

Ms. Phoebe W. Brown
Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: Proposing Release: *Amendments to PCAOB Auditing Standards Related to a Company's Noncompliance with Laws and Regulations* (PCAOB Release No. 2023-003, June 6, 2023; PCAOB Rulemaking Docket Matter No. 051)

Dear Ms. Brown:

We, the undersigned representatives of the American business community, write regarding the Public Company Accounting Oversight Board's ("PCAOB" or "Board") Exposure Draft ("Exposure Draft" or "Proposal") on *Company's Noncompliance with Laws and Regulations* ("NOCLAR").¹ While we appreciate the opportunity to comment, the Exposure Draft raises a series of significant concerns for the business community.

First, the Proposal does not use precise terminology or otherwise reasonably limit or clarify the Proposal's NOCLAR requirements. The Proposal would establish an obligation for the auditor to plan and perform procedures to identify *all* laws and regulations with which noncompliance "could reasonably" have a material effect on financial statements, and then would create a duty for auditors to assess and respond to the risks of material misstatements related to those regulations to determine whether noncompliance has or may have occurred.² This "could reasonably" standard is unbounded and imprecise and would not provide auditors with a practical filter or guide for which laws and regulations to evaluate. Further, the conditional terminology employed by the Proposal – such as "likely," "may," and "might," including a requirement to report to the audit committee "information indicating that noncompliance . . . *may have* occurred"³ – would create serious challenges in determining precisely which instances of NOCLAR to prioritize. The vague and intentionally expansive⁴ terminology used by the Exposure Draft would drive new liability concerns among auditors,

¹ Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations and Other Related Amendments. Available at: <https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-051/pcaob-release-no.-2023-003---noclar.pdf>.

² Exposure Draft, p. A1-2.

³ Exposure Draft, p. A1-7.

⁴ Exposure Draft, p. 24 ("As with the existing definition of 'illegal acts,' the Board intends 'noncompliance with laws and regulations' to have a broad meaning and to encompass violations of any law or any regulation having the force of law. We expect the auditor to focus on all types of noncompliance, whether the violations concern financial or operational issues or involve intentional or unintentional conduct.").

creating a more unfocused and ineffective risk mitigation environment that would push legal, compliance, and audit costs even higher.⁵

Related, the business community is concerned that the Exposure Draft transforms the nature and scope of auditor responsibilities, turning financial statement audits into wide-ranging investigations of potential instances of NOCLAR. Auditors perform a vital function in U.S. markets, ensuring the integrity of financial statement information that ultimately facilitates effective capital deployment. Changing the nature of the audit to serve as an examination of NOCLAR would add a host of new responsibilities and requirements for auditors, unnecessarily deviating from the purpose of an audit.⁶ These new auditor responsibilities would fundamentally alter the audit function and would insert auditors into core legal and management decisions. With respect to the legal function, auditors may be put into a position to second-guess a company's own legal counsel regarding whether noncompliance may have occurred. With respect to the management function, the requirement that auditors perform "enhanced risk assessment procedures"⁷ could result in auditors second-guessing how management allocates the company's financial and human resources. This would not only blur responsibility between the legal, management, and audit functions, but also would divert auditors' time, attention, and resources away from auditing financial statements. It would also divert additional management and employee resources, and audit committees, away from financial reporting to focus on NOCLAR.

The increased scope of audit in the proposal would significantly increase companies' audit costs without a clear corresponding benefit. Many industries affected by the proposal are highly regulated and closely supervised by relevant authorities in virtually all aspects of their business.⁸ Accordingly, companies have robust compliance programs and processes in place to comply with the laws and regulations to which they are subject. These laws and regulations vary across jurisdictions and require specialized expertise and judgment to evaluate how they apply to a company's business. The proposal does not provide sufficient clarity on how auditors

⁵ According to the National Bureau of Economic Research (NBER), the average U.S. firm spent between 1.3 and 3.3 percent of its total wage bill on regulatory compliance between 2002 and 2014, reflecting a growth rate of 1 percent a year, roughly *half* of the average annual GDP growth rate over the period. For specific industries, such as transit, manufacturing, and financial services, these rates were even higher. Moreover, the research conducted focused only on the *labor costs* of regulatory compliance, not the capital expenditure costs, lost profits by creating compliance risk, and outsourced compliance costs such as accounting services. See: NBER, "Tracking the Cost of Complying with Government Regulation." Feb. 2023. Available at: <https://www.nber.org/digest/20232/tracking-cost-complying-government-regulation>.

⁶ Indeed, PCAOB Chair Erica Williams recently published an op-ed in *The Wall Street Journal* stating that the quality of audits must be improved, without acknowledging that the PCAOB has put forward a proposal that would add a host of strenuous new requirements and expectations for auditors. See: Erica Williams, "We Audit the Auditors, and We Found Trouble." *The Wall Street Journal*. Jul. 24, 2023. Available at: <https://www.wsj.com/articles/we-audit-the-auditors-and-we-found-trouble-accountability-capital-markets-c5587f05>.

⁷ Exposure Draft, p.21.

⁸ Worryingly, the Exposure Draft proposes to treat all industries the same, regardless of the level of government scrutiny related to compliance or variations in legal requirements. See, e.g.: Letter from Jason J. Nagler, Senior Director, Accounting and Compliance, Investment Company Institute, *et al.*, to Mr. Phoebe W. Brown, Secretary, Public Company Accounting Oversight Board. Aug. 7, 2023.

should determine which among these many, often complex and highly technical, laws and regulations “could reasonably have a material effect on the financial statements.” Thus, the NOCLAR proposal could dramatically increase the scope and cost of audit for highly-regulated institutions while simultaneously disregarding the existing supervisory and examination frameworks that already assess compliance with laws and regulations.

Further, as noted in the Exposure Release, public accounting firms do not currently have the level of expertise needed to complete this kind of expansive review and the market for such specialized expertise is limited. Accordingly, in addition to higher fees, the proposed approach may result in a competition for qualified audit or legal talent among the very same institutions subject to the enhanced reviews. This could create new risks and costs for firms as they seek to retain or replace their existing qualified staff. Similarly, a continual auditor focus on legal matters not clearly related to the financial statements could threaten audit quality. The extensive inquiries and investigations auditors would have to undertake would threaten the effectiveness of a company's legal and compliance efforts by challenging the availability of attorney-client privilege. The Exposure Draft's failure to acknowledge the challenge these requirements pose to confidential legal matters normally protected by attorney-client privilege is concerning.

Finally, U.S. companies already have existing and stringent responsibilities for compliance with all applicable laws and regulations, as well as a series of appropriate checks against noncompliance. Various federal and state regulatory authorities in the United States have a responsibility to examine, monitor and, where appropriate, bring enforcement actions against companies that do not adhere to laws and regulations.⁹ Moreover, given the many and varied private rights of action available against corporations in the United States, companies are subject to even further scrutiny and liability for noncompliance. Auditors have rightly played a role in identifying illegal acts by clients, and indeed have existing standards for responsibilities toward identified illegal acts and NOCLAR, but auditors should not be expected to do the combined work of lawyers, management, and regulatory and law enforcement authorities in rooting out noncompliance related to *all* laws and regulations.

We appreciate your attention to our concerns and we encourage the Board to address these issues in any finalized standards.

Sincerely,

ACA International

American Bankers Association

⁹ Indeed, the unclear reporting standard in the proposal raises the prospect that auditors will be expected to make decisions on compliance that could diverge both substantively and procedurally from a company's regulators' consideration of the same issues.

American Exploration and Production Counsel

American Gas Association

American Petroleum Institute

Association of Corporate Counsel

Bank Policy Institute

Business Roundtable

Center for Audit Quality

U.S. Chamber of Commerce

Federation of American Hospitals

International Association of Drilling Contractors

Investment Company Institute

Marcellus Shale Coalition

Nareit

NIRI: The Association for Investor Relations

Petroleum Alliance of Oklahoma

Reinsurance Association of America

Retail Industry Leaders Association

Western Energy Alliance