NATIONAL ASSOCIATION OF Manufacturers

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

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

To whom it may concern:

On behalf of the National Association of Manufacturers ("NAM"), I write to respectfully request that the Public Company Accounting Oversight Board ("PCAOB") withdraw its proposed amendments to the auditing standards related to a company's noncompliance with laws and regulations.[1]

The NAM is the largest manufacturing industry association in the United States, representing manufacturers of all sizes and in all 50 states. Manufacturing is a capital-intensive industry, and many manufacturers turn to the public market to finance job-creating investments in new product lines, innovative facilities and equipment, expanded production capabilities, and research and development.

As publicly traded companies, manufacturers are subject to strict disclosure and assurance rules to ensure that shareholders' investments are protected. It is important that these standards are appropriately calibrated so that they reflect the actual risks to shareholders, the costs and resource diversion associated with compliance, and the feasibility of the underlying requirements.

Unfortunately, the PCAOB's proposed standards fail to strike this critical balance. As proposed, the amendments would significantly increase company costs by drastically expanding auditors' responsibilities to examine items unrelated to financial statements or their core professional competencies. As such, the NAM respectfully encourages the PCAOB to withdraw its proposed amendments.

I. **The proposed amendments would dramatically expand the scope of the audit, redefine auditors' role, and infringe on companies' attorney-client privilege.**

Audit Scope

At present, auditors are charged with identifying corporate noncompliance that could have a direct and material effect on the determination of financial statement amounts. These inspections are relevant to auditors' evaluations of companies' risk assessment programs. As such, they often necessitate auditor attention to certain laws and regulations, and a company's compliance therewith, that are most relevant to its operations, and thus to its financial statements. Auditors are *not* required

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

to seek out each and every potential law or regulation to which the company is subject, exercise professional judgment outside their area of expertise, or employ audit procedures specifically designed to detect potential violations.

The proposed standards would expand the categories of potential noncompliance that auditors would be charged with tracking. The PCAOB's proposal would replace the existing definition of "illegal acts" with a new term, "noncompliance with laws and regulations," which the PCAOB concedes is meant to "have a broad meaning."[2] It would then require auditors to adopt specific procedures to identify laws and regulations to which a company is subject, evaluate management processes to ensure compliance with those laws and regulations, and assess the risk of a potential misstatement based on their findings—"regardless of whether the effect of the noncompliance is perceived to be material to the financial statements."[3]

These changes would significantly expand the scope of the audit and require auditors to evaluate topics about which they are not subject matter experts and which do not have a material impact on a company's financial statements. In short, the PCAOB's proposed amendments represent a dramatic shift in the role of an auditor. As Board member Christina Ho has noted, "management prepares and discloses financial information, auditors provide an independent certification on the financial information, and regulators provide oversight of the public companies and auditors."[4] These divides are appropriate for maintaining auditor independence and are effective at focusing the audit on the reliability of the financial data on which shareholders rely. But the proposed amendments would require that auditors investigate and opine on matters unrelated to a company's financial statements and outside an auditor's professional expertise.

Auditors' Role and Function

Auditors are neither company management nor counsel, and their judgment should not be substituted for that of management or their experts. Requiring auditors to opine on companies' potential noncompliance with laws and regulations to the extent required by the proposal would significantly expand their role and could interfere with management's responsibilities. Indeed, auditors would be required to hire attorneys and other specialists to understand what rules apply to each of their audit clients, determine whether their clients are in compliance with said rules, perform legal analysis to identify individual instances of noncompliance, and evaluate whether appropriate remediation has been undertaken.

If auditors are expected to hire experts and make decisions regarding the application of various laws and regulations and companies' decisions with respect to compliance and remediation, it would effectively usurp the role of management and redefine the role and function of an auditor.

Attorney-Client Privilege

The proposal would create significant tension between a company's counsel and other experts and those hired by an auditor. Regulatory compliance is often nuanced, and the proposed amendments could implicate the important role that counsel and issue matter experts play in guiding company adherence to laws and regulations. For example, the proposal creates the risk that a company's

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[2] *Id.* at 24.

[3] *Id.* at 21.

[4] *Statement on Proposed Amendments to PCAOB Auditing Standards Related to a Company's Noncompliance with Laws and Regulations* (6 June 2023). Christina Ho, Board Member. *Available at* 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.

counsel and experts might be pressured to modify their analysis to confirm with the auditor's. It also is unclear how auditors will perform that analysis: would the company's counsel and other experts be required to divulge attorney-client or work-product privileged information in order to facilitate the auditor's work?

The NAM is concerned that the proposed standards would expand auditors' responsibilities to such a degree that they infringe on the traditional function of legal counsel to assess legal and regulatory risks. Manufacturers also are concerned that the amendments would require auditors to seek and share confidential information that is likely the subject of legal advice and strategy. Compelling companies to waive privilege by necessitating disclosure of confidential and privileged communications regarding assessments of compliance, litigation, or other legal matters would directly impact attorney-client privilege and ultimately put companies at greater legal risk. Given the strictness that some jurisdictions apply to the waiver of privileges, the proposed standards could expose companies to loss of privilege and thus have a chilling effect on the communications between legal counsel and their company clients.

II. <u>The proposed amendments would create significant confusion and uncertainty among both auditors and issuers.</u>

In addition to dramatically expanding the scope of the audit, the proposed amendments are likely to lead to substantial confusion and uncertainty. The proposal does not provide sufficient guidance on the extent, nature, and timing of potential noncompliance that should be tracked by auditors. As Board member Duane M. DesParte noted, even though the standard points auditors to potential noncompliance that "reasonably could" have a material effect on financial statements, "reasonably could" is not adequately defined.[5] And the examples provided by the PCAOB as to what the proposal would require simply illustrate the immaterial nature of what auditors would be required to investigate.

Furthermore, assessing noncompliance would require significant assumptions by auditors, including with respect to positions that might be taken by regulators and courts, oftentimes on topics that are well outside the auditor's core professional competencies. Moreover, an increased focus on items that may not be material to a company's financial statements would undermine the core purpose of the audit, which is to provide assurance to investors relying on those statements to make an investing decision. It is critically important that auditors focus on matters material to a company's financial statements; diverting auditors' attention and resources away from material topics could ultimately be detrimental to shareholders.

III. <u>The proposed amendments would drastically increase audit costs.</u>

The proposed amendments would mandate specific audit procedures necessary to comply with the new requirements. The resource burden associated with establishing the expertise and procedures to discharge these novel responsibilities is likely to be substantial for auditors. Similarly, the breadth and depth of the audit will grow considerably, as the items subject to assessment under the proposal far exceed those relevant to the financial statements. These changes are likely to increase audit complexity and reduce certainty for both businesses and auditors—while dramatically increasing audit fees. Companies also will be required to create complex internal processes to comply with the new audit demands, further increasing costs.

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[5] *Statement on Proposal to Amend PCAOB Auditing Standards Related to a Company's Noncompliance with Laws and Regulations and Other Related Amendments* (6 June 2023). Duane M. DesPartes, Board Member. *Available at* https://pcaobus.org/news-events/speeches/speech-detail/statement-on-proposal-to-amend-pcaob-auditing-standards-related-to-a-company-s-noncompliance-with-laws-and-regulations-and-other-related-amendments.

These cost increases would directly impact manufacturers given that the funds diverted to new audit processes and fees pursuant to the proposed standards would be more efficiently utilized investing in job-creating projects and groundbreaking R&D. Similarly, management time would be better spent on innovation and company operations rather than the extensive document preparation, information gathering, and auditor engagement processes that the proposed amendments would necessitate. Every dollar spent on manufacturing investment has a total impact of $2.60 on the U.S. economy, and every job created in manufacturing leads to 4.4 jobs elsewhere. Accordingly, the resource diversion associated with the proposed amendments would be damaging to both manufacturing companies and the broader economy.

Moreover, these costs come with limited investor benefit. The existing standards, under which auditors are already required to identify “illegal acts” that might impact financial statement reporting, are sufficient to protect and inform investors under a reasonable assurance framework. Although the PCAOB cites discrete examples of company misdeeds to justify its proposal, it is not clear how the proposed amendments would have uncovered or prevented these outcomes. And the PCAOB makes little effort to weigh these purported benefits against the substantial costs that would be imposed on thousands of law-abiding companies by the proposal. Simply put, the substantial resource diversion that would be required under the proposed amendments is not reasonably calibrated given their minimal benefits to investors.

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The NAM is concerned that the PCAOB’s proposal would require auditors to investigate issues that are unrelated to their professional expertise or to an investor’s reliance on a company’s financial statements. The proposed changes would dramatically expand the scope of the audit, impact attorney-client privilege afforded to companies, and substantially increase company costs despite limited investor benefit.

Manufacturers respectfully encourage the PCAOB to withdraw its proposed standards related to auditors’ responsibilities for companies’ potential noncompliance with laws and regulations. Rescinding the proposed amendments would protect companies from significant cost increases arising from a dramatic expansion of the scope and complexity of the audit, and thereby preserve manufacturers’ ability to create jobs, drive economic expansion, and bolster American competitiveness.

Sincerely,

Charles P. Crain

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