



United States House of Representatives
One Hundred Eighteenth Congress
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

August 23, 2023

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

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

Dear Ms. Brown:

We write to you with serious concern regarding the recent Exposure Draft from the Public Company Accounting Oversight Board (“PCAOB” or “Board”) on Company Noncompliance with Laws and Regulations (“NOCLAR”).

Preventing fraud and maintaining financial reporting integrity are paramount to the effective functioning of U.S. capital markets. However, the proposed changes to NOCLAR standards risk undermining audit quality. The revisions to NOCLAR standards are likely to divert auditors’ attention, dedication, and resources away from their principal responsibility of rigorously evaluating financial statements. This concern comes at a critical time, as the PCAOB is emphasizing the need to enhance audit standards, as underscored by Chair Erica Williams’ recent Op-Ed.¹ The proposed realignment will likely have the opposite effect resulting in a weakening of audit quality and increasing the risk of investor harm.

Auditors are not legal professionals and should not be expected to function as law enforcement agents. Notably, the Securities and Exchange Commission (“SEC”) has long-established rules for auditor independence. These rules prohibit auditors in the U.S. from offering services to audit clients that fall under the purview of legal experts.²

¹ See <https://www.wsj.com/articles/we-audit-the-auditors-and-we-found-trouble-accountability-capital-markets-c5587f05>.

² See Section 202 of the Sarbanes-Oxley Act (15 U.S. Code § 78j-1). The SEC’s implementing rules prevent an accountant from providing an audit client any service that, under circumstances in which the service is provided, could be provided only by someone licensed, admitted, or otherwise qualified to practice law in the jurisdiction in which the service is provided. See <https://www.sec.gov/news/press/2003-9.htm>.

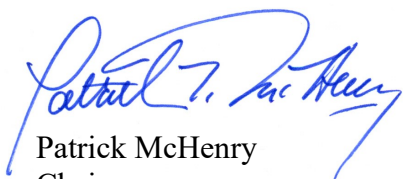
The proposed NOCLAR requirements appear to be in direct conflict with these existing rules. They would compel public accounting firms to establish specialized teams responsible for identifying laws and regulations imposing additional scrutiny for noncompliance. Further, the PCAOB's proposal may entangle auditors in legal and managerial decisions beyond their scope, potentially impinging on their ability to accurately assess financial statement information.

Additionally, the proposal risks undermining the materiality standard that is the foundation of U.S. capital markets, and to which the PCAOB must adhere. The vague and complex language in the Proposal, such as "could reasonably" and "may have occurred," introduce uncertainty regarding the PCAOB's future adherence to the materiality standard as established in *TSC v. Northway*. Use of such terms creates considerable ambiguity in determining the relevant laws and regulations that necessitate evaluation. This ambiguity, combined with the renewed emphasis on noncompliance, could lead to adverse outcomes for U.S. companies, including increased legal and compliance costs. It may also divert the attention of management, employees, and audit committees from financial reporting. Safeguarding investors requires the PCAOB to meticulously assess the repercussions and ramifications of this proposal for the public company model and, by extension, the attractiveness of U.S. capital markets.

U.S. companies are already burdened with substantial compliance obligations and are overseen by federal and state authorities. The existing oversight and enforcement frameworks competently address instances of noncompliance. While auditors have traditionally been responsible for detecting illicit activities as part of financial audits, broadening their purview to encompass noncompliance with all laws and regulations could blur the lines between legal, managerial, and audit functions. Put succinctly, the responsibilities of auditors must not be confused for the role of law enforcement, and the PCAOB must refrain from conflating its role as the "auditor of the auditors" with the mission of other prudential regulators.

The PCAOB should reevaluate the suitability of its proposed NOCLAR standards and revise any final standards to more effectively align with the PCAOB's mission. Striking a delicate equilibrium between fraud prevention, audit quality, and preserving essential financial reporting duties is imperative. We greatly appreciate your attention to these concerns and anticipate a productive dialogue on this critical matter.

Sincerely,



Patrick McHenry
Chairman
Committee on Financial Services



Ann Wagner
Chairman
Subcommittee on Capital Markets