SUBMITTED VIA EMAIL: COMMENTS@PCAOBUS.ORG
Erica Y. Williams, PCAOB Chair
Office of the Secretary
1666 K Street NW
Washington, D.C. 20006

Re: PCAOB Rulemaking Docket Matter No. 051 – Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations

September 18, 2023

Dear Members of the Public Company Accounting Oversight Board:

On behalf of the Investor Choice Advocates Network ("ICAN"), we thank the Public Company Accounting Oversight Board ("PCAOB" or "the Board") for the opportunity to comment on the proposal to amend PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations ("NOCLAR") set forth in the above-referenced release (the "Release" and the "Proposed Standards").

ICAN[1] is a nonprofit public interest litigation organization dedicated to serving as a legal advocate and voice for retail investors and entrepreneurs, working to highlight the crucial role robust capital markets play in creating a healthy, vibrant economy, where upward mobility is an opportunity available to all.

While we fully appreciate the PCAOB's commitment to upholding the integrity and transparency of financial reporting, we believe that the current iteration of the Proposed Standards may inadvertently lead to consequences detrimental to investors, among other things by limiting their investment choices. We note that the Board's Office of the Investor Advocate specifically and "strongly" encouraged comments from investors.[2] While the comment period is closed, we do not see substantial comments from the perspective of preserving investor choice, and, accordingly, we hope the Board will consider ICAN's comments, which are focused on the impact the Proposed Standards will have on investors.

[1] www.icanlaw.org

[2] Investor Bulletin - Opportunity to Comment on Proposed Standard Addressing an Auditor's Responsibility Related to a Company's Noncompliance With Laws and Regulations (NOCLAR) (June 30, 2023) (available at 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).

Adverse Impacts on Auditors, Public Companies, and Regulators Will Adversely Impact Investors

Other commenters have addressed the costs the Proposed Standards will likely impose on auditors and their public company clients. Those costs and burdens will also adversely impact investors.

For example, the Auditing Standards Committee of the Auditing Section of the American Accounting Association ("AAA Auditing Standards Committee") commented[3] in relevant part:

> The Release recognizes that costs are likely to be "substantial" (see pp. 76 and 79); however, the analysis does not reflect any effort to estimate the costs. In short, the cost analysis contains no numbers. For example, the Release states: "The Board recognizes that imposing new requirements would result in additional, potentially substantial costs to auditors and the companies they audit" (p. 76), and "Auditors may need to retain attorneys or other legal experts, including attorneys from different legal disciplines or specializations... These specialists could be costly to retain" (p. 79).
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> We believe identifying and analyzing all potential instances of noncompliance will substantially impact an engagement team's budget, as it has effects throughout the audit, including during planning and understanding the client, performing risk assessment, employing new specialists and attorneys with expertise in areas that are beyond the scope of an auditor's core knowledge base, communicating the new risks with the audit committee, and obtaining sufficient and appropriate audit evidence (e.g., new, previously untested controls related to compliance with laws and regulations).
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> Beyond the substantial new costs required throughout the audit process, four particular costs that should be considered further are (a) increased risks of auditor liability and effects on market concentration, (b) audit firms' reputational losses based on the new requirements, (c) likely increased effects of staff shortages on audit quality, and (d) possible impacts on companies going private.

The costs imposed on auditors go beyond the auditors themselves. Increasing costs borne by auditors has a potential chilling effect on the essential auditor-client relationship. By compelling auditors to report even minor instances of potential non-compliance with laws and regulations (without a universally recognized legal privilege protecting such reports from access by third parties), the Proposed Standards may strain auditors' relationships with their clients, potentially undermining the collaborative environment necessary for effective audits. At a minimum, public companies will bear additional expense. The AAA Auditing Standards Committee makes the point:

> [C]ompanies are likely to also incur incremental costs related to internal controls. When SOX mandated ICFR audits, the costs to companies were substantial. Alexander, Bauguess, Bernile, Lee, and Marietta-Westberg (2013) estimated that 19 companies' average cost of compliance with SOX 404 for 2007/2008 was $1.2 million, composed primarily of audit fees (35 percent of total audit fees), internal labor costs, and outside consultant fees. Given the breadth and scale of the present proposal, it is possible that increased costs of internal control testing also could be substantial.

[3] Available at:
https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-051/21_asc.pdf?sfvrsn=4cb8e6f_4

ICAN is concerned about the potential impact on public companies, particularly smaller ones, which may struggle to cope with the increased regulatory burden. These entities will be more challenged in allocating resources to address every reported instance of non-compliance, potentially diverting crucial resources from core operations. This could, in turn, make them less appealing to potential investors, stifling growth and innovation, particularly in sectors that are instrumental to economic development.

Additionally, the heightened reporting requirements may inadvertently overwhelm regulatory bodies, diverting their attention from more substantial issues and potentially diminishing their overall effectiveness in maintaining market integrity.

The Securities and Exchange Commission's ("SEC") experience dealing with whistleblower tips is instructive on this point. According to the 2019 Annual Report to Congress[4] about the SEC's whistleblower program, in fiscal 2019, the SEC "received over 5,200 whistleblower tips" and the Office of the Whistleblower "returned over 2,600 calls to the public." Over the life of the program, the OWB has returned nearly 24,000 calls and received more than 33,300 whistleblower tips. Over the period 2012 to 2019, the SEC made 70 awards to tipsters, meaning 99.8% of tips did not result in SEC awards. Similarly, the 70 tip awards from 2012 to 2019 (or about 10 per year) represent a very small amount of the roughly 820 enforcement actions the SEC brings every year. Of the roughly 5,000 tips received in any given year, only about 300 (or about 6%) result in an enforcement investigation. Put another way: More than 4,500 tips received by the SEC every year are not ever investigated by the Enforcement Division.

Stanford Law Professor David Freeman Engstrom, who has analyzed the SEC's bounty program along with other similar programs, observed[5]:

> A budget-constrained agency that receives additional tips must either ignore some of them, using a triage approach to focus its efforts on a subset of tips, or else allocate fewer investigative resources to examining each tip, thus degrading the agency's screening accuracy. Paradoxically, a bounty regime with a robust mix of incentives and protections that yields more whistleblower reports may overwhelm the agency.
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> By reducing the likelihood the agency detects and sanctions misconduct, such a regime may yield less overall deterrence compared to a regime with a less robust mix of incentives and protections.

ICAN submits that the Proposed Standards will result in a similar phenomenon: an overwhelming number of observations from auditors acting in good faith attempts to comply with the Proposed Standards. The inundation of alerts, many of which may not warrant extensive investigation, could lead to a misallocation of resources and divert focus away from more significant concerns. Such a result would do more harm than good for investors.

We urge the PCAOB to carefully consider the potential ramifications of the Proposed Standards, taking into account the adverse impacts on a diverse range of stakeholders, including auditors, public companies, and regulatory bodies

[4]Available at: https://www.sec.gov/files/sec-2019-annual-report-whistleblower-program.pdf

[5] David Freeman Engstrom, "Whither Whistleblowing? Bounty Regimes, Regulatory Context, and the Challenge of Optimal Design," Vol 15, Issue 2 (July 2014), pp 613-614.

– particularly in light of the fact that adverse impacts on those stakeholders will ultimately adversely impact investors.

The Proposed Standards' Adverse Impact on Investors

Heightened burdens on auditors and public companies will have a ripple effect on public company investors. As noted by the AAA Auditing Standards Committee in its comments to the Board, the Proposed Standards and accompanying release fail to address a fundamental question: What do investors want?

> [W]e believe that it is important to clearly state, from an investor perspective, exactly what problem the PCAOB is trying to solve, and why having auditors oversee legal and compliance audits is the best solution to that problem. Certainly, the costs of NOCLAR can be high. But is there evidence that investors are seeking a huge expansion of the scope and cost of audits in order to address NOCLAR? For example, how would investors respond if the NOCLAR proposal resulted in audit fees that are double current levels? What if fees were triple current levels? These important questions have not been addressed in the proposal, making it impossible to evaluate the economics of the proposed standard.
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> Further, is investor concern with NOCLAR related more to financial misstatements or to stock price crash risk ("adverse consequences" for investors)? If the main concern is stock price crash risk, is it appropriate for the auditor to play any role in mitigating that risk?

As the Board would presumably be the first to acknowledge, auditors serve as a linchpin in the assurance process, providing investors with a level of confidence in the financial statements of public companies. However, with the increased reporting obligations required by the Proposed Standards, auditors may find themselves navigating a complex landscape where minor discrepancies are subject to the same scrutiny as more significant compliance issues. This can divert auditors' attention and resources from critical areas of focus, potentially compromising the thoroughness of their audits. That trade off may well be something investors prefer, but the Proposed Standards make no allowance for the possibility that many investors may not prefer that trade off or many other potential trade offs, including:

- **An elongation of the audit process.** Prolonged audits may result in delayed financial reporting, impacting the timely availability of information that investors rely on to make informed decisions.
- **A reevaluation of fee structures for audit services.** Auditors may need to allocate additional resources to meet the demands of the Proposed Standards, potentially resulting in higher audit fees. For smaller public companies, already operating on leaner budgets, this could pose a substantial financial challenge. These added costs may be passed on to investors indirectly, potentially affecting their returns on investment.
- **A substantial reallocation of public company resources.** While striving to maintain compliance, companies may need to divert critical funds and personnel towards ensuring adherence to an increasingly complex regulatory environment. This redirection of resources could hinder companies' ability to invest in research, development, and growth initiatives, ultimately affecting their competitiveness and long-term viability.

- **Companies electing to remain private or go private.** The associated costs and burdens that accompany heightened scrutiny may discourage some companies, particularly smaller ones, from pursuing an initial public offering ("IPO") or remaining publicly listed, limiting the pool of opportunities available to the investing public. Reduced diversity of investment options could restrict investors' ability to construct diversified portfolios, potentially diminishing their ability to manage risk effectively.

Furthermore, just as a tidal wave of observations from auditors attempting to comply with heightened reporting requirements may inadvertently overwhelm regulatory bodies, many of those auditor observations will undoubtedly be what the United States Supreme Court described in another context as of "such dubious significance that insistence on its disclosure may accomplish more harm than good. . . [burying] shareholders in an avalanche of trivial information – a result that is hardly conducive to informed decision making." *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 448-449 (1976). The problem of "information overload" harming rather than helping investors has long been a concern, and the Proposed Standards would only exacerbate that harm. *See* Georgiev, G.S., Too big to disclose: Firm size and materiality blindspots in securities regulation, *UCLA Lew Review* 64(3), 602-683 (2017); and Paredes, T.A., Blinded by the light: Information overload and its consequences for securities regulation, *Washington University Law Quarterly*, 81(2), 417-485 (2003).

In conclusion, while the intention behind the Proposed Standards is laudable, we implore the PCAOB to carefully consider the broader implications for auditors, public companies, and, ultimately and perhaps most importantly, public company investors. Imposing a level of regulatory vigilance preferred by some members of the Board and PCAOB staff that is harmful to investors and will reduce choices available to investors should not be done lightly, particularly when the Release identifies no specific problem identified by investors that the Proposed Standards would address.

We appreciate this opportunity to comment on the Proposed Standards and hope the Board finds this letter helpful. If there are any questions about any of our comments, we welcome further discussion. Please do not hesitate to contact me at nicolas.morgan@icanlaw.org.

Sincerely,

Nicolas Morgan
Founder and President
ICAN