Members of the Investor Advisory Group

Via Email

August 10, 2023

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

***Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations - And Other Related Amendments* (PCAOB Release No. 2023-003, June 6, 2023: PCAOB Rulemaking Docket Matter No. 051)**.[1]

Dear Secretary Brown and Members of the Public Company Accounting Oversight Board (PCAOB or Board):

The Members of the Investor Advisory Group (MIAG)[2] appreciate the opportunity to comment upon the PCAOB's Proposing Release on *Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations - And Other Related Amendments* (Proposal).[3] The Proposal is part of the Board's standard-setting agenda to update and modernize PCAOB Auditing Standards (AS). As explained by PCAOB Chair Erica Y. Williams, the Proposal replaces an auditing standard:

> "[A]dopted by the PCAOB in April 2003 based on a standard issued by the Auditing Standards Board [ASB] of the American Institute of Certified Public Accountants [AICPA] in 1988.
>
> In the 35 years since 1988, we've seen far too many examples of investors getting hurt due to noncompliance with laws and regulations. We've seen changes in federal securities laws. And we've heard calls from investors for auditors to live up to their responsibilities to ensure financial statements are presented fairly, in all material respects.[4] It's time we answer those calls."[5]

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[1] PCAOB, Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations - And Other Related Amendments, PCAOB Release No. 2023-003 (June 6, 2023), https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-051/pcaob-release-no.-2023-003---noclar.pdf.

[2] This letter represents the majority view of the Investor Advisory Group (IAG) and does not necessarily represent the views of all of its individual members, or the organizations by which they are employed. Several members objected to the views of the majority and are free to express them individually. IAG views are developed by the members of the group independent of the views of the Public Company Accounting Oversight Board (PCAOB or Board) and its staff. For more information about the IAG, including a listing of the current members, their bios, and the IAG charter, see https://pcaobus.org/about/advisory-groups/investor-advisory-group.

[3] *See* PCAOB Release No. 2023-003.

[4] *See* CFA Institute Member Survey Report, Audit Value, Quality, and Priorities 13 (2018), https://www.cfainstitute.org/en/research/survey-reports/audit-value-quality-priorities-survey-report (Table 3: identifying "[a]uditor consideration of noncompliance with laws and regulations" as the third highest priority for audit standard-setters); *see also* How Pervasive Is Corporate Fraud? With Luigi Zingales, Voice of Corp. Governance (May 11, 2023), *available at* https://podcasts.apple.com/us/podcast/how-pervasive-is-corporate-fraudwith-luigi-zingales/id1433954314?i=1000612649586 (recommending increasing the responsibility of auditor's to identify when a fraud exists).

[5] Erica Y. Williams, Chair, PCAOB Open Board Meeting, Statement on Proposed New Standard Regarding Noncompliance with Laws and Regulations (June 6, 2023) (footnotes omitted), https://pcaobus.org/news-events/speeches/speech-detail/statement-on-proposed-

Background: Why Change Is Necessary

The original auditing standard promulgated by the AICPA relating to an auditor's obligation for detecting illegal acts was issued in 1977 (SAS 17).[6] The AICPA adopted "Consideration of Laws and Regulations in an Audit of Financial Statements" AU-C Section 250 in 2012. As noted by Chair Williams, the PCAOB's existing standard is the one adopted by the AICPA in 1988 (SAS 54).[7] We believe the fundamental concepts in SAS 17 did not change. As a result, those concepts are now over 45 years old, and have not kept pace with the AICPA's enhancements.

Since 1977, many changes have occurred, including passage of the Foreign Corrupt Practices Act,[8] Section 10A of the 1934 Securities and Exchange Act,[9] and the Sarbanes-Oxley Act of 2002 (SOX).[10] Importantly, SOX required publicly listed companies to institute whistleblower programs[11] and ethical codes of conduct,[12] and made it illegal to mislead the independent auditor.[13] In addition, a federal court found that an auditor has an obligation to detect material fraud (an example of an illegal act),[14] and the U.S. Supreme Court has stated that an auditor has an obligation to investors as well as the public.[15]

Over the same time period, business has undergone significant and far-reaching changes. Today, many more U.S. businesses operate internationally in countries which may not recognize the "rule of law." It should be beneficial to review the comparison provided by the PCAOB of the proposed standard- AS 2405, the International Auditing

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new-standard-regarding-noncompliance-with-laws-and-regulations#:~:text=The%20proposed%20standard%2C%20AS%202405,noncompliance%20with%20laws%20and%20regulations; *see* Anthony C. Thompson, Board Member, PCAOB Open Board Meeting, Statement on Proposed Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations (June 6, 2023), https://pcaobus.org/news-events/speeches/speech-detail/statement-on-proposed-amendments-to-pcaob-auditing-standards-related-to-a-company-s-noncompliance-with-laws-and-regulations-thompson ("Much has changed since [1988 and] . . . [i]t's critical our standards change and evolve to remain fit for purpose."); Kara M. Stein, Board Member, PCAOB Open Board Meeting, A Return to Roots: The Auditor's Role in Uncovering and Reporting of Illegal Acts (June 6, 2023), https://pcaobus.org/news-events/speeches/speech-detail/a-return-to-roots-the-auditor-s-role-in-uncovering-and-reporting-illegal-acts ("The current interim standard was originally drafted in 1977 and last revised in 1988 [and] [i]t does not take fully into account a series of unfortunate events, including the failure of more than 745 financial institutions during the savings and loan crisis; the 'Numbers Game' and 'earnings management' problems of the 1990s; the seeming prevalence of accounting fraud that included the misdeeds of Enron and WorldCom, and Adelphia and Tyco at the beginning of this century, matched with over 900 corrections or restatements of financial reports; or the collapse and/or rescue of nine major financial institutions in 2007 and 2008, including Lehman Brothers, that sparked a global financial crisis.").

[6] *See* Illegal Acts by Clients, SAS 17, AICPA (Jan. 1977), *available at* https://egrove.olemiss.edu/cgi/viewcontent.cgi?article=1013&context=aicpa_sas; *see also* Kenneth I. Solomon & Hyman Muller, The CPA should know what to do if he, in the course of an audit, encounters an illegality problem, JOA 52 (Jan. 1977) (on file with IAG) (discussing origins of SAS 17: "As a result of the Watergate scandal, disclosures that certain corporations made illegal political contributions have renewed interest in whether auditors should have blown the whistle.").

[7] See Illegal Acts by Clients, AU Section 317, AICPA (Apr. 1988), *available at* https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-00317.pdf.

[8] *See* Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (Dec. 19, 1977), *available at* https://www.govinfo.gov/content/pkg/STATUTE-91/pdf/STATUTE-91-Pg1494.pdf.

[9] *See* Audit requirements, 15 U.S.C. § 78j–1 (June 1934), *available at* https://www.law.cornell.edu/uscode/text/15/78j-1.

[10] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002), *available at* https://www.dol.gov/agencies/oalj/PUBLIC/WHISTLEBLOWER/REFERENCES/STATUTES/SARBANES_OXLEY_ACT_OF_2002#:~:text=%5B%5BPage%20116%20STAT.,laws%2C%20and%20for%20other%20purposes.

[11] *See id.* § 806 ("'(a) Whistleblower Protection for Employees of Publicly Traded Companies").

[12] *See id.* § 406 ("CODE OF ETHICS FOR SENIOR FINANCIAL OFFICERS.").

[13] *See id.* § 303 ("IMPROPER INFLUENCE ON CONDUCT OF AUDITS.").

[14] *See, e.g.,* COLONIAL BANCGROUP INC., v. PRICEWATERHOUSECOOPERS LLP, LLP, CASE NO. 2:11-cv-746-BJR 6 (M.D. of Ala. N.D. filed Dec. 28, 2017), *available at* https://www.wsj.com/public/resources/documents/PWC_rulingpdf.pdf ("PWC violated its professional duties to Colonial by negligently performing its 2003-2005 and 2008 audits. Specifically, this Court determined that (1) PWC did not design its audits so as to enable it to detect fraud, and (2) PWC did not obtain sufficient competent evidence of the COLB Facility or the AOT Facility to sign the 2003-2005 and 2008 audit reports.").

[15] *See* United States v. Arthur Young & Co., 465 U.S. 805, 817-18 (1984), *available at* https://supreme.justia.com/cases/federal/us/465/805/ ("in certifying the public reports that depict a corporation's financial status, the accountant performs a public responsibility transcending any employment relationship with the client, and owes allegiance to the corporation's creditors and stockholders, as well as to the investing public").

and Assurance Standards Board (IAASB) International Standard on Auditing (ISA) 250, and AICPA's AU-C Section 250.[16]

Industries are subject to federal and state rules and regulations that can and do materially impact business operations and accordingly, their financial statements. Adding to the complexity involving rules and regulations, financial institutions, pharmaceutical companies and hospitals have grown exponentially in size. An example of such growth: forty major banks at the turn of the last century have consolidated into just four large financial institutions today.[17] With multiple regulators at the federal and state levels, smooth combinations of so many firms into a handful has been a daunting task over time.

The Recurring Incidence Of Fraud

While the business and financial reporting environment has evolved dynamically, auditing standards have remained static. We are concerned that fraudulent behavior within companies can go undetected in periods of rapid change. Recent empirical research published in the Review of Accounting Studies estimates that only one-third of corporate frauds are detected, with an average of 10% of large publicly traded firms committing securities fraud *every year.*[18] This means that the true extent of corporate fraud is much larger than what is currently being reported. The research also estimates that corporate fraud destroys 1.6% of equity value each year, which equals to $830 billion in 2021.[19]

We also note that the Association of Certified Fraud Examiners in its 2022 Report to the Nations, estimates that organizations lose 5% of revenue to fraud each year.[20] That report also finds that while owners and executives account for only 23% of those losses, they were the source of the largest losses.[21]

EY published a Global Integrity Report in 2022 (EY Report).[22] The EY Report states that: "In spite of an increasing acknowledgement of the importance of integrity to reputation and to employee retention, the incidence of significant fraud shows no downward trend over the last 14 years, spiking in 2020 at the height of the COVID-19 pandemic."[23] The EY Report goes on to say that "[s]tandards at the top have dropped significantly in the aftermath of the pandemic: more than four in ten (42%) board members agree that unethical behavior in senior or high performers is tolerated in their organizations (compared to 34% in 2020); more board members (34%) agree that it is easy to bypass the business rules in their organization than in 2020 (25%); 18% of board members would mislead external parties such as auditors and regulators (compared to 14% in 2020); 15% would falsify financial records (compared to 12% in 2020); and 14% would offer or accept a bribe (compared to 12% in 2020)."[24]

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[16] https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-051/comparison_proposed_as_2405_to_isa_250_au-c_250.pdf?sfvrsn=dcaf4089_6

[17] *See, e.g.,* Largest banks in the United States in 2023, by total assets, Statista (last visited July 30, 2023), https://www.statista.com/statistics/799197/largest-banks-by-assets-usa/#:~:text=The%20%E2%80%9Cbig%20four%20banks%E2%80%9D%20in,%2C%20Wells%20Fargo%2C%20and%20Citibank ("The "big four banks" in the United States are JPMorgan Chase, Bank of America, Wells Fargo, and Citibank").

[18] *See* Alexander Dyck, Adair Morse, and Luigi Zingales, How Pervasive is Corporate Fraud, Rev. Acct. Studies (Jan. 5, 2023), *available at* https://link.springer.com/article/10.1007/s11142-022-09738-5 ("Our evidence suggests that in normal times only one-third of corporate frauds are detected [and] [w]e estimate that on average 10% of large publicly traded firms are committing securities fraud every year, with a 95% confidence interval of 7%-14%.").

[19] *See id.* ("Combining fraud pervasiveness with existing estimates of the costs of detected and undetected fraud, we estimate that corporate fraud destroys 1.6% of equity value each year, equal to $830 billion in 2021.").

[20] *See* Occupational Fraud 2022: A Report to the Nations, ACFE 3 (2022), https://acfepublic.s3.us-west-2.amazonaws.com/2022+Report+to+the+Nations.pdf (estimating that organizations lose 5% of revenues to fraud each year).

[21] *See id.* at 5 (finding that "Owners/executives committed only 23% of occupational frauds, but they caused the largest losses").

[22] *See* Tunnel vision for the bigger picture?, EY (Feb. 2022), https://www.ey.com/en_us/forensic-integrity-services/how-a-focus-on-governance-can-help-reimagine-corporate-integrity.

[23] *Id.* at 18.

[24] *Id.* at 11.

Implications For Trust

Our markets are based on confidence in their integrity, nourished by trust. Fraudulent reporting is more costly than in simple dollar terms: it also erodes trust and confidence in markets. In 2021 PwC published the results of a survey about "The Complexity of Trust".[25] The PwC 2021 Report states:

> "Consumers are voting on trust with their pocketbooks — and employees are voting with their feet. Almost half (49%) of consumers have started or increased purchases from a company because they trust it, and 33% have paid a premium for trust. On the flip side, 44% have stopped buying from a company due to a lack of trust. When we look at employees, 22% have left a company because of trust issues and 19% have chosen to work at one because they trusted it highly. In other words, one out of five of your employees who leave don't do so primarily for a better salary or position. They leave because they don't trust your company."[26]

PwC's 2022 Consumer Intelligence Series Survey on Trust states:

> "[O]f the 71% of customers who say they would buy less if a company lost their trust, a whopping 73% say they would spend significantly less. This highlights the potentially dire consequences of mistakes or missteps when it comes to stakeholder trust. It also aligns with earlier data on the ramifications of losing trust, in which 44% of respondents say that they had stopped buying from a company due to a lack of trust. The saying that "trust is hard to earn and easy to lose" holds true, especially if your company needs to manage the fallout from a data breach, product recall or other trust-crisis event. A solid foundation of earned trust is the leading defense against having to rebuild it."[27]

As clearly evidenced from the publications discussed above, illegal activities, such as fraud can result in very material and significant costs to investors and the companies they own, as well as to the public. We believe the costs in terms of lost customers and revenues, negative impact on company operations, including those imposed by regulators or law enforcement agencies, can be very real, very material and result in dire situations including bankruptcies. We believe such costs to investors are significantly more than the costs derived from ensuring companies are not engaged in illegal acts including fraud. That is why we believe an update to the outdated auditing standard is this area is long past due.

Included in this letter as Appendix I are illustrative examples where we believe auditing standards failed to protect investors since the issuance of SAS 17. While SAS 17 and SAS 54 were positive steps forward at the time they were issued, we believe they have not accomplished what was needed: improved reporting about fraud by auditors.

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[25] *See* The Complexity of Trust: PwC's Trust in US Business Survey, Trust is complicated, but customers and employees have clear priorities – which companies often miss, PwC (Sept. 16, 2021), https://www.pwc.com/us/en/library/trust-in-business-survey.html.

[26] *Id.*

[27] Trust: the new currency for business, How trust impacts business and how companies can cultivate it, PwC (last visited Aug. 2, 2023), https://www.pwc.com/us/en/services/consulting/library/consumer-intelligence-series/trust-new-business-currency.html.

The MIAG Supports the Proposal

The MIAG agrees with the aforementioned comments of Chair Williams and continues to support the Board's goal of updating and modernizing the "interim" standards issued by the ASB of the AICPA. As we explained in our September 2022 comment letter in response the *Request for Public Comment – PCAOB Draft Plan 2022-2026*:[28]

> "We know that auditors have been working with long-standing "interim" standards since the PCAOB's inception and their modernization is long overdue . . . . Setting dates for completion – and achieving them – establishes accountability for the PCAOB…
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> . . . We recommend that the Board prioritize modernization of interim auditing standards in this five-year plan . . . ."[29]

The MIAG believes that independent, external auditors should:

1. Assume more responsibility for the detection and reporting of fraud and illegal acts,

2. Improve audit effectiveness – that is, improve detection of material misstatements,

3. Communicate to financial statement users more useful information about the nature and results of the audit process,

4. Communicate more clearly with audit committees and others interested in or responsible for reliable financial reporting, and

5. Design the audit to provide reasonable assurance of detecting errors and irregularities that are material to the financial statements.[30]

These five beliefs appeared in a 1988 Journal of Accountancy article, *The Expectation Gap Auditing Standards,* authored by Dan M. Guy and Jerry D. Sullivan.[31] Mr. Guy was then the vice-president-auditing at the AICPA. Mr. Sullivan was then the chairman of the AICPA ASB and a partner of Coopers & Lybrand where he served as director of audit policy.[32]

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[28] PCAOB, Request for Comment, Draft 2022-2026 PCAOB Strategic Plan, PCAOB Release No. 2022-003 (Aug. 16, 2022), https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/2022-003-rfc-draftstrategicplan.pdf?sfvrsn=fdc9859a_4/%202022-003-RFC-DraftStrategicPlan.pdf; PCAOB, Strategic Plan, 2022-2026, Draft for Comment (Aug. 2022), https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/draft-2022-2026-strategic-plan.pdf?sfvrsn=65f830db_4/%20Draft-2022-2026-Strategic-Plan.pdf.

[29] Letter from Members of the IAG to Office of the Secretary, PCAOB 2 (Sept. 15, 2022), https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/administration/strategic-plan-comments-2022/10_iag.pdf?sfvrsn=f24d0e63_4*; see* Letter from Members of the IAG to Office of the Secretary, PCAOB 1 (May 16, 2023), https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-049/3_miag.pdf?sfvrsn=d18fac00_4 ("We commend the Board for undertaking this project to bring the interim auditing standards into the twenty-first century, and approve the combination of the four single standards into one comprehensive standard."); Letter from Members of the IAG to Office of the Secretary, PCAOB 2 (Feb. 16, 2023), https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket_028/16_iag.pdf?sfvrsn=d6603e53_4 ("The MIAG believes that by replacing AS 2310, the Proposal, subject to the adoption of our proposed revisions, would be generally consistent with the following recommendation contained in our comment letter in response to 'Request for Public Comment – PCAOB Draft Plan 2022-2026' . . . ."); Letter from Members of the IAG to Office of the Secretary, PCAOB 1 (Oct. 21, 2022), https://assets.pcaobus.org/pcaob-dev/docs/default-source/standards/staff-request-for-comment/4_miag.pdf?sfvrsn=4ca3a488_4 ("We applaud the PCAOB for 'requesting information and public comment on matters relating the application and use of the Board's interim attestation standards.').

[30] *See* Dan M. Guy & Jerry D. Sullivan, The Expectation Gap Auditing Standards, JOA 36-37 (April 1988) (on file with the IAG).

[31] *Id.* at 36.

[32] *Id.*

More than 35 years after the article was published, the MIAG is writing to strongly support the Proposal. We believe the Proposal includes provisions that are responsive, at least in part, to our five beliefs. Moreover, we believe the approach taken by the PCAOB, subject to the adoption of our recommended improvements, is a strong step forward in clarifying the obligation of auditors with respect to the detection of fraud and legal and regulatory noncompliance.

We have observed data showing that when fraud is exposed, it rarely comes from the auditors.[33] We believe this should change and the Proposal appropriately moves in that direction.

Properly done, the Proposal should force auditors to engage in frank and honest conversations with management and the audit committee about evidence of noncompliance of laws and regulations. These conversations should include, when applicable, the potential effect on the financial statements. Because this is mostly a reporting obligation that is designed to put audit committees on notice of NOCLAR, the approach should maximize the information communicated by the auditor to those directors.

The approach taken in the Proposal provides much of what should have been the norm with respect to audits over the past 35 years. For example, the Proposal would require firms, in considering laws and regulations that could have a material effect on financial statements, to explicitly consider those that could have an *indirect* effect as well. Many, if not most, investors would have assumed that auditors already did this when conducting the required risk assessment for material misstatements in the financial statements.

Overall, we generally agree with PCAOB Member Kara M. Stein that the Proposal, subject to our recommended improvements, strikes the right balance because it:

> "[W]ill provide a right-sized approach to increase the likelihood that auditors will identify and respond to risks of misstatement material to the financial statements by using the umbrella of risk assessment, by considering the information the company is publishing as well as the information about the company that is generated outside of the company, and by using a holistic approach to challenge management instead of cordoning off potential sources of misstatements."[34]

While the MIAG strongly supports the Proposal, we recommend a number of improvements that we believe are generally consistent with our aforementioned beliefs. The following is a summary of our views on the proposed requirements, including our key recommended improvements. Additional details about our proposed improvements and our views on the Proposal generally are provided in response to the questions identified in the Proposal and included as Appendix II to this letter.

[33] *See, e.g.,* Occupational Fraud 2022: A Report to the Nations, ACFE at 22 (finding that 4% of fraud is initially detected by the external auditor, 5% by accident, and 42% by tips).

[34] Kara M. Stein, Board Member, PCAOB Open Board Meeting, A Return to Roots: The Auditor's Role in Uncovering and Reporting of Illegal Acts.

Summary Of Views:

Auditor Responsibility To Identify NOCLAR

We support the Proposal's requirements for the auditor to plan and perform audit procedures to: (1) proactively identify laws and regulations with which noncompliance could reasonably have a material effect on the company's financial statements; and (2) assess and respond to risks of material misstatement of the financial statements due to NOCLAR. We also strongly support the Proposal's removal of the distinction between direct and indirect.

We are aware some in the accounting/auditing profession believe the Proposal's "could reasonably have a material effect" requirement introduces a new and undefined concept that provides limited guidance to auditors. In response to that criticism by the profession, we would respectfully recommend replacing the proposed phrase "could reasonably" with the phrase "is reasonably likely to." For decades, the phrase "reasonably likely" has served as an integral part of the risk-probability assessment for management discussion and analysis (MD&A) disclosures. Additionally, the phrase holds the benefit of an existing explanatory note. It could be incorporated into the final standard to ensure greater guidance clarity for auditors in complying with the proposed requirements.[35]

In addition, we believe that a company's compliance functions, including whistleblower programs[36] and corporate ethical policies are a critical source for identifying NOCLAR. As indicated, SOX passed long after the issuance of SAS 17 and SAS 54. Among its other provisions, SOX required companies to adopt a whistleblower program and ethical codes of conduct.

More specifically, with respect to whistleblower programs, we would respectfully recommend amending the Proposal's requirements by providing for more explicit auditor responsibilities when such programs exist, including:

- Requiring the auditor to obtain an understanding of the audit committee's and management's policies, processes, and procedures for the program. This includes employee training with respect to the program, determining the independence of the program from those responsible for defending the company against such complaints, and the process for investigating, assessing and resolving complaints.
- Testing controls to determine if the process operates as expected.
- Reviewing and assessing complaints that are reasonably likely to have a material effect on the financial statements.
- When the auditor considers it necessary, and is able, the auditor should undertake an interview of the complainant.

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[35] *See, e.g.,* Financial Reporting Manual, TOPIC 9 - Management's Discussion and Analysis of Financial Position and Results of Operations (MD&A), 9100 MD&A Objectives, § 9220.11 (Last updated: 9/30/2008), https://www.sec.gov/corpfin/cf-manual/topic-9 ("Note that 'reasonably likely' is a lower threshold than 'more likely than not' but a higher threshold than 'remote'. The concept of 'reasonably likely' is used in the context of disclosure for MD&A purposes and is not intended to mirror the tests in ASC 450 established to determine when accrual is necessary, or when disclosure in the footnotes to the financial statements is required.").

[36] *See, e.g.,* SEC Whistleblower Office Announces Results for FY 2022, Agency's Program Tops $1.3 Billion in Awards since Inception; Rapid Growth in Tips and Awards Continues (Nov. 15, 2022), https://www.sec.gov/files/2022_ow_ar.pdf (Indicating that since the beginning of the U.S. Securities and Exchange Commission's (SEC) whistleblower program, it has paid more than $1.3 billion in 328 awards to individuals for providing information that led to the success of SEC and other agencies' enforcement actions. Enforcement actions brought using information from meritorious whistleblowers have resulted in orders for more than $6.3 billion in total monetary sanctions, including more than $4.0 billion in disgorgement of ill-gotten gains and interest, of which more than $1.5 billion has been, or is scheduled to be, returned to harmed investors. In FY 2022, the SEC received over 12,300 whistleblower tips—the largest number of whistleblower tips received in a fiscal year.). We also observe that a number of material financial statement frauds have involved whistleblowers disclosing the matters, including, but certainly not limited to, Enron, WorldCom, Lehman Brothers, Xerox, Wells Fargo, and Madoff Investment Securities LLC. Investors incurred significant losses as a result of such frauds.

Current PCAOB standards require an auditor to gain an understanding of the business they are auditing at the beginning of each audit. While some knowledge may carry over from prior audits, a complete understanding of the present business is essential for conducting a proper risk assessment. To achieve this end, auditors must also fully understand the regulatory and legal environment in which the company operates.

For example, when auditing banks, it is important to understand the federal and/or state regulations related to capital requirements, anti-money laundering, opening new accounts, regulations applicable to new loans, as well as laws applicable to insured and uninsured accounts. For a pharmaceutical research and manufacturing company, it would be important to gain an understanding of the regulations applicable to manufacturing facilities and whether a company is complying with them or not. Failure to comply with those regulations can result in closure of the facilities with material impacts on profits. Likewise, when auditing a medical services company, such as an owner of hospitals, the auditor needs to gain an understanding of the regulations for billing Medicaid and Medicare services, including supplemental payments the hospital may bill for.

The auditor's understanding of the business should include an understanding of its compliance program. This includes the company's code of conduct.[37] While many companies have a code of conduct, we believe wide diversity may exist in how companies determine compliance with their code.

After gaining an understanding of the company and its business, including its regulatory and compliance environment, the auditor is required to assess the risk of a material misstatement of the financial statements, regardless of whether it is due errors, or illegal acts such as fraud. Then based on that risk assessment, the auditor is required to design tests of controls and/or substantive tests that will provide reasonable assurance that the financial statements are free of a material misstatement. None of that requires an auditor to function as a lawyer. In fact, auditors already do this today if they are complying with existing PCAOB standards. Notwithstanding that fact, some representing the auditing industry are alleging the Proposal will require auditors to function as lawyers.[38] We believe that allegation is simply not true.

If an auditor in performing audit tests obtains evidence that it is reasonably likely a NOCLAR event has occurred, the auditor should follow up on that information including communicating with management and the board, except when inconsequential. If an auditor has a question as to whether an illegal act has or has not occurred, the auditor will use a specialist – legal counsel – to provide counsel and/or an opinion. For example, the auditor, under the Proposal, would not decide as to whether an illegal act, such as fraud, has occurred.

Finally, as indicated, we strongly support the Proposal's requirement that auditors should consider both direct and indirect effects of noncompliance. We, and many investors, are frankly surprised that this would not already be a required part of the audit. Auditors are expected to engage in a risk assessment to uncover possible material misstatements in the financial statements. Noncompliance that can affect the financial statements is relevant to assessing this risk whether it does so directly, say through an understatement of pension obligations, or indirectly, say through bribes paid to a foreign government official.

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[37] *See* Tunnel vision for the bigger picture?, EY at 5 ("Companies are increasing their reinforcement of integrity values through communication and training; compared with 2020, more companies have a code of conduct (53% vs. 47%), more companies are investing in regular integrity training (46% vs. 38%), and more companies have a statement of organizational values in place (37% vs.34%).").

[38] *See, e.g.,* Michael Cohn, CAQ pushes back against PCAOB NOCLAR proposal, Acct. Today (Aug. 2, 2023), https://www.accountingtoday.com/news/caq-pushes-back-against-pcaob-noclar-proposal ("Auditors aren't lawyers, and as a result the proposed changes would expand the auditor's role to include knowledge and expertise outside their core competencies, the CAQ argues, ...").

Auditor Responsibility To Evaluate NOCLAR

We support the Proposal's requirements strengthening the auditor's evaluation of whether NOCLAR has occurred, and if so, the possible effects on the financial statements and other aspects of the audit. We are particularly supportive of the Proposal's requirements to document the auditor's consideration of NOCLAR in a financial statement audit. In that regard, we would respectfully recommend that those requirements be further revised to explicitly require documentation of the audit team members who performed procedures to obtain the information necessary to identify and assess NOCLAR risks. We believe raising the expectations for auditor documentation of NOCLAR brings needed discipline to the auditing process.

Auditor Responsibility To Communicate NOCLAR

We support the Proposal's requirements that when the auditor becomes aware of information indicating NOCLAR, including those related to fraud, has or may have occurred, the auditor would be required to make an initial communication to appropriate management and the audit committee. However, we note that one exception to this communication requirement would be for matters that are "clearly inconsequential."

We are concerned the Proposal's description of "clearly inconsequential" is inconsistent with the long-understood meaning of the phrase and could result in the phrase being misinterpreted as creating a broad exception from the proposed communication requirements. As a result, we would respectfully recommend the insertion of a note to the proposed requirements more fully describing the meaning of clearly inconsequential.[39]

We support the Proposal's requirements that the auditor communicate NOCLAR to the board of directors when the auditor has become aware of an illegal act that is other than inconsequential. We, however, would revise the proposed requirement to extend the communication requirement when an auditor has determined it is reasonably likely that an instance of NOCLAR has occurred and management or the board of directors has failed to take appropriate actions to address the matter. In such an instance, the auditor should report to the U.S. Securities and Exchange Commission (SEC), the PCAOB, and to investors, whether or not the auditor resigns from the engagement unless the communication is otherwise prohibited by federal or state law. We believe expanding the auditor responsibility to communicate NOCLAR to the SEC, the PCAOB, and investors could increase audit quality and potentially function as a deterrent to issuer fraud and NOCLAR.

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Thank you for carefully considering the comments of the MIAG and other investors—the primary customers of audited financial reports.[40] If you, any members of the Board, or your staff have questions or seek further elaboration of our views, please contact Amy McGarrity at amcgarrity@copera.org.

Sincerely,

Members of the Investor Advisory Group

Members of the Investor Advisory Group

[39] *See, e.g.,* D.R. Carmichael, The Auditor's New Guide To Errors, Irregularities and Illegal Acts, JOA 41(Sept. 1988) (on file with IAG) (Discussing the meaning of "inconsequential" stating: "Questions have . . . arisen about the meaning of 'clearly inconsequential[]' [and] [c]learly inconsequential is an amount significantly below the border of material and immaterial . . . [and] it's a de minimis amount that's so obviously immaterial that its insignificance is unquestionable").

[40] *See, e.g.*, Council of Institutional Investors, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (updated Mar. 1, 2017), https://www.cii.org/policies_other_issues#indep_acct_audit_standards ("investors are the key customer of audited financial reports and, therefore, the primary role of audited financial reports should be to satisfy in a timely manner investors' information needs").

APPENDIX I

Members of the Investor Advisory Group
Instances of Existing Auditing Standards Failing to Protect Investors
***Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations - And Other Related Amendments* (PCAOB Release No. 2023-003, June 6, 2023: PCAOB Rulemaking Docket Matter No. 051)**
August 10, 2023

KPMG LLP's audits of Wells Fargo's Financial Statements for 2011-2015

Wells Fargo Employees Creating Fake Customer Accounts
In its response to an October 27, 2016 letter from United States Senators Elizabeth Warren, Bernard Sanders, Mazie K. Hirono, and Edward J. Markey, KPMG acknowledged the Wells Fargo audit team was aware of instances of unethical and illegal conduct by Wells Fargo employees. KPMG's letter, signed by Lynne M. Doughtie, the Chairman and CEO of the firm stated:

> As a result of these procedures, KPMG became aware of instances of unethical and illegal conduct by Wells Fargo employees, including incidents involving these improper sales practices, and we were satisfied that the appropriate members of management were fully informed with respect to such conduct. In 2013, the company initiated an investigation into potential sales misconduct (referred to as "simulated funding") in Southern California.[41]

However, in its letter to the Senators, KPMG also maintained the unauthorized accounts did not impact Wells Fargo's financial statements.

> The opening of an unauthorized account did not itself have an impact on Wells Fargo's financial statements. If a bank employee placed a customer's funds in one authorized account, or in many unauthorized accounts, the total amount of deposits remained constant. Only the total amount of deposits is reported in the bank's financial statements. KPMG analyzed the potential impact on the financial statements of setting up unauthorized accounts, whether caused by an improper sales practice or otherwise. The audit team concluded that the potential impact of any such errors would likely be insignificant.[42]

KPMG also stood by its opinions that Wells Fargo's internal control over financial reporting was effective in all material respects from 2011-2015:

> Accordingly, KPMG has not withdrawn its reports on the bank's financial statements or management's assessment of the effectiveness of its internal controls over financial reporting. As detailed above, the facts developed thus far with respect to the improper sales practices do not implicate the effectiveness of internal controls over financial reporting.[43]

Despite KPMG's assertion that the creation of fake customer accounts did not impact the presentation of Wells Fargo's financial statements or indicate material weaknesses in internal control over financial reporting, the bank and its investors were significantly affected. Wells Fargo ultimately agreed to pay $3 billion to settle criminal charges and a civil action stemming from its widespread mistreatment of customers in its community bank over a 14-year period.[44] In addition, the fake account scandal negatively impacted Wells Fargo's reputation and stock price.[45]

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[41] October 27, 2016 letter from Lynne M. Doughtie, Chairman and CEO of KPMG LLP to United States Senators Elizabeth Warren, Bernard Sanders, Mazie K. Hirono, and Edward J. Markey.
[42] October 27, 2016 letter from Lynne M. Doughtie, Chairman and CEO of KPMG LLP to United States Senators Elizabeth Warren, Bernard Sanders, Mazie K. Hirono, and Edward J. Markey.
[43] October 27, 2016 letter from Lynne M. Doughtie, Chairman and CEO of KPMG LLP to United States Senators Elizabeth Warren, Bernard Sanders, Mazie K. Hirono, and Edward J. Markey.
[44] https://www.nytimes.com/2020/02/21/business/wells-fargo-settlement.html
[45] https://money.cnn.com/2016/09/26/investing/wells-fargo-stock-fake-account-scandal/index.html

Deloitte & Touche LLP's Audit of Adelphia's Financial Statements for 2000

Deloitte failed to detect massive fraud perpetrated by Adelphia and members of the Rigas family

Deloitte identified Adelphia as one of the firm's highest risk clients.[46] The firm's Pittsburgh office deemed Adelphia to have "much greater than normal audit risk."[47]

However, Deloitte failed to design an audit appropriately tailored to address audit risk areas that Deloitte had explicitly identified.[48]

> Specifically, Deloitte issued an audit report containing an unqualified opinion on Adelphia's financial statements for fiscal year 2000 while Deloitte knew or should have known that Adelphia: (a) failed to record all debt on its balance sheet or otherwise failed to disclose that it had improperly excluded $1.6 billion in debt from its balance sheet; (b) failed to disclose significant related party transactions; and (c) overstated its stockholders' equity by $375 million.[49]

Deloitte had received documentation stating Adelphia was jointly and severally liable for $1.6 billion of debt. However, the audit team accepted the company's position that the company was only a "guarantor" for the debt and incorrectly allowed the company to exclude the debt from the audited financial statements.

> As of December 31, 2000, the Co-Borrowing Credit Facilities were completely drawn- down. Of the $3.751 billion outstanding, approximately $1.6 billion of Co-Borrowing debt was improperly excluded from Adelphia's balance sheet for the year-ended 2000 as an Adelphia liability. Moreover, Adelphia's 2000 Form 10-K included a footnote disclosure that was at best ambiguous and was misleading in that it suggested that all of the debt for which Adelphia was liable, including the $1.6 billion owed by the Rigas Co-Borrowers, was properly reflected on Adelphia's balance sheet. This amount represented over 28% of Adelphia's reported bank debt and nearly 10% of Adelphia's reported total liabilities.
>
> Adelphia's rationale to Deloitte for excluding $1.6 billion in debt from its balance sheet was that it was a mere "guarantor" of the Rigas Co-Borrowers, and therefore did not have to reflect such debt as a liability on its balance sheet. Adelphia, however, provided Deloitte's engagement team copies of the agreements underlying the Co-Borrowing Credit Facilities, which revealed that Adelphia was jointly and severally liable for the full amount of such debt. Deloitte's engagement team failed to recognize this discrepancy or to take steps to understand the impact of joint and several liability.[50]

In addition, Deloitte apparently understood the shortcomings with Adelphia's disclosures and repeatedly suggested improvements to the company's disclosure. However, Deloitte ultimately acquiesced to the Adelphia's management and did not require the company to make appropriate disclosure.

> In addition, during the 2000 Audit, Deloitte repeatedly proposed disclosure of the full amount of the Co-Borrowing debt. Deloitte inserted more explicit disclosure, including the amount of Rigas Co-Borrowing debt, in at least six drafts of Adelphia's 2000 Form 10-K. But when Adelphia's management resisted, Deloitte abandoned its attempts to make the disclosure more accurate.[51]

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[46] https://www.sec.gov/news/press/2005-65.htm

[47] Accounting and Auditing Enforcement Release No. 2237 / April 26, 2005, Administrative Proceeding File No. 3-11910, In the Matter of Deloitte & Touche LLP Respondent.

[48] https://www.sec.gov/news/press/2005-65.htm

[49] https://www.sec.gov/news/press/2005-65.htm

[50] Accounting and Auditing Enforcement Release No. 2237 / April 26, 2005, Administrative Proceeding File No. 3-11910, In the Matter of Deloitte & Touche LLP Respondent.

[51] Accounting and Auditing Enforcement Release No. 2237 / April 26, 2005, Administrative Proceeding File No. 3-11910, In the Matter of Deloitte & Touche LLP Respondent.

Deloitte also failed to recognize numerous red flags that indicated the existence of fraudulent entries throughout Adelphia's general ledger[52] and failed to properly object to Adelphia's improper netting of related party payables and receivables.[53]

Deloitte & Touche LLP agreed to pay $50 million to settle charges stemming from its audit of Adelphia Communications Corporation's fiscal year 2000 financial statements.[54]

[52] Accounting and Auditing Enforcement Release No. 2237 / April 26, 2005, Administrative Proceeding File No. 3-11910, In the Matter of Deloitte & Touche LLP Respondent.
[53] Accounting and Auditing Enforcement Release No. 2237 / April 26, 2005, Administrative Proceeding File No. 3-11910, In the Matter of Deloitte & Touche LLP Respondent.
[54] https://www.sec.gov/news/press/2005-65.htm

KPMG LLP's Audits of Xerox's Financial Statements for 1997 – 2000

KPMG failed to comply with Generally Accepted Auditing Standards ("GAAS") and allowed Xerox to utilize accounting actions that did not comply with GAAP

The SEC found:

- KPMG caused and willfully aided and abetted Xerox's violations of the anti-fraud, reporting, recordkeeping and internal controls provisions of the federal securities laws.
- KPMG violated its obligations to disclose to Xerox illegal acts that came to its attention during the Xerox audits.
- From 1997 through 2000, KPMG permitted Xerox to manipulate its accounting practices to close a $3 billion "gap" between actual operating results and results reported to the investing public.[55]

The SEC also determined KPMG was "intimately familiar" with Xerox's improper accounting actions during 1997-2000 but did not require the company to rectify the deficiencies.

> The Order finds that KPMG was intimately familiar with the accounting actions Xerox used on a quarterly and annual basis to increase reported revenues and earnings during 1997-2000. KPMG's audit partners received many warnings from member firms of KPMG International in Europe, Brazil, Canada and Japan that methods adopted by Xerox to "close the gap" between actual and desired results were not based on adequate evidentiary support. Even KPMG's U.S. office in Rochester, N.Y., where Xerox had a major manufacturing and administrative center, warned that topside adjustments were creating unnecessary internal accounting control weaknesses. Nevertheless, from at least 1997 through 2000, KPMG ignored these warnings and did not demand evidence sufficient to establish that these accounting actions and the assumptions Xerox asserted to justify their use were in fact grounded in business realities or fairly reflected the company's performance.[56]

KPMG suggested Xerox management test the assumptions and results of its accounting adjustments to ensure they accurately portrayed Xerox's business. However, Xerox management repeatedly ignored KPMG's requests. KPMG did not demand that Xerox test, and KPMG itself never adequately tested, the assumptions Xerox used to justify its topside accounting actions. KPMG did not test -- or demand Xerox test -- to determine whether the topside accounting adjustment Xerox used resulted in financial statements which fairly presented Xerox's financial results.[57]

The SEC also determined KPMG was aware of information that illegal acts had, or may have occurred, but did not properly inform the board of directors or audit committee.

> In addition, the Order finds that during its audits of Xerox's 1997-2000 financial statements, KPMG became aware of information indicating that illegal acts had or may have occurred as a result of Xerox's use of accounting actions. Although KPMG at times raised concerns to Xerox's management about certain of these accounting actions, KPMG failed prior to the SEC's investigation in this matter to inform Xerox's board of directors or its audit committee about these illegal acts.[58]

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[55] Accounting and Auditing Enforcement Release No. 2235 / April 19, 2005, *SEC v. KPMG LLP, et al.,* Civil Action No. 03 CV 0671 (DLC) (S.D.N.Y.).
[56] Accounting and Auditing Enforcement Release No. 2235 / April 19, 2005, *SEC v. KPMG LLP, et al.,* Civil Action No. 03 CV 0671 (DLC) (S.D.N.Y.).
[57] Accounting and Auditing Enforcement Release No. 2235 / April 19, 2005, *SEC v. KPMG LLP, et al.,* Civil Action No. 03 CV 0671 (DLC) (S.D.N.Y.).
[58] Accounting and Auditing Enforcement Release No. 2235 / April 19, 2005, *SEC v. KPMG LLP, et al.,* Civil Action No. 03 CV 0671 (DLC) (S.D.N.Y.).

In response to Xerox's complaints about KPMG's engagement partner after the 1999 financial statement audit, the firm replaced the engagement partner.[59]

KPMG paid $22 million and undertook a variety of remedial actions to settle the litigation with the SEC related to its audits of Xerox's financial statements.[60]

[59] Accounting and Auditing Enforcement Release No. 2235 / April 19, 2005, *SEC v. KPMG LLP, et al.*, Civil Action No. 03 CV 0671 (DLC) (S.D.N.Y.).
[60] Accounting and Auditing Enforcement Release No. 2235 / April 19, 2005, *SEC v. KPMG LLP, et al.*, Civil Action No. 03 CV 0671 (DLC) (S.D.N.Y.).

Arthur Andersen LLP's Audits of Waste Management, Inc.'s Financial Statements for 1993 – 1996

Arthur Andersen knowingly and recklessly issued false and misleading unqualified audit reports on Waste Management's annual financial statements for the years 1993 through 1996

The SEC found:

- Andersen knowingly or recklessly issued false and misleading unqualified audit reports on Waste Management's annual financial statements for the years 1993 through 1996. The audit reports incorrectly stated the company's financial statements were presented fairly, in all material respects, in conformity with generally accepted accounting principles ("GAAP") and that Andersen's audits were conducted in accordance with generally accepted auditing standards ("GAAS").
- In February 1998, Waste Management announced it was restating its financial statements for the five-year period 1992 through 1996 and the first three quarters of 1997 (the "Restatement"). To date, the Restatement is the largest in the Commission's history. In the Restatement, the company admitted that through 1996 it had materially overstated its reported pre-tax earnings by $1.43 billion and that it had understated certain elements of its tax expense by $178 million.
- The Restatement addressed misstatements that resulted from accounting practices that improperly increased reported operating income primarily by understating operating expenses. In most instances, the company had improperly deferred recognition of current operating expenses to future periods in order to inflate its current period income.
- Andersen, through its partners, identified and documented numerous accounting issues causing the misstatements and likely misstatements the Restatement ultimately addressed, and brought certain of the issues to the attention of Andersen's Practice Director, the firm's Managing Partner and the Audit Division Head for the firm's Chicago office ("Audit Division Head").
- Andersen quantified only certain misstatements. The engagement team also identified, but did not quantify and estimate, accounting practices that gave rise to other known and likely misstatements.
- In connection with the 1993 audit, following the consultations noted above, and prior to the company's announcement of its 1993 earnings, Allgyer presented a "plan" - known as the "Summary of Action Steps" ("Action Steps") - to the company's Chief Executive Officer (later signed and initialed by the company's Chief Financial Officer and Chief Accounting Officer) to reduce, going forward, the cumulative amount of the quantified misstatements and to change, among other things, the accounting practices that gave rise to the quantified misstatements and to the other known and likely misstatements.
- According to an internal memorandum, the Action Steps were the "minimum changes we have concluded are necessary for WMX to implement immediately" and concluded the company's compliance with the "must do" items [in the Action Steps] "brings the Company to a minimum acceptable level of accounting…" The Action Steps also evidenced the fact Andersen had identified the non-GAAP accounting practices that gave rise to numerous misstatements in the company's 1993 through 1996 financial statements.
- In 1995, in many instances, the company did not implement the Action Steps and continued to utilize accounting practices that did not conform with GAAP. Andersen monitored the company's compliance or lack of compliance with the Action Steps.
- In its 1995 financial statements, the company used a $160 million gain that it realized on the exchange of its interest in an entity known as ServiceMaster to offset $160 million in unrelated operating expenses and misstatements that, in most instances, had been identified as misstatements in 1994 and earlier. The company offset the misstatements and expenses against the gain in Sundry Income, Net. The amount netted represented 10% of 1995 pre-tax income before special charges. The company made no disclosure of the netting.
- After reaching a preliminary determination that the amounts being netted were not material to the financial statements taken as a whole, two of the partners on the engagement consulted with the Practice Director

for Andersen's Central Region about the netting and whether Andersen would be required to qualify or withhold its audit report if the company netted the ServiceMaster gain and did not disclose the netting. The Practice Director understood that only prior period adjustments would be netted. He concluded, although the netting did not conform with GAAP and the netted items would not be disclosed, Andersen did not need to qualify or withhold its audit report. He reasoned the netting and the non-disclosure of the misstatements, and the unrelated gain did not prevent the issuance of the unqualified audit report because he concluded they were not material to the company's 1995 financial statements taken as a whole. In fact, these items were material. Andersen's 1995 unqualified audit report was materially false and misleading.

- Several months after the completion of the 1995 audit and the company's filing of its 1995 Form 10-K with the Commission, Andersen prepared a memorandum articulating its disagreement with the company's use of netting and the lack of disclosure. The memorandum discussed the ServiceMaster transaction of 1995 and gains from other transactions in 1996 that were netted without disclosure.
- As reported to the audit committee, between 1991 and 1997, Andersen billed Waste Management corporate headquarters approximately $7.5 million in audit fees. Over this seven-year period, while Andersen's corporate audit fees remained capped, Andersen also billed Waste Management corporate headquarters $11.8 million in other fees, much of which related to tax, attest work unrelated to financial statement audits or reviews, regulatory issues, and consulting services.
- A related entity, Andersen Consulting, also billed Waste Management corporate headquarters approximately $6 million in additional non-audit fees. Of the $6 million in Andersen Consulting fees, $3.7 million related to a Strategic Review that analyzed the overall business structure of the company and ultimately made recommendations on implementing a new operating model designed to "increase shareholder value."
- The Commission in this case found that Andersen failed to stand up to management to prevent the issuance of materially misstated financial statements. Instead, Andersen allowed the company to establish - and then continue for many years - a series of improper accounting practices.[61]

Arthur Andersen settled with the SEC. The settlement included (1) consent to a permanent injunction from violating securities laws, (2) payment of a civil money penalty of $7 million, and (3) censure under rule 102(e) based upon the Commission's finding the firm had engaged in improper professional conduct.[62]

The SEC also settled with individual Arthur Andersen partners who participated in the audits of Waste Management's financial statements. These individuals consented to permanent injunctions agreeing to not violate securities laws, paid civil money penalties, and were denied the privilege of practicing as accountants before the Commission, subject to requesting reinstatement after periods ranging from one to five years.[63]

[61] Accounting and Auditing Enforcement Release No. 1410 / June 19, 2001, Securities and Exchange Commission v. Arthur Andersen LLP, et al., Civil Action No. 1:01CV01348 (J.R.) (D.D.C. June 19, 2001).
[62] Accounting and Auditing Enforcement Release No. 1410 / June19, 2001, Securities and Exchange Commission v. Arthur Andersen LLP, et al., Civil Action No. 1:01CV01348 (J.R.) (D.D.C. June 19, 2001).
[63] Accounting and Auditing Enforcement Release No. 1410 / June19, 2001, Securities and Exchange Commission v. Arthur Andersen LLP, et al., Civil Action No. 1:01CV01348 (J.R.) (D.D.C. June 19, 2001).

Public Company Accounting Oversight Board ("PCAOB") Registered Public Accounting Firm Former Partner's Audit of Magnum Hunter Resources ("MHR") Corporation's 2011 Internal Control Over Financial Reporting ("ICFR")

Former Partner engaged in improper professional conduct by failing to conduct the 2011 audit of MHR's ICFR in accordance with PCAOB Standards

Wayne Gray is a former partner at a PCAOB-registered public accounting firm. Gray was the engagement partner responsible for providing MHR's external auditing services for the December 31, 2009 through June 30, 2012 reporting periods. At this time, he was a CPA licensed in the state of Texas.

In connection with the issuance of the external auditor's report on MHR's 2010 year-end audit results, Gray informed Ormand [MHR's Chief Financial Officer], Krueger [MHR's Chief Accounting Officer], and MHR's Audit Committee in February 2011 that MHR's accounting department was experiencing "manpower issues" and lacked sufficient personnel to complete all required tasks on a timely basis.[64] These factors are indicators of ineffective ICFR.

In February 2012, a year after first raising concerns over MHR's accounting "manpower issues," Gray reported to MHR's Audit Committee:

> a "[d]elay in closing the books due to [the] Company manpower shortage relative to [the] volume of financial activity." This resulted in "[n]umerous top-side adjustments" creating significant audit inefficiencies.
>
> We believe there is not adequate internal control over financial reporting due to inadequate and inappropriately aligned staffing. This factor increases the possibility of a material error occurring and being undetected and reduces the Company's ability to file its 10-K on time.[65]

MHR's inability to remediate these deficiencies, which Gray was aware of, over the course of a year illustrates the company's lack of ability or initiative to solve the problem. These are the types of issues auditors at a PCAOB registered firms should analyze and directly address.

The SEC order identifies:

> Despite assessing that there was "not adequate internal control over financial reporting due to inadequate and inappropriately aligned staffing," Gray concluded that this control deficiency rose to the level of a significant deficiency—rather than a material weakness. The audit work papers failed to adequately document the basis for this conclusion.[66]

The SEC order states:

> Gray improperly applied the definitions of "material weakness" and "significant deficiency" codified in Rule 1-02(a)(4) of Regulation S-X and Appendix A of AS 5. The severity of a deficiency does not depend on whether an error actually occurred.

[64] Accounting and Auditing Enforcement Release No. 3754 / March 10, 2016, Administrative Proceeding, File No. 3-17164, In the Matter of Wayne Gray, CPA, Respondent.
[65] Accounting and Auditing Enforcement Release No. 3754 / March 10, 2016, Administrative Proceeding, File No. 3-17164, In the Matter of Wayne Gray, CPA, Respondent.
[66] Accounting and Auditing Enforcement Release No. 3754 / March 10, 2016, Administrative Proceeding, File No. 3-17164, In the Matter of Wayne Gray, CPA, Respondent.

> Notwithstanding the systemic importance of an entity-level control, the written analysis was deficient for two reasons. First, it failed to apply the appropriate standard for defining a material weakness. Second, it failed to evaluate the severity of MHR's control deficiency in accordance with AS 5.[67]

The SEC Order also states:

> Gray engaged in improper professional conduct by failing to conduct the 2011 audit of MHR's ICFR in accordance with PCAOB Standards. First, Gray failed to properly evaluate identified deficiencies using the appropriate standard of a material weakness as defined in Rule 1-02(a)(4) of Regulation S-X and AS 5. Second, Gray failed to document the basis of his conclusion in a manner consistent with AS 3.[68]

The Commission imposed the sanctions agreed to in Gray's settlement offer, which included:

- Gray cease and desist from committing or causing any violations and any future violations of securities laws,
- Gray was denied the privilege of appearing or practicing before the Commission as an accountant,
- After one year Gray could request the Commission consider his reinstatement to resume appearing or practicing before the Commission.[69]

[67] Accounting and Auditing Enforcement Release No. 3754 / March 10, 2016, Administrative Proceeding, File No. 3-17164, In the Matter of Wayne Gray, CPA, Respondent.
[68] Accounting and Auditing Enforcement Release No. 3754 / March 10, 2016, Administrative Proceeding, File No. 3-17164, In the Matter of Wayne Gray, CPA, Respondent.
[69] Accounting and Auditing Enforcement Release No. 3754 / March 10, 2016, Administrative Proceeding, File No. 3-17164, In the Matter of Wayne Gray, CPA, Respondent.

Foreign Corrupt Practices Act ("FCPA")

The FCPA has been part of United States law for more than 45 years old. Compliance with the FCPA and its anti-bribery provisions remains a top priority for regulators, including the Securities and Exchange Commission ("SEC"), the Department of Justice ("DOJ"), and the Public Company Accounting Oversight Board ("PCAOB"). The SEC enhanced its Enforcement Division in 2010 by creating a specialized unit devoted to FCPA enforcement activities. The DOJ and SEC collaborated to produce a comprehensive resource guide regarding the FCPA. In 2016, the DOJ initiated a program to encourage self-reporting of FCPA violations, the DOJ's Fraud Section increased its staff of FCPA prosecutors by 50 percent, and the FBI added three new squads of agents specifically devoted to FCPA enforcement.[70]

The FCPA created prohibitions against bribery of foreign officials and provided an enforcement mechanism for the SEC and DOJ to prosecute violators. Often included among the violations in bribery-related enforcement actions are the accounting provisions contained within the FCPA.[71]

Those provisions require issuers:

(1) to make and keep books and records that accurately reflect the transactions of the firm (commonly known as the "books and records" provision);
(2) to devise and maintain a system of internal accounting controls (the "internal controls" provision); and
(3) to prevent anyone from knowingly circumventing or failing to implement a system of internal controls or from falsifying any book, record, or account.[72]

As of December 31, 2017, 90 percent of the 278 FCPA enforcement actions involved at least one of the accounting provisions, suggesting that internal auditors, forensic specialists, and external auditors are critical to FCPA enforcement. Every global accounting firm promotes awareness of the FCPA and offers services to assist with compliance.[73]

Importantly, the FCPA does not have a materiality threshold and the Act's accounting provisions are of foremost importance to regulators. Auditors need to consider FCPA risk, in part because in the context of the FCPA, penalties and other costs – such as investigations, remediation, increased audit fees – incurred by violators can increase potentially immaterial concerns into material contingencies.[74]

[70] American Accounting Association, Research Article, July 1, 2019, How Do Auditors Respond to FCPA Risk? Bradley P. Lawson; Gerald Martin; Leah Muriel; Michael S. Wilkins
[71] American Accounting Association, Research Article, July 1, 2019, How Do Auditors Respond to FCPA Risk? Bradley P. Lawson; Gerald Martin; Leah Muriel; Michael S. Wilkins
[72] American Accounting Association, Research Article, July 1, 2019, How Do Auditors Respond to FCPA Risk? Bradley P. Lawson; Gerald Martin; Leah Muriel; Michael S. Wilkins
[73] American Accounting Association, Research Article, July 1, 2019, How Do Auditors Respond to FCPA Risk? Bradley P. Lawson; Gerald Martin; Leah Muriel; Michael S. Wilkins
[74] American Accounting Association, Research Article, July 1, 2019, How Do Auditors Respond to FCPA Risk? Bradley P. Lawson; Gerald Martin; Leah Muriel; Michael S. Wilkins

Magnum Hunter Resources ("MHR") Corporation's 2011 Internal Control Over Financial Reporting ("ICFR")

MHR's ICFR Deficiencies and "Books and Records" Violation

The SEC settled its proceeding with MHR related to the failure by MHR and MHR's management's to properly implement, maintain, and evaluate ICFR for the fiscal year-ended December 31, 2011 and to maintain ICFR sufficient to keep pace with MHR's growth from at least the fiscal year-ended December 31, 2011 through the quarter-ended September 30, 2013. MHR's failures resulted in part from Ronald D. Ormand ("Ormand") [MHR's Chief Financial Officer] and David S. Krueger ("Krueger") [Chief Accounting Officer] improperly evaluating the severity of identified control deficiencies.[75]

The SEC determined:

> MHR violated Section 13(b)(2)(A) of the Exchange Act, which requires Section 12 registrants to make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer, and Section 13(b)(2)(B) of the Exchange Act, which requires Section 12 registrants to devise and maintain a system of sufficient internal accounting controls.
>
> MHR violated Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13, thereunder, which require issuers with classes of securities registered pursuant to Section 12 to file periodic and other reports with the Commission and Rule 13a-15(a) which requires issuers to maintain ICFR.[76]

Due to these violations MHR was directed to cease and desist from future violations of the securities laws and paid a civil money penalty of $250,000.[77]

[75] Accounting and Auditing Enforcement Release No. 3756 / March 10, 2016, Administrative Proceeding, File No. 3-17166, In the Matter of Magnum Hunter Resources Corporation Respondent.
[76] Accounting and Auditing Enforcement Release No. 3756 / March 10, 2016, Administrative Proceeding, File No. 3-17166, In the Matter of Magnum Hunter Resources Corporation Respondent.
[77] Accounting and Auditing Enforcement Release No. 3756 / March 10, 2016, Administrative Proceeding, File No. 3-17166, In the Matter of Magnum Hunter Resources Corporation Respondent.

APPENDIX II

Members of the Investor Advisory Group
Responses to Questions
***Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations - And Other Related Amendments* (PCAOB Release No. 2023-003, June 6, 2023: PCAOB Rulemaking Docket Matter No. 051)**
August 10, 2023

1. Is the proposed definition of "noncompliance with laws and regulations" sufficiently clear? If not, why not?[78]

The Public Company Accounting Oversight Board (PCAOB or Board) Proposing Release on *Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations - And Other Related Amendments* (Proposal) states that the auditor should focus on those laws and regulations with which noncompliance "could reasonably have a material effect on the financial statements . . . ."[79] This is consistent with the PCAOB's current standards which state: "The exercise of due professional care allows the auditor to obtain *reasonable assurance* about whether the financial statements are free of material misstatement, whether caused by error or fraud . . . ."[80]

2. Is the rationale for including fraud, as described in AS 2401, within the proposed definition of noncompliance with laws and regulations sufficiently clear? If not, why not?[81]

We believe that the rationale for including fraud, as described in AS 2401,[82] within the proposed definition of noncompliance with laws and regulations (NOCLAR) is sufficiently clear. More specifically, we agree with the PCAOB's conclusion that:

> AS 2401.05 describes fraud as an "intentional act that results in a material misstatement in financial statements that are the subject of an audit." Accordingly, by definition, such noncompliance has a material effect on the financial statements. While AS 2401 would continue to govern the auditor's responsibilities with respect to the identification of information that may be indicative of fraud, the evaluation and communication of fraud would be addressed by proposed AS 2405, and those requirements would be applied in the same manner as for other forms of noncompliance with laws and regulations.[83]

Similarly, we concur with PCAOB Chair Erica Y. Williams that:

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[78] PCAOB, Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations - And Other Related Amendments, PCAOB Release No. 2023-003 at 25 (June 6, 2023) (emphasis added), https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-051/pcaob-release-no.-2023-003---noclar.pdf.
[79] *See, e.g., id.* at ¶.03, A1-2.
[80] AS 1015: Due Professional Care in the Performance of Work, PCAOB ¶.10 (last visited Aug. 3, 2023), https://pcaobus.org/oversight/standards/auditing-standards/details/AS1015#:~:text=Due%20professional%20care%20imposes%20a,of%20field%20work%20and%20reporting; *see also* AU Section 508 Reports on Audited Financial Statements (last visited Aug. 3, 2023), https://pcaobus.org/oversight/standards/auditing-standards/details/AS3101 ("Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.").
[81] PCAOB Release No. 2023-003 at 25 (emphasis added).
[82] AS 2401: Consideration of Fraud in a Financial Statement Audit, PCAOB (last visited July 15, 2023), https://pcaobus.org/oversight/standards/auditing-standards/details/AS2401.
[83] PCAOB Release No. 2023-003 at 25.

> [T]here is a direct relationship between the fraud standard and the proposed NOCLAR standard. Fraud is a type of NOCLAR. So, the proposed NOCLAR standard would govern the evaluation and communication of fraud and those requirements would be applied in the same manner as for other forms of noncompliance with laws and regulations.
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> Still, our fraud standard, AS 2401, *Consideration of Fraud in a Financial Statement Audit*, would continue to govern the auditor's responsibilities with respect to the identification of information that may be indicative of fraud. And we continue to have a project related to AS 2401 on our mid-term agenda.[84]

We support the PCAOB's separate mid-term project on its standard-setting agenda to consider how AS 2401 should be revised to enhance the auditor's responsibilities for the identification of information that may be indicative of fraud, including addressing matters that may arise from developments in the use of technology.[85] The Members of the Investor Advisory Group (MIAG) currently plan to comment on the pending proposed revisions to AS 2401 when issued, including the appropriateness of potentially combining those proposed revisions with a final standard resulting from the Proposal.

3. Is additional clarification necessary regarding the scope of the meaning of a company's noncompliance with laws and regulations? If so, please describe or provide examples of the types of noncompliance where additional clarification is needed.[86]

We believe additional clarification may be necessary regarding the scope of the meaning of a company's NOCLAR. Moreover, we believe providing additional clarification would be accomplished by providing a list of potential laws and regulations that might affect a company and that the auditor should consider. The following nonexclusive list is taken from International Standard on Auditing 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*:

- Fraud, corruption and bribery,
- Money laundering, terrorist financing and proceeds of crime,
- Securities markets and trading,
- Banking and other financial products and services,
- Data protection,
- Tax and pension liabilities and payments,
- Environmental protection, and
- Public health and safety.[87]

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[84] Erica Y. Williams, Chair, PCAOB Chair Williams Delivers Remarks at Investor Advisory Group Meeting (June 7, 2023), https://pcaobus.org/news-events/speeches/speech-detail/pcaob-chair-williams-delivers-remarks-at-investor-advisory-group-meeting-2023.

[85] *See* Standard-Setting, Research, and Rulemaking Projects, PCAOB (last visited July 15, 2023), https://pcaobus.org/oversight/standards/standard-setting-research-projects (Describing the mid-term project on fraud as "[c]onsider[ing] how AS 2401, *Consideration of Fraud in a Financial Statement Audit*, should be revised to better align an auditor's responsibilities for addressing intentional acts that result in material misstatements in financial statements with the auditor's risk assessment, including addressing matters that may arise from developments in the use of technology."); Investor Bulletin - Opportunity to Comment on Proposed Standard Addressing an Auditor's Responsibility Related to a Company's Noncompliance With Laws and Regulations (NOCLAR), PCAOB (June 30, 2023), https://pcaobus.org/resources/information-for-investors/investor-advisories/investor-bulletin-opportunity-to-comment-on-proposed-standard-addressing-an-auditor-s-responsibility-related-company-noncompliance-with-laws-regulations ("The PCAOB continues to have a separate mid-term project on its standard-setting agenda to consider how AS 2401 should be revised to enhance the auditor's responsibilities for the identification of information that may be indicative of fraud, including addressing matters that may arise from developments in the use of technology.").

[86] PCAOB Release No. 2023-003 at 25 (emphasis added).

[87] International Standard on Auditing 250 (Revised), Consideration of Laws and Regulations in an Audit of Financial Statements ¶A6, 12-13 (Oct. 2016), https://www.ifac.org/_flysystem/azure-private/publications/files/IAASB-NOCLAR-ISA-250-Revised-and-Related-

4. Is the introduction to proposed AS 2405 sufficiently clear? If not, how should the introduction be clarified?[88]

We believe the introduction to proposed AS 2405 is sufficiently clear.

5. Are the objectives for proposed AS 2405 sufficiently clear? If not, how should the objectives be clarified?[89]

We believe the objectives for proposed AS 2405 are sufficiently clear. We note that the language of the initial objective in paragraph .04a. is generally consistent with the following 2017 recommendation of the *Report of the Working Group on Auditor's Consideration with Laws and Regulations* (2017 Working Group): "Clarify that audit is responsible for detecting illegal acts which *could have a material effect on the financial statements* . . . ."[90]

Although we believe the proposed objective is sufficiently clear, we are aware that some in the accounting profession appear to disagree and allege the "could reasonably have a material effect" language is a new concept, is unclear or is undefined.[91] As an alternative, we would respectfully recommend the replacement of the phrase "could reasonably" with the phrase "is reasonably likely to."

We note that the phrase "reasonably likely" is well understood by issuers, auditors, and investors and has been an integral part of the risk-probability assessment for MD&A disclosures for more than a decade.[92] The phrase also includes the following explanatory note that could be incorporated into the Proposal to ensure even greater clarity:

> Note that "reasonably likely" is a lower threshold than "more likely than not" but a higher threshold than "remote." The concept of "reasonably likely" is used in the context of disclosure for MD&A purposes and is not intended to mirror the tests in ASC 450 established to determine when accrual is necessary, or when disclosure in the footnotes to the financial statements is required.[93]

We believe the replacement of the phrase "could reasonably" with the phrase "is reasonably likely to" could strengthen aspects of the proposed requirements that would otherwise provide for auditors to undertake appropriate risk-probability assessments, while also clarifying the primary focus of auditors. We also believe this proposed change could clarify the scope of auditor inquiry appropriately to those that are most likely to impact financial statements and reporting integrity.

6. Are there other objectives that should be included in proposed AS 2405? If so, what would those objectives be?[94]

We believe there should be at least one supplemental objective to the proposed objective in AS 2405 to "[i]dentify whether there are instances of noncompliance with laws and regulations that have or may have occurred . . . ."[95]

Conforming-Amendments-Oct-2016.pdf; *see* Report from the Working Group on Auditor's Consideration of a Client's Noncompliance with Laws and Regulations (NOCLAR) 15 (Oct. 24, 2017), https://pcaobus.org/News/Events/Documents/10242017-IAG-meeting/WG-slides-NOCLAR.pdf (recommending a "non exclusive list of example illegal acts as the IAASB has done").

[88] PCAOB Release No. 2023-003 at 28 (emphasis added).

[89] *Id.*

[90] Report from the Working Group on Auditor's Consideration of a Client's Noncompliance with Laws and Regulations at 15 (emphasis added).

[91] *See, e.g.,* To the Point, PCAOB – proposal, PCAOB proposes expanding auditor's responsibilities for considering noncompliance with all laws and regulations, EY 4 (June 29, 2023), https://www.ey.com/en_us/assurance/accountinglink/to-the-point-pcaob-proposes-expanding-auditors-responsibilities-for-considering-noncompliance-with-all-laws-and-regulations ("The proposal would introduce, without defining, new concepts such as 'could reasonably have a material effect,' . . . .").

[92] *See, e.g.,* Financial Reporting Manual, TOPIC 9 - Management's Discussion and Analysis of Financial Position and Results of Operations (MD&A), 9100 MD&A Objectives (Last updated: 9/30/2008), https://www.sec.gov/corpfin/cf-manual/topic-9.

[93] *Id*. § 9220.11.

[94] PCAOB Release No. 2023-003 at 34 (emphasis added).

[95] *See id.* at ¶.04c., A1-2.

More specifically, we would respectfully recommend that the proposed objectives in AS 2405 include a supplemental objective that the auditor obtain visibility to known instances of NOCLAR throughout the issuers' organization.

7. Is the proposed requirement for auditors to identify laws and regulations applicable to the company with which noncompliance could reasonably have a material effect on the financial statements sufficiently clear? If not, why not?[96]

We generally believe the proposed requirement for auditors to identify laws and regulations applicable to the company with which noncompliance could reasonably have a material effect is sufficiently clear. Please refer to our response to Question # 5.

We are supportive of Proposal's inclusion of "an unconditional responsibility (that is, a 'must') for auditors to plan and perform procedures to assess and respond to risks of material misstatement in the financial statements due to noncompliance with laws and regulations . . . ."[97] Our support is consistent with the 2017 Working Group recommended that AS 2405[98] should be revised "to clarify those audit procedures auditors MUST do versus SHOULD do."[99]

Finally, we agree with PCAOB Chair Williams that the proposed requirement "makes clear what investors already expect – that it is the auditor's responsibility to proactively be on guard for all noncompliance that may have a material impact on the financial statements."[100]

8. Will auditors be able to identify those laws and regulations applicable to the company with which noncompliance could reasonably have a material effect on the financial statements? If not, why not?[101]

We believe auditors will be able to identify those laws and regulations applicable to the company and with which noncompliance is reasonably likely to have a material effect on the financial statements. The Proposal sets up an established process whereby the auditor first gains an understanding of the company and its business, including operations. The understanding would include gaining an understanding of how the company determines compliance with the applicable laws and regulations.

Second, the auditor assesses the risk of whether noncompliance would be reasonably likely given the existing facts to result in a material misstatement of the financial statements. Third, through the design of the audit tests and procedures, the auditor would obtain and test relevant evidence, including internal controls. If necessary, the auditor would appropriately utilize a specialist, such as an attorney. This is an established process that would achieve the objective of the Proposal.

We agree with PCAOB Chair Williams that "the laws and regulations . . . are readily available to the auditor."[102] As Chair Williams explains:

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[96] *Id.* at 34 (emphasis added).
[97] *Id.* at 30.
[98] AS 2405: Illegal Acts by Clients, PCAOB (last visited July 21, 2023), https://pcaobus.org/oversight/standards/auditing-standards/details/AS2405.
[99] *See* Report from the Working Group on Auditor's Consideration of a Client's Noncompliance with Laws and Regulations at 15 (Noting categories of laws and regulation enumerated in International Auditing Standards and "**NOT Followed by PCAOB**").
[100] PCAOB Chair Williams' Statement on Proposed New Standard for the Auditor's Use of Confirmation (Dec. 20, 2022), https://pcaobus.org/news-events/speeches/speech-detail/pcaob-chair-williams-statement-on-proposed-new-standard-for-the-auditor-s-use-of-confirmation.
[101] PCAOB Release No. 2023-003 at 14 (emphasis added).
[102] Erica Y. Williams, Chair, PCAOB Open Board Meeting, Statement on Proposed New Standard Regarding Noncompliance With Laws and Regulations (June 6, 2023), https://pcaobus.org/news-events/speeches/speech-detail/statement-on-proposed-new-standard-regarding-noncompliance-with-laws-and-regulations#:~:text=The%20proposed%20standard%2C%20AS%202405,noncompliance%20with%20laws%20and%20regulations.

> [T]his does not mean auditors are required to know every single law or regulation on the books. In fact, the proposal itself clearly states: "These laws and regulations would necessarily be relevant to the company or its operations but would *not* represent every law or regulation to which the company is subject."
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> Other PCAOB standards already require auditors to have adequate technical training and proficiency to conduct an audit, which includes a basic understanding of a company's regulatory environment. And the companies themselves know the laws and regulations they must follow, and which ones pose the greatest risks, because they have to include such risks to comply with certain disclosure requirements.[103]

Similarly, PCAOB member Anthony C. Thompson observed:

> Auditors . . . are not required to know every single law or regulation a company might be subject to. In fact, the proposal itself clearly states, "These laws and regulations would necessarily be relevant to the company or its operations *but would not* represent every law or regulation to which the company is subject." Moreover, auditors do not start from a blank slate – the auditor benefits from management's process to identify these laws and regulations. Issuers currently identify and disclose material risks related to laws and regulations in periodic filings made under federal securities laws.
>
> . . . The list developed by management of such laws and regulations is a source of information for the auditor.
>
> In addition, auditors should already have knowledge of a company's regulatory environment as required under existing PCAOB standards, including risk assessment.
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> . . . [W]e believe the standard will promote audit quality by ensuring that auditors identify, assess, and respond to material noncompliance, and in so doing, the standard promotes investor protection.[104]

Moreover, we believe the ability of auditors to be able to identify those laws and regulations applicable to the company with which noncompliance is likely to have a material effect on the financial statements is enhanced by the Proposal's: (1) identification and description of two categories of laws and regulations: (a) those "that relate to the way matters are presented;"[105] and (b) those that may relate to the "operations of a company with which the company's noncompliance could reasonably result in material penalties, fines, or damages to the company . . . ."; [106] and (2) some examples for each category.[107]

9. Are there additional procedures that should be required for auditors to perform to identify those laws and regulations applicable to the company with which noncompliance could reasonably have a material effect on the financial statements? If so, describe.[108]

We believe there may be additional procedures that should be required for auditors to perform, other than those identified herein, to identify those laws and regulations applicable to the company with which noncompliance is

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[103] *Id.*
[104] Anthony C. Thompson, Board Member, PCAOB Open Board Meeting, Statement on Proposed Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations (June 6, 2023), https://pcaobus.org/news-events/speeches/speech-detail/statement-on-proposed-amendments-to-pcaob-auditing-standards-related-to-a-company-s-noncompliance-with-laws-and-regulations-thompson.
[105] PCAOB Release No. 2023-003 at 29.
[106] *Id.*
[107] *See id.* at 29 ("for example, tax, pension, and certain securities laws [and] . . . for example, for a chemical company, environment protection regulations").
[108] *Id.* at 34-35 (emphasis added).

likely to have a material effect on the financial statements.[109] As one example, we believe those additional procedures could include revisions to the proposed amendments to the AS 2805, *Management Representations*[110] explicitly requiring that the signatories to the management representation letter include each member of the management team with front line responsibility for the company's operational compliance with laws and regulations as well as those with higher level responsibility for individual business units. We believe this additional procedure could indirectly result in improved processes that better ensure that management and the auditor have greater ability to identify known instances of NOCLAR throughout the organization.

10. Is the proposed requirement for auditors to assess and respond to the risks of material misstatement due to noncompliance with laws and regulations sufficiently clear? If not, why not?[111]

We believe the proposed requirement for auditors to assess and respond to the risks of material misstatement due to noncompliance with laws and regulations is sufficiently clear. We are particularly supportive of requiring the auditor to plan and perform audit procedures to identify the laws and regulations with which compliance is reasonably likely to result in a material effect on the financial statements, including taking into account the "auditor's planning activities [and] . . . "[o]ther audit procedures performed during the audit."[112] We believe this aspect of the proposed requirements is also directly responsive to a recommendation of the 2017 Working Group to "[r]equire auditor to assess the risk of an illegal act as part of the audit planning process, including the audit procedures to be performed."[113]

11. Is the proposed requirement that auditors identify whether there is information indicating that noncompliance (with those laws and regulations with which noncompliance could reasonably have a material effect on the financial statements) has or may have occurred sufficiently clear? If not, why not?[114]

We believe the proposed requirement that auditors identify whether there is information indicating that noncompliance has or may have occurred is sufficiently clear. Moreover, we are surprised and disappointed by the suggestions of some that the "has or may have occurred" language in the proposed requirement[115] "introduce[es], without defining, [a] new concept[] . . . to guide the auditor's effort."[116] We note that the phrase "has or may have occurred" was taken directly from the requirements of Section 10A of the Securities and Exchange Act of 1934 (34 Act).[117] It is, at best, misleading to suggest that the phrase is a new concept for auditors.

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[109] *See id.* at ¶.05a., A1-2 (".05 The auditor must plan and perform procedures to: a. Identify the laws and regulations with which noncompliance could reasonably have a material effect on the financial statements; . . . .").

[110] *See id*. at ¶.6, A2-21 to -22 (".06 In connection with an audit of financial statements presented in accordance with generally accepted accounting principles, specific representations should relate to the following matters . . . .").

[111] *Id.* at 35 (emphasis added).

[112] *Id.* at 29-30; *see id.* at ¶.07 n.7, A1-4 ("Information from the auditor's client acceptance and retention evaluation, audit planning activities, past audits, and other engagements may inform and assist the auditor when evaluating information that the auditor has identified or becomes aware of that might indicate that noncompliance with a law or regulation has occurred.").

[113] *See* Report from the Working Group on Auditor's Consideration of a Client's Noncompliance with Laws and Regulations at 15.

[114] PCAOB Release No. 2023-003 at 35 (emphasis added).

[115] *See id*. at ¶.05c., A1-3.

[116] To the Point, PCAOB – proposal, PCAOB proposes expanding auditor's responsibilities for considering noncompliance with all laws and regulations, EY at 4.

[117] Audit requirements, 15 U.S.C. § 78j–1 (June 1934), *available at* https://www.law.cornell.edu/uscode/text/15/78j-1 ("**(b)REQUIRED RESPONSE TO AUDIT DISCOVERIES (1)INVESTIGATION AND REPORT TO MANAGEMENT** If, in the course of conducting an audit pursuant to this chapter to which subsection (a) applies, the registered public accounting firm detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred, the firm shall, in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the Commission—**(A)(i)** determine whether it is likely that an illegal act has occurred; and **(ii)** if so, determine and consider the possible effect of the illegal act on the financial statements of the issuer, including any contingent monetary effects, such as fines, penalties, and damages; and **(B)** as soon as practicable, inform the appropriate level of the management of the issuer and assure that the audit committee of the issuer, or the board of directors of the issuer in the absence of such a committee, is adequately informed with respect to illegal acts that have been detected or have otherwise come to the attention of such firm in the course of the audit, unless the illegal act is clearly inconsequential.").

12. Are there other specific procedures the auditor should be required to perform to assist them in identifying whether there is information indicating that noncompliance (with those laws and regulations with which noncompliance could reasonably have a material effect on the financial statements) has or may have occurred? If so, what are those procedures?[118]

As indicated in response to Question # 9, we believe there may be other specific procedures the auditor should be required to perform to assist them in identifying whether there is information indicating that noncompliance has or may have occurred. In addition, while we acknowledge that the proposed requirements include procedures that provide that "the auditor . . . would perform additional procedures to understand the company's . . . whistleblower . . . . compliance programs," we believe the proposed requirements could be improved.[119]

In addition, and consistent with a recommendation of the 2017 Working Group, we believe the proposed requirements should be revised to explicitly "[r]equire the auditor to gain an understanding of the whistleblower hot line system, including how it is operated, who calls are reported to, and whether calls and tips have been resolved to the satisfaction of the auditor."[120] We believe the proposed requirements should also be revised to require the auditor:

- To obtain an understanding of the audit committee's and management's policies, processes, and procedures for the program. This includes employee training with respect to the program, determining the independence of the program from those responsible for defending the company against such complaints, and the process for investigating, assessing and resolving complaints.
- To test controls to determine if the policies, processes, and procedures operate as expected.
- To review and assess complaints that are reasonably likely to have a material effect on the financial statements. When the auditor considers it necessary, and is able, to undertake an interview of the complainant.
- To discuss with the audit committee the nature of whistleblower hotline's operation.

We note that this last proposed requirement is generally consistent with a "best practice" suggested by the SEC Chief Accountant Paul Munter who recently stated:

> For companies . . . a whistleblower hotline or other means of anonymously reporting questionable accounting or auditing matters is . . . another good start; however, has the issuer simply checked the box on the requirement, or does the issuer have a culture that encourages whistleblowers who see something to actually say something? For example, an auditor may want to discuss with the audit committee the nature of the whistleblower hotline's operation.[121]

We also note that in some industries, independent as well as internal auditors will obtain reports from regulators and read and review them for relevant information. Such reports may or can be relevant to assessing NOCLAR.

The independent auditor should also gain an understanding of management's and the company's disclosure committee, including who is on it, how often it meets, its agenda and the basis it reached with respect to the

[118] PCAOB Release No. 2023-003 at 35 (emphasis added).
[119] *Id.* at 82; *see id.* at ¶.26f., A2-7, ¶.56a(7), A2-9, ¶.56b(4), A2-10.
[120] Report from the Working Group on Auditor's Consideration of a Client's Noncompliance with Laws and Regulations at 16.
[121] Paul Munter, Acting Chief Accountant, Statement, The Auditor's Responsibility for Fraud Detection (Oct. 11, 2022), https://www.sec.gov/news/statement/munter-statement-fraud-detection-101122.

disclosures made or omitted.[122] The U.S. Securities and Exchange Commission (SEC or Commission) defines "disclosure controls and procedures" as follows:

> *[D]isclosure controls and procedures* means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Act (15 U.S.C. 78a *et seq.*) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms.[123]

PwC also appropriately highlights in its publication "Getting the most out of disclosure committees:"

> A disclosure committee is a great opportunity for senior management to set the right tone for the broader management team that disclosure controls and procedures are important. In addition, a disclosure committee with the right composition helps ensure that information from across the organization is considered for disclosure and provides its members with an opportunity to learn from each other.[124]

13. Are there other examples of procedures which might assist the auditor in identifying laws and regulations with which noncompliance could reasonably have a material effect on the financial statements or alert the auditor to information indicating that noncompliance has or may have occurred that should be included? If so, what are they?[125]

Please refer to our responses to Questions # 9 and # 12.

14. Are there other procedures that auditors perform today that should be required to assist the auditor in (1) identifying laws and regulations with which noncompliance could reasonably have a material effect on the financial statements, (2) assessing and responding to risks of material misstatement due to noncompliance with those laws and regulations, or (3) identifying information indicating that noncompliance with those laws and regulations has or may have occurred? If so, what are they?[126]

Please refer to our responses to Questions # 9 and # 12.

15. Are auditors using technology-assisted audit procedures to assess and respond to risks of material misstatement due to noncompliance with laws and regulations or to identify information indicating that noncompliance with laws and regulations has or may have occurred? If so, describe those audit techniques.[127]

It is our understanding that auditors do not disclose whether they are using technology-assisted audit procedures to assess and respond to risks of material misstatement due to noncompliance with laws and regulations or to identify information indicating that noncompliance with laws and regulations has or may have occurred.

16. Is the proposed approach to include the requirements related to understanding (1) the laws and regulations that govern the determination of the form and content of the financial statements and (2) those

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[122] *See generally,* Disclosure Committee Essentials, Governance Insights Center, PwC (July 2022), https://www.pwc.com/us/en/governance-insights-center/publications/assets/pwc-disclosure-committee-essentials.pdf (discussing disclosure committees).
[123] Controls and procedures, 17 C.F.R. § 240.13a-15(e) (as amended June 27, 2007), *available at* https://www.law.cornell.edu/cfr/text/17/240.13a-15.
[124] Disclosure Committee Essentials, Governance Insights Center, PwC at 2.
[125] PCAOB Release No. 2023-003 at 35 (emphasis added).
[126] *Id.*
[127] *Id.*

other laws and regulations with which the company's noncompliance could reasonably have a material effect on the financial statements sufficiently clear? If not, why not?[128]

We believe the proposed approach to include the requirements related to understanding (1) the laws and regulations that govern the determination of the form and content of the financial statements and (2) those other laws and regulations with which the company's noncompliance could reasonably have a material effect on the financial statements is sufficiently clear.

17. Is the proposed approach to include the requirements related to understanding management's related processes for identifying laws and regulations with which noncompliance could reasonably have a material effect on the financial statements and for preventing, identifying, investigating, evaluating, and communicating compliance in AS 2110 sufficiently clear? If not, why not?[129]

We generally believe the proposed approach to include the requirements related to understanding management's related processes for identifying laws and regulations with which noncompliance is likely to have a material effect on the financial statements and for preventing, identifying, investigating, evaluating, and communicating compliance in AS 2110[130] is sufficiently clear.

18. Are the proposed requirements related to reading publicly available information about the company sufficiently clear? If not, why not?[131]

We believe the proposed requirements related to reading publicly available information about the company are sufficiently clear. We are particularly supportive of the proposed requirement in AS 2220.11 that provides the auditor "observe or read transcripts of earnings calls . . . ."[132] We believe that reading the company's transcripts of management earnings calls with analysts is a critical source of information that "may bring to the auditor's attention statements made by the company and its executive officers, which may . . . indicate potential risks of material misstatement in the financial statements."[133]

19. Are the proposed additional requirements in AS 2110 regarding inquiries of others within the company sufficiently clear? If not, why not?[134]

Please refer to our responses to Questions # 9 and # 12.

20. Is the requirement to inquire about whether correspondence exists with the company's relevant regulatory authorities regarding instances, or alleged or suspected instances, of fraud or other noncompliance with laws and regulations that could reasonably have a material effect on the financial statements and the nature of such correspondence sufficiently clear? If not, why not? Would this requirement change auditors' current practices of communicating directly with regulators about the company when appropriate and necessary? If so, how?[135]

We believe the requirement to inquire about whether correspondence exists with the company's relevant regulatory authorities regarding instances, or alleged or suspected instances, of fraud or other noncompliance with laws and regulations that could reasonably have a material effect on the financial statements and the nature of

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[128] *Id.* at 40 (emphasis added).
[129] *Id.*
[130] *See* AS 2110: Identifying and Assessing Risks of Material Misstatement, PCAOB (last visited July 27, 2023), https://pcaobus.org/oversight/standards/auditing-standards/details/AS2110.
[131] PCAOB Release No. 2023-003 at 35 (emphasis added).
[132] *Id.* at ¶.11, A2-4.
[133] *Id.* at 37.
[134] *Id.* at 40 (emphasis added).
[135] *Id.*

such correspondence is sufficiently clear. It should not result in a change with respect to an audit that has been performed in accordance with existing standards.

21. Are there other examples of the application of procedures that should be included for clarity? If so, please describe those examples.[136]

We have no comment at this time.

22. Are the proposed requirements and examples regarding understanding changes to the company's operating strategy and the impact on the company's accounting principles and disclosures sufficiently clear? If not, why not?[137]

We believe the proposed requirements and examples regarding understanding changes to the company's operating strategy and the impact on the company's accounting principles and disclosures are sufficiently clear.

23. Are there additional procedures the auditor should be required to perform to identify noncompliance with laws and regulations that are not currently contemplated by the proposed amendments? If so, what are the procedures?[138]

We believe there are additional procedures the auditor should be required to perform to identify NOCLAR that are not currently contemplated by the proposed amendments. For example, we would respectfully recommend the auditor should be required to perform procedures regarding the company's code of conduct with respect to NOCLAR, including at a minimum: (1) the auditor under proposed AS 2110.26[139] should obtain an understanding of management's process for enforcing its code of conduct including whether the entity annually requires all employees to certify they have complied with the code of conduct; (2) the auditor under proposed AS 2110.56a[140] should make inquiries of management regarding who, if anyone, in management violations of the code of conduct get reported to and how, if at all, management enforces violations of the code of conduct; and (3) the auditor under proposed AS 2110.56b[141] should make inquiries of the audit committee or equivalent, or of its chair regarding who, if anyone, on the audit committee violations of the code of conduct get reported to and how, if at all, the audit committee enforces violations of the code of conduct.

24. Is the proposed approach to evaluate instances of noncompliance that have or may have occurred sufficiently clear? If not, why not?[142]

We generally believe the proposed approach to evaluate instances of noncompliance that has or may have occurred is sufficiently clear.

25. Is the proposed requirement for auditors to consider whether specialized skills or knowledge is needed to assist the auditor in evaluating noncompliance that has or may have occurred sufficiently clear? If not, why not?[143]

We believe the proposed requirement for auditors to consider whether specialized skills or knowledge is needed to assist the auditor in evaluating noncompliance that has or may have occurred is sufficiently clear.

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[136] *Id.* at 41 (emphasis added).
[137] *Id.*
[138] *Id.*
[139] *See id.* at ¶.26, A2-7 ("The auditor should obtain an understanding of management's process for: . . . .").
[140] *See id.* at ¶.56a(7), A2-8 ("The auditor's inquiries regarding fraud risks and noncompliance with laws and regulations should include . . . [i]nquiries of management regarding . . . .").
[141] *See id.* at ¶.56b(4), at A2-9 ("The auditor's inquiries regarding fraud risks and noncompliance with laws and regulations should include . . . [i]nquiries of the audit committee, or equivalent, or its chair regarding: . . . .").
[142] *Id.* at 47 (emphasis added).
[143] *Id.*

26. Are the procedures the auditor may perform to obtain an understanding of the nature and circumstances of potential noncompliance and to determine whether it is likely the noncompliance occurred sufficiently clear? If not, why not? What additional procedures, if any, should be added?[144]

We believe the procedures the auditor may perform to obtain an understanding of the nature and circumstances of potential noncompliance and to determine whether it is likely the noncompliance occurred are sufficiently clear.

27. Are there other procedures that the auditor should be required to perform when evaluating information indicating that noncompliance with laws and regulations has or may have occurred? If so, what are those procedures?[145]

Please refer to our response to Questions # 9 and # 12.

28. When evaluating information that may be indicative that noncompliance has or may have occurred, should the auditor consider the impact of that information on other information in documents containing the audited financial statements? If not, why not?[146]

When evaluating information that may be indicative that noncompliance has or may have occurred, we believe the auditor should consider the impact of that information on other information in documents containing the audited financial statements.

29. Is the proposed requirement to determine whether senior management has taken timely and appropriate remedial action, including any impact on the auditor's report sufficiently clear? If not, why not?[147]

We believe the proposed requirement to determine whether senior management has taken timely and appropriate remedial action, including any impact on the auditor's report, is sufficiently clear.

30. Are the proposed communication requirements sufficiently clear? If not, why not?[148]

We generally believe the proposed communication requirements are sufficiently clear. We, however, believe the clarity of the communication requirements could be enhanced with respect to the phrase "clearly inconsequential."[149]

More specifically, we are concerned with the Proposal's description of the phrase "clearly inconsequential," which states that "[w]e believe that a matter deemed clearly inconsequential would be significantly below the threshold of materiality when considering both qualitative and quantitative factors."[150] We believe this description is inconsistent with the long understood meaning of the phrase[151] and could result in the phrase being misinterpreted as creating a broad exception from the proposed communication requirements for a "pattern of annual 'inconsequential' activities building in time to consequential matters [or] . . . matters appearing inconsequential

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[144] *Id.*
[145] *Id.* at 48 (emphasis added).
[146] *Id.*
[147] *Id.*
[148] *Id.* at 51 (emphasis added).
[149] *Id.* at ¶.12b., A1-7 ("12 When the auditor identifies or otherwise becomes aware of information indicating that noncompliance with laws and regulations (whether or not perceived to have a material effect on the financial statements), including fraud, has or may have occurred, the auditor must, as soon as practicable and before the issuance of the engagement report, communicate the matter(s) to: a. The appropriate level of management; and b. The audit committee, unless the matter is clearly inconsequential or has been communicated as provided for in the note to paragraph .13 below.").
[150] *Id.* at 49.
[151] *See, e.g.,* D.R. Carmichael, The Auditor's New Guide To Errors, Irregularities and Illegal Acts, JOA 41 (Sept. 1988) (on file with IAG) ("Questions have . . . arisen about the meaning of 'clearly inconsequential[]' [and] [c]learly inconsequential is an amount significantly below the border of material and immaterial . . . [and] it's a de minimis amount that's so obviously immaterial that its insignificance is unquestionable").

[that] may be indicators of more serious underlying problems."[152] As a result, we would respectfully recommend proposed AS 2405.12b[153] be revised to include the following note:

> Note: For purposes of this paragraph "clearly inconsequential" is an amount significantly below the border of material and immaterial. It is a *de minimi*s amount that is so obviously immaterial that its insignificance is unquestionable.

Absent the adoption of our proposed "Note," we would respectfully recommend removing the phrase "clearly inconsequential' from the proposed requirements. In that regard, we generally agree with the following 2017 comments of the National Association of State Boards of Accountancy in response to a NOCLAR Exposure Draft of the AICPA Professional Ethics Executive Committee:

> On page 13, section 1.700.010.09 contains the concept of "clearly inconsequential" as a safe harbor for not reporting NOCLAR. The definition of "clearly inconsequential" should be further defined, or the paragraph should be deleted because we do not agree that there should be any exceptions for reporting of NOCLAR and, especially, fraud. We can envision a pattern of annual "inconsequential" activities building in time to consequential matters. Further, some matters appearing inconsequential may be indicators of more serious underlying problems. We believe responsible audit committees and those charged with governance are concerned with all illegal acts as a matter of tone at the top."[154]

31. Should the auditor's communication requirements differ when the information about noncompliance is identified by management, as compared to when identified by the auditor? Would the proposed exceptions for previous communications help in avoiding duplicative communications? Should the auditor communications be expanded or narrowed? If so, how?[155]

We do not object to the auditor's communication requirements differing when the information about noncompliance is identified by management. However, we believe that in all cases the auditor should be required to "make an initial communication to . . . the audit committee upon becoming aware that noncompliance 'has or may have occurred."'[156] Moreover, we believe that the proposed exceptions for previous communications by management should be applied only to "to the 'source' of the information."[157]

32. Are there any additional matters related to noncompliance with laws and regulations that should be communicated to management and the audit committee? If so, what?[158]

We have no comment at this time.

33. Does the timing of the proposed communications (that is, "as soon as practicable") to management and the audit committee pose any particular challenges to the auditor? If so, how should the proposed requirement be changed?[159]

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[152] Letter from Telford A. Lodden, CPA, NASBA Chair and Keith L. Bishop, NASBA President and CEO to Professional Ethics Executive Committee, c/o Lisa A. Snyder, Director, AICPA 3 (May 9, 2017), https://nasba.org/app/uploads/2017/05/FINMay92017-NOCLAR-NASBAResponse2.pdf.
[153] *See* PCAOB Release No. 2023-003 at ¶.12b., A1-7.
[154] Letter from Telford A. Lodden, CPA, NASBA Chair and Keith L. Bishop, NASBA President and CEO to Professional Ethics Executive Committee, c/o Lisa A. Snyder, Director, AICPA at 3.
[155] PCAOB Release No. 2023-003 at 51 (emphasis added).
[156] *Id.* at 49.
[157] *Id.*
[158] *Id.* at 51 (emphasis added).
[159] *Id.*

We do not believe the timing of the proposed communications to management and the audit committee pose any particular challenges to the auditor, of which we are currently aware. We agree with the Board that "[e]arlier communication would better enable management and the audit committee to be responsive, as necessary to such matters."[160]

34. Is it appropriate to require the auditor to have a subsequent communication to management and the audit committee to communicate the results of the auditor's evaluation of information indicating noncompliance with laws and regulations has or may have occurred? If not, why not? Does this communication pose any particular challenges? If so, what are they?[161]

We believe it is appropriate to require the auditor to have a subsequent communication with management and the audit committee to communicate the results of the auditor's evaluation of information indicating NOCLAR has or may have occurred.

35. Does the requirement to communicate the results of the auditor's evaluation of information indicating noncompliance with laws and regulations has or may have occurred pose any particular challenges? If so, how should the proposed requirement be changed?[162]

We do not believe the requirement to communicate the results of the auditor's evaluation of information indicating NOCLAR has or may have occurred poses any particular challenges of which we are currently aware.

36. Are there other communications the auditor should make (for example, to the PCAOB or other regulatory body, investors, other stakeholders)? If so, what should those communications include and who should those communications be made to?[163]

We generally support the Proposal's requirements that parallel those required for issuer audits in Section 10A(b)(2) of the 34 Act.[164] More specifically, we support the Proposal requiring "the auditor . . . communicate directly to the board of directors when the auditor concludes (a) the likely noncompliance has a material effect on the financial statements; (b) senior management has not taken, and the board of directors has not caused senior management to take, timely and appropriate remedial action with respect to the likely noncompliance; and (c) the failure to take remedial action is reasonably expected to warrant departure from an unqualified opinion or resignation from the audit engagement."[165] We, however, would revise the Proposal to require when an auditor believes it is reasonably likely a NOCLAR event has occurred, and (1) has communicated it as required to the appropriate management and Board, and (2) management and the Board have failed to take appropriate action, the auditor should communicate the matter to the appropriate regulator(s) and investors, unless prohibited by federal or state law.

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[160] *Id.* at 49.
[160] *Id*. at 51 (emphasis added).
[161] *Id.*
[162] *Id.*
[163] *Id.*
[164] *See* Audit requirements,15 U.S.C. § 78j–1(b)(2).
[165] PCAOB Release No. 2023-003 at 50; *see id.* at ¶.15, A1-8 to -9 (".15 If after the auditor has communicated noncompliance with laws and regulations in accordance with paragraphs .12-.14 to the audit committee, the auditor concludes that: a. Such noncompliance has a material effect on the financial statements; b. Senior management has not taken, and the board of directors has not caused senior management to take, timely and appropriate remedial action with respect to such noncompliance; and c. The failure to take remedial action is reasonably expected to warrant departure from an unqualified opinion or warrant resignation from the audit engagement, the auditor must directly communicate these conclusions to the board of directors or equivalent, as soon, as practicable.").

We would also revise the Proposal to require that the auditor not be permitted to resign from an engagement unless the communication is first reported to all parties.[166] We believe reporting to the SEC, PCAOB and investors[167] increases the transparency of the quality of the audit and may function as a deterrent to issuer noncompliance with laws and regulations.[168]

37. Is the proposed requirement for the lead auditor to obtain the written affirmations from the other auditor sufficiently clear? If not, why not?[169]

We believe the proposed requirement for the lead auditor to obtain the written affirmations from the other auditor is sufficiently clear.

38. Are the proposed communication requirements if either the lead auditor or other auditor identifies or otherwise becomes aware of any instances, or alleged or suspected instances, of fraud or other noncompliance that may be relevant to the audit work being performed sufficiently clear? If not, why not? Should additional communication requirements be considered, and if so, what are the requirements?[170]

We believe the proposed communication requirements if either the lead auditor or other auditor identifies or otherwise becomes aware of any instances, or alleged or suspected instances, of fraud or other noncompliance that may be relevant to the audit work being performed are sufficiently clear.

39. Are there additional auditor reporting considerations that should be considered? If so, what are they?[171]

We believe there are additional reporting considerations that should be considered. For example, we would be supportive if the Board were to require the auditor under certain circumstances to (1) provide negative assurance that they did not detect any incidents of NOCLAR; and (2) to report their approach to testing NOCLAR as a critical audit matter. We generally believe such requirements could increase professional skepticism and improve the quality of the audit from the perspective of investors.

40. Should the proposed standard include a requirement for communication in the engagement report regarding specific aspects of a company's noncompliance with laws and regulations? If so, what should that communication include?[172]

We would be supportive of including a requirement for communication in the engagement report regarding specific aspects of a company's NOCLAR to the extent the auditor believes that management failed to make appropriate disclosures or accruals. The communication could amount to a qualified or adverse opinion and a material weakness.

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[166] *See* Discussion Paper, Illegal Acts Including Fraud, Investor Advisory Group 13 (May 30, 2023) (on file with IAG) ("Auditors should not be able to resign from an audit when it is likely an illegal act, including fraud has come to their attentions, unless it is reported to law enforcement agencies, the audit committee and investors.").

[167] *See, e.g.,* Letter from Members of the Investor Advisory Group to Office of the Secretary, Public Company Accounting Oversight Board 3 (May 16, 2023), https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-049/3_miag.pdf?sfvrsn=d18fac00_4 ("**Given the recent discussions about the lack of critical audit matters appearing in audit reports, auditors need to be reminded of exactly whom they should be communicating the results of their examinations**.").

[168] *See* Letter from Members of the Investor Advisory Group to Office of the Secretary, Public Company Accounting Oversight Board at 4 (Feb. 16, 2023), https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket_028/16_iag.pdf?sfvrsn=d6603e53_4 ("we believe a final standard should require that this decision also be communicated to investors, increasing the transparency of the quality of an audit for investors and providing an incentive to use confirmations").

[169] PCAOB Release No. 2023-003 at 52 (emphasis added).

[170] *Id.*

[171] *Id*. at 54 (emphasis added).

[172] *Id.*

41. Should specific requirements be retained related to an auditor's withdrawal or resignation from the audit engagement in circumstances when likely noncompliance with laws and regulations has been identified? If so, which requirements?[173]

We believe clearer guidance would be useful regarding specifically what the PCAOB expects of the auditor in the event management and the board do not take appropriate actions when an auditor determines a NOCLAR event has occurred, and it is material to the financial statements.

42. Is the proposed incorporation of the requirements to document the auditor's consideration of fraud in a financial statement audit into AS 1215 sufficiently clear? If not, what changes are necessary and why?[174]

We believe the proposed incorporation of the requirements to document the auditor's consideration of fraud in a financial statement audit into AS 1215[175] is sufficiently clear. We are particularly supportive of the proposed expansion of the documentation requirements.[176] In that regard, we would respectfully recommend that AS 1215 be further revised to explicitly require documentation of the audit team members who are assigned to and performed the procedures to "obtain information necessary to identify and assess fraud risks."[177] Overall, and consistent with a recommendation of the 2017 Working Group, we believe raising the expectations for documentation "brings discipline to the auditing process."[178]

43. Is the proposed documentation requirement in AS 1215.12h sufficiently clear? If not, what changes are necessary and why? Are there any specific challenges related to this documentation requirement? If so, please describe.[179]

We believe communications with management and the Board regarding the findings of the auditor, in addition to evaluating the evidence, would be best if done in writing. This would add discipline to the process.

44. Are the proposed requirements to amend the understanding with an auditor's specialist – whether employed or engaged by the auditor – sufficiently clear? If not, why not?[180]

We believe the proposed requirements to amend the understanding with an auditor's specialist – whether employed or engaged by the auditor – are sufficiently clear.

45. Are the amendments to AS 2410 sufficiently clear? If not, why not?[181]

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[173] PCAOB Release No. 2023-003 at 54 (emphasis added).
[174] *Id.* at 55 (emphasis added).
[175] *See* AS 1215: Audit Documentation (last visited July 9, 2023), https://pcaobus.org/oversight/standards/auditing-standards/details/AS1215.
[176] *See* PCAOB Release No. 2023-003 at 55 ("The documentation requirements in AS 2401 are proposed to be removed, moved to AS 1215, Audit Documentation, and expanded to include documentation of instances, or alleged or suspected instances, of other noncompliance with laws and regulations."); *id.* at ¶.09A, A2-17 to -18 ("Documentation of risk assessment procedures and responses to risks of misstatement should include: a. The discussion among engagement personnel regarding the susceptibility of the entity's financial statements to material misstatement due to fraud, including how and when the discussion occurred, the audit team members who participated, and the subject matter discussed; b. The procedures performed to obtain information necessary to identify and assess fraud risks; c. (1) A summary of the identified risks of misstatement, including fraud risks, and the auditor's assessment of risks of material misstatement at the financial statement and assertion levels; and (Note: If the auditor has not identified improper revenue recognition as a fraud risk in a particular circumstance, the auditor should document reasons supporting the auditor's conclusion. d. The auditor's responses to the risks of material misstatement, including fraud risks, and including linkage to the responses to those risks; and e. The discussion of significant matters related to fraud and other noncompliance with laws and regulations with management, the audit committee, and others.").
[177] *Id.* at ¶.09b, A2-17; *see* Discussion Paper, Illegal Acts Including Fraud, Investor Advisory Group at 13 ("Specific members of the audit team responsible for key fraud detection procedures should be identified.").
[178] *See* Report from the Working Group on Auditor's Consideration of a Client's Noncompliance with Laws and Regulations at 16 ("Discuss expectations for documentation of illegal acts [and] [d]ocumentation brings discipline to the auditing process").
[179] PCAOB Release No. 2023-003 at 55 (emphasis added).
[180] *Id.* at 56 (emphasis added).
[181] *Id.*

We believe the amendments to AS 2410 are sufficiently clear.

46. What steps or procedures do auditors currently take or perform to comply with Section 10A obligations when information related to noncompliance is identified during an interim review?[182]

It is our understanding that auditors do not disclose such information, so we are unable to respond to this question.

47. Is the addition of the management inquiry in proposed paragraph .18c of AS 4105 sufficiently clear? If not, why not? Are auditors making this inquiry currently?[183]

We believe the addition of the management inquiry in proposed paragraph .18c of AS 4105 is sufficiently clear[184]

48. Is the proposed amendment to AS 4105.23 sufficiently clear? If not, what changes are necessary and why?[185]

We believe the proposed amendment to AS 4105.23 is sufficiently clear.[186]

49. Is the timing for any required communications in proposed AS 4105.32 reasonable? If not, what changes are necessary and why?[187]

We believe the timing for any required communications in proposed AS 4105.32 is reasonable.[188]

50. Should an interim review requirement be added for the auditor to make specific inquiries regarding the company's ongoing investigations related to noncompliance with laws and regulations? If so, what should those specific inquiries be?[189]

We generally believe that an interim review requirement should be added for the auditor to make specific inquiries regarding the company's ongoing investigations related to NOCLAR. Those inquiries should include:

> Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the interim financial information or as a basis for recording a loss contingency.[190]

We believe the additional requirement is appropriate because ongoing investigations related to NOCLAR may uncover information that changes the materiality assessment on the company's operations.

51. Is rescinding AS 6110 appropriate? Does this standard continue to be used by auditors? If so, what are the specific provisions that are used by auditors and when is this standard used?[191]

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[182] *Id*. at 57 (emphasis added).
[183] *Id.* at 58 (emphasis added).
[184] *See id.* at 57 ("Proposed AS 4105.18c would require inquiries of members of management who have responsibility for financial and accounting matters [and] [t]his requirement mirrors required written representations from management pursuant to existing AS 4105.24p.").
[185] *Id.* at 58 (emphasis added).
[186] *See id.* at 57 ("Proposed AS 4105.23 would require that if, in performing a review of interim financial information, the auditor identifies or otherwise becomes aware of information indicating that noncompliance with laws or regulations, including fraud, has or may have occurred, the auditor would be required to determine their responsibilities under proposed AS 2405 and Section 10A.107.23 Coordination with the audit").
[187] *Id.* at 58 (emphasis added).
[188] *Id.* at 57 ("Proposed AS 4105.32 would require that any required communication under AS 2401, proposed AS 2405, or Section 10A would be required to be made as soon as practicable and prior to the registrant's filing its periodic report with the SEC [and] [g]iven review reports are not required to be issued in a review of interim information,108 and if a review report is issued it would likely include a date close to the day the registrant files its periodic report with the SEC, the proposed amendment specifies that any required communications are to be made before the periodic report is filed with the SEC.").
[189] *Id.* at 58 (emphasis added).
[190] Standards And Emerging Issues Advisory Group Meeting, Discussion – Interim Financial Information Reviews, ¶.24p, A-13 (June 29, 2023) (on file with CII).
[191] PCAOB Release No. 2023-003 at 58 (emphasis added).

We have no comment at this time.

52. Is rescinding AI 13 appropriate, or does the interpretation contain specific guidance necessary to apply PCAOB standards? If so, what is that specific guidance?[192]

We have no comment at this time.

53. Is rescinding AI 21 and replacing its content with a footnote in AS 2805 appropriate? If not, why not?[193]

We have no comment at this time.

54. Are there other changes that should be made to AS 2805? If so, what are those changes?[194]

We have no comment at this time.

55. Are the proposed conforming amendments in Appendix 3 appropriate and clear? Why or why not? What changes to the amendments are necessary?[195]

We have no comment at this time.

56. In addition to the proposed conforming amendments in Appendix 3, are other conforming amendments necessary in connection with the proposed changes to AS 2405 and AS 2110?[196]

We have no comment at this time.

57. Are there other benefits and costs not addressed above that we should consider?[197]

We have no comment at this time.

58. Are there additional academic studies or data that would inform our analysis of the expected economic impacts of the proposed amendments? If so, please provide such studies or data. Are there any sources of data that could provide a quantitative estimation of the expected benefits and costs? If so, please provide the names of such sources.[198]

We believe that the following additional academic study would inform the PCAOB's analysis of the expected economic impacts of the proposed amendments, including the potential costs of noncompliance with the Foreign Corrupt Practices Act: Bradley P. Lawson et al., *How Do Auditors Respond to FCPA Risk?*, 13(2) Current Issues in Auditing 21 (2019), *available at* https://publications.aaahq.org/cia/article/13/2/P21/7142/How-Do-Auditors-Respond-to-FCPA-Risk.

59. Which proposed amendments are likely to be associated with more substantial costs? Are the costs quantifiable?[199]

We have no comment at this time.

60. Is the expansion of the auditor's responsibilities to identify information indicating noncompliance with laws and regulations has or may have occurred without regard to the effect of such noncompliance on the

[192] *Id.* at 59 (emphasis added).
[193] *Id.* at 60 (emphasis added).
[194] *Id.*
[195] *Id.*
[196] *Id.*
[197] *Id.* at 84 (emphasis added).
[198] *Id.*
[199] *Id.*

financial statements practical and cost effective to implement? Are small/medium firms equipped and capable of implementing these new requirements? If not, why not?[200]

We believe the expansion of the auditor's responsibilities to identify information indicating NOCLAR has or may have occurred without regard to the effect of such noncompliance on the financial statements is cost effective to implement.

We note that the Association of Certified Fraud Examiners in its 2022 Report to the Nation, estimates that organizations lose 5% of revenue to fraud each year.[201] It also indicates that while owners and executives account for only 23% of those losses, they were the source of the largest losses.[202]

We also believe the recent empirical evidence about the cost of corporate misconduct or alleged fraud in Alexander Dyck, Adair Morse, and Luigi Zingales, *How Pervasive Is Corporate Fraud?,* is relevant to the economic analysis for the Proposal.[203] That article states:

> Our evidence suggests that in normal times only one-third of corporate frauds are detected. We estimate that on average 10% of large publicly traded firms are committing securities fraud every year, with a 95% confidence interval of 7%-14%. Combining fraud pervasiveness with existing estimates of the costs of detected and undetected fraud, we estimate that corporate fraud destroys 1.6% of equity value each year, equal to $830 billion in 2021.[204]

The article also states:

> [T]he annual cost of fraud among US corporations at the end of our sample period (2004) is $254 billion or – bringing our cost calculation forward to 2021 – $830 billion. If we compare the 2004 expected cost of fraud with the $19.9 billion of annual SOX compliance cost (as estimated by Hochberg et al. (2009)), for the benefits of SOX to exceed its costs, SOX would have to reduce the probability of fraud initiation by 1 percentage point (equal to 10% of the baseline probability).[205]

We are confident that the cost of implementing the proposed requirements is substantially less than the annual cost of implementing Sarbanes-Oxley Act of 2002 (SOX).[206]

Investors as shareholders ultimately pay for the audit. We believe that even if the proposed requirements were to double auditing fees, the benefits of the proposed requirements would be worth the cost for investors. We, therefore, agree with the Board that "we would expect that the benefits of the proposed amendments would justify the costs."[207]

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[200] *Id.*

[201] *See* Occupational Fraud 2022: A Report to the Nations, ACFE 3 (2022), https://acfepublic.s3.us-west-2.amazonaws.com/2022+Report+to+the+Nations.pdf (estimating that organizations lose 5% of revenues to fraud each year).

[202] *See id.* at 5 (finding that "Owners/executives committed only 23% of occupational frauds, but they caused the largest losses").

[203] Alexander Dyck, Adair Morse, and Luigi Zingales, How Pervasive is Corporate Fraud, Rev. Acct. Studies (Jan. 5, 2023), *available at* https://link.springer.com/article/10.1007/s11142-022-09738-5*; see generally,* How Pervasive Is Corporate Fraud? With Luigi Zingales, Voice of Corp. Governance (May 11, 2023)*, available at* https://podcasts.apple.com/us/podcast/how-pervasive-is-corporate-fraud-with-luigi-zingales/id1433954314?i=1000612649586 (recommending enhancing the responsibility of auditor's to identify when a fraud exists).

[204] Alexander Dyck, Adair Morse, and Luigi Zingales, How Pervasive is Corporate Fraud, Rev. Acct. Studies.

[205] *Id.*

[206] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002), *available at* https://www.dol.gov/agencies/oalj/PUBLIC/WHISTLEBLOWER/REFERENCES/STATUTES/SARBANES_OXLEY_ACT_OF_2002#:~:text=%5B%5BPage%20116%20STAT.,laws%2C%20and%20for%20other%20purposes.

[207] PCAOB Release No. 2023-003 at 72.

Finally, we believe that auditors in small/medium firms could be equipped and capable of implementing these new requirements. As we indicated in our letter of May 16, 2023, in response Proposed Auditing Standard – *General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards*, *"*if auditors are willing to assume the risks of auditing publicly traded firms and to reap the consequent rewards, they should be fully prepared to abide by the rules and standards set by the PCAOB without exceptions."[208]

61. Will the proposed requirement for auditors to assess the risk of material misstatement, including risks of material misstatement due to noncompliance with laws and regulations, change how auditors assess risks of material misstatement and design related audit responses? If so, how and to what extent?[209]

We believe the proposed requirement for auditors to assess the risk of material misstatement, including risks of material misstatement due to NOCLAR, will change how auditors assess risks of material misstatement and design related audit responses.

62. Are there substantial costs associated with an increased need to use auditor's specialists to assist the auditor in evaluating noncompliance that has or may have occurred as a result of the proposed requirements? If so, are the costs quantifiable? Are there any applicable means of mitigating or reducing such costs?[210]

We agree with the Board that there "could be" varying levels of costs associated with an increased need to use auditor's specialists to assist the auditor in evaluating noncompliance that has or may have occurred as a result of the proposed requirements.[211] Such costs often vary based on the persuasiveness of the illegal act, whether it is a local violation or one that spreads around the globe, and the cooperation of management and the company with the independent auditor, the regulator and law enforcement agencies. We, however, also agree with the Board that there are factors that may mitigate or reduce the costs of retaining specialists including the following:

> Auditors already may be identifying relevant laws and regulations during the audit, for example through the risk assessment process or for purposes of compliance with Section 10A. Further, auditors may be able to make use of company-generated information. For example, issuers may already disclose certain relevant laws and regulations (e.g., as risk factors), which could serve as a starting point for the auditor's identification. Companies with a more formalized compliance program may have already identified the relevant laws and regulations for their own purposes; the auditors could potentially leverage these efforts more comprehensively, even if they would not be able to fully rely upon them without performing further procedures of their own.[212]

63. Would the economic impacts be different for smaller firms or emerging growth companies? If so, how?[213]

We do not believe the economic impacts of the Proposal would be different for emerging growth companies (EGCs). More specifically, we agree with the Board that:

> [T]he benefits of the higher audit quality resulting from the proposed amendments may be larger for EGCs than for non-EGCs, including improved efficiency of capital allocation, lower cost of capital, and enhanced capital formation. In particular, because investors who face uncertainty about the reliability of a company's financial statements may require a larger risk premium that increases

[208] Letter from Members of the Investor Advisory Group to Office of the Secretary, Public Company Accounting Oversight Board at 10.
[209] PCAOB Release No. 2023-003 at 84 (emphasis added).
[210] *Id.* at 84-85 (emphasis added).
[211] *Id.* at 79.
[212] *Id.*
[213] *Id.* at 85 (emphasis added).

> the cost of capital to companies, the improved audit quality resulting from applying the proposed amendments to EGC audits could reduce the cost of capital to those EGCs. While the associated costs may also be higher for EGC audits than for non-EGC audits, they are unlikely to be disproportionate to the benefits due to the scalability of the risk-based requirements…
>
> …Overall, the proposed amendments are expected to enhance audit quality and contribute to an increase in the credibility of financial reporting by EGCs, thereby fostering efficiency. Because of the scalability of the risk-based requirements, the costs of performing the procedures are unlikely to be disproportionate to the benefits of the procedures. Conversely, if any of the proposed amendments were determined not to apply to the audits of EGCs, auditors would need to address differing audit requirements in their methodologies, or policies and procedures, with respect to audits of EGCs and non-EGCs, which would create the potential for confusion.[214]

64. The Board requests comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release appropriate? Are there additional potential unintended consequences that the Board should consider? If so, what are the potential unintended consequences and what responses should be considered?[215]

Based on the objectives of the proposed standard, we believe there will be more timely and complete reporting of illegal acts to investors, the owner of the company, its board, regulators, and law enforcement agencies. To that end, we do not believe there are consequences the PCAOB does not intend.

65. The Board also requests comment on the potential unintended consequences of the proposal on competition in the market for audit services. How and to what extent could competition be affected by the proposal? How would smaller firms be affected? Would audit fees be meaningfully affected by the proposal? Would the availability of qualified auditors in the market be meaningfully affected by the proposal?[216]

We believe the Proposal and the discipline it will bring to audits will improve audit quality. We believe it will have a positive impact on those audit firms, both large and small, who demonstrate they are providing investors with a higher quality audit.

66. Are there any factors specifically related to audits of brokers and dealers that may affect the application of the proposal to those audits? If so, what are those factors and how should they be considered?[217]

23We have no comment at this time.

67. The Board requests comment generally on the alternative approaches described in this release that we considered, but are not proposing. Are any of these approaches, or any other approaches, preferable to the approaches that we are proposing? What reasons support those approaches over the approaches we are proposing? Would any other alternatives better promote investor protection, efficiency, competition, or capital formation?[218]

We do not believe that any of the alternative approaches as described in the Proposal are preferable to the approaches the Board is proposing. We are particularly supportive of the Board's decision not to retain "the distinction in extant AS 2405[[219]] between violations of laws and regulations that have a direct effect on the

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[214] *Id.* at 93-94 (footnote omitted).
[215] *Id.* at 87 (emphasis added).
[216] *Id.*
[217] *Id.* at 88 (emphasis added)
[218] *Id.* at 91 (emphasis added).
[219] *See* AS 2405: Illegal Acts by Clients, PCAOB ¶¶.05-.07.

financial statements versus those with an indirect effect."[220] We agree with the Board that the disadvantages of the direct-indirect distinction "support a new approach."[221] More specifically, we agree with the Board that:

> [I]n considering investor protection, the material misstatement of financial results harms investors regardless of whether the violations arise from misapplication of corporate tax rates (direct effect) or unrecorded environmental remediation liabilities (indirect effect). The magnitude of any harm is, moreover, independent of such distinction. We believe auditors should plan and perform procedures to address material misstatements from noncompliance without regard to the type of law violated. Furthermore, we believe the distinction can sometimes be difficult to apply or potentially artificial in practice. For example, violations of tax law may result in both known quantitative impacts (e.g., application of a new tax rate) and a contingent liability (e.g., from penalty proceedings). In such a scenario, we believe auditors should focus on the risks of material misstatement, appropriate responses, and proper evaluation and communication of any identified noncompliance, all without regard to the nature of the effect – direct or indirect. Accordingly, we believe the proposed amendments give appropriate and improved direction to auditors.[222]

Similarly, we agree with PCAOB Member Kara M. Stein's following analysis of the direct vs. indirect distinction:

> I am also pleased that the staff's recommendation has eliminated the outdated and hard-to-justify categorization of illegal acts into "direct" and "indirect" buckets.
>
> Both auditors and investors agree that the current judgmental splitting of laws into categories of so-called "direct" and "indirect" effects on the financial statements is a source of confusion. The primary purpose of this categorization was to bifurcate the auditor's duty to identify and assess illegal acts, particularly rejecting any responsibility for the detection of so-called "indirect" effect laws.
>
> However, staff research has indicated that laws considered to have "indirect effects" on the financial statements, such as the prohibition of bribery of foreign officials by domestic companies, evasion of anti-money laundering statutes and protocols, false and misleading disclosures, and environmental contamination, among others, can and have led to substantial fines and penalties. And that may be part of the problem. The parsing of laws and regulations may have caused a lack of emphasis, or diminution of attention, to certain laws and regulations.
>
> So, I am pleased that the current proposal simplifies the auditor's work by removing this distinction: the auditor must do sufficient work to be reasonably assured against material errors of either commission or omission…
>
> …Today's proposal, if adopted, would make it clear that indications of noncompliance with laws and regulations should not be dismissed by the auditor just because management is aware of the matter, or because the effects on the financial statements are not "direct" effects.[223]

68. The Board requests comment generally on the analysis of the impacts of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so

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[220] PCAOB Release No. 2023-003 at 90.
[221] *Id.*
[222] *Id.* at 90-91.
[223] Kara M. Stein, Board Member, PCAOB Open Board Meeting, A Return to Roots: The Auditor's Role in Uncovering and Reporting of Illegal Acts (June 6, 2023), https://pcaobus.org/news-events/speeches/speech-detail/a-return-to-roots-the-auditor-s-role-in-uncovering-and-reporting-illegal-acts.

that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation?[224]

The MIAG includes former audit partners among its members. Based on the experience of all of our members, we believe the analysis of the impacts of the Proposal EGCs is reasonably accurate.

We support the Board's conclusion that "if it adopts the proposed amendments, it will request that the Commission determine that it is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply the proposed amendments to audits of EGCs."[225] And we are not aware of any reasons why the Proposal should not apply to audits of EGCs.

69. Would requiring compliance for fiscal years beginning after the year of SEC approval provide challenges for auditors? If so, what are those challenges, and how should they be addressed?[226]

An effective date should provide sufficient time for auditors to train their partners and staff with respect to the changes required in audit practices resulting from the final standard.

70. How much time following SEC approval would audit firms need to implement the proposed requirements? [227]

Please refer to our response to Question # 69.

[224] PCAOB Release No. 2023-003 at 94 (emphasis added).
[225] *Id.*
[226] *Id.*
[227] *Id.*