, the PCAOB makes information available to SEC investigators but defers its own investigation to the SEC's, which are resolved in public proceedings.

Under the Sarbanes-Oxley Act as it exists today, the PCAOB's disciplinary proceedings are nonpublic, unless the Board finds there is good cause for a hearing to be public *and* each party consents to public hearings.³ The auditors and audit firms charged with violating applicable laws, rules or standards have little incentive to consent to opening the case against them to public view, and, in fact, none have ever done so.

This state of affairs is not good for investors, for the auditing profession, or for the public at large. Providing transparency to PCAOB enforcement proceedings has gained bipartisan support. In the Senate, Judiciary Committee Chairman Chuck Grassley and Senator Jack Reed have introduced S. 1084, The PCAOB Enforcement Transparency Act. I encourage this Committee and this Congress to support this bill.

III. Auditing and Related Professional Practice Standards

The Sarbanes-Oxley Act also charges the Board with establishing auditing and related professional practice standards for audits of public companies and SEC-registered broker-dealers, and the Board has followed a transparent and fair process for doing so. The Board uses information that it learns in its inspections and from other sources to evaluate the need for changes in auditing standards. In developing new standards, the PCAOB casts a wide net to seek advice from various interested people and groups on ways to improve audits.

The Board's actions are informed by meetings and dialogue with investors, auditors, representatives of public companies and members of the academic community, among other ways through its Standing Advisory Group. The Board also works closely with the SEC on the development of standards and monitors the work of accounting standard setters, such as the Financial Accounting Standards Board, for developments that may affect auditing.

PCAOB standards are rules of the Board. To adopt or change them, the Board uses a notice-and-comment process similar to the process used by federal agencies, under which the Board proposes standards for public comment before adopting new or amended standards in a public meeting. All Board standards must be approved by the SEC before they can become effective.

³ See Sarbanes-Oxley Act, Section 105(c)(2).



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The PCAOB's most recent standard-setting agenda is attached at Appendix 1. All of these projects involve considerable economic analysis, consistent with the PCAOB's staff guidance on economic analysis issued in 2014. This guidance is modeled on the SEC staff's own such guidance and was developed in close consultation with Commission staff.

The PCAOB's guidance sets forth four main elements –

- critically focusing on describing the need for a new rule,
- developing a baseline for measuring the effects of the rule,
- considering reasonable alternatives to the rule, and
- analyzing the economic impact of the rule, including both the costs and the benefits.

By improving our economic analysis of standards under development, we can have greater confidence that the benefits of our standards justify their costs. Moreover, by reviewing the actual effect of standards that have already been implemented, we expect to learn much more about the consequences of new standards, both those intended and any unintended. This is why I have championed the PCAOB's establishment of a Center for Economic Analysis, which brings together many creative minds and experts under the leadership of University of Chicago Professor Luigi Zingales. The Center is an important investment in smarter regulation. Analysis and research performed by the Center can help make our oversight programs more effective and efficient.

We have adopted many improvements related to audit procedures, such as standards on documentation, internal control, risk assessment, engagement quality reviews, communication with audit committees, audits of broker-dealers and transactions involving related parties. We have also adopted independence standards related to the effects of auditor involvement in risky tax shelter work.

More recently, late last year we adopted a transparency rule that will soon provide markets the names of engagement partners and other firms that participate in an audit. Over time, this will allow investors to differentiate auditors on the basis of track records for quality. We are also nearing completion of a multi-year effort to make the audit report more informative for investors, by including a discussion of critical audit matters.



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V. The PCAOB's FY2017 Budget

Under the Sarbanes-Oxley Act, the PCAOB's fiscal year begins in January. The Commission has established a rule governing the PCAOB's budget.⁴ That rule provides for several steps to be completed at various points in the year preceding a budget year, beginning with a communication in March on program and operational issues and outlook for the next year before culminating with submission, by December 1 as required by the Sarbanes-Oxley Act, of a final budget that reflects the PCAOB's recoverable budget expenses for that year. We are now deep into the process of developing the 2017 budget, including through close interaction with Commission staff as well as considerable internal analysis, to refine our cost estimates and identify opportunities for savings and efficiencies.

Our 2017 budget is still under development, in consultation with the Commission, which must ultimately approve it. I should point out that, by law, our budget is funded primarily by public companies, brokers and dealers, not taxpayers. In order to adequately address these priorities, the PCAOB needs to, at least, maintain the current budget level. I do anticipate the need for a small increase over our \$257.7 million budget for 2016. This would be for cost of living and annual merit increases, as well as expected expenses for travel, particularly for inspections, information technology (including cybersecurity), and facilities. But we do have a keen sense of stewardship. It is my goal to accomplish our objectives through careful and continuous assessment of the best use of our resources, without a significant increase.

* * *

In conclusion, I appreciate the Subcommittee's interest in the work of the PCAOB and I look forward to continuing to work with you to protect the interests of the investing public in independent, accurate and informative audit reports. I would be happy to answer any questions.

⁴ 17 CFR § 202.190.

STANDARD-SETTING AGENDA

OFFICE OF THE CHIEF AUDITOR

JUNE 30, 2016

The Public Company Accounting Oversight Board ("PCAOB" or "Board") seeks to establish and maintain high-quality auditing and related professional practice standards for audits of issuers and brokers and dealers in support of the PCAOB's overall mission to protect investors and the public interest. The PCAOB's Office of the Chief Auditor ("OCA"), with a continued focus on improving the effectiveness of PCAOB standards, takes a priority-based approach in establishing the standard-setting agenda¹ which may include developing new standards or rules, or amending existing standards or rules.

The standard-setting agenda is informed by the PCAOB's oversight activities, monitoring of the environment, consultation with the Board's Standing Advisory Group ("SAG"), input from the Board's Investor Advisory Group ("IAG"), discussion with the U.S. Securities and Exchange Commission ("SEC") staff, and other factors. In addition, as part of establishing its standard-setting agenda, OCA takes into consideration the work of other standard setters (for example, the International Auditing and Assurance Standards Board ("IAASB"), Financial Accounting Standards Board ("FASB"), and International Accounting Standards Board) in the development of new or modified standards.

The development of new or modified standards includes economic analysis. As part of the process, consideration also is given to the applicability of new standards to audits of emerging growth companies ("EGCs").

Finally, the PCAOB issues staff audit practice alerts prepared by OCA to highlight new, emerging, or otherwise noteworthy circumstances that may affect how auditors conduct audits under the existing requirements of PCAOB standards and relevant laws.

The following table and overview of projects present OCA's current standard-setting agenda. Timing of these projects is subject to change.

¹ The PCAOB is implementing changes to its standard-setting process, and some may affect future versions of the standard-setting agenda, such as the possible inclusion of a PCAOB research agenda.

This standard-setting agenda was prepared by the staff of the Office of the Chief Auditor. Standard-setting agendas, staff consultation papers and staff audit practice alerts are not statements of the Board, nor do they necessarily reflect the views of the Board, individual Board members, or other staff.

Standard-Setting Projects

Project	Current Stage	Timing
Supervision of Audits Involving Other Auditors	Proposal issued for public comment	Comment period ends July 29, 2016
Auditor's Reporting Model	Reproposal issued for public comment	Comment period ends August 15, 2016
Auditing Accounting Estimates, Including Fair Value Measurements	Drafting proposal	Q1 2017
The Auditor's Use of the Work of Specialists	Drafting proposal	Q1 2017
Going Concern	Next action under consideration	
Quality Control Standards, Including Assignment and Documentation of Firm Supervisory Responsibilities	Research and outreach	

Standard-Setting Agenda—Project Overviews

- 1. *Supervision of Audits Involving Other Auditors.*** On April 12, 2016, the Board issued for public comment amendments to improve the auditing standards that govern the supervision of audits involving other auditors, and a new auditing standard for situations in which the auditor divides responsibility for the audit with another accounting firm. The roles of other accounting firms and individual accountants in audits (collectively, "other auditors") have taken on greater significance with the increasingly global operations of companies. The lead auditor often involves other auditors at various locations of the company, including in areas of the audit where there is a high risk of material misstatement in the financial statements. The comment period on the proposal ends on July 29, 2016. For further information, see [Rulemaking Docket No. 042](#).
- 2. *Auditor's Reporting Model.*** On May 11, 2016, the Board issued for public comment a repropose auditor reporting standard. The reproposal revises the Board's initial proposal issued in August 2013 (the "2013 proposal"). The reproposal would retain the pass/fail model in the existing auditor's report, but would update the form and content of the report to make it more relevant and informative to investors and other financial statement users. In particular, the auditor's report would include a description of "critical audit matters," which would provide audit-specific information about especially challenging, subjective, or complex aspects of the audit. In addition, the reproposal includes other improvements, primarily intended to clarify the auditor's role and responsibilities in the audit of financial statements and to make the auditor's report easier to read. The comment period on the repropose standard and related amendments to PCAOB standards ends on August 15, 2016. While the 2013 proposal also included a new auditing standard, *The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report*, regarding the auditor's responsibilities for other information outside the financial statements, the Board did not repropose this standard on May 11, 2016. The staff is continuing to evaluate the other information standard in light of comments received and anticipates making a recommendation for next steps to the Board at a later date. For further information, see [Rulemaking Docket No. 034](#).
- 3. *Auditing Accounting Estimates, Including Fair Value Measurements.*** On August 19, 2014, the PCAOB issued a staff consultation paper to seek public comment on certain issues related to auditing accounting estimates, including fair value measurements. As discussed in the paper, auditing accounting estimates and fair value measurements has proven challenging to auditors. Additionally, there have been changes in the financial reporting frameworks relating to accounting estimates and an increasing use of fair value as a measurement attribute, together with new related disclosure requirements. The paper described the staff's preliminary views concerning the potential need for change and presented potential revisions to

PCAOB standards. The staff is evaluating the responses from commenters in addition to considering feedback received from the discussions at the October 2014 and June 2015 SAG meetings and the September 2015 IAG meeting. In addition, the staff is monitoring developments related to the IAASB's project on Accounting Estimates (ISA 540) and Special Audit Considerations Relevant to Financial Institutions. The staff anticipates recommending that the Board propose for public comment revisions to its current standards on auditing accounting estimates, including fair value measurements, in the first quarter of 2017. The project is also being closely coordinated with the project on specialists. For further information, see Staff Consultation Paper: Auditing Accounting Estimates and Fair Value Measurements.

4. **The Auditor's Use of the Work of Specialists.** On May 28, 2015, the PCAOB issued a staff consultation paper to seek public comment on certain matters related to the auditor's use of the work of specialists. As discussed in the paper, the use and importance of specialists has increased in recent years, in part due to the increasing complexity of business transactions and the resulting complexity of information needed to account for those transactions. Specialists covered by the project include specialists employed or engaged by the auditor and also the use by auditors of the work of specialists employed or retained by the company. The paper described the staff's preliminary views concerning the potential need for change and presented potential revisions to PCAOB standards. The staff is evaluating the responses from commenters in addition to considering feedback received from the discussions at the June and November 2015 SAG meetings and the September 2015 IAG meeting. The staff anticipates recommending that the Board propose for public comment revisions to its current standards on the auditor's use of the work of specialists in the first quarter of 2017. The project is also being closely coordinated with the project on auditing accounting estimates, including fair value measurements. For further information, see Staff Consultation Paper No. 2015-01: The Auditor's Use of the Work of Specialists.
5. **Going Concern.** The auditor's evaluation of a company's ability to continue as a going concern is an important part of an audit under PCAOB standards and federal securities law. The purpose of this project is to evaluate potential revisions to the existing PCAOB standard on the auditor's going concern evaluation in light of changes in the relevant accounting requirements² and concerns from investors

² On August 27, 2014, FASB issued Accounting Standards Update No. 2014-15, *Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. On September 22, 2014, the PCAOB issued Staff Audit Practice Alert No. 13, to remind auditors to continue to follow existing PCAOB standards when considering a company's ability to continue as a going concern.

about the effectiveness of auditor going concern reporting. This project is considering, among other things, input from the SAG and IAG, observations from the Board's oversight activities, and relevant research. The staff plans to continue its research and outreach activities to seek input on potential approaches to improving the existing standard and addressing the changes in the accounting requirements. These activities could result in a staff consultation paper, a staff audit practice alert, or other possible actions.

6. **Quality Control Standards, Including Assignment and Documentation of Firm Supervisory Responsibilities.** Deficiencies identified in PCAOB inspections suggest that improvements are needed in firms' systems of quality control. The staff is exploring whether changes to PCAOB quality control standards—including improvements related to assignment and documentation of firm supervisory responsibilities—could prompt firms to improve their quality control systems and, in turn, audit quality. This project is considering, among other things, observations from the Board's oversight activities, relevant research, input from the SAG, and activities of international audit regulators, as well as related PCAOB activities, specifically, the root cause analysis and audit quality indicator initiatives. The staff is also monitoring developments related to the IAASB's project on quality control. The staff also plans to perform outreach (e.g., staff consultation paper or public roundtable) to seek input on current practice and the potential need to improve the quality control standards, taking into account potential impacts on large and small domestic and international firms.

Testimony of Russell G. Golden

**Hearing on Examining the Agenda of Regulators, SROs, and Standards-Setters for
Accounting, Auditing, and Municipal Securities**

**Before the U.S. House of Representatives Committee on Financial Services
Subcommittee on Capital Markets and Government Sponsored Enterprises**

**Washington, D.C.
September 22, 2016**

Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee:

My name is Russell Golden and I am the Chairman of the Financial Accounting Standards Board (“FASB” or “Board”). I would like to thank you for this opportunity to participate in today’s important hearing.

As part of the Subcommittee’s oversight of financial reporting matters, including current issues facing accountants and auditors, I would like to outline for you the manner in which the FASB develops accounting standards for the benefit of U.S. investors and U.S. markets. In doing so, I will begin by providing a brief overview of the FASB and its parent organization, the Financial Accounting Foundation (“FAF”). I also want to describe both the FASB’s robust standard-setting process and how we remain accountable to our stakeholders. I also would like to update you on several of our recently completed projects as well as our ongoing standard-setting activities. Finally, I want to discuss how the FASB is addressing financial accounting and reporting issues for other types of organizations, including not-for-profit organizations, private companies, and employee benefit plans.

The FASB

Established in 1973, the FASB operates under the oversight of FAF, a private-sector, not-for-profit organization based in Norwalk, Connecticut. Through authority that Congress has granted to the U.S. Securities and Exchange Commission (“SEC”), the SEC has recognized the FASB as the designated accounting standard-setter for public companies. The FASB also establishes financial accounting and reporting standards for private companies and not-for-profit organizations that follow U.S. Generally Accepted Accounting Principles (“U.S. GAAP”). Additionally, many organizations, including state Boards of Accountancy and the American Institute of Certified Public Accountants (“AICPA”), recognize FASB standards as authoritative.

U.S. GAAP is essential to the efficient functioning of the U.S. economy because investors, creditors, donors, and other users of financial reports rely heavily on credible, concise, and understandable financial information. Many of those who make decisions cannot require reporting entities to provide the information they need directly to them and must rely on general purpose financial reports. Because the goal of the FASB is to improve financial information that is useful in making capital allocation decisions, the needs of those investors and other users are a

primary consideration in developing accounting standards. While not all users analyze information in the same manner, they all share a desire for financial reports that are comparable and provide information that faithfully represents the results of an organization's activities.

The FASB recognizes, however, that information contained in financial reports is produced by a financial reporting system with multiple participants, including entities that prepare financial statements, auditors, regulators, and other stakeholders. Therefore, the FASB gives careful consideration to all stakeholders' views on all aspects of an accounting standard proposal, including the benefits and costs of the standard, as the standard is developed. In today's dynamic financial markets, the need for integrity, transparency, and objectivity in financial reporting has become even more critical to ensuring the continued strength of U.S. capital markets and to the broader prosperity of our economy as a whole.

We at the FASB take our role in promoting the integrity of our capital markets very seriously, as has the Congress. In the Sarbanes-Oxley Act of 2002 ("SOX"), the Congress recognized the importance of protecting the integrity of the FASB's accounting standard-setting process from undue influence by providing the FASB with an independent, stable source of funding from annual accounting support fees collected from issuers of securities, as those issuers are defined in SOX. Similarly, the Dodd-Frank Act of 2010 provides our sister standard-setter, the Governmental Accounting Standards Board ("GASB"), with an independent and stable funding source through accounting support fees, which the Congress should maintain.

It is important to note that although the FASB has the responsibility to set accounting standards, it does not have authority to enforce them. Officers and directors of a company are responsible for preparing financial reports in accordance with the accounting standards that the FASB issues. Auditors then provide an opinion as to whether those financial statements have been prepared in accordance with those accounting standards. The Public Company Accounting Oversight Board ("PCAOB") is charged with overseeing auditors of public companies, which includes an auditor's analysis of whether a public company has complied with appropriate accounting standards. The SEC has the ultimate authority to analyze whether public companies have complied with accounting standards.

The FASB's Mission

As I have noted, the FASB recognizes the critical role that high-quality accounting standards play in financial reporting and in supporting the efficient functioning of our capital markets. Robust and transparent financial reporting increases investor confidence, which in turn leads to better capital allocation decisions and economic growth.

The objective of financial reporting is to *neutrally depict the economics of a transaction* and thus provide financial information about the reporting organization that is useful to existing and potential investors, lenders, and other creditors in making resource allocation decisions. These decisions typically involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit.

The FASB's mission is to establish and improve financial accounting and reporting standards to provide useful information to investors and other users of financial reports and educate stakeholders on how to most effectively understand and implement those standards. Accounting standards are not intended to drive behavior in a particular way; rather, they seek to present financial information so that users can make informed decisions about how to best deploy their capital. The FASB remains committed to ensuring that our nation's financial accounting and reporting standards provide investors with the information they need to confidently invest in the U.S. markets.

As it works to develop accounting standards for financial reporting, the FASB is committed to following an open, orderly process. Our comprehensive procedures permit timely, thorough, and open study of financial accounting and reporting issues and because we understand that the FASB's actions affect so many stakeholders, the procedures also encourage broad public participation throughout the standard-setting process.

The FASB accomplishes its mission through a transparent and inclusive process that:

1. Improves the usefulness of financial reporting by focusing on the primary characteristics of relevance and faithful representation of financial information, as well as other enhancing characteristics of useful information including comparability, verifiability, timeliness, and understandability;
2. Guides and educates the public, including users of financial statements, the individuals that prepare financial statements, auditors, and others. Through its open, transparent and inclusive process, outreach to stakeholders, the form of standards themselves, and related implementation activities, the FASB improves the common understanding of the nature and purposes of information contained in financial reports;
3. Keeps standards current to reflect changes in methods of doing business and changes in the economic environment;
4. Considers promptly any significant areas of deficiency in financial reporting that might be improved through the standard-setting process; and
5. Promotes the convergence of accounting standards internationally when that helps to improve the quality of financial reporting where such convergence is deemed to be appropriate in the public interest and for the protection of investors.

The Standard-Setting Process

An independent standard-setting process is an integral component in producing high-quality accounting standards. The FASB sets accounting standards through processes that are open and that encourage input from all stakeholders. I note that the FASB's Rules of Procedure, established under the FAF's bylaws, require this level of openness and stakeholder involvement in the standard-setting process.

Stakeholder Feedback

The FASB's standard-setting process involves a range of activities intended to solicit and incorporate stakeholder feedback, including, as appropriate, public meetings, public roundtables, field visits or field tests, liaison meetings and presentations to interested parties, and the exposure of our proposed standards for public comment. The FASB provides videocasts of its Board meetings and education sessions on its website to make it easier for stakeholders to observe and participate in our standard-setting process. The FASB also creates podcasts and webcasts to provide short, targeted summaries of our proposals and new standards so that stakeholders can quickly assess whether they have an interest and want to comment.

We also proactively request meetings with stakeholders, including a wide range of investors, auditors, and reporting entities, to discuss our proposals or to identify implementation issues with existing standards, which helps us to assess whether the proposals or existing standard will lead to better information as well as to assess the related implementation and ongoing costs. Those meetings with stakeholders help us to assess whether U.S. GAAP is providing useful information as well as the related implementation and ongoing costs. The FASB supplements its direct outreach by meeting regularly with its numerous advisory groups whose members are drawn from a broad cross-section of the profession. The FASB's standard-setting process and the resulting standards necessarily benefit from advisory group members sharing their views and experience with us on matters related to projects on the agenda, possible new agenda items, practice and implementation of new standards, and strategic and other matters.

In addition to the FASB's advisory groups, the FAF has established a Private Company Council ("PCC") that advises the FASB on private company matters while the Emerging Issues Task Force ("EITF" or "Task Force") assists the FASB in improving financial reporting through the timely identification, discussion, and resolution of financial accounting issues relating to U.S. GAAP.

The PCC has an integral role in the process of establishing and improving standards of accounting and reporting as they apply to private companies. The PCC advises the FASB on whether modifications or exceptions to existing U.S. GAAP should be afforded to address the needs of private company financial statements. Any proposed changes to existing U.S. GAAP are subject to endorsement by the FASB and undergo a thorough vetting process. The PCC serves as the primary advisory body to the FASB for private companies for items under active consideration on the FASB's agenda.

The EITF assists the FASB in addressing implementation, application, or other emerging issues that can be analyzed within existing U.S. GAAP. The EITF was designed to develop implementation guidance for accounting standards to reduce diversity in accounting practice on a timely basis. Task Force members are drawn from a cross section of the FASB's stakeholders, including auditors, preparers, and users of financial statements. The chief accountant or the deputy chief accountant of the SEC attends Task Force meetings regularly as an observer. The structure of the EITF is designed to include persons in a position to be aware of emerging issues

before they become widespread and before divergent practices become entrenched. The FASB also meets regularly with SEC and PCAOB staff.

Because banking regulators have a keen interest in U.S. GAAP financial statements as a starting point in assessing the safety and soundness of financial institutions, our staff is in frequent contact with them. Additionally, FASB members and members of our senior staff meet with them on a quarterly basis and otherwise, as appropriate. We also understand Congress's interest as a stakeholder in the FASB's work, so we periodically brief Members and their staffs on accounting developments. In short, the FASB actively seeks input from all of its stakeholders on proposals and processes and we are listening to them. Broad consultation provides the opportunity for the FASB to hear and consider all stakeholder views, to identify unintended consequences, and, ultimately, to seek acceptance and understanding of the standards that are adopted.

FASB Guiding Principles

The FASB is keenly aware of the need to balance compliance costs with the benefits investors and other users of financial reports gain. The FASB's broad and inclusive consultation process helps it to assess these factors and strike appropriate balances. The FASB exercises its judgment after considering relevant research, analyzing stakeholder views, and carefully deliberating issues. The FASB is guided by these principles:

1. To be objective in its decision making and to ensure, insofar as possible, the neutrality of information resulting from its standards. To be neutral, information must report economic activity as faithfully as possible without coloring the image it communicates for the purpose of influencing behavior in any particular direction.
2. To actively solicit and carefully weigh the views of stakeholders in developing standards and concepts. The ultimate determinant of standards and concepts, however, must be the FASB's judgment, based on research, public input, and careful deliberation, about the usefulness of the resulting information.
3. To issue standards only when the expected benefits justify the expected costs. The FASB strives to determine that proposed standards fill a significant need and that the expected costs they impose, compared with possible alternatives, are justified in relation to the overall expected benefits.
4. To issue high-quality standards, which are grounded in a consistently applied conceptual framework, set forth objectives and principles stated in clear and unambiguous language, and foster consistent application by providing structure and necessary detail derived from the principles.
5. To manage the process of improving standards in ways that balance the desire to minimize disruption of accounting and financial reporting processes with the need to improve the decision-usefulness of information in financial reports. The FASB establishes reasonable effective dates and transition provisions when new standards are

introduced. The FASB also must balance the desire for comprehensive improvements in standards with the need for incremental changes that produce timely reporting improvements in areas important to users.

6. To provide clear and timely communications, endeavoring at all times to keep the public informed of important developments about the FASB's operations and activities.
7. To review the effects of past decisions and interpret, amend, or replace standards in a timely fashion if such action is indicated.

Oversight of FASB

The FASB operates in an open, collaborative, and accountable manner. First, the FAF Board of Trustees exercises its authority over the FASB by overseeing its administration and finances, as well as that of the FASB's sister organization the GASB and their advisory councils, the Financial Accounting Standards Advisory Council ("FASAC"), the Governmental Accounting Standards Advisory Council ("GASAC"), and the PCC. The Board of Trustees is made up of 14-18 independent members from varied backgrounds and perspectives, including users, preparers, and auditors of financial statements; state and local government officials; academics; and regulators.

Through its oversight, the Trustees ensure the effective, efficient, and appropriate stewardship of the FASB's resources as it carries out its standard-setting mission, selects and appoints members to the FASB and its advisory councils, oversees the FASB's activities, and promotes and protects the integrity of the FASB's processes. To further enhance this oversight function, the Trustees have initiated a post-implementation review process that evaluates the FASB's standard-setting processes to ensure they are as robust, transparent, and inclusive as possible.

Second, the FASB also is subject to oversight by the SEC with respect to standard-setting for public companies. The SEC has the statutory authority to establish financial accounting and reporting standards for publicly held companies and for over 40 years, the SEC has looked to the FASB to set accounting standards. In 2003, the SEC issued a Policy Statement, Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, which reaffirms this longstanding relationship with the FASB. Additional information about the FASB and the FAF can be found in the 2015 Annual Report of the FAF, which is available on the FAF website.

And last, but certainly, not least, the FASB is accountable to its stakeholders for establishing standards that are consistent with our guiding principles and our comprehensive processes.

FASB Activities

I will now discuss a number of current FASB activities. One of the challenges facing our financial reporting system is the need to improve the transparency and overall usefulness, and

reduce the complexity, of reported financial information to investors and other users of financial reports. The FASB is addressing this challenge in a number of ways. First, the FASB has completed and is assisting on implementation of standards in major areas that users told us are in need of improvement—including revenue recognition, leases, and financial instruments. Second, the FASB is working on a disclosure framework project intended to increase the utility of information disclosed in the financial statements. Third, the FASB continues to enhance the *FASB Accounting Standards Codification*® (“Codification”), which is the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities, and the eXtensible Business Reporting Language (“XBRL”) U.S. GAAP financial reporting taxonomy.

As the FASB seeks to ensure that existing accounting standards continue to provide useful and relevant information, it seeks stakeholder input. With the completion of several major projects, the FASB issued an Invitation to Comment that seeks input from all stakeholders, including users, on potential future agenda items.

The FASB Chairman’s Reports for the first two quarters of 2016, which enumerate the FASB’s technical activities, its education and communication activities, and its various forms of outreach with stakeholders, are provided as Attachment 1. The FASB recognizes that the quality of our conclusions is enhanced by careful consideration of the comments we receive from stakeholders. Therefore, our process is often iterative, with our proposals being modified either slightly or substantially in response to stakeholder and public feedback. The table below illustrates an overview of the FASB agenda for the first half of 2016 by number of projects.

	Number of Projects				# EDs Issued
	As of Dec. 31	Added	Completed	As of June 30	
Concepts statements	3	-	-	3	-
Broad improvement projects	5	-	(3)	2	-
Targeted improvements:					
Recognition & measurement	15	2	(5)	12	3
Simplification/other	3	1	(1)	3	2
Presentation or Disclosure	9	-	-	9	-
PCC	2	1	(2)	1	-
EITF	5	1	(3)	3	1
Total	42	5	(14)	33	6

Recently Completed Standard-Setting Activities

The FASB has recently completed a number of amendments to U.S. GAAP through the issuance of Accounting Standard Updates (“Updates”) to improve accounting and disclosure requirements. These Updates affect how companies recognize and present certain transactions in their financial statements and enhance footnote disclosure, as indicated below:

1. **Timelier recognition of credit losses on loans and other financial instruments.** Update No. 2016-13, *Financial Instruments—Credit Losses* (Topic 326), addresses concern from a wide range of stakeholders—including financial statement preparers and users—that the existing incurred loss approach provides insufficient information about an organization’s expected credit losses. The Update requires an organization to measure all expected credit losses for all financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. The Update also requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. This guidance is effective in 2020 for calendar-year-end public companies that meet the definition of an SEC filer and beginning in 2021 for all other companies.
2. **Recognition on the balance sheet by organizations that lease assets.** Organizations that lease assets—referred to as “lessees”—are required to recognize the assets and liabilities for the rights and obligations created by leases with lease terms of more than 12 months. The new guidance in Update No. 2016-02, *Leases (Topics 842)* responds to requests from investors and other financial statement users for a more faithful representation of an organization’s leasing activities. It ends what the SEC and other stakeholders have identified as one of the largest forms of off-balance-sheet accounting, while requiring more disclosures related to leasing transactions. Consistent with current U.S. GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. The Update also requires disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures, including qualitative and quantitative requirements, provide additional information about the amounts recorded in the financial statements. This change is effective in 2019 for calendar-year-end public companies and in 2020 for calendar-year-end private companies.

3. **Improved certain aspects of recognition, measurement, presentation, and disclosure of financial instruments.** Update No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, will:
- Benefit users by providing a more relevant measurement attribute for equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income.
 - Decrease complexity for preparers by replacing the challenging impairment model for equity investments without readily determinable fair values with a simpler qualitative impairment assessment.
 - Provide more decision-useful information by allowing an entity to report the change in fair value of a liability, measured under the fair value option that is attributable to changes in instrument-specific credit risk, in other comprehensive income.
 - Reduce costs for other than public business entities by eliminating the requirement to disclose the fair values of financial assets and financial liabilities measured at amortized cost.
 - Increase comparability by reducing the diversity in applying the deferred tax asset guidance to available-for-sale debt securities.
 - Create consistency in fair value disclosures by eliminating an entity's ability to estimate the disclosed fair values of financial assets and financial liabilities on the basis of entry prices.

For calendar-year-end public business entities, the guidance is effective in 2018, and 2019 for all other entities.

4. **Improved existing standards for financial statement presentation by not-for-profit organizations.** Update No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, focuses on improving the current net asset classification requirements and information presented in financial statements and notes that are useful in assessing a not-for-profit's liquidity, financial performance, and cash flows. The FASB's Not-for-Profit Advisory Committee ("NAC") and other stakeholders indicated that existing standards for financial statements of NFPs are sound but could be improved to provide more useful information to donors, grantors, creditors, and other users of financial statements. The guidance is effective in 2018 for calendar-year-end companies.

An important part of the FASB's mission of developing high-quality standards is monitoring its implementation and assisting preparers and other practitioners in their understanding and ability to consistently apply a new standard. We ensure that stakeholders have sufficient time to transition to a new standard and our goal is to be in a position to help them facilitate a smooth transition. With that goal in mind, we undertake a variety of initiatives focused on educating our stakeholders, helping preparers and practitioners interpret the standards, and making necessary clarifications to the standards to address unintended consequences, if any. Our post-issuance initiatives include conducting outreach with stakeholders, working with a Transition Resource Group ("TRG"), and addressing stakeholders' technical questions. The nature and extent of the initiatives vary depending on the scope and degree of changes in the new standard. For example, TRGs are most useful for comprehensive standards that have significant and broad changes. Accordingly, the FASB created TRGs with the issuance of our Revenue Recognition guidance in 2014 and our Credit Losses guidance in June.

Revenue Recognition TRG

Similarly, the Revenue Recognition TRG addresses potential issues arising from the implementation of the new revenue recognition guidance that was issued in May 2014. Earlier this year, the FASB issued a number of Updates to address narrow aspects (to improve operationally, reduce implementation cost, and mitigate the potential for broad noncomparability in application) of the guidance that do not impact the core principle of the guidance, namely that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Credit Losses TRG

The Credit Losses TRG, which was formed to solicit, analyze, and discuss issues arising from implementation of the impairment standard, held its first public meeting on April 1. The TRG will, in turn, inform the FASB about the implementation issues that the TRG raises, which will help the FASB determine what, if any, action is needed to address those issues. Furthermore, the TRG will provide a forum for stakeholders to learn about the new guidance from others involved with implementation.

Ongoing Standard-Setting Activities

The Technical Agenda Overview provides information about current FASB projects at a glance, including status updates and expected issuance timelines for process documents and final standards. That overview is provided as Attachment 3.

Hedging

Earlier this month, the FASB issued an Exposure Draft that proposed improvements to the hedge accounting model for financial instruments and nonfinancial items. The proposed standard is intended to improve and simplify the requirements related to hedge accounting and to more closely align them with companies' risk management activities. The FASB expects the

proposed amendments to benefit not only companies but also users in their understanding of the hedge results and the costs of hedging programs. The core principal of the proposal is that hedge accounting should be permitted for a broader range of financial and nonfinancial risk management strategies than under current U.S. GAAP. The proposed presentation and disclosure changes also would provide users with a more complete overview of the impact of hedge accounting on the income statement and balance sheet.

Insurance

In the coming weeks, the FASB will issue a revised Exposure Draft for public comment. The Exposure Draft will outline targeted improvements to insurance accounting and reporting for long-duration insurance contracts. This Exposure Draft is the result of a 2008 project undertaken jointly with the International Accounting Standards Board with an objective of developing common, high-quality guidance that would establish the principles that an entity would apply in the recognition, measurement, presentation, and disclosure of insurance contracts (including reinsurance). In 2013, the FASB issued an Exposure Draft on insurance contracts. The FASB received 206 comment letters and conducted extensive outreach with insurance industry trade groups, preparers, auditors, and financial statement users, including roundtables and workshops. As a direct result of that extensive outreach, the FASB decided to focus the revised Exposure Draft on making the targeted improvements. The FASB anticipates that the proposed changes will result in meaningful improvements to the financial reporting of an insurance entity.

Disclosure Framework

The FASB continues its work on the Disclosure Framework project, which is a project whose objective is to improve the effectiveness of disclosures in the financial statements. That project includes the development of a framework in the form of a Concepts Statement for the FASB to use as a tool when setting disclosure requirements. It also includes a review, which will be instructive for the FASB as it considers additional changes, of disclosures currently in place on specific topics including fair value, income taxes, pensions, and inventory using the framework under development. Another aspect of that project is providing guidance to entities when determining the disclosures that they make in the financial statements as well as further work on interim disclosures. We plan to hold a roundtable in 2016 to solicit feedback from affected stakeholders on all aspects of the project; feedback that the FASB will use throughout 2017 as we redeliberate each topic more broadly.

Government Assistance

The FASB is continuing its redeliberations on the proposed disclosure requirements about government assistance received by businesses. Examples of government assistance include grants, low interest rate loans, loan guarantees, tax incentives, tax abatements, and the transfer of assets from governments to businesses. The final Update will seek to create greater transparency around financial reporting of assistance agreements that businesses enter into with governments.

It would provide users with more information about existing government assistance agreements to help them better assess the nature of the assistance.

Other Initiatives

The FASB also will focus on making targeted improvements, through projects that impact the recognition and measurement of financial reporting, which will help reduce complexity and simplify financial reporting. In addition, the FASB will consider and continue to make progress on certain foundational initiatives, such as our current project on the Conceptual Framework.

The FASB also devotes substantial time to the consideration of financial accounting and reporting issues that affect other types of organizations, including not-for-profit organizations, private companies, and employee benefit plans. Once we have identified the problem that needs to be addressed, the first step that we take is to develop a broad solution grounded in sound accounting concepts and principles and then determine based on user relevance whether differences among diverse types of organizations are needed. These considerations require a balance of listening, analysis, and outreach with our stakeholders throughout the process to be successful. The FASB's NAC and the PCC are both helping us in this area. The NAC helps us understand where differences exist in the not-for-profit sector. Similarly, the PCC helps us to understand critical financial reporting issues faced by private companies and to identify solutions.

Finally, in the area of employee benefit plans, the FASB is looking to reduce complexity. We are approaching this project in two waves. The first wave was completed in July 2015, when we issued a standard that reduces cost and complexity for employee benefit plans when preparing their financial statements, while maintaining or improving the usefulness of the information provided to users. The Board worked extensively with experts in benefit plan accounting to identify opportunities for improvement. As a part of the second wave, we currently are working on a proposal to improve the reporting by an employee benefit plan for its interest in a master trust. A master trust is a trust in which assets of more than one plan sponsored by a single employer or by a group of employers under common control are held. Because many employee benefit plans hold investments in master trusts, some stakeholders have said that master trust disclosures are an area in which standard-setting is needed.

FASB Accounting Standards Codification[®]

In 2009, the FASB officially launched the Codification as the source of authoritative nongovernmental U.S. GAAP. This was a milestone event for the FASB and the U.S. financial reporting system, ushering in a new era of modern accounting research to accounting and financial reporting professionals, as well as to analysts and investors. The Codification's launch culminated a multiyear effort to make the U.S. GAAP literature more accessible and user friendly. Instead of U.S. GAAP standards scattered among many pronouncements issued by various standard setters over the years, the Codification provides stakeholders with one topically organized, easily accessible online research system. With the launch of the Codification, the FASB is no longer adding numbered Statements, Interpretations, FASB Staff Positions, and the like to U.S. GAAP but, rather, is issuing Updates that contain amendments to the relevant

sections of the Codification. The new system significantly reduces the amount of time and effort required to research accounting issues, mitigates the risk of noncompliance with standards through improved usability of the literature, provides accurate information with real-time updates as new standards are released, and assists the FASB with the research efforts and literature amendments required during the standard-setting process. To monitor the effectiveness of the Codification, the Codification system allows users to submit content feedback. In addition, the FASB meets with stakeholders to discuss concerns about the Codification and recently solicited feedback via a user survey. The FASB staff reviews feedback on the Codification in an ongoing manner and periodically issues technical corrections to update the Codification to address feedback received.

XBRL Taxonomy

In 2010, the FASB assumed ongoing development and maintenance responsibilities for the US GAAP Financial Reporting Taxonomy (“Taxonomy”), which was originally developed by XBRL US, Inc. under contract to the SEC. In 2009, the SEC issued rules requiring public companies and foreign private issuers that prepare their financial statements in accordance with U.S. GAAP to phase in use of the Taxonomy. Under these rules, companies will tag and submit their financial statements and related notes to the SEC using the Taxonomy.

The Taxonomy is a list of machine-readable tags in XBRL that allows companies to label precisely the thousands of pieces of financial data that are included in typical long-form financial statements and related footnote disclosures. (XBRL is a standard tagging business and financial reports to increase the transparency and accessibility of business information by using a uniform format.) Once tagged with the taxonomy, financial reports can be analyzed rapidly and cost effectively by investors, analysts, journalists, and the SEC staff. The FASB updates the taxonomy each year to reflect new accounting and financial reporting guidance. The FASB also launched an online review and comment system to make it easier for stakeholders to submit comments on the Taxonomy.

Future Agenda

We also are in the process of reviewing our future agenda. Last spring, the FASB’s principal advisory group, the FASAC, conducted a survey of its members, as well as members of our other advisory groups, which represent a cross section of our stakeholders. The survey respondents were asked to opine on what they believed were the most-needed financial reporting improvements, including identifying the problem and suggesting feasible improvements. The FASB has summarized the survey results in the discussion paper issued in August. The discussion paper affords all of our stakeholders an opportunity to tell us whether they agree or disagree on areas of improvement that we have identified—and why. This feedback will help us better understand our stakeholders’ concerns as we continue to shape our agenda.

The discussion paper covers financial reporting areas of concern identified by stakeholders in the recent survey of the FASB’s advisory groups. The paper includes potential issues and possible solutions about the following areas:

1. Intangible assets, including research and development
2. Pensions and other postretirement benefit plans
3. Distinguishing liabilities from equity, and
4. Reporting performance and cash flows, including income statement, segment reporting, other comprehensive income, and statement of cash flows.

Conclusion

The FASB is committed to producing high-quality accounting standards. To achieve that goal, we are committed to a comprehensive and transparent process that encourages broad participation and objectively considers all stakeholder views. In doing so, we will continue to guide and educate the public, including users, the individuals who prepare financial statements, auditors, and others. Through its open and robust process, which includes extensive outreach to stakeholders, the FASB improves the resulting standards and related implementation activities. Furthermore, the FASB's efforts also improve the common understanding of the nature and purposes of information contained in financial reports. Thank you for the opportunity to appear before you. We look forward to working with you on these and related issues.

Attachments:

1. The FASB Chairman's Reports for the first quarter and second quarter of 2016.
2. List of Accounting Standards Updates issued by the FASB in 2016.
3. Current Technical Agenda Overview.



REPORT OF THE FASB CHAIRMAN**January 1, 2016 through March 31, 2016**

ITEM 1: STANDARDS-SETTING ACTIVITIES**A. FINAL STANDARDS AND DOCUMENTS ISSUED FOR PUBLIC COMMENT**

1. The Board issued the following final documents:
 - a. Accounting Standards Update No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, issued January 5, 2016.
 - b. Accounting Standards Update No. 2016-02, *Leases (Topic 842)*, issued February 25, 2016.
 - c. Accounting Standards Update No. 2016-03, *Intangibles—Goodwill and Other (Topic 350); Business Combinations (Topic 805); Consolidation (Topic 810); Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance* (a consensus of the Private Company Council), issued March 7, 2016.
 - d. Accounting Standards Update No. 2016-04, *Liabilities—Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products* (a consensus of the FASB Emerging Issues Task Force), issued March 8, 2016.
 - e. Accounting Standards Update No. 2016-05, *Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships* (a consensus of the FASB Emerging Issues Task Force), issued March 10, 2016.
 - f. Accounting Standards Update No. 2016-06, *Derivatives and Hedging (Topic 815): Contingent Put and Call Options in Debt Instruments* (a consensus of the FASB Emerging Issues Task Force), issued March 14, 2016.
 - g. Accounting Standards Update No. 2016-07, *Investments—Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting*, issued March 15, 2016.



- h. Accounting Standards Update No. 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, issued March 17, 2016.
- i. Accounting Standards Update No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*, issued March 30, 2016.
- 2. The Board issued the following Exposure Drafts for public comment:
 - a. Proposed Accounting Standards Update, *Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost* (issued January 26, 2016). Comment deadline: April 25, 2016.
 - b. Proposed Accounting Standards Update, *Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Changes to the Disclosure Requirements for Defined Benefit Plans* (issued January 26, 2016). Comment deadline: April 25, 2016.
 - c. Proposed Accounting Standards Update, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* (a consensus of the FASB Emerging Issues Task Force) (issued January 29, 2016). Comment deadline: March 29, 2016.

B. CHANGES TO THE STANDARDS-SETTING AGENDA

- 1. The Board added the following projects to its technical agenda:
 - a. Consolidation: Interest Held Through Related Parties under Common Control (January)
 - b. Technical Corrections and Improvements to Update 2014-09, Revenue from Contracts with Customers (January)
- 2. The Board decided not to add a project to either its or the EITF's agenda on Simplifying the Measurement of Asset Retirement Obligations (February).

C. SIGNIFICANT TECHNICAL DECISIONS

- 1. Insurance-targeted improvements to the accounting for long-duration contracts.
 - a. The Board made decisions on the disclosures on an interim and annual basis related to the liability for future policy benefits, the liability for policy holder's account balances, market risk benefits, separate account liabilities, and deferred acquisition costs.



2. Disclosure Framework: disclosure review—income taxes
 - a. The Board decided that all entities would be required to disaggregate (1) income tax expense (benefit) between domestic and foreign and (2) foreign income taxes paid to any country that are significant relative to total income taxes paid.
 - b. The Board decided to reverse its prior decisions requiring disclosure of the line item on the balance sheet in which the amount of deferred taxes are presented and the amount of domestic income tax expense on foreign sourced earnings.
 - c. The Board decided to reverse its prior decisions that would have required private companies to disclose a rate reconciliation, an explanation of the nature and amounts of the valuation allowance recorded and/or released during the reporting period, and the amounts and expiration dates of operating loss and tax credit carryforwards that will give rise to deferred tax assets and the total amount of the unrecognized tax benefit that offsets the tax-effected carryforwards.
3. Financial Statements of Not-for-Profit Organizations
 - a. The Board decided to enhance the current reporting requirements for those not-for-profit organizations (NFPs) that present a self-defined operating measure in a statement of activities (or changes in net assets) that also presents internal board designations, appropriations, and similar actions on the face of the financial statements affecting that measure. Those NFPs would be required to report these types of internal transfers appropriately disaggregated and described by type, either on the face of the financial statements or in the notes.
 - b. The Board decided to clarify the objective of providing information useful in assessing an NFP's liquidity and the type of information that financial statements are capable of providing for that purpose. The Board decided to require NFPs to provide (1) qualitative information in the notes that communicates how an NFP manages its liquid resources available to meet cash needs for general expenditures within one year of the balance sheet date and (2) quantitative information either on the face of the balance sheet or in the notes that communicates the availability of the an NFP's financial assets at the balance sheet date to meet cash needs for general expenditures within one year of the balance sheet date.



4. The Board is in the final stages of initial deliberations and redeliberations on several other projects, and while a number of decisions were made by the Board, none of those decisions were individually significant.

ITEM 2: PREAGENDA RESEARCH

A. CHANGES TO THE RESEARCH AGENDA

1. The Board discussed issues relating to the development of a Discussion Paper addressing the Board's future technical agenda and recommended that the following potential financial reporting topics be included (February):
 - a. Financial Performance Reporting (including the Performance Statement, Other Comprehensive Income, Cash Flows Statement, and Segment Reporting)
 - b. Distinguishing Liabilities from Equity
 - c. Intangible Assets
 - d. Pensions and Other Postretirement Employee Benefit Plans.
2. The following potential financial reporting projects were added to the research agenda:
 - a. Inventory and Cost of Sales (February)
 - b. Consolidation (February)
 - c. Revenue Recognition of Grants and Contracts by Not-for-Profit Entities (March).
3. The Board removed Accounting for Convertible Financial Instruments from its research agenda (February).

B. SIGNIFICANT RESEARCH ACTIVITIES

1. The staff conducted research on Simplifying the Measurement of Asset Retirement Obligations. The staff presented its research to the Board, and the Board decided not to pursue any further research on whether to add this project to the agenda (February 2016).

C. ACTIVITIES OF THE FINANCIAL ACCOUNTING STANDARDS ADVISORY COUNCIL (FASAC) AND FASB ADVISORY COMMITTEES

1. FASAC Meeting



- a. Six Board members, the FASB technical director, and several FASB staff members participated in the March 15, 2016 FASAC meeting. The meeting topics focused on the role of judgment in financial reporting and improvements to the statement of cash flows.
2. The following advisory committee meetings were held:
 - a. Public meeting of the Not-for-Profit Advisory Committee (NAC) (March): Seven Board members, the FASB technical director, and several FASB staff participated; discussion focused on the FASB's projects related to proposed FASB Accounting Standards Update, *Not-for-Profit Entities (Topic 958) and Health Care Entities (Topic 954): Presentation of Financial Statements of Not-for-Profit Entities*, and the preagenda research project on Revenue Recognition by NFPs for Grants and Contracts. The NAC members also discussed other FASB projects and activities, recent trends, and the FASB's future agenda.
 3. Advisory committee membership changes:
 - a. Alice Antonelli, Cathy Clarke, Jim Croft, Michael Forster, Andrew Prather, and Amy Robinson all began their terms on the NAC on January 1, 2016. Each of those members is eligible for a four-year term.

D. OTHER SIGNIFICANT STAKEHOLDER OUTREACH ACTIVITIES

1. One or more Board members met with the following industry liaison groups:
 - a. Teleconference meeting with the IMA's Small Business Financial and Regulatory Affairs Committee (January). One Board member and several FASB staff members participated. Topics included an update on the activities of the Private Company Council and the FASB's projects on Financial Statements of Not-for-Profit Entities.
 - b. Private meeting with the Institute of Management Accountants' Financial Reporting Committee (February). One Board member participated. Topics included FASB projects on financial instruments, revenue recognition (implementation), leases, disclosure framework, conceptual framework (measurement and presentation), goodwill and other intangibles, government assistance disclosures, and research on financial performance reporting.
 - c. Private meeting with the Financial Executives International Committee on Corporate Reporting (CCR) (March). One Board member participated; topics



included the results from the 2015 FASAC Survey on potential future FASB agenda topics, as well as FASB projects on revenue recognition (implementation), financial instruments (impairment and hedging), and disclosure framework (multiple projects).

- d. Public meeting with the National Association of College and University Business Officers (NACUBO) (March). Seven Board members, the FASB technical director, and several FASB staff met with members of NACUBO's Accounting Principles Committee to discuss challenges in higher education accounting, the FASB's project on Financial Statements of Not-for-Profit Entities, and information about sponsored grants (in conjunction with the FASB's research project on Revenue Recognition of Grants and Contracts by Not-for-Profit Entities).
 - e. Private meeting hosted by the American Bankers Association (ABA). Two Board members, the FASB technical director, and two FASB staff members participated in a private workshop hosted by the ABA (March) that also included representatives from banks, banking regulators, the SEC, the PCAOB, and auditors. The discussion focused on the FASB's project on the Accounting for Financial Instruments: Impairment.
 - f. The FASB held its annual Financial Reporting Issues Conference in January 2016 inviting representatives of the IASB, members of academe involved in accounting education and research, and members of the business community.
2. Significant project-specific outreach activities follow:
 - a. The FASB Board members and staff conducted approximately 167 meetings with a variety of stakeholders to discuss issues in 32 different FASB and EITF projects.
 - b. Through meetings and comment letters, the Board received feedback from a range of stakeholder types: 13% from financial statement users; 25% from auditors; 33% that were representatives of public companies, private companies, and not-for-profit organizations; and 29% from professional, trade, and advocacy organizations and others (including state societies, regulators, and other standard setters).

D. COLLABORATION WITH THE FASB'S PRIVATE COMPANY COUNCIL (PCC)

1. The PCC Variable Interest Entities (VIE) Working Group (whose members include six PCC members, one Board member, and several FASB staff members) met on March 1, 2016, to discuss PCC Issue No. 15-02, "Applying Variable



Interest Entity Guidance to Entities under Common Control," and to develop examples to help clarify application of VIE guidance to such situations.

E. EMERGING ISSUES TASK FORCE (EITF) ACTIVITIES

1. Six Board members attended the March 3, 2016 EITF meeting at which Issue No. 16-A, "Restricted Cash" was discussed and a consensus-for-exposure was reached.
2. Mark Scoles (Grant Thornton) was appointed as an EITF member (effective March 3, 2016), fulfilling the term left vacant by the passing of Charles Evans, and will be eligible for a five-year term.

F. INTERNATIONAL ACTIVITIES

1. Cooperative activities between the FASB and the IASB were as follows:
 - a. The FASB chairman, a Board member, and the FASB technical director held a video conference with the IASB.
2. Cooperative activities among the FASB and other national standards setters included the following:
 - a. The FASB chairman and a Board member participated by video in a private networking meeting with representatives from several different national standards-setting organizations.
 - b. Two Board members met privately with representatives from the Hong Kong Institute of CPAs (HKICPAs) in Hong Kong.
 - c. The FASB chairman and two Board members met privately with representatives of the Ministry of Finance (MOF) in China.
 - d. The FASB chairman and two Board members met privately with the Accounting Standards Board of Japan (ASBJ) in Japan.
 - e. Five Board members (on a rotational basis), the FASB technical director, and several staff members met privately with representatives from the Autorité des normes comptables (ANC) in Norwalk.
 - f. The FASB chairman, two Board members, and staff members met privately with representatives from the Australian Accounting Standards Board in Norwalk.

ITEM 3: STAKEHOLDER EDUCATION AND COMMUNICATIONS

1. The FASB held one educational webinar:



- a. IN FOCUS: FASB Accounting Standards Update on Leases
- 2. The FASB posted three featured videos:
 - a. FASB Preview of 2016
 - b. FASB Investor Podcast on Software Revenue Recognition
 - c. Why a New Leases Standard.

B. SPEECHES DELIVERED

- 1. FASB members or staff delivered speeches at 16 different conferences. The more significant conferences follow:
 - a. Michigan State University Department of Accounting and Information Systems Professional Speaker Series
 - b. NAREIT: REITWise Law, Accounting, and Finance Conference
 - c. Ohio State University Fisher College of Business EY Masters of Accounting (MAcc) Speaker Event Series
 - d. PCAOB's 2016 Annual Inspection Training
 - e. Tax Executives Institute (TEI) 66th Midyear Conference.

C. PRESS RELEASES, MEDIA ADVISORIES, AND TWEETS

- 1. The FASB issued 15 press releases or media advisories on a variety of topics.

D. OTHER COMMUNICATIONS ACTIVITIES

- 1. The ninth issue of FASB Outlook was published in January.

ITEM 4: STRATEGIC, ADMINISTRATIVE, AND PROCEDURAL ACTIVITIES

A. STRATEGIC PLAN ACTIVITIES

- 1. FASB members participated in a discussion of the FAF, FASB, and GASB strategic plan with the Board of Trustees at its February meeting

B. ADMINISTRATIVE MATTERS

- 1. None.



C. PROFESSIONAL DEVELOPMENT PROGRAMS

1. The Conceptual Framework Project: An Overview and Update. James Leisenring, FASB Senior Advisor.
2. FASB-IASB Financial Reporting Issues Conference (FRIC) Recap. James Leisenring, FASB Senior Advisor; Jill Switter, Senior Project Manager; Ryan Carter, Assistant Project Manager; Melissa Rutzen, Postgraduate Technical Assistant.
3. Accounting for Natural Resources: Emerging Issues and Perspectives. Edward Harrington, (Retired) General Manager, San Francisco Public Utilities Commission, former FAF Trustee, former Government Finance Officers Association President; David Batker, Executive Director, Earth Economics; and Rowan Schmidt, Program Director, Earth Economics.

ITEM 5: FEDERAL GOVERNMENT AND REGULATORY LIAISON ACTIVITIES

A. REPRESENTATIVES OF CONGRESS AND FEDERAL REGULATORY BODIES

1. The FASB chairman responded to congressional letters from U.S. Senator Dean Heller regarding the FASB's lease accounting project; U.S. Representatives Scott Tipton and Patrick Murphy regarding the FASB's Accounting for Financial Instruments: Impairment project; and U.S. Representative Jeb Hensarling regarding the FASB's 2016 standard-setting agenda.

ITEM 6: FAF/FASB/GASB INTERACTION

A. MEETING MINUTES

1. GASB and FASB meeting minutes were shared with the FASB and GASB Board members and staff.

B. MEETINGS

1. The FASB and GASB directors met monthly to discuss their technical agenda projects and other matters of mutual interest.
2. The FASB and GASB chairmen and their respective directors held their quarterly meeting to discuss technical issues and other matters of mutual interest.



C. DOCUMENT DRAFT REVIEWS

1. The GASB distributed the following drafts for the FASB's review:
 - a. Final Statement on implementation of recent pronouncements
 - b. Final Statement on irrevocable split-interest agreements
 - c. Final Statement on pension implementation issues.
2. The FASB staff distributed the following drafts for the GASB's review:
 - a. Final Accounting Standards Update, *Investments—Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting*
 - b. Final Accounting Standards Update, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*
 - c. Final Accounting Standards Update, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*
 - d. Final Accounting Standards Update, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*
 - e. Final Accounting Standards Update, *Revenue from Contracts with Customers (Topic 606): Narrow Scope Improvements and Practical Expedients*
 - f. Proposed Accounting Standards Update, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill Impairment*
 - g. Proposed Accounting Standards Update, *Technical Corrections and Improvements*
 - h. Proposed Accounting Standards Update, *Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Subtopic 610-20 and Partial Sales of Nonfinancial Assets*
 - i. Proposed Accounting Standards Update, *Statement of Cash Flows (Topic 230): Restricted Cash* (a consensus of the FASB Emerging Issues Task).

ITEM 7: XBRL ACTIVITIES

The FASB is responsible for the ongoing development and maintenance of the GAAP Financial Reporting Taxonomy (Taxonomy) applicable to public issuers registered with the U.S. Securities and Exchange Commission (SEC).



A. TECHNICAL ACTIVITIES

1. The SEC accepted the 2016 GAAP Financial Reporting Taxonomy effective March 8, 2016.
2. The FASB published Taxonomy Updates as final for:
 - a. Accounting Standards Update 2016-01—*Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* [Early Application Provisions]
 - b. Update No. 2016-04, *Liabilities—Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products* (a consensus of the FASB Emerging Issues Task Force)
 - c. Update No. 2016-05, *Derivatives and Hedging (Topics 815): Effects of Derivative Contract Novations on Existing Hedge Accounting Relationships* (a consensus of the FASB Emerging Issues Task Force)
 - d. Update 2016-06, *Derivatives and Hedging (Topics 815): Contingent Put and Call Options in Debt Instruments* (a consensus of the FASB Emerging Issues Task Force)
 - e. Update 2016-07, *Investments—Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting*.
3. The FASB published Taxonomy Exposure Drafts for:
 - a. Proposed Accounting Standards Update—*Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* (a consensus of the FASB Emerging Issues Task Force)
 - b. Proposed Accounting Standards Update—*Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*.
4. Implementation/Reference Guides:
 - a. New guides issued for 2016:
 - i. Other Comprehensive Income
 - ii. Short-Duration Insurance Contracts.
 - b. Existing guides updated for 2016:
 - i. Disposal Groups and Discontinued Operations
 - ii. Insurance: Concentration of Credit Risk Disclosures
 - iii. Liquidation Basis of Accounting



- iv. Measurement Date Practical Expedient for Defined Benefit Plans
- v. Notional Amount Disclosures
- vi. Disclosure about Offsetting Assets and Liabilities
- vii. Repurchase-to-Maturity Transactions and Repurchase Financings
- viii. Segment Reporting
- ix. Subsequent Events.
- c. Proposed guides issued for 2016:
 - i. Dimensional Modeling for Financing Receivables Disclosures.

B. OUTREACH ACTIVITIES

1. The more significant Taxonomy-related outreach activities this quarter included the following:
 - a. Held meetings of the FASB Taxonomy Advisory Group, industry working groups, the Dimension Working Group, the XBRL US Data Quality Committee, XBRL US Surety Working Group, various XBRL International technical working groups, the IASB IFRS Taxonomy Consultative Group, quarterly staff meeting with IASB Taxonomy staff, and the SEC Division of Economic and Risk Analysis (DERA) staff.
 - b. Hosted a two-day meeting of the Dimension Working Group to address and gain consensus on several deep XBRL technical issues.
 - c. Launched first meeting of XBRL International Entity Specific Disclosure Task Force chaired by FASB Chief of Taxonomy Development and IASB Senior Technical Manager—IFRS Taxonomy. The purpose of this Task Force is to identify best practice for handling entity-specific disclosures (ESDs) in XBRL including, but not limited to, the use of preparer extension taxonomies.



REPORT OF THE FASB CHAIR**April 1, 2016 through June 30, 2016**

ITEM 1: STANDARDS-SETTING ACTIVITIES**A. FINAL STANDARDS AND DOCUMENTS ISSUED FOR PUBLIC COMMENT**

1. The Board issued the following final documents:
 - a. Accounting Standards Update No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, issued April 14, 2016.
 - b. Accounting Standards Update No. 2016-11, *Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF (SEC Update)*, issued May 2, 2016.
 - c. Accounting Standards Update No. 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, issued May 9, 2016.
 - d. Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, issued June 16, 2016.
2. The Board issued the following Exposure Drafts for public comment:
 - a. Proposed Accounting Standards Update, *Technical Corrections and Improvements* (issued April 21, 2016). Comment deadline: July 5, 2016.
 - b. Proposed Accounting Standards Update, *Statement of Cash Flows (Topic 230): Restricted Cash* (a consensus of the FASB Emerging Issues Task Force) (issued April 28, 2016). Comment deadline: June 27, 2016.
 - c. Proposed Accounting Standards Update, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment* (issued May 12, 2016). Comment deadline: July 11, 2016.
 - d. Proposed Accounting Standards Update, *Technical Corrections and Improvements to Update 2014-09, Revenue from Contracts with*



Customers (Topic 606) (issued May 18, 2016). Comment deadline: July 2, 2016.

- e. Proposed Accounting Standards Update, *Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets* (issued June 6, 2016). Comment deadline: August 5, 2016.
- f. Proposed Accounting Standards Update, *Consolidation (Topic 810): Interests Held through Related Parties That Are under Common Control* (issued June 23, 2016). Comment deadline: July 25, 2016.

B. CHANGES TO THE STANDARDS-SETTING AGENDA

1. The Board added a project to its technical agenda on Revenue Recognition of Grants and Contracts by Not-for-Profit Entities (April).
2. The Board added a project to the EITF's agenda on Employee Benefit Plan Master Trust Reporting (April).
3. The Board decided not to add the following projects to either its or the EITF's agenda:
 - a. Effects of Yield Co Dropdown Transactions on Historical Earnings per Share (April)
 - b. Presentation of Gains and Losses from the Sale of a Business (April).
4. The Board removed its project on Improving the Equity Method of Accounting from its technical agenda (May).
5. The following PCC decisions directly affected the Board's agenda as follows:
 - a. The PCC recommended that the Board add a project to its agenda on Applying Variable Interest Entity Guidance to Entities under Common Control. Therefore, the PCC removed the project on the same topic from its agenda and likewise the Board removed the complementary project for other stakeholders (April) from its technical agenda and added the PCC recommended project to its research agenda.



C. SIGNIFICANT TECHNICAL DECISIONS

1. Accounting for Financial Instruments—Credit Losses
 - a. The Board decided to defer the planned effective dates by one year for the following:
 - i. For public business entities that meet the definition of an SEC filer, the standard will be effective for fiscal years (and interim periods within those fiscal years) beginning after December 15, 2019.
 - ii. For other public business entities, the standard will be effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years.
 - iii. For all other entities, including not-for-profit organizations and employee benefit plans, the standard will be effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021.
 - iv. Early adoption will be permitted for all entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.
 - b. The Board also decided that public business entities that are not SEC filers would be permitted to provide their vintage disclosures using a phase-in transition approach. The phase-in transition approach would require three origination years to be disclosed (including the originations during the first year of adoption), and then an incremental year for every fiscal year thereafter until five separate fiscal years are disclosed, consistent with SEC filers.
2. The Board is in the final stages of initial deliberations and redeliberations on several other projects, and while a number of decisions were made by the Board, none of those decisions were individually significant.

ITEM 2: PREAGENDA RESEARCH

A. CHANGES TO THE RESEARCH AGENDA

1. At the PCC's suggestion, the Board added a project to its research agenda on Applying Variable Interest Entity Guidance to Entities under Common Control (April). That project had formerly been on the PCC's and the Board's technical agenda.



2. The PCC removed from its research agenda, the project on Partnership Accounting. Likewise, the Board removed the project on Partnership Accounting from its research agenda (April).

B. SIGNIFICANT RESEARCH ACTIVITIES

1. The staff conducted research on Modifications to Share-Based Payments and Cloud Computing. Both potential projects will be discussed with the Board at a future agenda prioritization meeting.
2. The staff began research on Measuring the Fair Value of Liabilities and Equity Instruments Held by Other Parties as Assets.

C. ACTIVITIES OF THE FINANCIAL ACCOUNTING STANDARDS ADVISORY COUNCIL (FASAC) AND FASB ADVISORY COMMITTEES

1. FASAC Meeting
 - a. Six Board members, the technical director, and several staff members participated in the June 15, 2016 FASAC meeting. The discussion topics were intangible assets, including research and development, and segment reporting.
2. The following advisory committee meetings were held:
 - a. None.
3. Advisory committee membership changes:
 - a. None.

D. OTHER SIGNIFICANT STAKEHOLDER OUTREACH ACTIVITIES

4. One or more Board members met with the following industry liaison groups:
 - a. The FASB chair and five Board members met publicly with members of the Healthcare Financial Management Association's (HFMA) Principles and Practice Board in April. Topics included the FASB's projects on disclosure framework, not-for-profit financial statements, revenue recognition of grants and contracts by not-for-profit entities, cash flow classification, and financial instruments.
 - b. Two Board members and two staff members met privately with members of the American Bankers Association's Accounting Administrative Committee in May. The topic discussed was the FASB's project on financial instruments: credit losses.



- c. One Board member met privately with the Institute of Management Accountants' Financial Reporting Committee via teleconference in May. Topics discussed were the FASB's future agenda priorities; the FASB's projects on financial instruments, disclosure framework, goodwill and other intangibles, and conceptual framework; and the implementation of FASB standards on revenue recognition and leases.
 - d. The FASB chair, four Board members, the technical director, and an assistant director met publicly with members of the Financial Executives International's Committee on Corporate Reporting in June. Topics discussed were the FASB's future agenda priorities; FASB projects on financial instruments (credit losses and hedging), disclosure framework, and disclosures on government assistance and income taxes; and the implementation of FASB standards on revenue recognition and leases.
 - e. One Board member (via teleconference) and a staff member met privately with the American Council of Life Insurers' Accounting Committee in June in Washington, D.C. to discuss the FASB's project on insurance: long duration contracts.
 - f. Three Board members, the technical director, and various staff met privately with a group of representatives from insurance companies in June to discuss participating contracts and the FASB's project on insurance: long duration contracts.
5. Significant project-specific outreach activities follow:
- a. The FASB Board members and staff conducted approximately 109 meetings with a variety of stakeholders to discuss issues in 24 different FASB and EITF projects.
 - b. Through meetings and comment letters, the Board received feedback from a range of stakeholder types: 11% from financial statement users; 33% from auditors; 32% that were representatives of public companies, private companies, and not-for-profit organizations; and 24% from professional, trade, and advocacy organizations and others (including state societies, regulators, and other standard setters).

E. COLLABORATION WITH THE FASB'S PRIVATE COMPANY COUNCIL (PCC)

- 1. The PCC and the FASB jointly hosted a Private Company Town Hall Meeting on June 13, 2016, at Baruch College in New York City.
- 2. Six Board members, the technical director, and certain staff participated in the April 12, 2016 PCC meeting. The discussion topics were FASB projects on



government assistance disclosures, nonemployee share-based payment, restricted cash, the equity method, and disclosure reviews on income taxes, inventory, and fair value measurement.

3. PCC members voted nine to one to recommend that the Board add PCC Issue No. 15-02, "Applying Variable Interest Entity Guidance to Entities under Common Control," to the FASB agenda.

E. EMERGING ISSUES TASK FORCE (EITF) ACTIVITIES

1. Five Board members attended the June 10, 2016 EITF meeting. Issues No. 15-F, "Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments," and No. 16-B, "Employee Benefit Plan Master Trust Reporting," were discussed. The EITF reached a consensus on Issue 15-F and a consensus-for-exposure on Issue 16-B.

G. INTERNATIONAL ACTIVITIES

1. Cooperative activities between the FASB and the IASB were as follows:
 - a. The FASB and the IASB held a joint videoconference Board meeting and discussed goodwill impairment, the subsequent accounting for goodwill, and accounting for identifiable intangible assets in a business combination.
2. Cooperative activities among the FASB and other national standards setters included the following:
 - a. The FASB chair and a Board member participated in a private networking meeting by video and in a private networking meeting in Berlin with representatives from several different national standards-setting organizations.
 - b. The FASB chair, three Board members (on a rotational basis), the technical director, and various staff met privately with representatives of the Organismo Italiano di Contabilità–OIC (the Italian Standard Setter).
 - c. The FASB chair, two Board members, and various staff members met privately with representatives from the Korea Accounting Standards Board (KASB) in Norwalk.
 - d. Two Board members and an assistant director participated in the International Forum on Accounting Standard Setters (IFASS) meeting in Toronto.
 - e. Three Board members and the technical director met with representatives from the Accounting Standards Board (AcSB) of Canada in Toronto.



ITEM 3: STAKEHOLDER EDUCATION AND COMMUNICATIONS

A. WEBINARS AND VIDEOS

1. The FASB held two educational webinars:
 - a. IN FOCUS: FASB Update for Private Companies and Not-for-Profit Organizations (June 20, 2016)
 - b. IN FOCUS: 2016 GAAP Financial Reporting Taxonomy Changes and Beyond, and SEC Update (April 5, 2016)
2. The FASB posted three featured videos:
 - a. Putting Leases on the Balance Sheet
 - b. The GAAP Taxonomy: Why It's Important
 - c. Why a New Credit Losses Standard?

B. SPEECHES DELIVERED

1. FASB members or staff delivered 60 speeches at different conferences. The more significant conferences follow:
 - a. 35th Annual SEC and Financial Reporting Institute Conference
 - b. AICPA's 2016 Annual Not For Profit Industry Conference
 - c. American Society of Appraisers and University of Southern California 11th Annual Fair Value Conference
 - d. Colorado State University Accounting Awards Banquet
 - e. Compliance Week Annual Conference
 - f. Connecticut Society of Certified Public Accountants Not-for-Profit Organizations Conference
 - g. Edison Electric Institute and American Gas Association Accounting Leadership Conference
 - h. EY and The Risk Management Association (RMA)—Allowance for Loan Losses (ALLL) Round Table Meeting
 - i. EY Oil & Gas Symposium
 - j. Institute of Management Accountants 42nd Annual Meonske Professional Development Conference



- k. NYU Stern School of Business Ross Institute of Accounting Research Roundtable
- l. PwC Financial Markets Insights 2016
- m. The 15th Annual Baruch College Financial Reporting Conference
- n. University of Tulsa School of Accounting and Management Information Systems 70th Annual Conference of Accountants
- o. University of Washington 12th Annual University of Washington Financial Reporting Conference
- p. Woman's Accounting Leadership Series

C. PRESS RELEASES, MEDIA ADVISORIES, AND SOCIAL MEDIA

- 1. The FASB issued 7 press releases or media advisories on a variety of topics, as well as a variety of updates on Twitter and LinkedIn.

D. OTHER COMMUNICATIONS ACTIVITIES

- 1. The 2nd Quarter FASB Outlook was issued on April 26.

ITEM 4: STRATEGIC, ADMINISTRATIVE, AND PROCEDURAL ACTIVITIES

A. STRATEGIC PLAN ACTIVITIES

- 1. The FASB completed all of its second quarter 2016 strategic plan action steps, including a review of the processes and systems related to the FASB Technical Inquiry Service.

B. ADMINISTRATIVE MATTERS

- 1. None.

C. PROFESSIONAL DEVELOPMENT PROGRAMS

- 1. Conceptual Framework Training. Jill Switter, FASB Senior Project Manager; Nicholas Cappiello, FASB Supervising Project Manager; Ryan Carter, FASB Assistant Project Manager; and Melissa Rutzen, FASB Postgraduate Technical Assistant.
- 2. Investor Case Studies. Marc Siegel, FASB Board Member.



3. Leases Update. Danielle Zeyher, Senior Project Manager; Lisa Kaestle, Assistant Project Manager; Kendall Verbeek, FASB Postgraduate Technical Assistant.
4. Lessons Learned: A Conversation with Ron Bossio about His 33 Years of Setting Standards. Ronald J. Bossio, Senior Project Manager.
5. Inclusion and Respect in the Workplace (training program). Lourdes Tango, CDO Insights.
6. Non-GAAP Reporting. Theodore E. Christensen, Director & Terry Chair; Benjamin C. Whipple, Assistant Professor, The University of Georgia, Terry College of Business, J.M. Tull School of Accounting; and Dirk Black, Tuck School of Business, Dartmouth University.
7. *IN FOCUS*: FASB Update for Private Companies and Not-for-Profit Organizations. James L. Kroeker, FASB Vice Chair; Daryl E. Buck, FASB Member; Candace Wright, Private Company Council Chair; Jeffrey D. Mechanick, FASB Assistant Director; Mike Cheng, FASB Supervising Project Manager; and Richard A. Cole, FASB Supervising Project Manager.
8. Confessions of a Retiring Board Member. Thomas J. Linsmeier, Board Member.
9. New York Law and Ethics. Timothy F. Gearty, Becker Professional Education.

ITEM 5: FEDERAL GOVERNMENT AND REGULATORY LIAISON ACTIVITIES

A. REPRESENTATIVES OF CONGRESS AND FEDERAL REGULATORY BODIES

1. The FASB chair responded to a letter from U.S. Senators Joe Donnelly, Pat Toomey, and Sherrod Brown about the FASB's expected credit losses standard.

ITEM 6: FAF/FASB/GASB INTERACTION

A. MEETING MINUTES

1. GASB and FASB meeting minutes were shared with the FASB and GASB Board members and staff.

B. MEETINGS

1. The FASB and GASB directors met monthly to discuss their technical agenda projects and other matters of mutual interest.



2. The FASB and GASB chairs and their respective directors held their quarterly meeting to discuss technical issues and other matters of mutual interest.

C. DOCUMENT DRAFT REVIEWS

1. The GASB did not distribute any drafts to the FASB for review.
2. The FASB staff distributed the following drafts for the GASB's review:
 - a. Final Accounting Standards Update, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*
 - b. Final Accounting Standards Update, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* (a consensus of the FASB Emerging Issues Task)
 - c. Proposed Accounting Standards Update, *Technical Corrections and Improvements to Update 2014-09, Revenue from Contracts with Customers (Topic 606)*
 - d. Proposed Accounting Standards Update, *Consolidation (Topic 810): Interests Held through Related Parties That Are under common Control*
 - e. Proposed Accounting Standards Update, *Not-for-Profit Entities—Consolidation (Subtopic 958): Clarifying When a Not-for-Profit Entity That Is a General Partner Should Consolidate a For-Profit Limited Partnership or Similar Entity*
 - f. Proposed Accounting Standards Update, *Income Taxes (Topic 740): Disclosure Framework—Changes to the Disclosure Requirements for Income Taxes*
 - g. Proposed Accounting Standards Update, *Plan Accounting: Defined Benefit Pension Plans (Topic 960); Defined Contribution Pension Plans (Topic 962); Health and Welfare Plans (Topic 965); Employee Benefit Plan Master Trust Reporting* (a consensus of the Emerging Issues Task Force)
 - h. Proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815)—Targeted Improvements to Accounting for Hedging Activities*
 - i. Proposed Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 7: Presentation*.



ITEM 7: XBRL ACTIVITIES

The FASB is responsible for the ongoing development and maintenance of the GAAP Financial Reporting Taxonomy (Taxonomy) applicable to public issuers registered with the U.S. Securities and Exchange Commission (SEC).

A. TECHNICAL ACTIVITIES

1. The FASB published Taxonomy Updates as final for:
 - a. Accounting Standards Update 2016-08—*Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)* [Evaluated: however, no changes to the Taxonomy.]
 - b. Accounting Standards Update 2016-10—*Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing.* [Evaluated: however, no changes to the Taxonomy.]
2. The FASB published Taxonomy Exposure Drafts for:
 - a. Proposed Accounting Standards Update—*Intangibles and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment*
 - b. Proposed Accounting Standards Update—*Technical Corrections and Improvements to Update 2014-09, Revenue from Contracts with Customers (Topic 606)*
 - c. Proposed Accounting Standards Update—*Statement of Cash Flows (Topic 230): Restricted Cash* (a consensus of the FASB Emerging Issues Task Force)
 - d. Proposed Accounting Standards Update—*Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*
 - e. Proposed Accounting Standards Update—*Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Changes to the Disclosure Requirements for Defined Benefit Plans.*
3. Implementation/Reference Guides:
 - a. New guides issued for 2016:
 - i. Dimensional Modeling for Financing Receivable Disclosures
 - ii. Balance Type.



- b. Proposed guides issued for 2016:
 - i. Decision Tree for Hierarchical Distinct Domains
 - ii. Dimension Uses
 - iii. Dimensional Modeling for Financing Receivables Disclosures.

B. OUTREACH ACTIVITIES

- 1. The more significant Taxonomy-related outreach activities this quarter included the following:
 - a. Held or participated in meetings of the FASB Taxonomy Advisory Group, industry working groups, the Dimension Working Group, the XBRL US Data Quality Committee, XBRL U.S. Surety Working Group, various XBRL International technical working groups including the Entity Specific Disclosure Task Force chaired by FASB Chief of Taxonomy Development and IASB Senior Technical Manager—IFRS Taxonomy, the IASB IFRS Taxonomy Consultative Group, and the SEC Division of Economic and Risk Analysis (DERA) staff.

Accounting Standards Updates

The *FASB Accounting Standards Codification*® (FASB Codification) is the sole source of authoritative GAAP other than SEC issued rules and regulations that apply only to SEC registrants. The FASB issues an Accounting Standards Update (Update or ASU) to communicate changes to the FASB Codification, including changes to non-authoritative SEC content. ASUs are not authoritative standards.

Issued In 2016

- Update 2016-15—Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)
- Update 2016-14—Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities
- Update 2016-13—Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments
- Update 2016-12—Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients
- Update 2016-11—Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting (SEC Update)
- Update 2016-10—Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing
- Update 2016-09—Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting
- Update 2016-08—Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)

- Update 2016-07—Investments—Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting
- Update 2016-06—Derivatives and Hedging (Topic 815): Contingent Put and Call Options in Debt Instruments (a consensus of the Emerging Issues Task Force)
- Update 2016-05—Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships (a consensus of the Emerging Issues Task Force)
- Update 2016-04—Liabilities—Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakeage for Certain Prepaid Stored-Value Products (a consensus of the Emerging Issues Task Force)
- Update 2016-03—Intangibles—Goodwill and Other (Topic 350), Business Combinations (Topic 805), Consolidation (Topic 810), Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance (a consensus of the Private Company Council)
- Update 2016-02—Leases (Topic 842)
 - Section A—Leases: Amendments to the *FASB Accounting Standards Codification*®
 - Section B—Conforming Amendments Related to Leases: Amendments to the *FASB Accounting Standards Codification*®
 - Section C—Background Information and Basis for Conclusions
- Update 2016-01—Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities



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Technical Agenda Overview

Revised September 8, 2016

FRAMEWORK PROJECTS	Current Stage	Timing
Conceptual Framework: Measurement	Initial deliberations	
Conceptual Framework: Presentation	ED out for public comment	Ends Nov 9, 2016
Disclosure Framework: Board's Decision Process	ED redeliberations	
RECOGNITION & MEASUREMENT: BROAD PROJECTS	Current Stage	Timing
Accounting for Financial Instruments: Hedging	ED out for public comment	Ends Nov 22, 2016
Insurance: Targeted Improvements to the Accounting for Long-Duration Contracts	Drafting revised ED	Q3 2016
RECOGNITION & MEASUREMENT: NARROW PROJECTS	Current Stage	Timing
Accounting for Goodwill Impairment	ED redeliberations	
Accounting for Identifiable Intangible Assets in a Business Combination for Public Business Entities and Not-for-Profit Entities	Initial deliberations	
Accounting for Income Taxes: Intra-Entity Asset Transfers	Drafting final standard	Q3 2016
Accounting for Interest Income Associated with the Purchase of Callable Debt Securities	Drafting ED	Q4 2016
Accounting for Service Concession Arrangements (EITF 16-C)	Initial deliberations	
Clarifying the Definition of a Business (phase 1)	ED redeliberations	
Clarifying the Scope of Subtopic 610-20 and Accounting for Partial Sales of Nonfinancial Assets (<i>formerly Definition of a Business phase 2</i>)	ED redeliberations	
Clarifying When a Not-for-Profit Entity That Is a General Partner Should Consolidate a For-Profit Limited Partnership (or Similar Entity)	ED out for public comment	Ends Oct 3, 2016
Consolidation: Interests Held through Related Parties that Are under Common Control	Drafting final standard	Q4 2016
Liabilities & Equity: Targeted Improvements	Drafting ED	Q4 2016
Nonemployee Share-Based Payment Accounting Improvements	Initial deliberations	
Revenue Recognition of Grants and Contracts by Not-for-Profit Entities	Initial deliberations	

RECOGNITION & MEASUREMENT: NARROW PROJECTS (continued)		Current Stage	Timing
Scope of Modification Accounting in Topic 718		Initial deliberations	
Subsequent Accounting for Goodwill for Public Business Entities and Not-for-Profit Entities		Initial deliberations	
Technical Corrections and Improvements		ED redeliberations	
Technical Corrections and Improvements—Update 2014-09, Revenue from Contracts with Customers		ED redeliberations	
PRESENTATION & DISCLOSURE PROJECTS		Current Stage	Timing
Disclosure Framework: Disclosure Review—Defined Benefit Plans		ED redeliberations	
Disclosure Framework: Disclosure Review—Fair Value Measurement		ED redeliberations	
Disclosure Framework: Disclosure Review—Income Taxes		ED out for public comment	Ends Sept 30, 2016
Disclosure Framework: Disclosure Review—Inventory		Initial deliberations	
Disclosure Framework: Disclosures—Interim Reporting		Initial deliberations	
Disclosure Framework: Entity's Decision Process		ED redeliberations	
Disclosures by Business Entities about Government Assistance		ED redeliberations	
Employee Benefit Plan Master Trust Reporting (EITF 16-B)		ED out for public comment	Ends Sept 26, 2016
Financial Statements of Not-for-Profit Entities (phase 2)		ED redeliberations	
Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost		ED redeliberations	
Restricted Cash (EITF 16-A)		ED redeliberations	
Simplifying the Balance Sheet Classification of Debt		Drafting ED	Q4 2016



RESEARCH PROJECTS
Accounting for Financial Instruments: Interest Rate Risk Disclosures
Accounting for Income Taxes: Presentation of Tax Expense/Benefit
Applying Variable Interest Entity Guidance to Entities under Common Control Consolidation
Distinguishing Liabilities from Equity (including convertible debt)— <i>comments on agenda consultation Invitation to Comment due October 17, 2016</i>
Financial Performance Reporting (including 2014 Financial Performance Reporting research project; as well as broader research on potential improvements to the performance statement, other comprehensive income, cash flows statement (including classification), and segment reporting)— <i>comments on agenda consultation Invitation to Comment due October 17, 2016</i>
Intangible Assets (including research and development)— <i>comments on agenda consultation Invitation to Comment due October 17, 2016</i>
Inventory and Cost of Sales
Pensions and Other Postretirement Employee Benefit Plans — <i>comments on agenda consultation Invitation to Comment due October 17, 2016</i>



**Testimony on Examining the Agenda of Regulators, SROs, and Standards-Setters for
Accounting, Auditing, and Municipal Securities**

by
Jessica S. Kane
Director, Office of Municipal Securities
U.S. Securities and Exchange Commission

**Before the U.S. House of Representatives Committee on Financial Services
Subcommittee on Capital Markets and Government Sponsored Enterprises**

September 22, 2016

Chairman Garrett, Ranking Member Maloney, and Members of the Subcommittee:

I am Jessica Kane, Director of the Office of Municipal Securities (OMS) at the United States Securities and Exchange Commission (Commission). I appreciate the opportunity to appear before you today to testify on behalf of the Commission regarding the Office of Municipal Securities and current issues related to the municipal securities market.

Office of Municipal Securities

The Office of Municipal Securities was created in September 2012 as an independent office that reports directly to the SEC Chair, as required by section 979 of the Dodd Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The municipal securities market encompasses over \$3.7 trillion in outstanding municipal securities and over 44,000 municipal issuers consisting of a diverse group of entities that includes states, their political subdivisions (such as cities, towns, counties, and school districts), and their instrumentalities (such as housing, health care, airport, port, and economic development authorities and agencies). In 2015 alone, there were over 14,000 new bond issues.¹

OMS is responsible for overseeing the municipal securities market and administering the Commission's rules pertaining to municipal securities brokers and dealers, municipal advisors,

¹ See *EMMA Market Statistics*, MUNICIPAL SECURITIES RULEMAKING BOARD, <http://emma.msrb.org/MarketActivity/ViewStatistics.aspx>.

investors in municipal securities, and municipal issuers. OMS also coordinates with the Municipal Securities Rulemaking Board (MSRB) on rulemaking and enforcement actions.

Upon its establishment, OMS devoted its attention primarily to finalizing and implementing the municipal advisor registration rules, including providing interpretive guidance to market participants, participating in the review of municipal advisor registrations, and reviewing a considerable number of rule filings by the MSRB related to municipal advisor regulation. OMS expects to continue to devote significant attention to implementing these final municipal advisor rules.

In addition, OMS is continuing to provide oversight for the municipal securities market and is responsible for policy development, coordination, and implementation of Commission initiatives to improve the municipal securities market, as well as providing technical assistance to the Division of Enforcement and the Office of Compliance Inspections and Examinations. OMS also closely monitors current issues in the municipal securities market.

Set forth below are some of OMS's most prominent current activities.

Municipal Advisors

The Dodd-Frank Act imposed a new requirement that "municipal advisors" register with the SEC and provided for regulation of municipal advisors by the MSRB.² This registration requirement applies to persons who provide advice to municipal entities or obligated persons with respect to municipal financial products or the issuance of municipal securities, or who solicit municipal entities or obligated persons. In September 2013, the Commission adopted final rules for municipal advisor registration.³

² See 15 U.S.C. § 78o-4(b).

³ See Registration of Municipal Advisors, Exchange Act Release No. 70462, 78 Fed. Reg. 67468 (Nov. 12, 2013), <http://www.sec.gov/rules/final/2013/34-70462.pdf>. See also OFFICE OF MUN. SEC., SEC, REGISTRATION OF MUNICIPAL ADVISORS FREQUENTLY ASKED QUESTIONS (issued Jan. 10, 2014, last updated May 19, 2014).

These registration requirements and regulatory standards were intended to mitigate some of the problems observed with the conduct of some municipal advisors, including failure to place the duty of loyalty to their municipal entity client ahead of their own interests, undisclosed conflicts of interest, and advice rendered by financial advisors without adequate training or qualifications.

OMS has significant responsibilities related to the implementation of municipal advisor registration and is currently overseeing the registration of over 650 municipal advisory firms and over 4,000 associated persons who engage in municipal advisory activities. Municipal advisors were required to comply with the final rules as of July 1, 2014, including registering with the SEC using the final registration forms.⁴ Except for certain personally identifiable information, the SEC municipal advisor registration information is available to the public through the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system website.⁵

OMS continues to implement the final rules for municipal advisor registration by monitoring and improving the SEC's registration system for municipal advisors, participating in the review of municipal advisor registrations, and reviewing and processing MSRB rule filings related to municipal advisor regulation. In December 2015, the Commission approved the MSRB's adoption of new MSRB Rule G-42, which establishes the core standards of conduct and duties of municipal advisors when providing advice to municipal entities or obligated persons with respect to municipal financial products or the issuance of municipal securities.⁶ OMS also

<http://www.sec.gov/info/municipal/mun-advisors-faqs.pdf>.

⁴ The final rules require municipal advisors to register with the SEC by completing a Form MA and to provide information regarding natural persons associated with the municipal advisor and engaged in municipal advisory activities on such municipal advisor's behalf by completing a Form MA-I for each such natural person.

⁵ To search by a municipal advisor company's name, see <http://www.sec.gov/edgar/searchedgar/companysearch.html>.

⁶ See Order Granting Approval of a Proposed Rule Change Consisting of Proposed New Rule G-42, on Duties of Non-Solicitor Municipal Advisors, and Proposed Amendments to Rule G-8, on Books and Records to be Made by Brokers, Dealers, Municipal Securities Dealers, and Municipal Advisors, Exchange Act Release No. 76753, 80 Fed. Reg. 81614 (Dec. 30, 2015), <https://www.sec.gov/rules/sro/msrb/2015/34-76753.pdf>.

consults with the Commission's Office of Compliance Inspections and Examinations regarding inspections and examinations of municipal advisors, coordinates with the MSRB and FINRA⁷ to help promote fair and uniform application of new rules applicable to municipal advisors, and provides interpretive guidance to those market participants who may be required to register as municipal advisors.

Disclosure and Market Structure Initiatives

OMS's current efforts also include the development and implementation of important disclosure and market structure initiatives for the municipal securities market. On July 31, 2012, the Commission issued a Report on the Municipal Securities Market that recommended a number of possible actions to improve the municipal securities market in these two areas.⁸ In a June 2014 speech, Chair White discussed three of the 2012 Report's market structure recommendations with respect to the fixed income markets.⁹ First, Chair White explained that to assure that brokers are subject to meaningful obligations to achieve the best executions for investors in both corporate and municipal bond transactions, staff will be working closely with the MSRB as they finalize a robust best execution rule for the municipal securities market, and with FINRA and the MSRB as they work together to provide practical guidance on how brokers might effectively achieve best execution. Second, Chair White noted that to help investors better understand the cost of their fixed income transactions, staff will work with FINRA and the

⁷ Section 15A of the Securities Exchange Act of 1934 provides FINRA with authority to conduct examinations of its members' activities as registered municipal advisors in order to evaluate their compliance with the Exchange Act, rules and regulations thereunder, and MSRB rules. *See* 15 U.S.C. § 78o-3. In addition, pursuant to Exchange Act Section 15B (as amended by the Dodd-Frank Act), the Commission designated FINRA to examine its members' activities as registered municipal advisors and evaluate compliance by such members with federal securities laws, Commission rules and regulations, and MSRB rules applicable to municipal advisors. *See* 15 U.S.C. § 78o-4.

⁸ *See* U.S. SECURITIES AND EXCHANGE COMMISSION, REPORT ON THE MUNICIPAL SECURITIES MARKET (JULY 31, 2012), <https://www.sec.gov/news/studies/2012/munireport073112.pdf>.

⁹ Mary Jo White, Chair, SEC, Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors, Speech Before the Economic Club of New York (June 20, 2014), <https://www.sec.gov/News/Speech/Detail/Speech/1370542122012>.

MSRB in their efforts to develop rules regarding disclosure of markups in certain principal transactions for both corporate and municipal bonds. Third, Chair White explained that she asked the staff to focus on a regulatory initiative to enhance the public availability of pre-trade pricing information in the fixed income markets, particularly with respect to smaller retail-size orders. This initiative would require the public dissemination of the best prices generated by alternative trading systems and other electronic dealer networks in the corporate and municipal bond markets.

Steady progress has been made on these initiatives. The MSRB filed a proposed rule change to require brokers, dealers, and municipal securities dealers to seek best execution of customer transactions in municipal securities, and the Commission approved the rule change.¹⁰ In addition, the MSRB and FINRA have issued related practical guidance on their respective best execution rules. The MSRB and FINRA also have filed proposed rule changes with the Commission to require broker-dealers to disclose markups and markdowns to retail customers on certain principal transactions for municipal, corporate debt, and agency debt securities. In addition, OMS continues to work with the Division of Trading and Markets to consider ways to enhance the public availability of pre-trade pricing information for municipal and corporate bonds.

With respect to the 2012 Report's disclosure recommendations, the Division of Enforcement's Municipalities Continuing Disclosure Cooperation (MCDC) Initiative has focused significant attention on compliance with the continuing disclosure requirements of Rule 15c2-12 and disclosure practices more generally. Announced in March 2014, MCDC is a self-reporting

¹⁰ See Order Granting Approval of a Proposed Rule Change Consisting of Rule G-18, on Best Execution of Transactions in Municipal Securities, and Amendments to Rule G-48, on Transactions with Sophisticated Municipal Market Professionals ("SMMP"), and Rule D-15, on the Definition of SMMP, Exchange Act Release No. 73764, 79 Fed. Reg. 73658 (December 11, 2014), <https://www.sec.gov/rules/sro/msrb/2014/34-73764.pdf>.

program designed to encourage underwriters and municipal issuers to self-report federal securities law violations involving issuers' inaccurate certifications in their municipal bond offerings of their compliance with their continuing disclosure obligations. The federal securities law violations reported by underwriters and issuers pursuant to the MCDC Initiative have provided OMS with valuable information as to how Rule 15c2-12 is working, which in turn will help us determine where to best channel our efforts going forward.

In addition, OMS will continue assisting with the development of disclosure and market structure initiatives recommended for potential further consideration by the Commission in the 2012 Report.

Regulatory Coordination

OMS regularly coordinates with other regulators of municipal securities. OMS acts as the Commission's liaison to the MSRB, FINRA, the Internal Revenue Service's (IRS) Office of Tax-Exempt Bonds, the Department of the Treasury's Office of State and Local Finance, a variety of investor and industry groups, and regulators on municipal securities issues. OMS interacts closely with the MSRB and is responsible for reviewing and processing all MSRB rule filings on behalf of the Commission. OMS communicates with the MSRB Chairman, Board, and staff concerning MSRB activities, market developments, and potential improvements of MSRB systems that either collect information for regulators or provide information to the public.

OMS staff also continues to lead semiannual meetings with the MSRB and FINRA regarding the municipal securities market, as required by the Dodd-Frank Act; meets with MSRB and FINRA staff regularly to discuss rulemaking, examination, and enforcement activities; meets with IRS staff to discuss market risks, practices, and events relating to tax-exempt bonds and municipal securities; and has coordinated with banking and other regulators. OMS also continues

to work closely with the municipal securities industry to educate state and local governmental officials and conduit borrowers about the Commission's rules and to foster a thorough understanding of the Commission's policies among all market participants.

FY 2017 Budget Request

OMS's budget request for FY 2017 seeks to continue and expand on OMS's efforts to provide effective oversight of the municipal securities market, as set forth above. OMS's workload is anticipated to grow due to the expanding responsibilities of OMS and the offices OMS directly supports, such as the Office of Compliance Inspections and Examinations and the Division of Enforcement. Specifically, OMS's budget request for FY 2017 seeks to:

- Continue to implement the final rules for municipal advisor registration by monitoring and improving the SEC's registration system for municipal advisors, participating in the review of municipal advisor registrations, reviewing and processing MSRB rule filings related to municipal advisor regulation, advising the Office of Compliance Inspections and Examinations regarding municipal advisor examinations, coordinating with the MSRB and FINRA to help promote fair and uniform application of new rules applicable to municipal advisors, and providing interpretive guidance to those market participants who may be required to register as municipal advisors;
- Continue its oversight of MSRB rule filings and regulatory coordination with the MSRB concerning MSRB activities, market developments, and potential improvements of MSRB systems that either collect information for regulators or provide information to the public;
- Provide increased support to other SEC divisions and offices with respect to examinations and enforcement relating to the municipal securities market;

- Continue to monitor current developments and emerging risks in the municipal securities market and communicate OMS's observations and conclusions to other SEC offices and divisions and other regulators for possible regulatory responses; and
- Continue to work closely with the municipal securities industry to educate state and local governmental officials and conduit borrowers about the Commission's rules and foster a thorough understanding of the Commission's policies among market participants.

Conclusion

OMS will continue its efforts to provide effective oversight of the municipal securities market guided by the Commission's mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation.

Thank you, and I would be happy to answer your questions.



Testimony of Lynnette Kelly
Executive Director, Municipal Securities Rulemaking Board
Before the Capital Markets and Government Sponsored Enterprises Subcommittee of the
House Financial Services Committee
Hearing on “Examining the Agenda of Regulators, Self-Regulatory Organizations and Standards-
Setters for Accounting, Auditing and Municipal Securities”
September 22, 2016

On behalf of the Municipal Securities Rulemaking Board (MSRB), we appreciate this opportunity to provide testimony to the Capital Markets and Government Sponsored Enterprises Subcommittee of the House Financial Services Committee for the hearing entitled, “Examining the Agenda of Regulators, Self-Regulatory Organizations (SROs), and Standards-Setters for Accounting, Auditing and Municipal Securities.” The MSRB regulates the \$3.8 trillion municipal securities market with approximately one million bonds outstanding, 35,000 daily trades and over \$11 billion in par value traded every day. About two-thirds of municipal bonds are held by retail investors either directly or through mutual funds. Municipal bonds finance most infrastructure projects across the United States and are issued by more than 50,000 different state and local governments and issuing authorities.

You have asked that we focus our testimony on the MSRB’s 2017 agenda; its relationship with the Financial Industry Regulatory Authority (FINRA) and relationship with and oversight by the Securities and Exchange Commission (SEC); our use of economic impact guidance; and how the MSRB’s initiatives are consistent with its mission to, among other things, promote market transparency. This testimony will address each of those issues, including progress the MSRB has made on market transparency efforts as part of rulemaking, transparency and education initiatives the MSRB has completed since the 2012 SEC Report on the Municipal Securities Market. Since that report, the MSRB, with oversight from the SEC, has made purposeful, significant and effective strides in fostering a greatly enhanced level of transparency in the municipal securities market.

I. About the MSRB

Congress established the MSRB in 1975 under the Securities Exchange Act of 1934 as an SRO with a mandate to regulate the activities of broker-dealers and bank dealers (collectively, “dealers”) that buy, sell and underwrite municipal securities. The MSRB is a 501(c)(6) organization governed by a 21-member board of directors that has a majority of public members, in addition to representatives of regulated entities. The MSRB is overseen by both Congress and the SEC, and its rules generally must be approved by the SEC before becoming

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effective. The MSRB's mission is to protect investors, state and local government issuers, other municipal entities and the public interest by promoting a fair and efficient municipal market through: (1) establishing rules for dealers and municipal advisors; (2) collecting and disseminating market information; and (3) engaging in market leadership, outreach and education.

MSRB rules can be categorized as: (1) professional qualification rules that establish core standards for conducting business; (2) fair practice rules that protect investors, municipal entities, obligated persons and the general public; (3) uniform practice rules that ensure consistent behavior of regulated entities in the marketplace; (4) market transparency rules that provide for the complete and timely flow of information to the marketplace; and (5) regulated entity administration rules that set internal requirements for firms. The MSRB is not authorized to examine for compliance with or to enforce these rules; rather, the MSRB plays a supporting role to the regulatory agencies that do enforce its rules, including the SEC, FINRA and bank regulators. That supporting role entails providing training on MSRB rules for examiners, analyzing and sharing market data, providing rule interpretations, sponsoring a dedicated website that gives enforcement agencies direct access to information on dealer activities (Regulator Web), and preparing routine and customized data reports.

Congress expanded the MSRB's authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to include the regulation of municipal advisors—professionals that municipal entities may hire to act in a fiduciary capacity to provide advice regarding the issuance of municipal bonds or on municipal financial products. Simultaneous with this new authority to regulate municipal advisors, Congress expanded the MSRB's original mandate to protect investors to include the protection of municipal entities. Currently, the MSRB is regulating 675 registered municipal advisor firms and 1,454 registered dealers.

It is important to note that neither the MSRB's original mandate nor expanded mandate to protect municipal entities authorizes the MSRB to regulate issuers of municipal securities. MSRB rules apply only to dealers and municipal advisors. Therefore, in order to fulfill its mandate to protect investors and municipal entities beyond the protection afforded by its rules for financial professionals, the MSRB engages in two additional activities: supporting market transparency, and conducting education and outreach.

With respect to market transparency, the MSRB provides free, public access through its Electronic Municipal Market Access (EMMA[®]) website to municipal bond offering documents, continuing disclosures, trade data, credit ratings and other information. Through the EMMA platform, issuers and investors can better understand the trading activity, terms, characteristics, pricing and risks of a particular municipal security, and retail and professional investors enjoy equal access to this information.

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Through its education program, the MSRB serves as a trusted and objective resource on the municipal market. Its education efforts include frequent presentations and outreach to market stakeholders, including investors, issuers, dealers, municipal advisors and others, on rulemaking developments and market information. The online MSRB Education Center organizes resources by topic and target audience providing videos, webinars, fact sheets and a significant library of educational resources.

The MSRB recognizes the great responsibility of having been entrusted with regulation of the \$3.8 trillion municipal securities market, and part of fulfilling that trust is a meticulous organizational focus on internal operations and prudent financial management. The MSRB's operations are funded primarily by assessments and fees on regulated entities: dealers and municipal advisors engaged in municipal securities activities and municipal advisory activities. The MSRB also receives revenue for subscriptions to certain market data products. Although the MSRB does not enforce its own rules, the SEC and FINRA share with the MSRB, according to statute, a portion of the fine revenues they assess and collect for violations of MSRB rules, which the MSRB applies to market transparency and education but not to rulemaking efforts.

To assure proper stewardship of the assessments and fees collected each year, the MSRB Board of Directors sets the organization's strategic direction—which entails a comprehensive strategic review every two years, and approval of a strategic plan and operating plan each year—and reviews organizational performance each quarter. The MSRB's strategic and operating plans are living documents that are modified based upon changing market conditions and policy developments, and closely followed. These plans inform an internal controls framework for risk management.

One result of consistent internal reviews and Board oversight has been the rebate of fees and assessments to regulated entities when certain budget targets were met. In 2014, the MSRB distributed a discretionary technology fee rebate to eligible dealers because the technology fund had reached targeted levels. In 2015, the MSRB undertook a holistic review of fees and at its July 2016 board meeting, approved a rebate distribution of excess reserves that had resulted from underwriting and trading volumes that exceeded budgeted levels as well as careful management of expenses.

II. Coordination with the SEC and FINRA

The MSRB undertakes significant coordination efforts on both a statutorily mandated and prudential basis with the SEC, FINRA and banking regulators, all of which enforce MSRB rules. The MSRB and the SEC meet on a monthly basis for discussions led by either the Office of Municipal Securities or the Office of Compliance Inspections and Examinations and attended by professionals across SEC departments. Semiannually, as required by the Dodd-Frank Act, the MSRB, SEC and FINRA meet jointly to discuss regulatory activities and share information about interpretations of MSRB rules and the examination and enforcement of compliance with those rules. The MSRB, SEC and FINRA also meet annually regarding the registration and examination

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of municipal advisors. Finally, FINRA and the MSRB meet on a bimonthly basis to discuss FINRA's surveillance program, areas of potential MSRB rulemaking, technology and FINRA's risk-based examination program, and on an annual basis to collaborate on an annual risk-based examination plan and for a closing meeting to discuss significant findings and report on disciplinary actions. The MSRB meets on a semiannual basis with bank regulatory agencies as well to review recent rulemaking initiatives.

These coordination efforts, supplemented by ongoing conversations and a periodic regulator summit hosted by MSRB to share key information among all relevant regulators, have only increased in the wake of a significant effort to consider and act upon, as appropriate, the recommendations of the SEC's 2012 Report on the Municipal Securities Market (2012 Report). These information-sharing initiatives greatly assist the MSRB as it does not have "boots on the ground" for auditing or enforcement and might not have first-hand knowledge of whether the effectiveness of its rules is being eroded or whether more training, education or guidance is needed. Not only do the discussions among regulators reveal where new or stronger rules may be needed, but they also help the MSRB improve, consolidate and harmonize its rules with other regulators, where appropriate, resulting in greater regulatory efficiency.

III. MSRB Progress on Market Transparency and Regulatory Efficiency

The SEC's 2012 Report set an important tone and direction for policymaking in the municipal securities arena. Two broad objectives of that report were enhancing market structure and improving disclosure practices—both of which are designed to improve market transparency. In fulfilling those objectives, the MSRB has sought to promote regulatory efficiency both through the integration of economic analysis in its rulemaking process and the consolidation of or improvements to existing rules for the sake of clarity and reducing undue burdens on regulated entities. Attached to this testimony is a comprehensive MSRB "report card" that shows progress the MSRB has made on numerous initiatives aligned with recommendations of the 2012 Report. These include nine new EMMA features to give retail investors better access to pricing and other information on municipal securities; six new EMMA features to facilitate improved disclosure practices; six rules codified, revised or clarified to promote regulatory efficiency; and the development of best execution, mark-up disclosure and other rules. This testimony highlights the MSRB's progress on those initiatives most relevant to the Committee's request that we focus on the topics of market transparency and regulatory efficiency.

A. Market Transparency

In February 2012, the MSRB published a Long-Range Plan for Market Transparency Products, which is currently being reviewed and updated as part of the MSRB's strategic planning process. The SEC's 2012 Report echoed many aspects of this plan and the MSRB has made progress on multiple fronts resulting in greater market transparency. Given the size and scope of the municipal market,¹ the MSRB achieves its market transparency objectives through

¹ On average, over \$10.4 billion in 35,000 trades exchanged hands every day through the first eight months of 2016.

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rulemaking, operation of the EMMA website and initiatives to encourage more timely and complete disclosure by municipal entities, as detailed below.

i. Market Transparency through Rulemaking

With respect to rulemaking that advances transparency, many rules are intended to ensure retail investors have a more transparent view of the market. In that regard, the MSRB has filed with the SEC for its approval a significant new rule on the topic of mark-up disclosures. The MSRB's rule filing proposes amendments to MSRB Rule G-15 that would require brokers, dealers and municipal securities dealers to disclose mark-ups and mark-downs to retail customers on certain principal transactions. The rule filing also proposes amendments to Rule G-30 to provide guidance to dealers on establishing the prevailing market price of a security for the purpose of calculating their compensation. Because of the significance of the proposed rule, the MSRB included extensive explanation of its intent with respect to how the rule would apply to different trading situations and the practical realities of the unique municipal market, which has approximately one million individual bonds outstanding, the majority of which do not trade frequently. The rule filing on mark-up disclosure was the result of coordination with FINRA and the SEC, and FINRA has filed a parallel proposal for corporate bonds with the SEC.

In another effort to protect investors and promote market efficiency, MSRB Rule G-18 on best execution of customer orders or inquiries became effective in December 2015. The rule requires brokers and dealers to use reasonable diligence to determine the best market for a customer's security and to buy or sell the security in that market so that the resulting price to the customer is as favorable as possible under prevailing market conditions. The best execution rule is designed to help ensure investors receive fair and reasonable prices for their transactions and better execution quality, while promoting fair competition among brokers and improving market efficiency. The MSRB coordinated closely with the SEC and FINRA in the development of this rule and the publication of implementation guidance to achieve consistency, as appropriate, in the obligations for the municipal and corporate bond markets, with the goal of promoting regulatory efficiency across the fixed income markets.

ii. Market Transparency through EMMA

The MSRB has undertaken significant efforts under its Long-Range Plan for Market Transparency Products to bolster municipal market transparency, primarily through its EMMA website, the official repository for information on virtually all municipal bonds. Launched in 2008, EMMA has since rapidly expanded the information it makes freely available to investors and others. By 2012, EMMA features included:

- A primary market disclosure service with official statements, preliminary official statements, related pre-sale document and advance refunding documents;
- A continuing disclosure service providing continuing disclosure documents submitted under Exchange Act Rule 15c2-12 and other voluntarily submitted documents;

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- A Real-Time Transaction Reporting System (RTRS)/EMMA trade price transparency service which generally disseminates all trade information within fifteen minutes of the time of trade;
- A feature dedicated to disclosures of political contributions;
- A short-term obligation rate transparency (SHORT) system; and
- Municipal market research services.

The MSRB has also enhanced EMMA by adding analytical tools and resources to improve retail investor access to market information, such as a price discovery tool to help investors find and compare prices of securities with similar characteristics; graphical displays to explore trade data, prices and trends; initial offering price and yield information; expanded access to credit ratings; advanced search functionality; an economic calendar with descriptions of upcoming macroeconomic developments that could have an impact on the trading and issuance of municipal securities; and the ability to receive EMMA alerts to stay current on newly available information about securities.

iii. Market Transparency through Encouraging Timely Disclosures

One key function served by EMMA is facilitating timely and complete disclosures on the part of municipal entities. When state and local governments issue most types of municipal securities, their underwriters are required under SEC Rule 15c2-12 to reasonably determine that the issuer, or other persons obligated to make payment on the securities, has agreed to provide ongoing disclosures that include updated financial information to investors using the MSRB's EMMA website. The financial and operating status of any issuer of municipal securities is likely to change over time. Whether the changes are positive or negative, disclosing timely, accurate and complete financial information is critical for issuers, investors and the municipal market. Through the first eight months of 2016, EMMA has made publicly available more than 40,000 audited financial statements or CAFRs (Comprehensive Annual Financial Reports) and Annual Financial Information and Operating Data disclosures. The MSRB does not regulate municipal entities, but has a mission to protect investors and municipal entities alike. As such, beyond the protections offered by its rules for financial professionals, the MSRB provides issuers with education resources through its Education Center on MSRB.org and special features on the EMMA website to facilitate timely disclosures, highlight key information and ensure municipal entities can access and monitor market data.

Issuers that regularly provide financial disclosures help protect their future access to capital through the municipal market. In this regard, the Education Center's section "For State and Local Governments" provides extensive resources on the topic of disclosing information to investors to aid issuers in their ability to identify required financial and operational disclosures, and establish disclosure policies and procedures. EMMA is also designed to encourage and facilitate the availability of these disclosures, with features that permit the scheduling of email reminders through EMMA for recurring disclosures and checklists to assist in the process of posting disclosures. The EMMA website also provides for customized issuer homepages that

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give investors access to consolidated information about each issuer's securities, providing a centralized view of trading activity, pre-sale documents, official statements, continuing disclosures and other information. The MSRB takes advantage of many outreach opportunities to stress the importance of complete and timely disclosures, and most recently provided a submission to the Congressional Task Force on Economic Growth in Puerto Rico to highlight the principles and practices Puerto Rico and any municipal securities issuer should consider to ensure timely and complete disclosures.

An emerging policy issue in this area is what the MSRB believes to be insufficient disclosure of bank loans by municipal entities. Bank loans and direct-purchase debt are increasingly used by municipal entities as financing alternatives to the public offering of municipal bonds to fund capital improvement projects or refund outstanding bonds. These debt obligations are not currently subject to the disclosure requirements of SEC Rule 15c2-12, and therefore disclosures about bank loans and alternative financings are not required to be submitted to EMMA. Nonetheless, the MSRB believes that the timely disclosure of material information about any debt or debt-like obligations held by issuers is essential to market transparency and to ensuring a fair and efficient municipal market. Without adequate disclosure of debt or debt-like obligations, bondholders could be unaware of the presence of bank loans that could have an impact on the seniority status of bondholders or could affect the credit or liquidity profile of an issuer. Given these concerns, the MSRB wrote to the SEC on January 20, 2015 requesting that the SEC review Rule 15c2-12 to identify ways to enhance the quality and timeliness of information made available to the municipal market, including with regard to a lack of disclosure of bank loans and direct-purchase debt.

In addition to this request, the MSRB published a Bank Loan Disclosure Market Advisory on January 29, 2015 to alert municipal market participants to the importance of voluntarily posting information on bank loans and other alternative financings to EMMA and to highlight the best practices of industry participants. Finally, on April 4, 2016, the MSRB and FINRA jointly provided guidance to remind broker-dealer firms of their obligations in connection with the private placement of municipal securities, even if such securities are labeled "bank loans."

B. Regulatory Efficiency Initiatives

i. Economic Analysis

A key element of the MSRB's efforts to enhance regulatory efficiency and strengthen the effectiveness of its rulemaking process is the further integration of economic analysis into its rulemaking process. In September 2013, the MSRB adopted a policy to more formally integrate economic analysis in its rulemaking process, following the SEC staff's adoption of such guidance in March 2012. The MSRB policy incorporates the principles of the SEC staff's guidance, and consistent with that guidance, identifies four elements of effective regulatory economic analysis:

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- 1) Identifying the need for a proposed rule and explaining how the rule will meet that need;
- 2) Articulating a baseline against which to measure the likely economic impact of the proposed rule;
- 3) Identifying and evaluating alternative regulatory approaches; and
- 4) Assessing the benefits and costs, both quantitative and qualitative, of the proposed rule and the main reasonable alternative regulatory approaches.

Bolstering the effectiveness of this policy, in 2014, the MSRB formed a Market Structure group to consolidate the organization's activities and functions related to market structure, market transparency, economic analysis, research and industry operations. The group includes economic and municipal market professionals with industry experience across disciplines, from trading to sales and operations, to help inform the MSRB's development of regulatory policy.

The MSRB seeks to integrate economic analysis at the earliest possible stages in the rulemaking process. This has allowed us to identify ways in which our rule proposals can be shaped to achieve the greatest benefit at the lowest cost and has helped to ensure that we seek and incorporate any relevant data into the Board's deliberations. If data is not available or costs and benefits cannot reasonably be quantified or quantification is impracticable, an explanation of that determination is included and a qualitative analysis is provided that highlights the strengths and limitations of the analysis. An example of the use of a qualitative analysis is the fact that the MSRB carefully evaluates, clarifies and discusses the potential impact of its rules on smaller-sized dealers and municipal advisor firms.

Economic analysis has helped to inform many MSRB rules, including the new municipal advisor regulatory regime and notably, the MSRB's new rule proposal referenced above that would require dealers to disclose mark-ups and mark-downs to retail customers on certain principal transactions and would provide guidance on prevailing market price for the purpose of calculating mark-ups and mark-downs. Initially, the MSRB proposed what was referred to as a "pricing reference proposal." Based on further analysis of that proposal and the comments received by the MSRB, the MSRB determined that a mark-up disclosure rule, such as the rule recently filed with the SEC for approval, would have comparable or greater benefits for retail investors in the municipal securities market than a pricing reference information disclosure requirement, with fewer costs to the market as a whole.

ii. Streamlining Rules

Further strengthening its regulatory efficiency initiative, the MSRB has undertaken a multi-year project to review and streamline its rule book. One outcome of this initiative was the consolidation of fair-pricing requirements for customer transactions, parts of which had previously been contained in three separate rules and various interpretive materials. A new, single fair-pricing rule was developed under MSRB Rule G-30, requiring dealers that transact municipal securities with or on behalf of customers to use a "fair and reasonable" standard for

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the pricing of the security and for any related commission or service charge. The consolidation did not make any substantive change to dealer pricing obligations. Other examples include, but are not limited to, updating procedures regarding open inter-dealer transactions to require a close-out no later than 20 days after settlement to reflect modern dealer operations (MSRB Rule G-12) and consolidation of multiple dealer and municipal advisor registration requirements into a single rule and form (MSRB Rule A-12).

Prior to writing a rule, the MSRB seeks to consider the effectiveness of alternatives that could affect a practice or behavior, including education, outreach, the issuance of best practices, the development of compliance tools, enhanced professional qualifications, more informed enforcement, new transparency products and interpretations. The MSRB engages in rulemaking consistent with its mission, but also seeks to harmonize its rules, where appropriate, with FINRA rules that apply to broker-dealer conduct in order to advance regulatory efficiency.

IV. The MSRB's 2017 Agenda

The MSRB's agenda for fiscal year (FY) 2017 is governed by its operating plan. It is noteworthy that in FY 2016, the MSRB completed implementation of its core regulatory framework for municipal advisors as authorized by the Dodd-Frank Act, including rules for registration, professional standards of conduct, recordkeeping, professional qualifications; fair dealing; prevention of acts not consistent with a fiduciary duty; supervision and compliance obligations; pay-to-play rules; and gift limitations. MSRB Chair Nathaniel Singer detailed these accomplishments in a September 19, 2016 letter to the Chairs and Ranking Members of the House Financial Services and Senate Banking Committees.

For FY 2017, the MSRB will consider additional requirements to supplement the core municipal advisor regulatory regime and continue to focus on improvements to market transparency. The Board has approved making third-party yield curves available on EMMA, adding a calendar of new municipal bond issues, enhancing the EMMA user experience and exploring the publication of pre-trade market data on EMMA. The MSRB also plans to continue its regulatory efficiency initiative and begin to study the impact of its recently developed municipal advisor regulations.

In a significant new initiative, the MSRB will be enhancing its education program with a new municipal market education platform. Early in September, the MSRB launched MuniEdProSM, a suite of interactive, online courses about municipal market activities and regulations that allow the user to apply MSRB rules to real-world scenarios. This new platform seeks to fulfill a need for professional continuing education resources for the industry, and is also available to any other user interested in increased understanding of the market. Education is key to the MSRB's regulatory efficiency initiatives because outreach and education on existing rules could inform or even limit the need for new rules.

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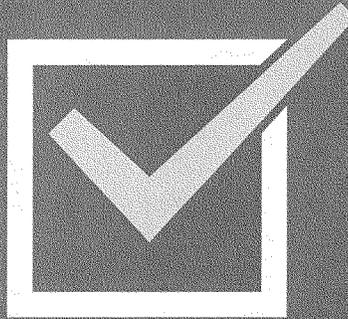
V. Conclusion

The MSRB is pleased to have the opportunity to testify before the Committee today. The MSRB has made significant strides toward municipal securities industry transparency through regulation, EMMA enhancements and education initiatives, including regular communications with state and local government issuers about full and timely disclosures, with an eye towards ensuring we use every means available under the current regulatory framework to strengthen the timeliness and completeness of municipal market disclosures. The MSRB intends to continue to review its existing rules and use economic analysis to inform new rulemaking. These commitments are reflected in our FY 2017 agenda, and we look forward to being available to this Committee to answer questions and identify areas for continued improvement in market regulation and market practices.

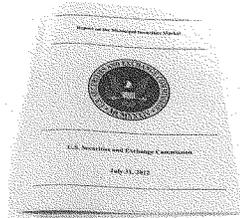


MSRB Report Card

Initiatives Aligned with Recommendations of
SEC's 2012 Report on the Municipal Securities Market



February 2016



Since 1975, the Municipal Securities Rulemaking Board (MSRB) has been entrusted by Congress to protect municipal securities investors. Informed by the recommendations of the Securities

and Exchange Commission's (SEC) comprehensive 2012 Report on the Municipal Securities Market, the MSRB is building on its strong regulatory foundation to better protect investors. Broadly, the MSRB's current initiatives align with the report's recommendations on market structure and disclosure, with a focus on regulatory cooperation and efficiency.

This report card demonstrates the substantial progress the MSRB has made toward addressing these objectives. The report card also identifies new investor protection initiatives under development.

OBJECTIVES

Enhance Market Structure	1
Improve Disclosure Practices	3
Promote Regulatory Efficiency	4

ABOUT THE MSRB

The MSRB protects investors, state and local governments and other municipal entities, and the public interest by promoting a fair and efficient municipal securities market. The MSRB fulfills this mission by regulating the municipal securities firms, banks and municipal advisors that engage in municipal securities and advisory activities. To further protect market participants, the MSRB provides market transparency through its [Electronic Municipal Market Access \(EMMA®\) website](http://www.fmmma.com), the official repository for information on all municipal bonds. The MSRB also serves as an objective resource on the municipal market, conducts extensive education and outreach to market stakeholders, and provides market leadership on key issues. The MSRB is a Congressionally-chartered, self-regulatory organization governed by a 21-member board of directors that has a majority of public members, in addition to representatives of regulated entities. The MSRB is subject to oversight by the Securities and Exchange Commission.

OBJECTIVE: ENHANCE MARKET STRUCTURE

The MSRB has taken meaningful steps to increase price transparency in the municipal securities market and continues to work to enhance the availability of more robust pricing information for the benefit of retail investors.

SEC REPORT RECOMMENDATIONS	MSRB INITIATIVES
<p>The MSRB should promptly pursue enhancements to its EMMA website so that retail investors have better access to pricing and other municipal securities information.</p>	<ul style="list-style-type: none"> <input checked="" type="checkbox"/> Created Price Discovery Tool on EMMA to help investors find and compare prices of securities with similar characteristics <input checked="" type="checkbox"/> Created trade detail graphs on EMMA that plot dealer and customer trade prices to facilitate identification of pricing differentials <input checked="" type="checkbox"/> Developed graphical display of historical trade data to help EMMA users visualize trading trends <input checked="" type="checkbox"/> Incorporated new issuance data into EMMA Market Statistics section <input checked="" type="checkbox"/> Introduced MyEMMA customized user accounts to enhance investor access to EMMA information through email subscription services <input checked="" type="checkbox"/> Provided display of initial offering price and yield on EMMA <input checked="" type="checkbox"/> Amended MSRB rules to display in real-time on EMMA par value on all transactions of \$5 million or less <input checked="" type="checkbox"/> Expanded access to credit ratings on EMMA with addition of Kroll Bond Rating Agency and Moody's Investors Service <input checked="" type="checkbox"/> Provided free educational webinars and tutorials on using EMMA features <input checked="" type="checkbox"/> Improved calculation of bid-to-cover ratios for auction rate securities
<p>The Commission and the MSRB could consider ways to encourage the use of ATSs or similar electronic networks that widely disseminate quotes and provide fair access.</p>	<ul style="list-style-type: none"> <input checked="" type="checkbox"/> New MSRB Rule G-18 on best execution should promote broader use of ATSs

OBJECTIVE: **ENHANCE MARKET STRUCTURE** (continued)

SEC REPORT RECOMMENDATIONS	MSRB INITIATIVES
<p>The MSRB should consider a rule that would require municipal bond dealers to seek "best execution" of customer orders for municipal securities.</p>	<p><input checked="" type="checkbox"/> Created new MSRB Rule G-18 on "best execution" of customer orders for municipal securities</p> <p><input checked="" type="checkbox"/> Published best execution guidance for dealers</p>
<p>The MSRB could consider rules requiring a brokers' broker with material transaction or dollar volume in municipal securities to publicly disseminate the best bid and offer prices on any electronic network it operates and, on a delayed and non-attributable basis, responses to "bids wanted" auctions.</p>	<p><input checked="" type="checkbox"/> Collected extensive public feedback on developing a central transparency platform for pre- and post-trade data</p> <p><input type="checkbox"/> Collecting and analyzing voluntary pre-trade data from ATSs and broker's brokers</p>
<p>The Commission and the MSRB should consider initiatives to improve the understanding of retail investors as to the various ways they might buy or sell a municipal bond, and relative advantages and disadvantages of each.</p>	<p><input checked="" type="checkbox"/> Published educational materials for retail investors on the way bonds are bought and sold</p>
<p>The MSRB should consider issuing more detailed interpretive guidance to assist dealers in establishing the "prevailing market price" for a municipal security, for purposes of determining whether the price offered a customer (including any markup or markdown) is fair and reasonable.</p>	<p><input checked="" type="checkbox"/> Issued draft guidance to assist dealers in establishing the "prevailing market price" of a municipal security</p>
<p>The MSRB should consider requiring municipal bond dealers to disclose to customers, on confirmations for riskless principal transactions, the amount of any markup or markdown.</p>	<p><input type="checkbox"/> Continuing collaboration with FINRA on next steps in developing confirmation disclosure requirements</p>
<p>The MSRB could consider requiring municipal bond dealers to report "yield spread" information to its Real-Time Transaction Reporting System to supplement existing interest rate, price and yield data.</p>	<p><input type="checkbox"/> Pursuing addition of yield curve(s) on EMMA</p>

OBJECTIVE: IMPROVE DISCLOSURE PRACTICES

Since 2009, the MSRB has worked to help improve disclosure practices of municipal securities issuers through the operation and enhancement of its EMMA website. In recent years, the MSRB has played a leading role in educating issuers about disclosure best practices and has helped build consensus on issuer disclosure of all types of debt.

SEC REPORT RECOMMENDATIONS	MSRB INITIATIVES
<p>The Commission should continue to work with the MSRB to enhance EMMA.</p>	<ul style="list-style-type: none"> <input checked="" type="checkbox"/> Created automated email reminders to assist issuers with timely filing of periodic financial disclosures to EMMA <input checked="" type="checkbox"/> Launched pilot feature on EMMA to provide issuers with unique homepages to enhance accessibility of disclosures <input checked="" type="checkbox"/> Integrated political contribution disclosures on EMMA, including disclosures concerning bond ballot campaigns <input checked="" type="checkbox"/> Enhanced EMMA search functionality to facilitate access to disclosures <input checked="" type="checkbox"/> Added feature to help investors locate information about securities that receive new security identifiers following changes to payment of debt service <input checked="" type="checkbox"/> Integrated municipal asset-backed security disclosures from SEC Form ABS-15G on EMMA
<p>Municipal market participants should follow and encourage others to follow existing industry best practices and expand and develop additional best practice guidelines in a number of areas to enhance disclosures and disclosure practices in the municipal securities market.</p>	<ul style="list-style-type: none"> <input checked="" type="checkbox"/> Released market advisory to help issuers understand practices in submitting of financial disclosures to EMMA <input checked="" type="checkbox"/> Produced multimedia educational resources on financial disclosure, including a podcast reviewing the requirements under SEC Rule 15c2-12 and resources on using EMMA to comply <input checked="" type="checkbox"/> Published market advisories calling for additional transparency of undisclosed bank loans, additional debt in any form and debt-like obligations <input checked="" type="checkbox"/> Published directory of industry resources about disclosure best practices
<p>The Commission could consider amendments to Exchange Act Rule 15c2-12 to further improve the disclosures made regarding municipal securities.</p>	<ul style="list-style-type: none"> <input checked="" type="checkbox"/> Provided comment letter to SEC offering assistance in review of Rule 15c2-12 to ensure it reflects current market practices, including increasing reliance on bank loans

OBJECTIVE: PROMOTE REGULATORY EFFICIENCY

The MSRB promotes regulatory efficiency by ensuring that new and existing municipal securities regulations function as efficiently as possible and are consistent with those of other regulators as appropriate.

SEC REPORT RECOMMENDATIONS	MSRB INITIATIVES
<p>The Commission should continue the collaborative work with the MSRB, especially in identifying potential rule changes or new rules that could address some of the issues discussed in this Report.</p>	<p><input checked="" type="checkbox"/> Revised MSRB Rule G-19 to generally harmonize its provisions with FINRA's suitability rule</p>
	<p><input checked="" type="checkbox"/> Codified existing Rule G-17 guidance on the time-of-trade disclosure obligations of dealers</p>
	<p><input checked="" type="checkbox"/> Clarified retail order periods to ensure issuers can provide investors with access to bonds in the primary market and required underwriters to communicate issuer's retail order requirements to the syndicate</p>
	<p><input checked="" type="checkbox"/> Amended MSRB Rule G-11 to limit dealers from consenting to amendments to bond authorizing documents for municipal securities except in limited circumstances</p>
	<p><input checked="" type="checkbox"/> Amended MSRB Rule G-39 on telemarketing to more closely align with similar rules of the Federal Trade Commission</p>
	<p><input checked="" type="checkbox"/> Adopted new fair pricing Rule G-30 that combines elements of Rule G-18 and former Rule G-30, and incorporates Rule G-17 interpretive guidance on fair pricing</p>
	<p><input checked="" type="checkbox"/> Conducted review of uniform practice rules to identify opportunities for modernization of outdated or redundant regulations</p>



Visit the "Market Leadership" area of the MSRB's website at www.msrb.org to read more about the MSRB's investor protection initiatives related to:

- Market Structure
- Municipal Market Disclosure
- Regulatory Efficiency



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Questions for the Record from U.S. Representative Ed Royce (R-Cal.)
House Committee on Financial Services, Subcommittee on Capital Markets and
Government Sponsored Enterprises

Hearing: “Examining the Agenda of Regulators, SROs, and Standards-Setters for Accounting,
Auditing, and Municipal Securities”

September 22, 2016

Ms. Jessica Kane, Director, Office of Municipal Securities, U. S. Securities and Exchange Commission

- 1. In drafting the municipal advisor definitional rule, why did the SEC abandon the approach that exists for many other regulated entities like broker dealers and registered investment advisors, where a firm must be engaged to provide relevant services, in some cases for compensation, before being treated as a regulated entity?**

Response:

Section 15B(e)(4) of the Securities Exchange Act of 1934 (“Exchange Act”) defines the term “municipal advisor” to mean a person (who is not a municipal entity or an employee of a municipal entity) that (i) provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues, or (ii) undertakes a solicitation of a municipal entity.¹ In the 2013 Adopting Release for the Commission’s final rules for municipal advisor registration², the Commission noted that, in defining the term municipal advisor in Exchange Act Section 15B(e)(4), Congress did not distinguish between persons who are compensated for providing advice and those who are not. Accordingly, as stated in the 2013 Adopting Release, the Commission believes compensation for providing advice with respect to municipal financial products or the issuance of municipal securities should not factor into the determination of whether a person must register with the Commission as a municipal advisor.³

However, as the Commission stated in the 2013 Adopting release, whether or not a person would have to register as a municipal advisor in connection with solicitation of a municipal entity or obligated person would depend upon whether such person receives compensation (direct or indirect).⁴ The Exchange Act definition of “solicitation of a municipal

¹ *C.f.* Exchange Act Section 3(a)(4) (defining “broker”), Exchange Act Section 3(a)(5) (defining “dealer”), and Investment Advisers Act of 1940 Section 202(a)(11) (defining “investment adviser”).

² See Release No. 34-70462, *Registration of Municipal Advisors* (2013 Adopting Release) (September 20, 2013); 78 Fed. Reg. 67467 (November 12, 2013), available at <http://www.sec.gov/rules/final/2013/34-70462.pdf>.

³ 2013 Adopting Release, 78 Fed. Reg. at 67477.

⁴ *Id.*

entity or obligated person” provides that the solicitation must be performed for direct or indirect compensation.⁵ Accordingly, as stated in the 2013 Adopting Release, persons that are not compensated for soliciting a municipal entity or obligated person would not be required to register as municipal advisors.⁶ The Commission also noted that Commission staff has broadly construed the term “direct or indirect compensation” in other contexts and other regulatory agencies have interpreted indirect compensation to include nonmonetary compensation.⁷

2. Under current regulations, do you believe that municipal issuers are required to retain a municipal advisor? Would you support legislation to clarify whether they are?

Response:

The Commission’s final municipal advisor registration rules do not require municipal issuers to retain a municipal advisor. The Commission’s final rules interpret the statutory definition of the term municipal advisor, interpret the statutory exclusions from that definition, and provide certain additional regulatory exemptions. The Commission’s final rules require municipal advisors to register with the Commission and establish a registration regime for municipal advisors. The Commission’s final rules also require municipal advisors to make and maintain certain books and records.

Mr. Wesley R. Bricker, Interim Chief Accountant, Office of the Chief Accountant, U. S. Securities and Exchange Commission.

1. Mr. Bricker, should FASB be required to employ a cost-benefit analysis when issuing new standards?

Response:

The Financial Accounting Standards Board (FASB) is the designated independent standard setter for U.S. public companies. The FASB’s mission is to establish and improve financial accounting and reporting standards to provide useful information to investors and other users of financial reports. A key principle guiding the FASB Board’s work is to issue standards

⁵ Exchange Act Section 15B(e)(9) provides that the term “solicitation of a municipal entity or obligated person” means “a direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation, on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser (as defined in section 202 of the Investment Advisers Act of 1940 [15 U.S.C. 80b-2]) that does not control, is not controlled by, or is not under common control with the person undertaking such solicitation for the purpose of obtaining or retaining an engagement by a municipal entity or obligated person of a broker, dealer, municipal securities dealer, or municipal advisor for or in connection with municipal financial products, the issuance of municipal securities, or of an investment adviser to provide investment advisory services to or on behalf of a municipal entity.”

⁶ 2013 Adopting Release, 78 Fed. Reg. at 67501.

⁷ *Id.*

when the expected benefits of improved information justify the perceived costs of preparing and providing that information.⁸ The FASB has developed a Cost-Benefit Analysis summary that describes how the consideration of benefits and costs is integrated throughout the FASB's standards-setting process.⁹ Throughout the stages of a project, the FASB's procedures are designed to generate feedback about the costs and benefits of a proposed new standard. Prior to implementation, every proposal is exposed for public comment and discussed with stakeholders. Finally, decisions by the FASB Board are made in public meetings after careful consideration of comments from stakeholders.

2. We can all agree that external audits play a vital role in capital formation and well-functioning financial markets. The PCAOB's overarching mission is to maintain and improve audit quality for public companies and now broker-dealers. It is my understanding that broker-dealers typically do not use a public company structure. How does PCAOB deal with this different type of business model?

Response:

In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") amended certain provisions of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"). The amendments gave the Public Company Accounting Oversight Board (PCAOB) explicit authority over audits of SEC registered broker-dealers. As a result, in 2011, the PCAOB adopted amendments to its funding rule to provide for allocation of the accounting support fees between issuers and broker-dealers.¹⁰ In addition, the PCAOB set up a temporary inspection program to inspect audits of broker-dealers under its Rule 4020T.¹¹ Since 2011, the PCAOB has inspected audits of SEC-registered broker-dealers under its interim-inspection program and has issued five annual reports on the progress of its interim inspection program.¹²

Unlike public company audits that are required to be conducted under PCAOB standards, until June 2014 audits of broker-dealers were conducted under AICPA Generally Accepted Auditing Standards (GAAS). In 2013, the Commission amended its Rule 17a-5 – *Reports to Be Made by Certain Exchange Members, Brokers, and Dealers*, which includes the reporting requirement for an audited annual report to be filed with the SEC. The amendments became effective in June 2014 and, among other changes, required the audit to be conducted in

⁸ See *Cost-Benefit Analysis*, available at <http://www.fasb.org/cs/ContentServer?c=Page&pagename=FASB%2FPAGE%2FSectionPage&cid=1351027336339>.

⁹ *Id.*

¹⁰ See PCAOB Release No. 2011-002, *Final Rules for Allocation of the Board's Accounting Support Fee Accounting Among Issuers, Brokers, and Dealers, and other Amendments to the Board's Funding Rules*, available at https://pcaobus.org/Rulemaking/Docket033/PCAOB_Release_2011-002_Rules.pdf

¹¹ See PCAOB Rule 4020T available at https://pcaobus.org/Rules/Pages/Section_4.aspx

¹² See PCAOB Release No. 2016-004, *PCAOB Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers* (August 18, 2016), available at <https://pcaobus.org/Inspections/Documents/BD-Interim-Inspection-Program-2016.pdf>

accordance with PCAOB standards.¹³ By requiring broker-dealer audits to be conducted in accordance with the PCAOB standards, the amendments recognized the PCAOB's explicit oversight over broker-dealer audits as established by the Dodd-Frank Act. For instance, in 2013, the PCAOB proposed and adopted two attestation standards specific to broker-dealer reporting.¹⁴

Further, the PCAOB in carrying out its standard-setting and oversight functions, considers the business and risk characteristics of the broker-dealers. For example, in the recently adopted auditing standard on improving the transparency of audits, the PCAOB did not extend Form AP filing requirements to broker-dealers in light of the typical ownership structure of such entities.¹⁵ As noted in the PCAOB's annual inspection report, the Board is continuing to take a careful and informed approach in establishing a permanent inspection program taking into account the complexity and diversity of broker-dealers, the risk of loss to customers and audit, attestation and other deficiencies that have been identified during the inspections under interim inspection program. Further, the PCAOB staff is currently working to develop a rule proposal for the Board to consider during 2016 to establish a permanent inspection program.¹⁶

- 2. Mr. Bricker, what is the status of efforts to converge the GAAP and IFRS accounting standards?**
 - a. How will the convergence of international financial reporting standards benefit the U.S. economy?**
 - b. What are the current impediments to convergence to a single standard?**
 - c. Has the International Accounting Standards Board been receptive to converging GAAP and IFRS, or do you believe they are attempting to have IFRS adopted by the United States?**

The Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB") have completed the convergence projects currently contemplated to date. The result is that there have been increases in the level of converged accounting in priority areas such as business combinations, leases, revenue recognition, fair value measurement, and credit impairments.

¹³ See Release No. 70073, *Broker-Dealer Report* (July 30, 2013) available at: <https://www.sec.gov/rules/final/2013/34-70073.pdf>

¹⁴ See PCAOB Release No. 2013-007, *Standards For Attestation Engagements Related To Broker And Dealer Compliance Or Exemption Reports Required By The U.S. Securities And Exchange Commission And Related Amendments To PCAOB Standards* (October 10, 2014), available at https://pcaobus.org/Rulemaking/Docket035/PCAOB_Release_2013_007.pdf

¹⁵ See PCAOB Release No. 2015-08, *Improving The Transparency Of Audits: Rules To Require Disclosure Of Certain Audit Participants On A New PCAOB Form And Related Amendments To Auditing Standards* (December 15, 2015) available at <https://pcaobus.org/Rulemaking/Docket029/Release-2015-008.pdf>

¹⁶ See PCAOB Release No. 2016-004, *Annual Report On The Interim Inspection Program Related To Audits Of Brokers And Dealers* (August 18, 2016), available at <https://pcaobus.org/Inspections/Documents/BD-Interim-Inspection-Program-2016.pdf>

For background, in 2002, the FASB and the IASB executed the Norwalk Agreement, which established the Boards' shared goal of developing compatible, high-quality accounting standards that could be used for both domestic and cross-border financial reporting.¹⁷ The Norwalk Agreement also provided the means by which this goal could be achieved – through joint standard development, eliminating differences whenever possible, and maintaining existing convergence once converged. This shared goal was reaffirmed in 2006 when the Boards executed a Memorandum of Understanding (the "MoU") that described the progress they hoped to achieve.¹⁸ This MoU was further reaffirmed and updated in 2008 and established convergence goals extending through 2011.¹⁹ The FASB and the IASB have been receptive to and engaged in significant convergence efforts and, as noted above, have completed the convergence projects currently contemplated.

Convergence is a means to achieve and maintain high-quality, globally-accepted accounting standards that enhance the comparability of financial reporting both domestically and across borders. The FASB's efforts to improve U.S. GAAP have benefited from the international perspectives gained through its interactions with the IASB. In revising U.S. GAAP, the FASB seeks to provide investors with transparent decision-useful information, including improving the level of convergence with IFRS standards where appropriate.

Since the end of 2015, SEC staff has emphasized the need for maintaining convergence where standards are currently converged.²⁰ SEC staff has further emphasized the need for the Boards to continue collaborating and having dialogue regarding their respective standard setting work, and focusing on maintaining and increasing convergence wherever possible.²¹ Because U.S. GAAP and IFRS standards serve different constituents in different jurisdictions with different perspectives, legal systems, and regulatory environments, SEC staff considers the goal of increasing the level of convergence and maintaining existing convergence appropriate at this time.

¹⁷ See Memorandum of Understanding –FASB and IASB, *The Norwalk Agreement* (September 18, 2002), available at <http://www.fasb.org/news/memorandum.pdf>

¹⁸ See Memorandum of Understanding between the FASB and the IASB, *A Roadmap for Convergence between IFRSs and US GAAP—2006-2008* (February 27, 2006) available at http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156245558

¹⁹ See *Completing the February 2006 Memorandum of Understanding: A progress report and timetable for completion September 2008*, available at http://www.fasb.org/intl/MOU_09-11-08.pdf

²⁰ See James V. Schnurr, Chief Accountant, Office of the Chief Account, SEC, *Remarks at the AICPA National Conference on Banks and Savings Institutions* (September 17, 2015) at <https://www.sec.gov/news/speech/schnurr-remarks-aicpa-national-conf-banks-savings-institutions.html>

²¹ See James V. Schnurr, Chief Accountant, Office of the Chief Account, SEC, *Remarks Before the 2015 AICPA National Conference on Current SEC and PCAOB Developments* (December 9, 2015) available at <https://www.sec.gov/news/speech/schnurr-remarks-aicpa-2015-conference-sec-pcaob-developments.html>

**Financial Services Capital Markets Subcommittee Hearing entitled,
“Examining the Agenda of Regulators, SROs, and Standards-
Setters for Accounting, Auditing, and Municipal Securities”
September 22, 2016**

Questions for the Record From Congressman Hultgren (R-IL)

Ms. Jessica Kane, Director, Office of Municipal Securities, U. S. Securities and Exchange Commission

Question One

According to a September 16 story in the Financial Times, assets in tax exempt funds have dropped by nearly 50 percent, since standing at \$266 billion at the beginning of this year, and the cost of borrowing for issuers – states and local governments – is already beginning to increase significantly.¹

- a. In your role in advising the Commission on policy matters relating to the municipal securities market, how have you weighed whether the SEC’s money market fund rules (adopted July 23, 2014) would lead to an increase cost of borrowing for tax-exempt funds? As the Agency’s announcement notes, “These reforms are important both to investors who use money market funds as a cash management vehicle and to the corporations, financial institutions, municipalities and other that use them as a source of short-term funding.”²

Response:

On July 23, 2014, the Commission adopted amendments to the rules that govern money market mutual funds under the Investment Company Act of 1940. In the 2014 Adopting Release,³ the Commission acknowledged that the reforms would impact institutional investors in tax-exempt funds and therefore likely impact the short-term municipal markets. The 2014 Adopting Release analyzed the potential economic impacts of applying the reforms to tax-exempt funds, including the potential for higher borrowing costs for municipalities. As part of that analysis, the Commission determined that, on balance, the goals of the rulemaking justified application of the reforms to tax-exempt funds, despite these potential costs.

¹ Financial Times: Muni Borrowing Costs Jump As Money Market Reforms Loom. September 16, 2016. <https://www.ft.com/content/c1b84fb2-7b89-11e6-ae24-f193b105145e>

² SEC Adopts Money Market Fund Reform Rules. July 23, 2014. <https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542347679>

³ See Release No. 33–9616, *Money Market Fund Reform; Amendments to Form PF* (July 23, 2014); 79 Fed. Reg. 79, 47736 (August 14, 2014), available at <https://www.gpo.gov/fdsys/pkg/FR-2014-08-14/pdf/2014-17747.pdf>.

- b. What advice have you provided to the Commission regarding the impact of the MMF rules on the municipal securities market? Is there any evidence to suggest that the Rule is disincentivizing investment in tax exempt municipal securities, or do you believe the drop in investment is solely attributable to the low-interest rate environment?

Answer:

Since the reforms have gone into effect, a number of money market fund investors have re-evaluated their cash investment strategies, and fund managers have chosen to realign their fund offerings and close unprofitable tax-exempt funds, many of whose assets have been continually shrinking in the current extended low interest rate environment. This re-evaluation and closing of unprofitable funds may have contributed to some reductions in investment in tax-exempt money market funds, which may have contributed to some reduction in demand for short-term municipal securities. Rates on some short-term municipal securities have risen recently, which may have also facilitated new entrants coming into the market for investing in this debt, such as longer term bond funds. These rates remain very low by historical standards. On balance, the reforms may have had some current impact on short-term municipal markets, but as noted in the 2014 Adopting Release this potential impact was acknowledged and analyzed by the Commission in determining to apply the reforms to tax-exempt funds.

- c. In your role in advising the Commission, what information have you provided that suggests or refutes that money market funds are systemically important? Do you believe the MMF rules eliminate any systemic risk that may have existed?

Answer:

The 2014 Adopting Release discussed concerns that money market funds as they existed before the reforms could pose risks to investors and the broader markets, especially to the extent their features may have created a first mover advantage that incentivizes investor runs. Accordingly, the 2014 reforms included a variety of structural reforms designed to mitigate these risks. These included a floating net asset value for all non-government and retail money market funds designed to address potential first mover advantages and new liquidity fee and redemptions gate tools to give money market funds more options to manage stress and protect investors.

Question Two

In drafting the municipal advisor definitional rule, why did the SEC abandon the approach that exists for many other regulated entities like broker dealers and registered investment advisors, where a firm must be engaged to provide relevant services, in some cases for compensation, before being treated as a regulated entity?

Answer:

Section 15B(e)(4) of the Securities Exchange Act of 1934 (“Exchange Act”) defines the term “municipal advisor” to mean a person (who is not a municipal entity or an employee of a municipal entity) that (i) provides advice to or on behalf of a municipal entity or obligated person

with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues, or (ii) undertakes a solicitation of a municipal entity.⁴ In the 2013 Adopting Release for the Commission's final rules for municipal advisor registration⁵, the Commission noted that, in defining the term municipal advisor in Exchange Act Section 15B(e)(4), Congress did not distinguish between persons who are compensated for providing advice and those who are not. Accordingly, as stated in the 2013 Adopting Release, the Commission believes compensation for providing advice with respect to municipal financial products or the issuance of municipal securities should not factor into the determination of whether a person must register with the Commission as a municipal advisor.⁶

However, as the Commission stated in the 2013 Adopting release, whether or not a person would have to register as a municipal advisor in connection with solicitation of a municipal entity or obligated person would depend upon whether such person receives compensation (direct or indirect).⁷ The Exchange Act definition of "solicitation of a municipal entity or obligated person" provides that the solicitation must be performed for direct or indirect compensation.⁸ Accordingly, as stated in the 2013 Adopting Release, persons that are not compensated for soliciting a municipal entity or obligated person would not be required to register as municipal advisors.⁹ The Commission also noted that Commission staff has broadly construed the term "direct or indirect compensation" in other contexts and other regulatory agencies have interpreted indirect compensation to include nonmonetary compensation.¹⁰

⁴ *C.f.* Exchange Act Section 3(a) (4) (defining "broker"), Exchange Act Section 3(a)(5) (defining "dealer"), and Investment Advisers Act of 1940 Section 202(a)(11) (defining "investment adviser").

⁵ See Release No. 34-70462, *Registration of Municipal Advisors* (2013 Adopting Release) (September 20, 2013), 78 Fed. Reg. 67467 (November 12, 2013), available at <http://www.sec.gov/rules/final/2013/34-70462.pdf>

⁶ 2013 Adopting Release, 78 FR at 67477.

⁷ *Id.*

⁸ Exchange Act Section 15B(e)(9) provides that the term "solicitation of a municipal entity or obligated person" means "a direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation, on behalf of a broker, dealer, municipal securities dealer, municipal advisor, or investment adviser (as defined in section 202 of the Investment Advisers Act of 1940 [15 U.S.C. 80b-2]) that does not control, is not controlled by, or is not under common control with the person undertaking such solicitation for the purpose of obtaining or retaining an engagement by a municipal entity or obligated person of a broker, dealer, municipal securities dealer, or municipal advisor for or in connection with municipal financial products, the issuance of municipal securities, or of an investment adviser to provide investment advisory services to or on behalf of a municipal entity."

⁹ 2013 Adopting Release, 78 FR at 67501.

¹⁰ *Id.*

Question Three

Under current regulations, do you believe that municipal issuers are required to retain a municipal advisor? Would you support legislation to clarify that?

Answer:

The Commission's final municipal advisor registration rules do not require municipal issuers to retain a municipal advisor. The Commission's final rules interpret the statutory definition of the term municipal advisor, interpret the statutory exclusions from that definition, and provide certain additional regulatory exemptions. The Commission's final rules require municipal advisors to register with the Commission and establish a registration regime for municipal advisors. The Commission's final rules also require municipal advisors to make and maintain certain books and records.

House Committee on Financial Services, Subcommittee on Capital Markets and GSE

Hearing: "Examining the Agenda of Regulators, SROs, and Standards-Setters for Accounting, Auditing, and Municipal Securities"

September 22, 2016

Questions for the Record from U.S. Representative Ed Royce (R-Calif.)

Mr. Robert L. D. Colby, Chief Legal Officer, Financial Industry Regulatory Authority

1. **Does FINRA believe dealers are the correct party to bear the expenses of GASB? If so, why? If GASB is essential to the municipal securities market, why was the previous funding structure insufficient to meet its needs?**

In Section 978 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")¹, Congress amended Section 19(g) of the Securities Act of 1933 to authorize the SEC to order a national securities association to adopt a fee on its members to fund GASB.² The SEC exercised this authority in May 2011 and ordered FINRA, currently the sole national securities association, to impose such a fee on its members.³ During the course of complying with the SEC's order and developing FINRA's GASB fee rule, multiple commenters suggested that charging only dealers for the funding of GASB was not equitable given that numerous other parties are end users of GASB's accounting and financial reporting standards⁴; however, as FINRA noted in responding to these comments, Section 19(g) of the Securities Act, as amended by the Dodd-Frank Act, and the terms of the SEC's order substantially limit the parameters of the GASB fee, and FINRA has no authority to collect the fee from any party other than FINRA member firms.⁵

FINRA does not have sufficient insight into GASB's previous funding structure, or any deficiencies that may have existed in that structure, to speculate as to why it may have been insufficient to cover GASB's expenses. FINRA notes, however, that Section 978(b) of the Dodd-Frank Act also required that a study

¹ See Pub. L. No. 111-203 § 978, 124 Stat. 1376, 1925 (July 21, 2010).

² See 15 U.S.C. 77s(g).

³ See 76 Fed. Reg. 28247 (May 16, 2011).

⁴ See 77 Fed. Reg. 12340, 12342 (Feb. 29, 2012) ("GASB Approval Order") (noting that "[s]everal commenters who opposed the proposed rule change expressed the belief that the proposed GASB Accounting Support Fee is not equitable because it is imposed only on broker-dealers" and that one of those commenters "stated that the true beneficiaries of GASB's work are state and local governments, investors, rating agencies, and auditors, and they should directly fund GASB's operations").

⁵ See *id.* FINRA notes that the GASB fee does not apply to all FINRA members. The fee applies only to those members that report trades to the Municipal Securities Rulemaking Board. See Schedule A to the FINRA By-Laws, Section 14. In addition, if an individual member's quarterly assessment is less than \$25, the member is not required to pay the fee for that quarter and the amount is reallocated among those members subject to the GASB fee for that quarter. *Id.*

be undertaken to evaluate the role and importance of GASB in the municipal securities markets and the manner and the level at which GASB has been funded.⁶ On January 18, 2011, the United States Government Accountability Office (“GAO”) provided a report to Congress that, among other things, outlines the previous sources of GASB funding and various stakeholders’ views on GASB funding.⁷ The GAO report states that the Financial Accounting Foundation (“FAF”), the parent organization of GASB, received its funding “from subscription and publication revenues, accounting support fees for FASB pursuant to the Sarbanes-Oxley Act of 2002, and voluntary contributions in support of GASB.”⁸ The GAO report goes on to note that the FAF’s trustees “have explored various options to obtain stable sources of funding for GASB over the past several years”; however, “none of these options has succeeded in providing a long-term, permanent, and sufficient funding source to GASB.”⁹

2. The principal funding mechanism for FASB, the accounting standards body for companies, is a fee imposed on corporate securities issuers. Would you support restructuring the current GASB fee in such a way that dealers could pass the cost of the fee through to state and local bond issuers?

As described above, under current statutory provisions, FINRA can impose the GASB fee only on its members. At the time FINRA proposed the GASB fee rule, several comment letters were submitted to FINRA and to the SEC questioning whether FINRA members could pass the fee through to customers. As the SEC noted when approving the rule, “[s]everal commenters representative of state and local officials stated that the proposed rule change would allow FINRA members to pass the GASB [fee] on to the members’ customers, which would be inconsistent with the Dodd-Frank Act.”¹⁰ The SEC quoted two different comment letters arguing that FINRA’s proposed rule did not adhere to the Dodd-Frank Act requirements because the proposed rule did not specify that the GASB fee must be paid by FINRA members and therefore left open the possibility that the GASB fee may be passed along to customers, which could include state and local governments that issue municipal securities.¹¹ As FINRA noted in response to those comments, the manner by which FINRA’s members choose to recoup the expenditures associated with paying the GASB fee is not addressed by Section 19(g) of the Securities Act, the SEC’s order, or FINRA rules.¹² FINRA continues to believe that its rules do not dictate whether or how an individual firm can recover its costs associated with the GASB fee and that how a FINRA member chooses to generate the funds necessary to cover the GASB fee is within its business discretion.

⁶ See Pub. L. No. 111-203 § 978(b), 124 Stat. 1376, 1925 (July 21, 2010).

⁷ United States Government Accountability Office, Dodd-Frank Wall Street Reform Act: Role of the Governmental Accounting Standards Board in the Municipal Securities Markets and Its Past Funding (Jan. 2011).

⁸ Id. at 25.

⁹ Id. at 32.

¹⁰ See GASB Approval Order, supra note 14, at 12342.

¹¹ Id. at 12343.

¹² Id.

Of course, firms that choose to pass on the fee must ensure that the fees are properly disclosed, and any disclosure cannot be misleading and must conform to FINRA rules, including just and equitable principles of trade, as well as any applicable rules of the Municipal Securities Rulemaking Board.¹³

3. Does FINRA engage in retrospective reviews of your current regulations and standards?
 - a. Do you have a formal policy in place for such reviews? Is it public and available to interested parties?
 - b. Have there been regulations or standards that your organization has modified or streamlined in order to take out costs or reduce complexity while still providing material information to investors?

FINRA commenced a retrospective rule review program in April 2014. The reviews are intended to periodically look back at significant rulemakings or rule sets to ensure they remain relevant and properly tailored to achieve their objectives, particularly in light of market, industry and other changes.

FINRA's formal policy for retrospective review was set out in *Regulatory Notices* 14-14 and 14-15
<http://www.finra.org/sites/default/files/NoticeDocument/p479810.pdf>
<http://www.finra.org/sites/default/files/NoticeDocument/p479811.pdf>

FINRA separates its reviews into an assessment phase and an action phase. During the assessment phase, FINRA evaluates whether the rules are meeting their intended objectives by reasonably efficient means and seeks to identify opportunities to maintain or improve their effectiveness while minimizing their economic impacts. The reviews consider not only the substance of the rules, but also FINRA's administration of the rules. FINRA follows a multi-step assessment process that affords all stakeholders – internal and external – the opportunity to provide their experiences with, and opinions of, the rules. The process includes a Regulatory Notice providing the opportunity for public comment, in-depth interviews with a diverse group of external stakeholders; consultations with industry trade groups and FINRA advisory committees (including the Investor Issues Committee) and an extensive survey sent to all FINRA-regulated firms. The results of the assessment are published in a public report that includes a detailed description of the assessment process. The report includes a plan of action that, where appropriate, includes recommendations as to how a rule or rule set should be modified.

During the action phase, FINRA considers rulemaking, guidance and administrative measures to enhance the effectiveness and efficiency of the rules. To the extent FINRA pursues rulemaking, it follows its usual processes, including input from its advisory committees and the opportunity for public comment in a Regulatory Notice or rule filing with the SEC, or both.

¹³ See, e.g., FINRA [Regulatory Notice](#) 16-16 (May 2016) (announcing the GASB fee for 2016).

To date, FINRA has conducted three retrospective rule reviews:

- communications with the public;
- gifts, gratuities and non-cash compensation rules;
- membership application rules.

<http://www.finra.org/sites/default/files/p602011.pdf>

<http://www.finra.org/sites/default/files/p602010.pdf>

<http://www.finra.org/sites/default/files/RetroRuleReview-03-2016.pdf>

FINRA is in the midst of the action phase of all three reviews, in varying stages. In September 2016, the SEC approved amendments to the communications with the public rules arising from the retrospective rule review that eliminates or streamlines filing and disclosure requirements related to some communications to better align the investor protection benefits and economic impacts of the rules.

http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-16-41.pdf

FINRA's Board of Governors also approved in September another proposal arising from the retrospective review to permit brokers to provide additional financial planning information to customers that includes some projections with appropriate safeguards. In August, FINRA sought comment on a proposal to modify and streamline the gifts, gratuities and non-cash compensation rules based on the results of that retrospective assessment. http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-16-29.pdf

FINRA is also drafting a proposal to similarly modify and streamline the membership application rules.

Question for the Record

Subcommittee on Capital Markets and Government Sponsored Enterprises
“Examining the Agenda of Regulators, SROs, and Standards-Setters for Accounting, Auditing, and
Municipal Securities”

Thursday, September 22, 2016
2:00 p.m.
2128 Rayburn

Rep. Ed Perlmutter (CO-7)

Mr. Colby – FINRA recently released Regulatory Notice 16-22 (FINRA Rule 3210), replacing NASD Rule 3050. While I understand the intent, FINRA is requiring member broker-dealer firms to supervise and monitor personal accounts opened or established outside of the firm by its associated persons. Has FINRA thought about the privacy implications of placing member firms at risk of violating privacy laws such as Gramm-Leach-Bliley, the Bank Secrecy Act and others?

FINRA Rule 3210 was approved by the SEC on April 7, 2016 and becomes effective on April 3, 2017. Briefly, Rule 3210 requires associated persons to obtain the prior written consent of their employer when opening accounts, as specified under the rule, at other broker-dealers and financial institutions. The rule provides for duplicate confirmations and statements to be transmitted to the employer member upon its request.

In establishing the rule, FINRA noted that the rule is designed to fit within the broader framework of FINRA's supervision rules, in particular the requirement (referred to as Transaction Review and Investigation, pursuant to the Insider Trading and Securities Fraud Enforcement Act of 1988) that a member firm's supervisory procedures must include a process for the review of securities transactions, effected for specified accounts, that is reasonably designed to identify trades that may violate the provisions of the Exchange Act, its regulations or FINRA rules prohibiting insider trading and manipulative and deceptive devices.¹

Rule 3210 underwent public comment twice in the course of the rulemaking process, and FINRA made revisions to respond to concerns regarding potential burdens on member firms and their associated persons.

We note that the core requirements of FINRA Rule 3210 are not new. The rule is a consolidation of two longstanding rules, NASD Rule 3050 and NYSE Rule 407, that have been in effect for many years. For example, the original NASD rule goes back to 1953,² and the rule's purpose of helping member firms

¹ See FINRA Rule 3110(d).

² See Securities Exchange Act Release No. 4924 (August 21, 1953).

“discharge their supervisory responsibility over the securities activities conducted in their associated persons’ personal securities accounts” is long established.³

With respect to regulatory frameworks governing privacy issues, we note that Regulation S-P excepts from the Regulation’s notice and opt-out requirements disclosures made, among other things, to comply with federal, State, or local laws, rules and other applicable legal requirements.⁴ FINRA believes that disclosures pursuant to FINRA Rule 3210 would be consistent with Regulation S-P. FINRA notes it is mindful of privacy concerns, and expects member firms to act consistent with all applicable statutes and regulations when handling account information.

³ See Securities Exchange Act Release No. 23754 (October 28, 1986), 51 FR 40546 (November 7, 1986) (Proposed Rule Change; File No. SR-NASD-86-29).

⁴ See 17 C.F.R. § 248.15(a)(7)(i).

**Financial Services Capital Markets Subcommittee Hearing entitled,
“Examining the Agenda of Regulators, SROs, and Standards-Setters for
Accounting, Auditing, and Municipal Securities”
September 22, 2016**

Questions for the Record from Congressman Hultgren (R-IL)

Mr. Robert L. D. Colby, Chief Legal Officer, Financial Industry Regulatory Authority

Chair White stated on September 14, 2016, that the Commission is close to finalizing amendments to Rule 15b9-1 that would require broker-dealers trading in off-exchange venues become members of a national securities association.¹ Firms active in the options market have raised concerns about the impact of this rule if it is not finalized without changes.

- a. Can you tell please explain why this expanded FINRA supervision of new registrants, such as options market makers, would improve markets?

Rule 15b9-1 currently exempts a broker-dealer from the requirement to be a member of a national securities association if it is a member of a national securities exchange, carries no customer accounts, and has annual gross income of no more than \$1,000 that is derived from securities transactions effected otherwise than on a national securities exchange of which it is a member; however, income derived from transactions for the dealer’s own account with or through another registered broker-dealer does not count toward the \$1,000 threshold.² The SEC’s proposed amendments to Rule 15b9-1 reduce the availability of the exemption by eliminating the existing \$1,000 allowance and replacing it with a more narrow exemption for a broker-dealer that conducts business on a national securities exchange, to the extent it effects transactions off-exchange for the dealer’s own account with or through another registered broker-dealer that are solely for the purpose of hedging the risks of its floor-based activities, by reducing or otherwise mitigating the risks thereof.³

As FINRA stated in its comment letter on the SEC’s proposed amendments to Rule 15b9-1, FINRA supports the SEC’s proposed amendments and believes that narrowing the exemption and having many of these firms be subject to FINRA rules and oversight would enhance investor protection and market integrity. As the SEC noted, FINRA is the sole self-regulatory organization (“SRO”) charged with oversight of the over-the-counter (“OTC”) market. Many of

¹ Mary Jo White, Chair, SEC. Equity Market Structure in 2016 and for the Future. September 14, 2016. <https://www.sec.gov/news/speech/white-equity-market-structure-2016-09-14.html>

² See 17 CFR 240.15b9-1.

³ See 80 Fed. Reg. 18036, 18045-46 (Apr. 2, 2015) (“SEC Proposal”). The proposed amendments also include an exemption for a broker-dealer to the extent it executes orders that are routed by a national securities exchange of which it is a member to prevent trade-throughs consistent with the provisions of Rule 611 of SEC Regulation NMS. *Id.*

the firms relying on the current exemption in Rule 15b9-1—and therefore who are not FINRA members—are active participants in the OTC market.⁴ Thus, under the current structure, firms that are actively engaged in the OTC market are not members of the SRO with regulatory oversight of the OTC market and therefore not subject to FINRA rules. As the SEC stated in its proposal, “reliance by Non-[FINRA]-Member Firms on the Rule 15b9-1 exemption leaves FINRA charged with responsibility for the off-exchange market without jurisdiction over broker-dealers that conduct a substantial amount of off-exchange trading activity.”⁵ FINRA believes that having OTC market participants subject to an appropriate set of rules, and to appropriate regulatory oversight, would improve regulation of the OTC market and ensure consistent regulation of participants in this market.

In addition to enhancing the oversight of the OTC market, FINRA believes the proposed amendments to Rule 15b9-1 would also benefit FINRA’s ability to surveil trading activity across multiple markets. As the SEC noted when proposing its amendments, “FINRA currently conducts cross-market surveillance and is provided exchange audit trail data pursuant to existing [regulatory services agreements] and 17d-2 agreements.”⁶ These agreements allow FINRA to consolidate market data across multiple exchanges and OTC trading to identify potentially illicit trading activity conducted across multiple market venues that, when viewed in isolation, may not appear problematic. As the SEC noted in its proposal, “many of the most active, cross-market proprietary trading firms have been able to rely on the exemption from [FINRA] membership, despite effecting a significant volume of transactions off exchange.”⁷ FINRA believes the SEC’s proposal will help close this regulatory gap.

Although options market makers could be subject to FINRA membership requirements under the SEC’s proposed amendments to Rule 15b9-1, the proposed amendments contain an exemption for exchange member broker-dealers that operate on the floor of an exchange to the extent those firms effect transactions off-exchange solely for the purpose of hedging the risks of their floor-based activities. When the SEC sought comment on its proposed amendments to Rule 15b9-1, it asked dozens of questions regarding the proposed hedging exemption, including whether the proposed hedging exemption was too narrow, and several commenters, including options exchanges, suggested that the proposed exemption was too narrow and would capture options market-makers. FINRA believes the SEC will take these comments and views into account, including amending the proposal if necessary, before taking any final action to amend the rule.

⁴ For example, the SEC stated in its proposal that, by 2014, non-FINRA member firms represented a volume-weighted average of approximately 48% of orders sent directly to alternative trading systems (“ATs”). See SEC Proposal, supra note 3, at 18042.

⁵ Id. at 18055.

⁶ Id. at 18044-45.

⁷ Id. at 18038.

- b. The SEC explains the Amendments would “enhance regulatory oversight of active proprietary trading firms, such as high frequency traders” and states the purpose of the Amendments as expanding FINRA registration to an additional 14 broker-dealers. Doesn’t the scope of the SEC’s proposal capture additional trading firms, such as options market-makers?

As noted above, Rule 15b9-1 exempts a broker-dealer from the requirement to be a member of a national securities association if it is a member of a national securities exchange, carries no customer accounts, and has annual gross income of no more than \$1,000 that is derived from securities transactions effected otherwise than on a national securities exchange of which it is a member; however, income derived from transactions for the dealer’s own account with or through another registered broker-dealer does not count toward the \$1,000 threshold. The SEC’s proposed amendments to Rule 15b9-1 reduce the availability of the exemption by eliminating the existing \$1,000 allowance and replacing it with a more narrow exemption for a broker-dealer that conducts business on a national securities exchange, to the extent it effects transactions off-exchange for the dealer’s own account with or through another registered broker-dealer that are solely for the purpose of hedging the risks of its floor-based activities, by reducing or otherwise mitigating the risks thereof. Thus, to the extent an option market-maker’s off-exchange trading exceeds these parameters, it would not be able to rely on the Rule 15b9-1 exemption if the SEC adopted the proposed amendments in their current form. Each particular options market-maker’s ability to rely on the exemption would, of course, be dependent upon its specific business model and off-exchange trading activity.

FINRA notes, however, that the SEC stated that, as of March 2015, 125 of the approximately 4,209 registered broker-dealers were not FINRA members, and 77 disclose engaging in floor activities on a national securities exchange, as reported on Form BD.⁸ Although the SEC was able to identify 14 specific non-FINRA member firms that directly connected to ATSs because these firms were voluntarily identified in order data reported by FINRA members to FINRA, the SEC noted that “these 14 Non-[FINRA]-Member Firms represent a subset of the largest Non-[FINRA]-Member Firms that actively trade across multiple exchanges and off-exchange”⁹ FINRA believes that the purpose of the SEC’s proposed amendments to Rule 15b9-1 is to enhance the regulation of the OTC market and cross-market surveillance activities, which would necessitate expanding FINRA membership to more than an additional 14 broker-dealers.¹⁰

⁸ Id. at 18052.

⁹ Id. at 18052 & n.153.

¹⁰ See id. at 18058-59 (discussing the benefits of the SEC’s proposed amendments to Rule 15b9-1).

**Financial Services Capital Markets Subcommittee Hearing entitled,
“Examining the Agenda of Regulators, SROs, and Standards-Setters for
Accounting, Auditing, and Municipal Securities”
September 22, 2016¹**

Questions for the Record from Congressman Hultgren (R-IL)

**Mr. James R. Doty, Chairman, Public Company Accounting Oversight
Board**

Question One

Mr. Doty, if the PCAOB believes that an auditor who has been investigated poses a serious threat to investors, does the Board have the authority to refer the matter promptly to the SEC for handling, including a public hearing? Has the Board done that?

- a. Are there benefits to referring the matter to the SEC instead of using the PCAOB’s enforcement authority?*

Yes, the Board has authority to refer investigations to the SEC and it has used that authority. In fact, in addition to referral authority, both the Sarbanes-Oxley Act and PCAOB rules require the Board to coordinate its enforcement efforts with those of the SEC’s Division of Enforcement. Section 105(b)(4)(A) of the Act requires the Board to notify the SEC of all pending Board investigations that involve potential violations of the securities laws, and to coordinate its work with the work of SEC-Enforcement, as necessary to protect an ongoing SEC investigation. In addition, PCAOB Rule 5112 requires that, as soon as practicable after entry of a formal investigation that involves a potential violation of the securities laws, the Board send a copy of the formal order to the SEC.

And, yes, there are benefits to referring investigations involving serious, imminent threats to investors to the SEC, which has the ability, among other things, to seek temporary restraining orders in federal court. Doing so in exceptional cases, however, is not a viable or practical alternative to making all PCAOB enforcement proceedings transparent, which would be in the public interest for the reasons described in the PCAOB’s August 24, 2010 letter to Congress and my testimony.

As I testified before the Committee on September 22, 2016, the current lack of transparency for PCAOB enforcement proceedings is not good for investors, the auditing profession, or the public. I appreciate the bipartisan support for providing transparency to PCAOB enforcement proceedings, including from Capital Markets Subcommittee Chairman Garrett at the September 22 Hearing. In the

¹ These answers are my own and should not be attributed to the PCAOB as a whole or any other members or staff.

Senate, Judiciary Committee Chairman Chuck Grassley and Senator Jack Reed have introduced S. 1084, The PCAOB Enforcement Transparency Act. I encourage this Committee and this Congress to support this bill.

Questions for the Record from U.S. Representative Ed Royce (R-Calif.)

Mr. James R. Doty, Chairman, Public Company Accounting Oversight Board

1. *We can all agree that external audits play a vital role in capital formation and well-functioning financial markets. The PCAOB's overarching mission is to maintain and improve audit quality for public companies and now broker-dealers. It is my understanding that broker-dealers typically do not use a public company structure. How does PCAOB deal with this different type of business model?*

The PCAOB takes the fact that broker-dealers typically do not use a public company structure into account throughout its regulatory program. In 2014, for example, the PCAOB adopted rule amendments (that were approved by the Securities and Exchange Commission) to tailor certain rules to the audits and auditors of broker-dealers. Among other things, these amendments:

- (i) modified the Board's registration, withdrawal and reporting forms, and the general instructions to these forms, to call for audit client information specific to the broker-dealer context;
- (ii) excluded from applicability to broker-dealer audits certain of the Board's professional practice standards (such as Rule 3523, "Tax Services for Persons in Financial Reporting Oversight Roles" Rule 3524, "Audit Committee Pre-Approval of Certain Tax Services," and Rule 3525, "Audit Committee Pre-Approval of Non-Audit Services Related to Internal Control Over Financial Reporting"); and
- (iii) added a definition of "audit committee" so that Rule 3526, "Communication with Audit Committees Concerning Independence," can be applied to broker-dealers that may not have organizational structures that include audit committees.

The Board also takes this difference into account in its standards-setting. For example, the Board earlier this year re-proposed a standard that, if adopted, would enhance the form and content of the audit report to make it more relevant and informative to investors and other financial statement users, in part by requiring the report to include a description of "critical audit matters" (CAMs) containing audit-specific information about especially challenging, subjective, or complex aspects of the audit as they relate to the relevant financial statement

accounts and disclosures. In doing so, the Board expressly stated that it was not proposing to require communication of CAMs for audits of broker-dealers that are not public companies but report under Exchange Act Rule 17A-5.

Further, the Commission imposes different reporting obligations on different categories of broker-dealers – i.e., those that clear transactions or carry customer assets (which generally must file compliance reports, as prescribed by the Commission), on the one hand, and on broker-dealers that do not do so (which generally must file exemption reports, as prescribed by the Commission), on the other hand. The PCAOB has established, with the Commission's approval, attestation standards specific to the distinct reporting obligations imposed by the Commission on each category of broker-dealers.

2. *Mr. Doty, if the PCAOB believes that an auditor who has been investigated poses a serious threat to investors, does the Board have the authority to refer the matter promptly to the SEC for handling, including a public hearing? Has the Board done that?*
 - a. *Are there benefits to referring the matter to the SEC instead of using the PCAOB's enforcement authority?*

Yes, the Board has authority to refer investigations to the SEC and it has used that authority. In fact, in addition to referral authority, both the Sarbanes-Oxley Act and PCAOB rules require the Board to coordinate its enforcement efforts with those of the SEC's Division of Enforcement. Section 105(b)(4)(A) of the Act requires the Board to notify the SEC of all pending Board investigations that involve potential violations of the securities laws, and to coordinate its work with the work of SEC-Enforcement, as necessary to protect an ongoing SEC investigation. In addition, PCAOB Rule 5112 requires that, as soon as practicable after entry of a formal investigation that involves a potential violation of the securities laws, the Board send a copy of the formal order to the SEC.

And, yes, there are benefits to referring investigations involving serious, imminent threats to investors to the SEC, which has the ability, among other things, to seek temporary restraining orders in federal court. Doing so in exceptional cases, however, is not a viable or practical alternative to making all PCAOB enforcement proceedings transparent, which would be in the public interest for the reasons described in the PCAOB's August 24, 2010 letter to Congress and my testimony.

As I testified before the Committee on September 22, 2016, the current lack of transparency for PCAOB enforcement proceedings is not good for investors, the auditing profession, or the public. I appreciate the bipartisan support for providing transparency to PCAOB enforcement proceedings, including from Capital Markets Subcommittee Chairman Garrett at the September 22 Hearing. In the Senate, Judiciary Committee Chairman Chuck Grassley and Senator Jack Reed

have introduced S. 1084, The PCAOB Enforcement Transparency Act. I encourage this Committee and this Congress to support this bill.

3. Mr. Doty does your organizations engage in retrospective reviews of your current regulations and standards?

Yes. Since its earliest days, the PCAOB has monitored and produced reports on implementation of new auditing and related professional practice standards and when necessary taken steps to address unintended consequences, through revisions to standards, written questions and answers, as well as other means. For example, as discussed further below, the PCAOB looked back at implementation of its first auditing standard on internal control (Auditing Standard No. 2) and replaced it with a new, more streamlined standard (Auditing Standard No. 5).

Since I joined the PCAOB, I have taken steps to grow and formalize retrospective reviews, by establishing a Center for Economic Analysis, which conducts post-implementation reviews of PCAOB rules and standards. The objective of the PCAOB's post-implementation review program is to look back at significant rulemakings, after a reasonable period of time has passed, to evaluate the overall effect of the rule or standard. This includes: (1) evaluating whether a rule or standard is accomplishing its intended purpose, as identified in the rulemaking release; (2) identifying, wherever possible, costs and benefits; and (3) identifying unanticipated consequences, either positive or negative. I believe that retrospective or post-implementation review is an important component of high-quality economic analysis of regulatory decision-making, and I intend to continue to build the program.

a. Do you have a formal policy in place for such reviews? Is it public and available to interested parties?

Yes, Goal I.E.2 of the PCAOB's 2016-2020 strategic plan is to "Maintain a Program to Conduct Post-Implementation Reviews of PCAOB Standards and Rules, specifically to "[e]valuate the overall effect of PCAOB standards and rules including by evaluating whether a rule or standard is accomplishing its intended purpose; identifying, wherever possible, costs and benefits; and identifying unanticipated consequences, either positive or negative[, and to] [u]se insights from the reviews to enhance prospective economic analysis on standard-setting initiatives and otherwise inform PCAOB oversight activities." Performance measures are included at the end of the plan, as well as a more detailed discussion of the status of this initiative, as a "major effort/priority project."

The plan is available on the PCAOB's website. The website's page on the PCAOB's Center for Economic Analysis also describes in further detail how retrospective reviews are used to enhance the policymaking process, factors that are relevant in deciding whether to perform a review of a particular rulemaking and work the staff perform as part of a review. Again, I have championed

developing a post-implementation review program through the PCAOB's Center for Economic Analysis and am committed to building it even further.

- b. Have there been regulations or standards that your organization has modified or streamlined in order to take out costs or reduce complexity while still providing material information to investors?*

Yes. The most notable example would be Auditing Standard No. 5, *An Audit of Internal Control over Financial Reporting that is Integrated with an Audit of Financial Statements*, which the Board issued in 2007 to replace Auditing Standard No. 2. Part of the Board's stated rationale for doing so was that monitoring of AS No. 2's implementation had shown that "[c]osts have been greater than expected and, at times, the related effort has appeared greater than necessary to conduct an effective audit of internal control over financial reporting." PCAOB Release No. 2007-005A (June 12, 2007).

Under the PCAOB's post-implementation review program, the PCAOB's Center for Economic Analysis recently began a review to evaluate the overall effect of Auditing Standard No. 7, *Engagement Quality Review*. The Center began this review in April 2016 by seeking comment from interested members of the public. The Center is also analyzing data collected through PCAOB inspection and enforcement programs, reviewing relevant academic literature, and convening focus group meetings to obtain input from interested parties and experts. The Center anticipates concluding this first review and issuing a public report in 2017. The Center is also performing work to plan for reviews of other standards and rules recently adopted as well as new standards, including by considering how to evaluate the rule in the future and identifying data, before adoption, that may be needed to perform the reviews.

Rep. Ed Perlmutter (CO-7)

Chairman Doty – As you know, Section 982 of the Dodd-Frank Act authorized the PCAOB to oversee the audits of broker-dealers and permitted the creation of a program of inspection for auditors of the financial statements of all broker-dealers. Pursuant to that authority, the PCAOB in 2011 created an interim inspection program and annually inspects a selection of brokers. It is my understanding the PCAOB is currently working on a proposal to create a permanent inspections program for broker-dealer auditors. Will the PCAOB take into consideration the cost and compliance burden on small broker-dealers under the permanent inspection program, especially those who are not publicly traded?

Yes. An analysis of the potential economic impact will be an important part of the proposal to establish a permanent inspection program for auditors of broker-dealers. The economic analysis will assist the Board in considering associated costs and compliance burdens, including in particular costs and compliance burdens for small broker-dealers (including those that are not publicly traded) and their auditors.

Requesting Member: Dennis A. Ross, FL-15

Witness Response from: James Doty, Chairman, Public Company Accounting Oversight Board

Disciplinary Proceedings Questions:

- 1. It is my understanding that when SOX passed, there was significant discussion on the importance of confidentiality in PCAOB enforcement proceedings. Confidentiality was included by Congress to promote voluntary cooperation between the PCAOB and the accounting profession as an efficient way to enhance audit quality and also protect the reputation of the auditor in a profession where reputation is paramount. I am concerned that legislative proposals first floated by the PCAOB to make disciplinary proceedings public would have a detrimental effect on audit quality, which is the essential goal of the PCAOB. Has audit quality improved since the passage of the Sarbanes-Oxley Act of 2002? Therefore, one can reason that the PCAOB and the capital markets have benefited from the current cooperative relationship, as was structured in SOX, and it has helped improve audit quality. According to the PCAOB's 2010 letter, the new authority would be used to drive settlements. It seems logical that setting up a confrontational regulator-regulatee relationship would at least impact cooperation between the PCAOB and accounting firms; thus impacting audit quality.*

As I testified before the Committee on September 22, 2016, the current lack of transparency for PCAOB enforcement proceedings is not good for investors, the auditing profession, or the public. I appreciate the bipartisan support for providing transparency to PCAOB enforcement proceedings, including from Capital Markets Subcommittee Chairman Garrett at the September 22 Hearing. In the Senate, Judiciary Committee Chairman Chuck Grassley and Senator Jack Reed have introduced S. 1084, The PCAOB Enforcement Transparency Act. I encourage this Committee and this Congress to support this bill.

In specific response to the question for the record, in light of the PCAOB's experience enforcing the Sarbanes-Oxley Act over the past 13 years, I do not

believe that making enforcement proceedings public would harm audit quality or affect registered accounting firms' cooperation with the Board's inspections process. On the other hand, the current state of the law -- in which auditors who have been charged with serious violations of auditing standards, or even non-cooperation or fraud, can continue their public company audit practice for years while disciplinary proceedings make their way through appeals without any public notice or audit committee awareness of the PCAOB's charges -- has negative effects for both audit quality and public transparency and accountability. In addition, this situation adversely affects competition for audit services, by conferring an unwarranted competitive advantage on the "bad apples" of the profession.

2. *Proponents of making the PCAOB disciplinary proceedings public have argued that individuals subject to the enforcement action could prolong litigation. However, doesn't the PCAOB have the authority to refer the matter to the SEC, which could make them public? How many times has the PCAOB felt that it was in the public interest to refer a matter to the SEC?*

Yes, the Board has authority to refer investigations to the SEC and it has used that authority. In fact, in addition to referral authority, both the Sarbanes-Oxley Act and PCAOB rules require the Board to coordinate its enforcement efforts with those of the SEC's Division of Enforcement. Section 105(b)(4)(A) of the Act requires the Board to notify the SEC of all pending Board investigations that involve potential violations of the securities laws, and to coordinate its work with the work of SEC-Enforcement, as necessary to protect an ongoing SEC investigation. In addition, PCAOB Rule 5112 requires that, as soon as practicable after entry of a formal investigation that involves a potential violation of the securities laws, the Board send a copy of the formal order to the SEC.

And, yes, there are benefits to referring investigations involving serious, imminent threats to investors to the SEC, which has the ability, among other things, to seek temporary restraining orders in federal court. Doing so in exceptional cases, however, is not a viable or practical alternative to making all PCAOB enforcement proceedings transparent, which would be in the public interest for the reasons described in the PCAOB's August 24, 2010 letter to Congress and my testimony.

3. *The PCAOB's current system of confidential enforcement proceedings is a particularly important protection for small accounting firms, which outnumber large firms as respondents in the PCAOB's settled and adjudicated disciplinary proceedings by nearly two-to-one. Small firms are particularly susceptible to the public prejudgment and at the time of*

publication, an individual auditor's career is, in essence, ended. Publication itself is discipline. In a small firm, public prejudgment resulting from a pending enforcement proceeding could result in deterring new and existing clients from retaining the firm's services. Even if a small firm ultimately prevails on the merits it may be unable to repair the damage to its reputation or diversify its practice into other industries. . Do you believe that this proposal could create pre-judgement for the auditor of clients?

No. An investigation is not the same as a disciplinary proceeding. Investigations involve fact finding by the PCAOB staff and are not public. During an investigation, neither the staff nor the PCAOB makes any determination of wrongdoing. If, however, the staff ultimately believes there has been a violation of PCAOB standards or the federal securities laws, it will make a recommendation to the PCAOB to institute a disciplinary proceeding. The PCAOB may authorize all or part of the action recommended by the staff, or it may determine that no action is warranted. Under the proposal, only PCAOB disciplinary proceedings would be made public, as they are for the SEC and other financial regulatory authorities.



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RUSSELL G. GOLDEN
 Chairman

November 17, 2016

The Honorable Edward Royce
 U.S. House of Representatives
 2310 Rayburn House Office Building
 Washington, DC 20515

Re: FASB Responses to Questions for the Record

Dear Representative Royce:

Thank you for the questions you have posed to me following my September 22nd appearance before the Capital Markets and Government Sponsored Enterprises Subcommittee during the hearing entitled "Examining the Agenda of Regulators, SROs, and Standard-Setters for Accounting, Auditing, and Municipal Securities." Below are my responses:

Question No. 1: Mr. Golden – is your organization subject to the Administrative Procedure Act?

- a. What alternative procedures do you have in place to ensure that there are sufficient notice and comment opportunities for interested parties?
- b. Are there particular reasons why your organization should not have to comply with the APA?
- c. Is your organization subject to the Federal Advisory Committee Act or the Government in Sunshine Act? Are there particular reasons that it should not be?

Response: Established in 1973, the Financial Accounting Standards Board ("FASB") operates under the oversight of the Financial Accounting Foundation ("FAF"), a private-sector not-for-profit organization. Through authority that Congress has granted to the Securities and Exchange Commission ("SEC"), the SEC has designated the FASB as the accounting standard-setter for public companies. As you know, the Administrative Procedure Act¹ ("APA") governs

¹ 5 U.S.C. §§ 500, et seq.



the process by which federal government administrative agencies propose and adopt regulations. Thus, because the FASB is a private-sector, not-for-profit organization, the APA does not apply to the FASB's standard-setting activities.

The FASB, however, believes that an independent, fully transparent, and inclusive standard-setting process is the best way to fulfill its two-pronged mission to establish and improve financial accounting and reporting standards and to educate stakeholders on how to most effectively understand and implement those standards. We rigorously follow our Rules of Procedure,² established under the FAF's bylaws, which we believe are, in many instances, similar to the APA's comprehensive notice and comment provisions.

The FASB's standard-setting process involves a range of activities intended to solicit and incorporate stakeholder feedback. Activities that the FASB incorporates into the standard-setting process include public meetings and roundtables, field visits or field tests, liaison meetings and presentations to interested parties, and the exposure of our proposed standards for public comment. The FASB provides videocasts of its Board meetings and education sessions on its website to make it easier for stakeholders to observe and participate in the standard-setting process. The FASB also creates podcasts and webcasts to provide short, targeted summaries of our proposals and new standards so that stakeholders can quickly assess whether they have an interest in them and want to submit comments.

We also proactively request meetings with stakeholders, including a wide range of investors, auditors, and companies (public, private, and not-for-profits), to discuss our proposals to understand whether the proposals will lead to better, more transparent information for investors and to understand their related implementation and recurring costs. We also regularly meet with stakeholders to identify concerns with our existing standards, which helps us understand where additional implementation guidance or improvements may be needed. The FASB supplements its direct outreach and comment letter process by publicly meeting regularly with its numerous advisory groups whose members are drawn from a broad cross-section of the profession.

These advisory groups include the Private Company Council ("PCC") that advises the FASB on private company matters, and the Emerging Issues Task Force that assists the FASB in improving financial reporting through the timely identification, discussion, and resolution of financial accounting issues relating to U.S. generally accepted accounting principles (GAAP). The FASB's standard-setting process and the resulting standards benefit from our advisory

² See, http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&c_id=1176162391050.



group members sharing their views and experiences with us on a broad range issues, including current agenda projects, possible new agenda items, practice and implementation of new standards, and strategic and other matters.

Because we are a private-sector, not-for-profit organization, neither the Federal Advisory Committee Act nor the Government in Sunshine Act applies to the FASB. The FASB, however, purposely conducts its standard-setting activities in full public view, including meetings of its advisory groups. Additionally, the names and backgrounds of the advisory group members as well as the materials for each respective meeting are also publicly disclosed. The FASB actively and publicly solicits recommendations for advisory group membership from stakeholders.

Question No. 2: Mr. Golden, in your written testimony you describe the principles that FASB is guided by when setting new standards. In particular, you note that “FASB strives to determine that proposed standards fill a significant need and that the expected costs they impose, compared with possible alternatives, are justified in relation to the overall expected benefits.” Could you please explain further? For example, does FASB have set guidelines to follow related to conducting a cost-benefit analysis?

- a. Does FASB have public guidance on how it conducts economic analysis?
- b. Does FASB employ a Chief Economist, or a group of economists to undertake the analysis?
- c. Why do you believe that the current procedures are sufficient to consider the costs and benefits of standards that, as you say, impact so many stakeholders?
- d. If FASB does not have procedures in place for more robust economic analysis, similar federal regulators and SROs, how can the FASB ensure that it meets your stated principle of “issu[ing] standards only when the expected benefits justify the expected costs?”

Response: My fellow Board members and I share your concerns about reducing cost in financial reporting while at the same time ensuring that investors continue to benefit from clear and useful financial information about the companies in which they invest their money. Fully understanding costs and benefits is critically important to the standard-setting process to inform the judgments Board members make as they deliberate on solutions to improve the transparency of our capital markets.

Since I became the FASB chairman three years ago, the FASB has undertaken a simplification initiative that has focused on reducing complexity and removing costs in applying our standards. We solicited feedback from our stakeholders to identify areas of U.S. GAAP that would benefit from simplifying the accounting standards and improving disclosure requirements for those who prepare and use financial reports. With that initiative, we worked hard to improve and communicate the way we analyze the benefits of any change against its related costs. Below, I will describe the process we use to analyze the costs and benefits of proposed Accounting Standard Updates.





The FASB's analysis of costs and benefits includes clearly identifying the need for a change to U.S. GAAP, identifying reasonable alternatives that address the need for change, understanding and assessing the expected benefits and costs of each possible alternative, and evaluating and comparing the cost effectiveness of reasonable alternatives.

To assess the benefits of various accounting alternatives, the FASB gathers evidence about the relevance and significance of the information to financial statement users, whether the information accurately and neutrally reflects the underlying economic transactions and events, whether it improves or diminishes the comparability of reported financial information domestically and internationally, and how the change affects the effort or cost of using the information.

To assess the costs of proposed U.S. GAAP changes, the FASB gathers evidence about the effect of the change on the process of preparing and distributing the information, including the effort required to collect, analyze, and process the information; whether the change would create a difference between U.S. GAAP and any contractual, regulatory, or tax requirements, requiring companies to maintain multiple accounting systems; the effort and cost involved in auditing the information; and the effort involved in implementing the change, including costs related to understanding the new requirements, systems changes, and potential competitive harm to preparers.

Additionally, the FASB regularly undertakes analysis at the micro-economic level when we look at the potential costs of a new standard. That is, we seek information from many companies, large and small, public and private, about the one-time and recurring costs that they would incur if a new standard was adopted. Techniques that we employ include asking specific questions about the number of new employees or outside consultants that would be required to implement the new standard and the additional time that would be needed to meet the new requirements. We also ask about the need to develop new or modified accounting systems. Although we do not attempt to develop models to project the new costs that all preparers would incur, we believe that analyzing projected cost increases for a cross-section of different companies leads us to an equally useful result.

The FASB's cost-benefit analysis is continuous, with procedures integrated into each major standard-setting phase: pre-agenda research, issuing a proposal (Exposure Draft) for public comment, redeliberations, issuing a final standard, implementation, and post-implementation review. The FASB communicates its analysis of costs and benefits in the basis for conclusions of the Exposure Draft and the final Accounting Standards Update. This includes an executive summary describing the need for change, an explanation of the nature and extent of the Board's processes and procedures, a description of identified benefits and costs of the alternatives considered for each significant issue, and a clear statement of why the Board believes the chosen alternative is the most cost-effective.

The FAF Board of Trustees periodically reviews processes such as the FASB's cost-benefit analysis procedures to ensure that they continue to be robust. The SEC's Advisory Committee on Improvements to Financial Reporting ("CIFIR Advisory Committee") conducted a review in 2008 for then-SEC Chairman Chris Cox and concluded that the FASB's standard-setting process is appropriate and functions well. Specifically, the report stated:





“... participants in standards-setting have long acknowledged that reliable, quantitative cost-benefit calculations are seldom feasible, in large part because of the difficulty of quantifying the benefits and estimating costs prior to implementation.

“As a result, cost-benefit analyses are sometimes based largely on non-quantitative input received in various ways through standards-setting, including field visits, field tests, public comments, and other constituent outreach.”³

While the CIFI Advisory Committee concluded that the FASB’s process functions well, it also made recommendations to improve the way in which the FASB analyzes costs and benefits. Consequently, the FASB has taken steps to improve its process by developing an enhanced pre-agenda research process, best practice procedures and research tool kits, a stakeholder feedback database, project resource groups, a policy on complexity, procedures for analysis of potential economic consequences identified by our stakeholders, public discussion of the Board’s cost-benefit analyses and conclusions, and enhanced communications through more plain-English documents.

Additionally, in a process that is separate and distinct from the analysis of the costs that new standards impose on preparers – and the benefits they bring to investors – the FASB also considers the potential consequences of new standards to businesses and industry sectors. In this context, it is important to note that the purpose of accounting standards is to foster clear and useful financial reporting that reflects economic activity accurately and neutrally. Put another way, accounting standards are intended to reflect – not to drive – economic activity and behavior.

Our aim is to create a neutral playing field that enables investors, lenders, and other users of financial statements to make their own independent judgments about where to invest on the basis of the best possible information available.

The FASB recognizes that accurate financial reporting can have economic consequences, both positive and adverse. Positive consequences include fostering economic growth, by promoting more efficient capital allocation, greater market liquidity, a lower cost of capital, and a better allocation of capital.

In contrast, improved financial reporting can sometimes result in adverse economic consequences for some businesses or industry sectors, especially if that reporting replaces inaccurate information with accurate information. As investors receive better information about where to invest their money, they are able to make better-informed choices.

Replacing inaccurate information with accurate information could result in reduced capital flow to certain businesses or industries, more difficulty for some businesses to attract and retain talented employees, or in some cases, the failure of a poorly-run business. The FASB’s objective in analyzing those concerns is to determine, to the best of its ability, whether those potential consequences are the natural result of more relevant and neutral financial information or the consequence of unintentional bias resulting from a proposed standard.

³ Final Report, p. 65 (<https://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf>).



In other words, the FASB and staff constantly assess and re-assess the neutrality of the information that would result from a proposal. If that analysis reveals unintentional bias, the Board changes its decisions as necessary to restore and promote neutral reporting. We believe that this is the appropriate way for the FASB to think about economic impact.

If an analysis reveals that proposed financial reporting outcomes are representationally faithful/neutral, complete in all material respects, and presented in a way that allows users to comprehend the meaning and significance of the financial reporting outcomes, then the perceived adverse consequences would be the result of a better-informed realignment of capital. In this case, the Board does not attempt to alter financial reporting to mitigate such effects because doing so would be to bias the reporting in favor of a particular company or organization, which could reduce its usefulness.

Question No. 3: Mr. Golden, you also state that one of the principles guiding FASB is the need to “be objective in its decision making and to ensure, insofar as possible, the neutrality of information resulting from its standards. To be neutral, information must report economic activity as faithfully as possible without coloring the image it communicates for the purpose of influencing behavior in any particular direction.” Could you please elaborate?

Response: The objective of financial reporting is to *neutrally depict the economics of a transaction* and thus provide financial information about the reporting organization that is useful to existing and potential investors, lenders, and other creditors in making resource allocation decisions. Achieving this goal of neutrality benefits U.S. investors and our capital markets more broadly. While the FASB embraces fully this objective, it is important to note that it is both the Congress and the SEC that have determined the scope of the FASB’s standard-setting activities in how they have defined the FASB’s role.

As I noted in my written statement and more fully described in response to Question 2, accounting standards are not intended to drive behavior in a particular direction. Rather, they seek to neutrally present financial information so that users can make informed decisions about how to best deploy their capital. The FASB remains committed to ensuring that our nation’s financial accounting and reporting standards provide investors with the information they need to confidently invest in the U.S. markets.

Question No. 4: Mr. Golden, does your organization engage in retrospective reviews of current regulations and standards?

1. Do you have a formal policy in place for such reviews? Is it public and available to interested parties?
 - a. Have there been regulations or standards that your organization has modified or streamlined in order to take out costs or reduce complexity while still providing material information to investors?





Response: One of the FASB's guiding principles is that it reviews the effects of past decisions so that it can appropriately amend or replace standards in a timely manner. The FASB believes that accounting standards, like laws and regulations, should periodically be assessed to determine whether they are still meeting the goals they were intended to meet when initially implemented. For example, in 2014, the FASB issued Accounting Standards Update 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This guidance developed a single revenue recognition model that replaced numerous, industry-specific U.S. GAAP revenue recognition requirements that were very difficult to sustain as industries evolved, resulting in accounting conclusions that differed in some circumstances when transactions were economically similar.

Additionally, an important part of the FASB's mission of developing high-quality accounting standards is monitoring their implementation and assisting preparers and other practitioners in their understanding of and ability to consistently apply a new standard. With that goal in mind, we undertake a variety of initiatives focused on educating our stakeholders, helping preparers and practitioners interpret the standards, and making necessary clarifications to the standards to address unintended consequences when they are identified. As it relates to our revenue recognition standard, one such initiative was the creation of the Revenue Recognition Transition Resource Group ("TRG") jointly with the International Accounting Standards Board. The TRG helped the FASB to understand where clarifications of the application of the standard were needed, which provided, in some circumstances, practical expedients that should reduce cost and complexity both at implementation and on an ongoing basis.

Furthermore, to ensure that the processes by which the FASB undertakes its standard-setting activities are as good as they can be, the FAF Board of Trustees employs a post-implementation review process that evaluates the FASB's standard-setting processes to ensure they remain as robust, transparent, and inclusive as possible.

Question No. 5: Mr. Golden, what do you believe is the appropriate role of Congress in oversight of FASB and accounting standards?

Response: Through its oversight of the SEC, Congress, in effect, exercises its oversight of the FASB. The SEC's commissioners, as well as the SEC's Office of Chief Accountant, interact regularly with FASB members and staff on a variety of issues. Furthermore, members of Congress exercise direct oversight of the FASB through its periodic invitations to FASB members and senior staff to appear before committees of jurisdiction to update you on current and past projects as well as the FASB's future agenda.

One important result of Congress's interest in and oversight of the FASB (and its sister standard-setter, the Governmental Accounting Standards Board ["GASB"]) has been Congress's recognition of the importance to U.S. capital markets of protecting objective, independent accounting standard-setting. This recognition has manifested itself in Congress's decision to create a dedicated, stable, and conflict-free funding source in the form of accounting support





fees for the FASB and GASB in Section 109 of the Sarbanes-Oxley Act and Section 978 of the Dodd-Frank Act, respectively.⁴

Congress made it clear in the Sarbanes-Oxley Act that the FASB was not a federal government entity and that the accounting support fee was not to be considered a Congressional appropriation. Despite this clear intent, however, as you may be aware, for the past several years, the Office of Management and Budget (“OMB”) has improperly included the FASB’s accounting support fees in Sequestration. Because the FASB is a nongovernmental entity, the OMB’s inclusion of the FASB’s accounting support fees in Sequestration is inappropriate and contrary to Congressional intent. The FAF continues to urge Congress to effectuate its stated desire of providing the FASB with a stable, independent, and conflict-free funding source by acting to approve legislation removing the FASB from Sequestration.

Question No. 6: It is my understanding that in the past, the accounting profession was the major financial supporter of FASB. However, FASB’s funding is now derived from sources independent from the accounting industry due to reforms brought about by the Sarbanes-Oxley Act of 2002. Why is independent funding important?

a. Would the FASB be unable to function if its mandated funding stream were eliminated?

Response: As you note, the Sarbanes-Oxley Act created a dedicated, stable, and conflict-free funding source in the form of accounting support fees for the FASB that is independent from the accounting industry. Prior to the Sarbanes-Oxley Act, funding for the FASB was provided through the FAF by soliciting contributions from accounting firms and companies to carry out its accounting standard-setting activities. That model generated concerns about both the potential and perceived risks that contributions could be affected by the FASB’s actions and about the involvement of primarily accounting firms in the funding process. The legislative history of the Sarbanes-Oxley Act indicates that a stable and independent funding source without reliance upon voluntary contributions by accounting firms and companies was an important consideration for the Congress when evaluating the FASB’s independent funding provisions. Additionally, there were concerns that funding the FASB through the legislative appropriations process could potentially present real and perceived risks to its independence. Section 109 of the Sarbanes-Oxley Act provides that all of the budget of a standard-setting body that satisfies the criteria under Section 108 of the Sarbanes-Oxley Act must be payable from an annual accounting support fee assessed and collected against issuers, as may be necessary or appropriate to pay for the budget and provide for the expenses of the standard-setting body, and to provide for an independent, stable source of funding, subject to review by the SEC.

⁴ 15 U.S.C. § 7219 and 15 U.S.C. § 77s(g).



To fulfill its mandate under the Sarbanes-Oxley Act, the SEC undertakes an annual review of the FASB's proposed accounting support fee. In connection with that review, the SEC also reviews the FAF's budget with regard to the proposed uses of the fee and the reasonableness of the amounts requested. With a dedicated and predictable funding source, the FASB can confidently engage in independent standard-setting activities. Although the FASB would be able to engage in standard-setting activities if its current funding mechanism were eliminated, the very same and serious concerns that existed prior to the Sarbanes-Oxley Act about real and perceived risks would likely arise.

If you or your staff have any additional questions, please do not hesitate to contact me at (203) 956-5342 or rggolden@fasb.org, or Todd L. Cranford, Head of Government Affairs & External Relations, at (203) 956-5280 or tlcranford@f-a-f.org.

Sincerely,

A handwritten signature in black ink, appearing to read "Russell G. Golden". The signature is written in a cursive, flowing style.

Russell G. Golden
Chairman



Responses of Lynnette Kelly
Executive Director, Municipal Securities Rulemaking Board
Questions for the Record
Examining the Agenda of Regulators, SROs and Standards-Setters for
Accounting, Auditing and Municipal Securities
Thursday, September 22, 2016

Cong. Hultgren

- 1. You wrote in your written testimony that the MSRB advances transparency in the municipal securities market in three ways: (1) through rulemaking; (2) through your EMMA; and (3) by encouraging timely disclosures. What challenges have you observed with the timeliness of disclosures, and what steps does the MSRB plan to take, if any, to address them?**

The municipal marketplace, with approximately 50,000 distinct issuers, faces challenges with both the timeliness and completeness of disclosures. In considering these challenges with disclosures, it is important to understand the legal framework under which the MSRB operates. The MSRB, like the SEC, lacks the authority to directly regulate municipal issuer disclosures. To address the need for timely disclosures, the SEC adopted Rule 15c2-12 in 1989 (subsequently amended) to prohibit underwriters from selling municipal securities unless they have determined an issuer has undertaken to provide the continuing disclosure prescribed by the rule. Under this rule, municipal securities issuers (subject to certain exceptions) must provide official statements disclosing certain attributes of the transaction, or "issuance," to investors, and enter into contracts with their underwriter known as continuing disclosure agreements (CDAs). Through the CDAs, the issuers undertake to provide disclosure of annual financial information and specified material events that would be significant to investors, such as defaults and delinquencies. For new issuances after December 2010, these material event disclosures must be submitted to the MSRB's Electronic Municipal Market Access (EMMA[®]) web platform in a "timely" manner not in excess of ten business days after occurrence of the event. In most cases, annual financial statements must be provided on or before a date specified in the CDA and a notice of any failure to do so must be provided to EMMA. MSRB data shows that approximately three percent of all continuing disclosure documents posted on EMMA in 2015 were notices of failure to provide timely annual financial statements – only a partial picture of the scope of the challenges with the timeliness and completeness of disclosures.

The SEC relied upon the framework established by 15c2-12, as well as authority to bring enforcement actions for fraudulent misstatements or omissions harmful to investors, to develop the Municipalities Continuing Disclosure Cooperation Initiative (MCDC). Under MCDC, municipal securities issuers, obligated persons and underwriters could self-report violations involving materially inaccurate statements relating to prior compliance with the continuing

disclosure obligations specified in Rule 15c2-12. 72 underwriters and 71 municipal securities issuers have since been charged by the SEC with violations with respect to the timeliness or content of their disclosures. The MSRB did not have a role in the development or execution of the MCDC program. The MSRB is, however, monitoring behavior changes that may have resulted. Close in time to the program, the MSRB observed a surge in the number of financial and operating disclosures on EMMA, with an increase of 40% in June 2014 compared to the previous June. To put that number in perspective, there is more typically a year to year increase in June filings of about 7%. Comprehensive annual financial report submissions also jumped by 30% for the month of June 2014. Many of those submissions were “catch up” submissions of disclosures made more than one year after the end of the fiscal year, but the MSRB continues to track and report this data and has observed increases in most years since 2009.

Given limitations on the SEC and MSRB rulemaking authorities on disclosure and the inherent challenges in overseeing numerous unique state and local government issuers, the more that municipal entities are proactive about disclosure, the better for all investors. As specifically detailed in our September 22 testimony, the MSRB takes steps to foster timely and complete disclosures by offering a variety of tools to state and local governments through its EMMA platform (such as through e-mail reminders, simplified posting options for bank loans and other indebtedness and customized web pages), in-person education at state and local government forums, online resources, disclosure principles and best practice references that issuers can choose to adopt, and through market advisories and notices on key concerns, such as a lack of disclosure of bank loans and debt-like obligations.

In addition, the MSRB regularly tracks and makes public its data regarding disclosures in order to help understand trends in the timeliness of disclosures. In May 2015 the MSRB published a report, soon to be updated for 2016, called the [“Timing of Annual Financial Disclosures by Issuers of Municipal Securities.”](#) In order to call attention to the timeliness of disclosures, the report analyzes submissions of financial disclosures made to EMMA and measures the number of days after the end of a fiscal year that audited financial statements and annual financial information are made available. Excluding the submission of older documents that appear to be “catch up” submissions, the timing of audited financial statement submissions between 2010 and the first six months of 2016 averaged 201 calendar days after the end of the applicable fiscal year. Importantly, in evaluating this data, individual investors can go to the EMMA website for free and determine (for issuers not subject to certain exceptions) whether required disclosures have been made, whether they have been timely, and whether they have been consistent with continuing disclosure agreements. This is a powerful way in which investors can understand a municipal entity issuer before deciding to purchase a bond.

More comprehensively, the MSRB publishes an [Annual Fact Book](#) that includes a holistic look at municipal market disclosures and trends, including continuing financial and event disclosures. The 2015 Fact Book captures this data for the years 2011-2015.

2. Does the MSRB believe dealers are the correct party to bear the expenses of GASB? If so, why? If GASB is essential to the municipal securities market, why was the previous funding structure insufficient to meet its needs?

GASB plays an essential role that dovetails with the MSRB's mission to protect investors and municipal entities. Neither the MSRB nor SEC is authorized to prescribe accounting standards that municipal issuers must use, but GASB is designated by the SEC as a standard-setter which can establish and promote (but not mandate) "generally accepted accounting principles" (GAAP). Without such a standard-setter for state and local government accounting and financial reporting, state and local government financial statements required to be posted to EMMA under SEC Rule 15c2-12 could be less complete, or difficult to compare or understand from an investor's perspective. Many but not all municipal securities issuers follow GAAP standards.

A challenge and legal obstacle inherent in the municipal securities market is the fact that absent affirmative authorization by Congress, the SEC is not in a position to adopt rules directly regulating municipal securities issues with respect to disclosure standards. This is in part due to a lack of regulatory authority and in part to prohibitions in the Securities and Exchange Act of 1934 commonly referred to as the "Tower Amendment," which bars the MSRB and SEC from imposing a registration system on states and political subdivisions and bars the MSRB from imposing disclosure obligations on municipal issuers. Statutory limits to SEC and MSRB legal authority arose from a Congressional concern for the appropriate separation of federal and state/local powers, and recognition of state and local government support for local control. Consistent with these limitations, under the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress granted the SEC the authority to require a registered national securities dealer association (effectively, the Financial Industry Regulatory Authority) to establish a support fee for GASB collected from its members. The fee is collected by FINRA from member firms that report trades to the MSRB and is based upon their trading volume. The MSRB is not in a position to comment on whether certain funding structures are appropriate or sufficient and workable for GASB, but affirms the critical role of a standard-setter in the municipal securities marketplace to increase the likelihood that financial statements posted to EMMA as a result of the requirements of SEC Rule 15c2-12 provide clear, consistent and complete information for investors.

Cong. Royce

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2. **The principal funding mechanism for FASB, the accounting standards body for companies, is a fee imposed on corporate securities issuers. Would you support restructuring the current GASB fee in such a way that dealers could pass the cost of the fee through to state and local bond issuers?**

The MSRB regulates dealers that purchase municipal bonds from state and local governments as part of an underwriting. MSRB Rule-17 requires brokers, dealers and bank dealers in their municipal securities activities to deal fairly with all persons, including investors and states and political subdivisions that issue municipal securities. MSRB interpretive guidance under Rule G-17 provides that dealer compensation for a new bond issue that is disproportionate to the nature of the underwriting and related services performed could constitute an unfair practice that is a violation of the rule. The MSRB is not in a position to opine on the structure of GASB fees, but is not aware of any current legal prohibitions on the ability of dealers to pass the GASB accounting support fee to issuers. Rule G-17 does not *per se* prohibit passing such a fee to issuers, although the fundamental fair-dealing obligation applies.

MSRB Rule A-13 assesses fees to support MSRB on certain underwriting, inter-dealer and customer sales. The rule provides that no broker, dealer or municipal securities dealer shall charge or otherwise pass through a fee under this rule to an issuer of municipal securities, but the rule is not applicable to the question of whether dealers can, under current law, pass the

cost of the GASB support fee to customers. Again, the MSRB is not aware of any legal restriction on the ability of dealers to do so.

3. Does your organization engage in retrospective reviews from your current regulations and standards?

a. Do you have a formal policy in place for such review? Is it public and available to interested parties?

As referenced in our testimony, In 2013, the MSRB adopted a "[Policy on the Use of Economic Analysis in MSRB Rulemaking](#)" which is publicly available at MSRB.org by clicking on "Regulation" and a tab called "Reference Material." In addition to this policy, the MSRB has undertaken a holistic rule review through two initiatives: (1) a periodic retrospective review of rules and related interpretive guidance; and (2) a uniform practice rule review to promote consistent behavior and responsibilities for regulated entities. These rule reviews are in keeping with MSRB objectives (and longstanding internal policy) that its rules be responsive, evolving and relevant to changes in the municipal market. In 2012, the MSRB [requested public and industry comment regarding MSRB rules or interpretive guidance](#) that should be revised, consolidated, deleted, were unduly burdensome, failed to accomplish their intended purpose or could promote greater efficiency. As a result of comments received through this initiative, uniform practice reviews and direct outreach to municipal market participants, MSRB has consolidated, modernized and streamlined ten rules, and those results are publicly available [at this link](#). This rule review is ongoing.

b. Have there been regulations or standards that your organization has modified or streamlined in order to take out costs or reduce complexity while still providing material information to investors?

The ten rule updates referenced above achieve a number of regulatory efficiency measures, including reducing complexities or costs. One example expected to achieve cost savings became effective November 16, 2016: a change to Rule G-12(h) regarding close-out procedures for municipal securities. The amendment to Rule G-12(h) mandates that inter-dealer failed transactions be closed-out within 10 calendar days – with an allowance for an additional 10-calendar-day extension at the buyer's discretion – for a total of a 20-day time limit in which to resolve the inter-dealer fail. An inter-dealer fail occurs when a dealer fails to deliver securities to another dealer by the agreed-upon settlement date. Prior to the rule change, there was no mandatory requirement to close the inter-dealer failure – only an optional 90-day procedure. By mandating the close-out of inter-dealer fails and shortening the close-out period, the costs to dealers associated with inter-dealer fails and the systemic risk created by the inter-dealer fails is reduced.

Prior to the rule change, the MSRB was aware of dealers that wanted to resolve inter-dealer fails but, in the absence of a willing or cooperative counterparty, were unable to do so because the rule did not mandate resolution. Selling dealers unable to deliver securities

wanted to resolve fails in order to relieve them of the market risk associated with increases in the price of the securities. For some inter-dealer fails, the selling dealer would be required to repurchase the securities and if it did so in a rising market, that seller would be liable for the increase in the market value of the securities.

On the other hand, purchasing dealers wanted to resolve fails to ensure that any security they subsequently sold to a customer would not leave that customer with a long position allocated to a firm short position. Such an allocation can create a tax consequence in which the dealer must address the fact that the customer subsequently purchasing the bond expects tax-exempt interest but under tax law may be receiving "substitute" interest from the dealer, which is taxable.

Responding to these concerns, the MSRB took the initiative to amend Rule G-12(h) and received positive comments on the proposed rule, which is just now taking effect. The MSRB has observed that firms are already adjusting and believes the number of inter-dealer fails will decline, the resolution of inter-dealer fails will occur more quickly and dealer risk and costs will be significantly reduced.