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**Via Electronic Submission**

June 29, 2023

Ms. Phoebe Brown  
Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, NW  
Washington, DC 20006-2803

**Re: PCAOB Rulemaking Docket Matter No. 049  
Proposed Auditing Standard – General  
Responsibilities of the Auditor in Conducting an Audit  
and Proposed Amendments to PCAOB Standards**

Dear Ms. Brown,

This letter is submitted on behalf of the Law and Accounting Committee (the "Committee" or "we") of the Business Law Section of the American Bar Association (the "ABA"), on the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") Release No. 2023-001, *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards* (the "Proposed Standard" or the "Release"). We appreciate the opportunity to comment on the Proposed Standard.

The views expressed herein have not been reviewed or approved by the House of Delegates or Board of Governors of the American Bar Association and should not be construed as representing policy of the Association. In addition, this letter does not represent the official position of the ABA Business Law Section, nor does it necessarily reflect the views of all members of the Committee, the drafting committee or their respective firms or clients.

We are pleased to offer our thoughts on the Release and thank the PCAOB for this opportunity. We generally support the initiative by the PCAOB to update its standards regarding the general responsibilities of auditors in conducting an audit. We recognize the important role that auditors play in the financial reporting system and concur with the PCAOB's views of the necessity for auditors to perform their responsibilities with utmost professionalism and independence. We believe, however, that certain aspects of the proposed standard and accompanying Release could pose certain problems and warrant further analysis and consideration. In this letter, we address four specific observations and offer suggestions that the PCAOB may wish to consider before adopting any final standard.

**1. Further revisions to Proposed AS 1000 might better reflect the principal aspects of an auditor's responsibilities.**

We are concerned that Proposed AS 1000 fails to adequately set forth what we consider to be certain of the principal aspects of an auditor's responsibilities. We note initially the importance of three areas of responsibility in connection with financial reporting: (a) the obligation of companies and their managements to design and implement effective systems of internal control over financial reporting, (b) the obligation of preparers to prepare financial statements in accordance with a specified set of accounting standards,<sup>1</sup> and (c) the obligation of auditors to audit those financial statements in accordance with a specified set of auditing standards and, if applicable, to audit internal control over financial reporting in accordance with a specified set of internal control standards. We believe that it is important that auditors perform their obligations in a manner that reflects the nature of their obligations.<sup>2</sup>

Our specific comments with respect to the Proposed Standard are as follows:

- Although one of the roles of the auditor is to protect investors as contemplated in Paragraph .01 of Proposed AS 1000, there are other considerations integral to the protection landscape. As discussed below in

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<sup>1</sup>The Securities and Exchange Commission ("SEC") has recognized the Financial Accounting Standards Board ("FASB") as a Designated Private-Sector Standard Setter. Sec. Exch. Comm'n, Release No. 33-8221, *Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter* (April 25, 2003), <https://www.sec.gov/rules/policy/33-8221.htm>. The FASB was created following a study commissioned by the American Institute of Certified Public Accountants ("AICPA") on the establishment of accounting principles, often referred to as the Wheat Report. Am. Inst. Of Certified Pub. Accts., *Study on the Establishment of Accounting Principles* (Mar. 29, 1972), [https://www.fasb.org/page/ShowPdf?path=1.+Report+of+the+Study+on+Establishment+of+Accounting+Principles+-+Wheat+report.pdf&title=Report%20of%20the%20Study%20on%20Establishment%20of%20Accounting%20Principles,%20AICPA,%20March%201972%20\(%E2%80%9CWheat%20Report%E2%80%9D\)](https://www.fasb.org/page/ShowPdf?path=1.+Report+of+the+Study+on+Establishment+of+Accounting+Principles+-+Wheat+report.pdf&title=Report%20of%20the%20Study%20on%20Establishment%20of%20Accounting%20Principles,%20AICPA,%20March%201972%20(%E2%80%9CWheat%20Report%E2%80%9D)).

<sup>2</sup> We believe that a reasonable balancing of responsibilities is critical. An auditor should not, in our view, be induced to take overly aggressive positions during the course of an audit in order to mitigate the potential of its own liability, but should instead have the confidence that a professionally conducted audit in accordance with applicable auditing standards will not result in auditor liability.

Section 4, the Release omits certain key language in the existing standards and seems to focus heavily on management's controls. Many may assert that accounting standards constitute the principal basis upon which users of financial statements rely. The entities responsible for the creation of accounting standards, including the Financial Accounting Standards Board (FASB), have sought to adopt decision-useful standards that provide the transparency that users require. Although the auditor plays a critical role in helping to assure that the financial statements have been prepared in accordance with applicable accounting standards, the auditor is not responsible for the accounting standards adopted by the company in conformity with specified accounting principles. Enhanced auditing standards should not be deemed to be a substitute for accounting standards that the PCAOB does not consider to be optimal.

- Paragraph .03 of Proposed AS 1000 relates to the objectives of the auditor. We substantively agree with this provision, but we believe it would be better stated to refer to the objectives of the audit rather than the auditor, insofar as it is the audit, and the procedures that are to be undertaken in connection with the audit, that define the purposes of the audit, and therefore the objectives.
  - With respect to the audit of internal control over financial reporting in clause (b) of Proposed AS 1000.03, we consider it notable that the paragraph does not reflect that the auditor's role is to make a determination against the backdrop of an applicable standard, such as The Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework. Similar to the manner in which the provisions relating to an audit of financial statements reference conformity with the applicable financial reporting framework, the audit of internal control over financial reporting should also refer to conformity with the applicable internal control framework. This is a significant point in that it will underscore that it is management's responsibility to determine the applicable internal control standard that is to govern the internal control audit.
- Paragraph .15 of Proposed AS 1000 provides that the auditor must comply with applicable professional and legal requirements in conducting an audit. In fulfilling these requirements, the auditor is obligated to conduct an audit in accordance with applicable auditing standards. Whether the audit protects investors is extrinsic to this analysis. If an auditor believes a particular accounting standard should be more robust, it is not the role of the auditor to audit around its own self-created standards. Just as a baseball umpire makes calls based upon the rules of baseball, the auditor's responsibility is to conduct audits in accordance with applicable accounting and internal control standards. Neither the baseball umpire nor the auditor is permitted to digress from the adopted rules just because he or she believes "protection" deserves something more. As such, it is unclear what the Board's intended objective of

this proposed language is, what actions auditors would be required to take to satisfy this standard, and what consequences might flow from the text of the standard.

## **2. The Board should consider revising the reference to “relevant guidance” in Proposed AS 1000.**

Proposed AS 1000 paragraph .15 includes a note that “[t]he auditor should take into account relevant guidance applicable to the audit,” which is defined to include “PCAOB auditing interpretations, Board-issued guidance, and releases accompanying the standards and rules of the Board.” *Id.* at n.26. We agree that these materials can be helpful to auditors in applying PCAOB Auditing Standards. That said, we have some concerns with the inclusion of this language in the Proposed Standard.

As an initial matter, we suggest that the Board define what is included within “Board-issued guidance,” as this nomenclature is not clearly defined in existing standards or on the Board website. Additionally, we note that the Board may issue multiple documents, including concept and proposing releases, over a period of years setting out its intent in relation to proposed standards that are ultimately adopted. If it retains the note to Proposed AS 1000.15, it would be helpful for the PCAOB to codify and clearly delineate what parts of a document are considered “relevant guidance” in an accompanying release (*e.g.*, the Executive Summary, Background, Overview of Final Rules). In this regard, we are of the view that only documents accompanying the final standards should be authoritative, as previous discussions in proposals or concept releases may have been superseded as a result of cumulative changes made during the standard setting process, and requiring auditors to reconcile discussions between proposed and final standards could potentially give rise to conflicts that could result in reasonable auditors reaching different conclusions.

## **3. Clarifying the intended application in practice of the revised “competence” framework may be necessary to mitigate concerns with respect to staffing and potential liability.**

We have the following concerns about the discussion of competence in Section III.B.2.ii. of the Release and paragraphs .07-.08 of Proposed AS 1000: (a) the Proposed Standard may inhibit the development and training of younger audit staff; (b) the Proposed Standard may impose unclear requirements for competence and expertise on audit staff members; and (c) the Proposed Standard may require audit staff members to have an unreasonable level of legal expertise for non-lawyers.

### **a. Development and Training of Junior Audit Staff**

The accounting profession is facing staffing challenges.<sup>3</sup> With the critical function accountants serve in the capital markets, it is critical for the profession to attract and retain new talent at the entry level. The auditing practice has traditionally

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<sup>3</sup> See Neihaus, *Fixing the Crisis in Accounting*, CPA Journal (Nov. 2022), available at <https://www.cpajournal.com/2022/11/25/fixing-the-crisis-in-accounting/>.

relied on a tiered staffing model with junior, less experienced auditors performing much of the detailed work in the audit. It also has relied upon a significant amount of on-the-job training, which is desirable given the hands-on nature of the work.

Developing the talent requires giving junior professionals challenging work that provides opportunities for growth. The Proposed Standard could be interpreted to limit the ability to assign such work to junior talent because they may lack significant experience. The example at page 22 of the Release (under due professional care) of the less experienced staff performing inventory counts is helpful in suggesting less experience may be necessary for accountants on simpler audit functions, but it may also imply that junior staff persons can only perform the most basic functions. We recommend adding clarifying language to the adopting release to state that the competence required for an audit may be achieved through a combination of a staff member's individual competence and the supervisor's oversight and review of the audit work.

### **b. Unclear Competence and Expertise Requirements**

The Proposed Standard would replace the term “adequate technical training and proficiency” included in the current AS 1010 with the term “competence.” Proposed AS 1000, paragraph .07 also adds that competence includes “expertise” in SEC rules and regulations, a term that is not used in AS 1010 of the current standard. The Release and Proposed AS 1000 include a general discussion of competence. The Release is not clear as to whether the changes are intended to impose a higher standard of competence or proficiency beyond what is expected in current practice. If it is the Board's intent not to impose a higher standard, we recommend that the adopting release include a statement to that effect and to state that the Board intends only to clarify and modernize the language. If the Board intends to impose a higher standard than currently exists for competence in auditing, we recommend that, as part of the rulemaking process, the Board clearly state (i) such intent, (ii) the perceived problems which require such a higher standard, (iii) a clearer description of the new requirements imposed by the Proposed Standard, and (iv) the Board's rationale for the change.

We believe it is important to have clarity on these points to guide audit firms on what is expected in practice and also to avoid potentially unintended and unwarranted liability for audit firms.

### **c. Requirements for Legal Expertise**

The Release and the text of the Proposed Standard include several references to “legal requirements” and a cross reference to the definition of “applicable professional and legal requirements.” That definition<sup>4</sup> includes several specific items and, at the end

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<sup>4</sup> The Release at page 17 states, “The term “applicable professional and legal requirements,” as defined in the recently proposed quality control standard (“proposed QC 1000”), includes: (i) professional standards, as defined in PCAOB Rule 1001(p)(vi); (ii) rules of the PCAOB that are not professional standards; and (iii) to the extent related to the obligations and responsibilities of accountants or auditors

of the definition, “other legal requirements.” In addition, paragraph .07 of Proposed AS 1000 includes a requirement that the auditor should have expertise in SEC rules and regulations. We have no argument with the general intent of the standard that auditors should conduct their audit in accordance with such legal requirements. However, the Proposed Standard could have the effect of imposing upon individual auditors an inappropriate duty to have legal expertise and to apply a lawyer’s expertise in identifying legal issues. We recommend adding clarifying language in the release to state that although the auditor is expected to comply with applicable legal requirements, the auditor is not expected to have the expertise of a lawyer or to express opinions on matters of law.

#### **4. Referring to SEC Rule 12b-20 in Proposed AS 2810 may cause confusion and present practical difficulties.**

In conjunction with the Proposed Standard, the Board proposes to amend AS 2810, *Evaluating Audit Results*.<sup>5</sup> AS 2810, paragraph .30 currently requires that auditors “evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.” The proposed amended standard enumerates various matters that the auditor should evaluate pursuant to the standard.<sup>6</sup> In addition, the proposed amended standard includes a footnote following the statement of the auditor’s obligation in paragraph .30. The footnote refers to the SEC’s Rule 12b-20 under the Securities Exchange Act (“Exchange Act”) “for additional considerations regarding the fairness of presentation of financial statements.”<sup>7</sup> For the reasons set forth below, we are concerned about the inclusion of this reference in the amended auditing standards and the implicit incorporation of legal standards into auditing standards that this reference represents.

First, we question the relevance of Rule 12b-20 to audits or auditing standards. Rule 12b-20 is an SEC disclosure rule governing company disclosures in Exchange Act registration statements and required reports.<sup>8</sup> The rule provides: “In addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the

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or to the conduct of engagements, rules of the SEC, other provisions of U.S. federal securities law, and other applicable statutory, regulatory, and other legal requirements.”

<sup>5</sup> The Board also proposes to delete in its entirety AS 2815, *The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles”*.

<sup>6</sup> See Proposed AS 2810, ¶ .30A, Release at p. A2-2. AS 2810, ¶ .31 currently provides that the auditor should evaluate whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable reporting framework and identifies matters that the auditor should consider in that regard. The Board does not propose to amend AS 2810, ¶ .31, but it does add more specific matters to consider in new paragraph .30A. At the same time, the Board would delete AS 2815’s current discussion of specific factors upon which the auditor should base its judgement regarding fair presentation. Release at p. A2-3 to A2-4.

<sup>7</sup> Proposed AS 2810, ¶ .30n.17A, Release at p. A2-2.

<sup>8</sup> See Exchange Act Rule 12b-1, 17 C.F.R. § 240.12b-1 (Regulation 12B “governs all registration statements pursuant to sections 12(b) and 12(g) of the [Securities Exchange] Act and all reports filed pursuant to sections 13 and 15(d) of the Act . . .”).

required statements, in the light of the circumstances under which they are made not misleading.” Along with other rules, Rule 12b-20 establishes legal requirements for company disclosures under the Securities Exchange Act and related regulations. Rule 12b-20 reflects the fundamental policy of the securities laws that disclosure must be truthful and not misleading.<sup>9</sup> While Rule 12b-20’s general language encompasses information in financial statements (as well as all other information in the filing) in an Exchange Act filing, nothing in the rule regulates the substance of the information included in financial statements, much less what constitutes “fair presentation” of such financial statements for purposes of an auditor’s opinion on those financial statements. It is therefore difficult to see what “additional considerations” Rule 12b-20 provides with respect to an auditor’s consideration of the fairness of presentation of the financial statements.

In addition, the Board’s rationale for including the reference to Rule 12b-20 in Proposed AS 2810 is somewhat difficult to follow. It seems from the Release that the Board wishes to analogize to Rule 12b-20 to support the proposition that “the auditor’s evaluation of fairness goes beyond the evaluation of whether the financial statements are presented in conformity with the applicable financial reporting framework.”<sup>10</sup> Citing Rule 12b-20, the Board states that the securities laws “prohibit financial statements and company disclosures from being materially misleading” and characterizes “presented fairly” as a “parallel concept.”<sup>11</sup> It seems a stretch to go from a legal standard for securities disclosure by companies to setting parameters for an auditor’s evaluation of the fairness of an issuer’s presentation of its financial position, results of operations, and cash flows.<sup>12</sup>

Secondly, and perhaps more importantly, we are concerned about the practical implications of the reference to Rule 12b-20 in the “present fairly” standard. As noted, Proposed AS 2810.30 n.17A refers to Rule 12b-20 as a source of “additional considerations regarding the fairness of presentation of financial statements.” The standard provides no guidance as to what these “additional considerations” might be or how the auditor should evaluate them. Absent any other guidance, the reference to Rule 12b-20 might be construed to require the auditor to evaluate whether the financial

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<sup>9</sup> See Exchange Act Rule 10b-5(b), 17 C.F.R. § 10b-5; Securities Exchange Act § 18(a), 15 U.S.C. § 78r(a).

<sup>10</sup> Release at p. 30.

<sup>11</sup> *Id.*

<sup>12</sup> We do not take a position on whether auditors should have an obligation to “go beyond” compliance with the applicable financial reporting framework in its evaluation of the fairness of presentation if the applicable standards provide clear and workable guidance to auditors on how to do so. However, we do question whether this obligation currently exists “under extant PCAOB standards,” as the Board suggests. Current AS 2815, ¶ .03 provides, “The independent auditor’s judgment concerning the ‘fairness’ of the overall presentation of financial statements should be applied within the framework of generally accepted accounting principles. Without that framework, the auditor would have no uniform standard for judging the presentation of financial position, results of operations, and cash flows in financial statements.” This statement seems contrary to the Board’s position in the Release. The Release does not attempt to reconcile its current position with this statement. Nor does it cite any authority—other than the analogy to Rule 12b-20—to support its characterization of “extant PCAOB standards.” Instead, the Board, without discussion, deletes AS 2815, including ¶ .03, from the auditing standards.

statements complied with Rule 12b-20, *i.e.*, whether the statements did not omit material information necessary to make the financial statements not misleading. In this context, the auditor would have to consider whether there is material information, not required by the accounting standards themselves, that the company and its management should have included in the financial statements but did not. If this is the case, we believe it would constitute a substantial expansion of the auditor's responsibilities; if that is the Board's intention, it should be spelled out more clearly and justified explicitly.

We believe that there would be substantial problems with such a standard. It would require the auditor to prove (or, more precisely, obtain reasonable assurance about) a negative—that there is no material information that needs to be added to the financial statements to make them not misleading. How the auditor is to obtain the information necessary to prove or disprove this assertion is not clear. The standard might also require the auditor to make what are primarily legal judgments about what information needs to be added to the financial statements and to substitute the auditor's judgment for that of management and its counsel. Yet the auditor's ability to make such determinations will be inherently limited by its access to information. As the Board's current auditing standards recognize, "The entity's transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management. The auditor's knowledge of these matters and internal control is limited to that acquired through the audit."<sup>13</sup> In addition to these concerns, the proposed standard likely would lead to increased costs – direct and indirect – as auditors make inquiries of companies in seeking to prove the negative.

Another potential difficulty is obtaining audit evidence to support the auditor's determination regarding the issuer's compliance with Rule 12b-20. Yet such evidence would be required by the Proposed Standard in order for the auditor to issue an unqualified opinion.<sup>14</sup> Again, it is unclear what (if any) audit evidence would suffice to support the negative proposition that there is no material information that needs to be added to the financial statements to make them not misleading.

Finally, we are concerned that the reference to Rule 12b-20 may contribute to an "expectations gap." Investors and other users might assume, based on the reference, that the auditor's expression of a "fairly presents" opinion means that the auditor has determined that no material information has been omitted from the financial statements. Audit committees might also operate under this expectation. If the Board

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<sup>13</sup> AS 1001, *Responsibilities and Functions of the Independent Auditor*, ¶ .03. Interestingly, this language is not included in the Proposed Standard.

<sup>14</sup> See Proposed AS 1000, ¶ .18.a, (auditor should express unqualified opinion only when the auditor "has obtained sufficient appropriate audit evidence to conclude that . . . the financial statements, taken as a whole, are presented fairly, in all material respects, in conformity with the applicable financial reporting framework"), Release at p. A1-7. A footnote to this paragraph cites Proposed AS 2810, ¶¶ .30-.31, which includes the footnote reference to Rule 12b-20. See *id.* at n.31.



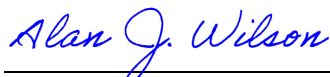
does not mean to impose on the auditor such a broad obligation to evaluate the completeness of a company's disclosures, it should make that clear.

In sum, we do not believe that the reference to Rule 12b-20 materially enhances proposed amended AS 2810. To the contrary, we believe that incorporating Rule 12b-20 into the auditing standards regarding fair presentation of financial statements is likely to create confusion about the auditor's responsibilities with respect to compliance with that rule and about the scope and substance of the auditor's opinion that the financial statements "are presented fairly, in all material respects, in conformity with the applicable financial reporting framework." Accordingly, we recommend that the Board omit any such reference to Rule 12b-20. If the Board does decide to include the reference, it should be accompanied by a disclaimer that the reference does not create any substantive audit requirements over and above those expressly outlined in Proposed AS 2810. Moreover, any attempt to impose a substantive requirement on the auditors that they consider whether in fact the financial statements have omitted material information necessary to make them not misleading must be accompanied by much more detailed discussion of how the auditors must make and document such a finding.

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We appreciate the opportunity to participate in this process and respectfully request that the Board consider our observations and suggestions. We are available to meet and discuss these comments or any questions that the Board and its staff may have, which may be directed to the individuals listed below.

Very truly yours,



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Alan J. Wilson  
Chair of the Law and Accounting Committee

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