ICAEW
REPRESENTATION 73/23

AMENDMENTS TO PCAOB AUDITING STANDARDS RELATED TO A COMPANY'S NONCOMPLIANCE WITH LAWS AND REGULATIONS AND OTHER RELATED AMENDMENTS

Issued 07 August 2023

ICAEW welcomes the opportunity to comment on *Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations And Other Related Amendments* published by the PCAOB on 06 June 2023, a copy of which is available from this link.

For questions on this response, please contact the ICAEW Audit and Assurance Faculty at tdaf@icaew.com quoting REP 73/23.

This response of 07 August 2023 has been prepared by the ICAEW Audit and Assurance Faculty. Recognised internationally as a leading authority and source of expertise on audit and assurance issues, the faculty is responsible for audit and assurance submissions on behalf of ICAEW. The faculty has around 20,000 members drawn from practising firms and organisations of all sizes in the private and public sectors.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 166,000 chartered accountant members in over 146 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

ICAEW
Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
T +44 (0)20 7920 8100 F +44 (0)20 7920 0547 icaew.com

KEY POINTS

General

1. We welcome the opportunity to comment on the PCAOB's proposed amendments to its auditing standards related to auditor consideration of a company's noncompliance with laws and regulations in the performance of an audit. Noncompliance results in substantial financial damage to both companies and investors and we congratulate the Board on its efforts to raise the bar in this difficult area. We make suggestions below for changes we believe are necessary to these proposals to make them effective. In particular, we urge the PCAOB to do what it can to further reassure all stakeholders that due regard should be had to management controls, such as those over the identification of relevant laws and regulations. This is important because the proposals can easily be misread as an attempt to address investor concerns about corporate governance by extending the work required of auditors.
2. Opposition to the substance of these proposals has been widely reported and we urge the Board to consider how some of the concerns expressed by auditors, which are not without foundation, can be dealt with to prevent the sort of over-auditing seen when reporting on internal controls over financial reporting was first introduced.
3. Significant change to auditing standards invariably requires auditors to do more. The question for auditors is always, 'how much more'? Even with good quality guidance, until accepted practice is embedded - which takes time - auditors must second-guess the reaction of audit inspectors to the changes that they, the auditors, make. This is complicated by spreading the requirements relating to fraud across different standards.
4. Auditors fear that whatever they do, they will always be expected to have done more. This fear should not be dismissed lightly. It is not unreasonable to ask auditors to be aware of laws and regulations affecting the companies they audit. Nevertheless, the PCAOB as a standard-setter and audit inspector owes it to the investors it serves to do what it can to ensure that companies are not subject to the sort of 'defensive' auditing that seems likely if auditors believe that they will need to justify why they have not done more to audit inspectors. This has cost-benefit implications.
5. The PCAOB should manage the implementation of the changes it is proposing by reassuring both companies and auditors that it is seeking a proportionate response to the proposals, and by seeking to avoid polarised positions which may play well to the financial press but do little to protect investors,

Management controls and the reporting threshold

6. Auditors should not approach the audit through the lens of management, but management's approach is nevertheless critical to the auditor's understanding of noncompliance. The proposals as they currently stand require auditors to identify all laws and regulations as a starting point, and page 29 of the release makes clear that 'the auditor's identification would not be limited to those laws and regulations identified by management'.
7. A perceived lack of regard to the controls-based approach is exacerbated by the absence of a 'clearly inconsequential' threshold for reporting, and the range of material auditors are being asked to consider, including social media and the media more broadly. The proposals are being widely interpreted as requiring auditors to identify every possible law and

regulation that a company could be subject to and investigating every possible instance of noncompliance. For the costs of the proposals to be exceeded by enhancements to audit quality, the assessment of management's controls would be appropriate in the context of the identification of relevant laws and regulations, rather than merely as a risk assessment procedure.

8. The omission of a threshold for evaluating and communicating instances of actual or potential noncompliance goes beyond current audit requirements and the requirements of Section 10A of the Securities Exchange Act. These only requires auditors to inform the appropriate level of management of an illegal act if it is not 'clearly inconsequential'. The absence of such a floor in proposed AS 2405 will lead to companies expending considerable resource on auditor work on many insignificant instances of noncompliance, of little value to investors.

Inherent limitations

9. The removal of wording in AS 2405 relating to the limitations of auditor capabilities regarding noncompliance will widen the expectation gap and has the potential to mislead investors. This language is present in ISA 250. It is important that investors understand the unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with auditing standards. Regardless of how unpalatable some of this material may appear to some, the limitations are real. Eliminating references to the limitations will not eliminate the limitations. The removal of the references can also be construed, rightly or wrongly, as representing a potentially major change of substance or regulatory direction. We do not believe that this is the intention, but the issue has caused significant concern.

10. We recommend that material on inherent limitations is included, but modified, similar to the FRC's approach within ISA (UK) 240 (Revised), which states that:

    While […] the risk of not detecting a material misstatement resulting from fraud may be higher than the risk of not detecting one resulting from error, that does not diminish the auditor's responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement due to fraud. Reasonable assurance is a high, but not absolute, level of assurance.

    It is critical that reasonable assurance is properly understood by investors. The descriptions of the limitations of an audit are widely accepted globally. If they are not reinstated within the auditing standard, they should be moved somewhere equally authoritative.

Management integrity and behavioural change

11. The proposals do not include any requirement for auditors to consider whether adverse findings indicate a particular management mindset, a lack of management integrity, or a lack of competence that may have implications for the wider audit. Fraud and noncompliance with laws and regulations do not take place in a vacuum, and we therefore recommend that the standard makes clear that findings in this area may increase risks in other areas or have a bearing on client acceptance and continuance.

12. The PCAOB needs to be clear in its messaging about the extent of behavioural change it expects from auditors, as well as the extent to which the proposals are intended to alter the purpose and objectives of an audit. Page 26 of the release states that proposed AS 2405 does not seek to change the foundational audit objective of auditor reporting on the financial statements. However, the proposed new objectives added to AS 2405 for auditors to identify whether there are instances of noncompliance that have or may have occurred and to evaluate and communicate instances of noncompliance regardless of materiality, are not aligned with this statement. Similarly, page 20 of the release asserts that the proposed amendments would change the existing presumption that currently, an audit in accordance with PCAOB auditing standards does not include audit procedures designed to identify noncompliance with an indirect effect on the financial statements. While we broadly agree with this change, it is nevertheless a very significant change.

13. Noncompliance is a matter of judgement and the exponential increase in law and regulation surrounding ESG matters, for example, will serve to highlight the fact that compliance and noncompliance are binary in name only. Auditors will likely require significant and scarce

specialist assistance to fulfil their responsibilities under the proposals as they stand, especially when auditing multi-national companies. This increases costs disproportionately for smaller audit firms, which in turn may lead to a reduction in firms undertaking PCAOB audits. The corresponding reduction in competitiveness in the audit market would not be in the public interest and would not enhance investor protection.

14. Questions on which we have no comment we omit from our response below.

ANSWERS TO SPECIFIC QUESTIONS

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

15. Yes, we welcome the change in terminology from 'illegal acts' to 'noncompliance with laws and regulations.' The new terminology is consistent with ISA 250 and more appropriately indicates to auditors that both acts and omissions are in scope. Greater alignment in the terminology and definitions used between ISAs and PCAOB standards is desirable as it reduces complexity for firms and helps auditors focus on the key requirements rather than concerning themselves with differences in terminology which are not meaningful.
16. The proposed definition of 'noncompliance with laws and regulations' is now much closer to the definition in ISA 250, which we applaud. However, while the two definitions are identical in meaning (except for the inclusion of fraud in AS 2405), there are small differences in wording. We do not believe that these differences are significant, we do not see their value or how they will change auditor behaviour, and we are not convinced that they need to be different. We caution against the use of different words simply to clarify meanings where the difference will have no impact on auditor methodology or behaviour.

Question 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?

17. The decision to include fraud within the proposed definition of noncompliance represents a genuinely transformational shift in the way that these concepts are defined and considered by auditors. We applaud the PCAOB's willingness to innovate to improve audit quality.
18. However, it is not clear whether the PCAOB's intention is to effectively remove the distinction between misreporting caused by error and misreporting caused by intentional fraud, by including all fraud, including non-scienter fraud, in the definition of noncompliance. If this is the intention, significant, as yet unspecified changes in auditor behaviour will be needed, as the definition of noncompliance would be broadened to effectively include all misreporting in the financial statements, regardless of management intentions.
19. We see some benefit to the inclusion of fraud as a type of noncompliance with laws and regulations. At a simple level, fraud is a type of noncompliance. We also agree with the removal of the distinction between direct and indirect noncompliance. Taken together though, this means that there is no longer any distinction between noncompliance due to management error and noncompliance due to intentional fraud, the only significant issue being the effect of any noncompliance on the financial statements.
20. However, if simplification is the goal, it is undermined by the PCAOB's decision to retain a separate auditing standard on fraud, especially given that fraud within AS 2401 will continue to be defined as 'an intentional act', whereas proposed AS 2405 will include other types of fraud, such as non-scienter fraud. This is acknowledged in existing AS 2401, but not in proposed AS 2405. The difference in definitions of fraud between AS 2401 and AS 2405 is very likely to cause confusion. Auditors cannot make legal determinations of whether fraud has occurred, which must be determined by the courts. This should be acknowledged in both standards.
21. We are concerned that requirements relating to fraud will now be spread across several standards. The proposal that AS 2401 will continue to govern the auditor's responsibilities with respect to the identification of information that may be indicative of fraud, but that the evaluation and communication of fraud will be addressed by proposed AS 2405, will make it harder for auditors to follow the standards consistently. The scope of this change is likely to require firms conducting PCAOB audits to make significant updates to their audit methodologies. If the PCAOB makes no further changes, it will need to embark on a significant program of education and outreach to help with implementation, if investor protection is to be enhanced.

22. We are also concerned about the failure of proposals relating to the communication of fraud in proposed AS 2405 to reflect the additional, widespread considerations regarding 'tipping-off' under anti-money laundering legislation and similar legislation in many jurisdictions. This prohibits auditors from communicating some suspected or actual frauds to management or the audit committee and requires auditors to report directly to law enforcement agencies instead. Combining the requirements relating to fraud and other kinds of noncompliance in the same standard eliminates these important differences and could lead to auditors failing to fulfil their legal obligations. If fraud is to be included within the definition of noncompliance, additional guidance must be provided regarding these restrictions on communication.
23. Furthermore, the omission of a threshold for evaluating and communicating instances of actual or potential fraud and noncompliance goes beyond current audit requirements and the requirements of Section 10A of the Securities Exchange Act, which only require auditors to inform the appropriate level of management of an illegal act if it is not 'clearly inconsequential'. The absence of such a floor in proposed AS 2405 will lead to auditors expending significant resource on evaluating and communicating insignificant instances of noncompliance. We do not believe that this will add any meaningful value to the audit, or that it will benefit investors. The cost of performing this work will simply be passed on to them via the audit fee.

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

24. No, the objectives for proposed AS 2405 are not sufficiently clear. We strongly believe that objective .04c should only apply to situations in which auditors assess a risk of material misstatement. This objective as it currently stands requires auditors to identify all instances of noncompliance regardless of materiality. Most instances of noncompliance that would likely be identified will be inconsequential to the financial statements, resulting in increased audit costs without a corresponding increase in investor protection. We recommend a proportionate, risk-based approach in which objective .04c ('Identify whether there are instances of noncompliance with laws and regulations that have or may have occurred'), applies only to laws and regulations where the auditor has identified a risk of material misstatement under objective .04b.
25. Similarly, objective .04d, requires auditors to evaluate and communicate all instances of noncompliance and potential noncompliance, regardless of materiality. This will result in substantial work effort to evaluate non-significant instances of noncompliance. Large entities may have thousands of calls to their whistleblowing hotlines every year, each of which could indicate potential noncompliance. Very few of these would have any potential to have a material effect on the financial statements. The likely increase to investor protection is negligible at best and does not justify the additional work. A 'clearly inconsequential' threshold for reporting in line with Section 10A of the US Securities Exchange Act is needed to enhance investor protection.

Question 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?

26. No, auditors will not be able to identify these laws and regulations simply because auditors would first be required to identify *all* laws and regulations applicable to the company, and then assess which of those could potentially have a material impact if not complied with. To identify every law and regulation applicable to the company, auditors are likely to need to engage specialist legal expertise in every jurisdiction in which the company operates. That expertise is unlikely to be available in some jurisdictions, regardless of cost. A large public company in a highly regulated industry is subject to thousands of new laws and regulations each year, globally, different specialists are likely to have different interpretations of legislation, and the quality of evidence that can be obtained may be poor in cases where there is a lack of available expertise. There may also be no local component auditors

operating in a particular jurisdiction to report to the lead auditor on laws and regulations locally.

27. We are concerned that there is insufficient regard within the proposed amendments to the role of management processes and controls in identifying applicable laws and regulations and assessing whether fraud or noncompliance has taken place. Companies are already required to have effective compliance processes in place to identify all the laws and regulations that they are subject to. Asking auditors to duplicate this work does not increase investor protection but it does significantly increase costs. The PCAOB should consider a more proportionate, risk-based approach and have greater regard to the significance of management's processes and controls to the auditor's response to the risk assessment.
28. Auditors should not approach the audit through the lens of management, but management's approach is nevertheless critical to auditor understanding of noncompliance with laws and regulations. We suggest that the PCAOB considers a more controls-based approach and the introduction of a 'clearly inconsequential' floor for reporting to better align the costs of the proposals to companies with the enhancement to investor protection.

Question 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?

29. No, the proposed requirement to identify information indicating non-compliance is not sufficiently clear. The proposed requirement is non-specific regarding the type and extent of information to be obtained by the auditor. Several sources of information are mandated in paragraph .06, but they are very broad, particularly in the light of the proposed amendments to AS 2110 to review publicly available information from a variety of sources, including company-issued press releases, company-prepared presentation materials, public statements issued by the company including those on its website, executive officers' social media accounts, and media and analysts' reports more generally.
30. The extent of potentially available information is almost limitless, and it will be impractical for auditors to identify and consider all possible sources of information. This requirement therefore gives rise to a completeness risk for auditors when determining how much information they should consider to appropriately fulfil their responsibilities.

Question 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.

31. Yes, our understanding is that auditors regularly make use of third-party company research and news media databases such as FAME and LexisNexis, which automatically aggregate publicly available information and news stories about companies. Research using these databases can highlight news stories about companies which may indicate noncompliance with laws and regulations, and whether the company has been fined or involved in litigation.

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

32. No, the proposed requirement for auditors to read publicly available information about the company is too broad. The scope of sources to be inspected by auditors is unclear given the potential volume of material available. It is not clear, for example, how many analyst reports should be looked at, whether every executive officer's social media posts should be examined, if so on which platforms, and how far back in time. This lack of clarity creates a completeness risk for the auditor. It is simply impractical to examine every item of information available.

33. Even if auditors were able to examine all publicly available information about a company, there is no guarantee that it would result in the identification of all actual and potential instances of noncompliance with laws and regulations. Much publicly available material is wholly irrelevant, and the remainder is rarely likely to present clear-cut evidence of noncompliance. Auditors will be required to use judgement to evaluate this information, which will require significant work effort given the volume of material available.

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

34. No, the proposed additional requirements regarding enquiries of others are not sufficiently clear. The open reference to 'others within the organization' in paragraph .57d presents a challenge similar to the proposed requirement to identify information indicating noncompliance. It is impracticable for auditors to inquire of everyone within a large company likely to have knowledge of the areas outlined, and the proposed amendments do not make clear what a reasonable level of enquiries would amount to. Auditors are exposed to a completeness risk when determining what enquiries to make, and to whom they should be made.

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?

35. Yes, the proposed requirement to inquire about correspondence is sufficiently clear. However, in some cases where fraud is suspected, it may not be appropriate for auditors to make inquiries internally within the company, and the standard should include guidance to this effect. Anti-money laundering and 'tipping off' legislation may prevent auditors from communicating directly with management where management is suspected of being implicated in noncompliance. As the proposals stand, the auditor's responsibility to communicate directly with the regulator could in some circumstances conflict with the proposed requirements of AS 2110.

Question 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?

36. Yes, the proposed requirement for auditors to consider whether specialized skills or knowledge is clear.

Question 30. Are the proposed communication requirements sufficiently clear? If not, why not?

37. No, the proposed communication requirements do not appropriately consider the different considerations that apply to communicating fraud. 'Tipping-off' laws in many jurisdictions may prevent auditors from communicating identified instances of fraud to management or the audit committee and may require them to report concerns directly to law enforcement agencies instead. Combining the requirements relating to fraud and other kinds of noncompliance in the same standard eliminates these key differences and could lead to auditors failing to fulfil their legal obligations in relation to fraud appropriately.

Question 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?

38. No, the standard should not include requirements to make additional communications to other parties. Legislation in various jurisdictions, including the USA, already requires auditors to report to other bodies in specific circumstances. This should not be duplicated in the standard, not least to avoid the risk of conflicting requirements. In some jurisdictions, reporting to regulators may conflict with local confidentiality rules.

Question 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?

39. No, the proposed standard should not include requirements for communication in the engagement report. Including more boilerplate disclosures in the audit report would not help a user's understanding of the financial statements, and giving details of specific instances of fraud or noncompliance could leave audit firms open to litigation (for example, if a fraud they have reported in the engagement report is not subsequently proven in court). Recent proposed changes to law and regulation have drawn back from requiring the reporting of specific frauds detected, because fraud is only determined by the courts and in many cases any fraud reported would be suspected rather than proven.

Question 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?

40. No, we support the PCAOB's decision not to retain requirements related to an auditor's withdrawal or resignation from the audit engagement. Decisions to withdraw or resign are dependent on circumstances and auditor judgement. Creating specific requirements in relation to this could have unintended consequences.

Question 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?

41. No, having some requirements relating to fraud within AS 2401, others within AS 2405 and still others in AS 1215 will increase complexity for auditors and make it harder for them to follow the standards.

Question 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?

42. Yes, we support the proposal to establish an understanding with an auditor's specialist regarding the specialist's responsibility to communicate any instances of fraud or other noncompliance. This includes the requirement to obtain a written affirmation that any instances or alleged or suspected instances identified during the specialist's work have been communicated to the auditor.

Question 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?

43. Yes, an interim review requirement should be added because auditor obligations under Section 10A apply to interim reviews as well as audits.

Question 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?

44. Yes, it is appropriate to rescind AI 13, as the issues covered are dealt with elsewhere within PCAOB standards.

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

45. Yes, we consider it appropriate to rescind AI 21 and replace its content with a footnote in AS 2805. Auditors will benefit from having all relevant guidance in the same place.

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

46. Of particular concern is the proposed requirement to identify all laws and regulations which may drain auditor resources, the proposed requirement to perform procedures in response to any noncompliance of which the auditor becomes aware, regardless of materiality, and the expanded requirement to read publicly available information about the company, including executive officer's social media posts. It is not currently possible to quantify these costs, nor is it clear from the proposals the extent of behavioural change with regard to evidence-gathering expected of auditors.

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

47. No, the proposed expansion will be time-consuming and costly for firms to implement given the volume of material that will need to be inspected. We do not consider that the expanded requirement would be cost effective. A large amount of incremental work will be required to be performed by firms under these proposals. The costs to firms and audited entities of performing this work will be high. Small and medium sized firms will struggle to deploy the resource required to perform this work, which may discourage them from taking on PCAOB audits. This in turn will reduce competition in the audit market and may have a negative impact on investor protection.

Question 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?

48. Yes, retaining auditor-engaged specialists to assist auditors in understanding complex technical and legal information that could indicate noncompliance will result in increased costs. Even where specialists are already routinely involved, they are likely to need to spend increased time on the engagement. Companies may also need to obtain legal specialist assistance to evaluate noncompliance identified by technical specialists, increasing costs further.
49. Larger firms may have access to in-house specialists, but smaller and medium sized firms may have to engage external experts, which will be more expensive. If the cost of engaging appropriate specialists is prohibitive, firms may be discouraged from taking on PCAOB audits. This in turn will reduce competition in the audit market and have a negative impact on audit quality.
50. In situations where legal experts are engaged to assess possible noncompliance with laws and regulations, they may also have differing opinions on whether noncompliance exists, which could result in second opinions being sought, at further expense. The expense of engaging legal professionals could prevent some firms from taking on PCAOB audits.
51. It is not currently possible to quantify these costs. Given the lack of clarity around the nature and extent of change expected as a result of the proposed requirements, it may not be clear

to audit firms what the expected level of specialist involvement is until audit inspection findings are published.

Question 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?

52. Highly likely unintended consequences include auditor overreaction to the standard, as identified by the PCAOB, due to the lack of clarity and broad scope of the requirements. The scale of the proposed changes means that some firms are likely to expend disproportionate resources in an attempt to comply, and others may choose to exit the PCAOB audit market altogether.

Question 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?

53. We believe that the proposal will be disproportionately costly for smaller audit firms to implement. This is likely to discourage smaller firms from taking on PCAOB audits. This in turn will reduce competition in the audit market and have a negative impact on audit quality.

Question 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 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?

54. Emerging growth companies have more limited internal processes and systems of internal control in place to identify applicable laws and regulations and monitor compliance. This will make it more difficult for auditors to fulfil their responsibilities under the proposed amendments. Depending on their stage of development, auditors may not yet be required to opine on the controls, which is likely to make the standard much more difficult to implement. EGCs may however rapidly come into scope.

Question 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?

55. Yes, requiring compliance for fiscal years beginning after the year of SEC approval would be a challenge because the proposed changes are so wide-ranging. It will be difficult for firms to update their methodologies, acquire additional resources, renegotiate their audit fees and involve legal and other specialists in time. We recommend a longer implementation period.

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

56. These proposals will be complex and time-consuming for auditors to implement. Firms would benefit from the opportunity for a dry run of the updated standards, followed by a longer implementation period. We consider a period of two years following SEC approval to be appropriate.