

investigation in The Netherlands, has requested that the Commission not seek penalties against the individuals because of potential double jeopardy issues under Dutch law. Because of the importance of this case in The Netherlands and the need for continued cooperation between the SEC and regulatory authorities in other countries, the Commission has agreed to the Dutch prosecutor's request.

Required

- a. Why can the SEC charge a company in The Netherlands with U.S. security violations?
- b. Why is The Netherlands conducting a parallel criminal investigation?
- c. Speculate on how many countries may be running a parallel criminal investigation relating to securities sold.

CASE 2-5 MATERIALITY: IN PRACTICE

Professional standards require auditors to make a preliminary judgment about materiality levels during the planning of an audit. Statement of Auditing Standards (SAS) No. 47 states that "the auditor plans the audit to obtain reasonable assurance of detecting misstatements that he/she believes could be large enough, individually or in the aggregate, to be quantitatively material to the financial statements."^{*}

SAS No. 47 indicates that materiality judgments involve both quantitative and qualitative considerations. This statement recognizes that it ordinarily is not practical to design procedures to detect misstatements that could be qualitatively material.

A number of rule-of-thumb materiality calculations have emerged, such as percentages of income, total assets, revenues, and equity. These rule-of-thumb calculations result in differing amounts for audit planning purposes. In fact, sizeable differences can result, depending on the rule of thumb and the industry.

Required

- a. It would seem prudent for auditors to give careful consideration to planning materiality decisions. Comment.
- b. It is difficult to design procedures to detect misstatements that could be qualitatively material. Comment.
- c. It is difficult to design procedures to detect misstatements that could be quantitatively material. Comment.
- d. In your opinion, would the application of materiality be a frequent issue in court cases involving financial statements? Comment.
- e. Comment on materiality implications of the Sarbanes-Oxley Act as it relates to control weaknesses.

^{*}This case is based on SAS No. 47 as updated and presented in AV312 of the *Codification of Statements on Auditing Standards* (American Institute of Certified Public Accountants, January 1989).

Source: American Institute of Certified Public Accountants, Jan. 1989

CASE 2-6 MANAGEMENT'S RESPONSIBILITY

3M* included these reports with its 2010 annual report:

Management's Responsibility for Financial Reporting

Management is responsible for the integrity and objectivity of the financial information included in this report. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Where necessary, the financial statements reflect estimates based on management's judgment.

(continued)

^{*}"3M is a diversified technology company with a global presence in the following businesses: Industrial and Transportation; Health Care; Display and Graphics; Consumer and Office; Safety, Security and Protection Services; and Electro and Communications. 3M is among the leading manufacturers of products for many of the markets it serves." 10-K

Source: U.S. Securities and Exchange

(CASE 2-6 CONTINUED)

Management has established and maintains a system of internal accounting and other controls for the Company and its subsidiaries. This system and its established accounting procedures and related controls are designed to provide reasonable assurance that assets are safeguarded, that the books and records properly reflect all transactions, that policies and procedures are implemented by qualified personnel, and that published financial statements are properly prepared and fairly presented. The Company's system of internal control is supported by widely communicated written policies, including business conduct policies, which are designed to require all employees to maintain high ethical standards in the conduct of Company affairs. Internal auditors continually review the accounting and control system.

3M Company

Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining an adequate system of internal control over financial reporting. Management conducted an assessment of the Company's internal control over financial reporting based on the framework established by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control—Integrated Framework*. Based on the assessment, management concluded that, as of December 31, 2010, the Company's internal control over financial reporting is effective.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2010 excluded Cogent Inc., Arizant Inc. and Attenti Holdings S.A., which were all acquired by the Company in the fourth quarter of 2010 in purchase business combinations. Total assets and total net sales recorded by the Company related to these acquisitions, in the aggregate, represented less than 10 percent of consolidated total assets and less than 1 percent of consolidated net sales of the Company, respectively, as of and for the year ended December 31, 2010. Companies are allowed to exclude acquisitions from their assessment of internal control over financial reporting during the first year of an acquisition while integrating the acquired company under guidelines established by the Securities and Exchange Commission.

The Company's internal control over financial reporting as of December 31, 2010 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2010.

3M Company

Required

- a. Who has the responsibility for the financial statements?
- b. What is the role of the accountant (auditor) as to the financial statements?
- c. Accountants (auditors) are often included as defendants in lawsuits that relate to the financial statements. Speculate as to why this is the case.
- d. Why did 3M include the report "Management's Report on Internal Control Over Financial Reporting"?

CASE 2-7 SAFE HARBOR

In 1995, Congress passed the Private Securities Litigation Reform Act (the "Act"). The principal provisions of the Act are intended to curb abusive litigation and improve the quality of information available to investors through the creation of a safe harbor for forward-looking statements.

Forward-looking statements were defined to include statements relating to projections of revenues and other financial items, plans and objectives, future economic performance assumptions, reports issued by outside reviewers, or other projections or estimates specified by rule of the SEC. The safe harbor applies to both oral and written statements.

Management frequently uses signals such as "we estimate," "we project," and the like where forward-looking statements are not otherwise identified as such. The forward-looking