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Via E-mail: comments@pcaobus.org

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

Re: PCAOB Rulemaking Docket Matter No. 051

Dear Office of the Secretary:

BDO USA, P.A. appreciates the opportunity to comment on the Public Company Accounting Oversight Board ("PCAOB" or the "Board") Proposing Release: *Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations And Other Related Amendments* (the "proposing release").

We support the PCAOB's mission to oversee the audits of public companies and SEC-registered brokers and dealers in order to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports. In addition, we support the Board's objectives of strengthening the existing requirements relating to the auditor's consideration of a company's noncompliance with laws and regulations to: (i) protect investors from the resulting harm of noncompliance with laws and regulations ("NOCLAR") when the effect of such noncompliance has a material effect on the financial statements, and (ii) improve audit quality through the auditor's identification of such noncompliance.

We find several aspects of the proposal to be positive; however, we have significant concerns with certain aspects of the proposing release that downplay the auditor's limited knowledge and expertise in laws and regulations, and the incremental audit effort that will be necessary to comply with the proposed requirements to proactively identify a complete and accurate population of laws and regulations with which noncompliance "could reasonably have a material effect on the financial statements."[1] Based on our experience, companies are subject to a wide variety of evolving laws and regulations that are complex and difficult to interpret without the assistance of experts in the specific areas of law and regulations.

The expansion in the scope of the auditor's responsibilities is further exacerbated by the proposed amendments to the definition of noncompliance with laws and regulations (discussed in Section A of this letter). Additionally, while the proposing release states that these proposed amendments "do not require the auditor to make judgments outside their areas of expertise"[2], we find this to be inconsistent with the proposed requirement for

[1] See proposed AS 2405.05
[2] See page 86 of the proposing release

auditors to identify the laws and regulations with which noncompliance "could reasonably have a material effect on the company's financial statements". In making such determinations, we believe that auditor will be required to make certain informed judgements about the risk of material misstatement due to noncompliance with relevant laws and regulations that the company is subject to.

Overall, the underlying economic analysis and research cited in the proposing release does not provide adequate evidence of any direct correlation between (a) broadening the scope of the auditor's responsibilities in the manner described above and (b) alleviating the specific problem[3] that the proposed amendments are intended to address. In addition, we have concerns that the expanded scope of auditor responsibilities created by these proposed amendments would contribute to further confusion in practice as a result of the different scope of auditor responsibilities between the proposed standards, Section 10A of the Securities Exchange Act of 1934 ("Section 10A"), and the international auditing standards.[4]

A. Definition of Noncompliance with Laws and Regulations

We are supportive of replacing the term "illegal acts" with "noncompliance with laws and regulations" in the proposed standard; however, we have concerns with certain aspects of the proposed definition of "noncompliance with laws and regulations" in proposed AS 2405.A2, which we believe contributes to a significant expansion of the auditor's responsibilities.

Specifically, the proposed amendments expand the proposed definition in the following ways:

1. Footnote 1 of the proposing release[5] expands the definition of "noncompliance with laws and regulations" to include both (i) "fraud" as defined under existing AS 2401.05 and (ii) "all other types of fraud, such as non-scienter-based fraud." We are supportive of including point (i) above; however, we have certain concerns with the inclusion of point (ii) in the proposal for the reasons noted below.

   Footnote 2 of Appendix 1- Proposed Amendments to AS 2405 reiterates that the term "fraud" within the broader term "noncompliance with laws and regulations, including *fraud*" (*emphasis added*) "has the same meaning as in paragraph .05 of AS 2401." We find the proposed definition of "noncompliance with laws and regulations, including fraud" in proposed AS 2405 to be inconsistent with other text within the proposing release.

[3] See page 69 of the proposing release (Section IV.B.1)
[4] International Standard on Auditing (ISA) 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements* (ISA 250), issued by the International Auditing and Assurance Standards Board (IAASB)
[5] See page 4 of the proposing release (Section I)

Additionally, the proposing release[5] describes the addition of point (ii) above as a clarification to the existing requirements; however, we believe that the inclusion of "all other types of fraud, such as non-scienter-based fraud" represents a significant expansion in the scope of existing auditor responsibilities and significantly increases the complexities associated with implementing the proposed amendments.

Lastly, the proposed amendments do not provide adequate clarity with respect to the linkage between existing AS 2401 and proposed AS 2405, and how, in practice, an auditor would apply the two standards in combination to meet their responsibilities with respect to fraud.

2. The existing standard makes a distinction between laws and regulations with a "direct effect" versus those with an "indirect effect" on the financial statements, and generally does not hold the auditor responsible for the detection of illegal acts that have an indirect effect[6]. However, the proposed standard removes this distinction between direct and indirect and makes clear the auditor's responsibility is to detect noncompliance that could reasonably have a material effect on the company's financial statements.

   The proposing release[7] acknowledges that the above amendments go beyond the current requirements in Section 10A. In addition, it acknowledges that companies are subject to a wide variety of legal and regulatory environments depending on a number of factors, including, among others, geographic location, the product or services provided, and the particular industry. Similar to point 1), we believe the removal of this distinction in the extant standards would significantly expand the scope of auditor responsibilities and increases the overall complexity in application of the proposed requirements.

B. Identification of laws and regulations with which noncompliance could reasonably have a material effect on the financial statements

The proposed amendments establish an unconditional responsibility for auditors to plan and perform audit procedures to proactively[8] identify laws and regulations with which noncompliance could "reasonably have a material effect on the company's financial statements." Specifically, proposed AS 2405.02 states that "[t]he auditor is required to design and implement audit responses that address the risks of material misstatement, including the risk of material misstatement of the financial statements resulting from noncompliance with laws and regulations." Additionally, proposed paragraph AS 2405.05a states that "[t]he auditor must plan and perform procedures" to "[i]dentify the laws and

[6] See existing AS 2405.08. Section 10A(a)(1) requires that issuer audits include "procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts."

[7] See page 28 of the proposing release (Section III.C.1)

[8] See PCAOB's news release and Investor Bulletin relating to these proposed amendments. The adverb phrase "proactively" is used in these communications in describing the auditor's responsibilities in accordance with the proposed amendments.

regulations with which noncompliance could reasonably have a material effect on the financial statements."

These proposed amendments significantly expand the auditor's responsibilities in comparison to the current standards. In addition, the expansion of the definition of "noncompliance with laws and regulations" discussed in Section A of this letter increases the overall scope of these requirements. We find the proposed requirements in this area to be unclear and complicated for various reasons described below.

1. The PCAOB's Investor Bulletin relating to these proposed amendments states that "[t]he proposed standard would require auditors to plan and perform audit procedures to proactively identify the laws and regulations with which noncompliance could 'reasonably have a material effect on the company's financial statements.'" Based on our observation, the adverb "proactively" is not used in the proposing release; however, it is used in other external communications regarding this proposal by the Board. The Merriam-Webster's dictionary defines the adverb "proactively" to mean "in a way that anticipates future problems, needs, or changes." It is unclear whether the above inconsistency in the phrase used to describe the proposed auditor requirements between the Board's external communications and the proposing release was unintentional. We believe the inconsistency in language may inadvertently increase the expectations gap between investors and auditors.

2. To identify laws and regulations with which noncompliance could reasonably have a material effect on the company's financial statements, it appears that the auditor would need to identify a complete population of all laws and regulations of which the company is subject. We believe the proposal would benefit from additional guidance to clarify proposed AS 2405.05a.

   The proposing release states[9] that "the proposed standard appropriately focuses the auditor's attention on laws and regulations that could have a material effect on the financial statements," and that "the auditor would be able to benefit from management's process to identify these laws and regulations" for purposes of the audit. The proposing release then states that "[t]he auditor's identification would not be limited to those laws and regulations identified by management when fulfilling this obligation, however, such laws and regulations are a source of information for the auditor." While the above guidance is helpful, it does not provide sufficient guidance to facilitate consistency and scalability in practice in complying with proposed AS 2405.05a.

   We are supportive of the proposed requirements in AS 2405.06a.2) for the auditor to obtain an understanding of management's process related to identifying laws and regulations with which noncompliance could reasonably have a material effect on the financial statements. Any information obtained from the company that is used as audit evidence would require further audit procedures in accordance with AS 1105.10 to test

[9] See page 29 of the proposing release (Section III.C.2)

the accuracy and completeness of such information, or test relevant controls at the company over that information.

Lastly, consistent with the points raised by Board Member DesParte in his statements on the proposal, "...the filtering threshold of 'reasonably could [*sic*]' is not addressed elsewhere in PCAOB standards or adequately explained in the proposal. For example, it is unclear whether auditors would make this likelihood assessment considering management compliance policies, programs, processes, and controls (i.e., on a residual risk basis) or on an inherent risk basis."[10]

3. The proposed amendments remove certain language from existing AS 2405 because, as described in the proposing release, the Board believes that such language "does not speak to the auditor's affirmative obligations."[11] For example, existing AS 2405 states that "[a]n auditor ordinarily does not have sufficient basis for recognizing possible violations of such laws and regulations"[12] and also notes that "the determination as to whether a particular act is illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law."[13]

   We understand the reasons for the Board's decision to remove such language from the proposed amendments. The economic analysis within the proposal acknowledges that "[a]uditors *may* need to retain attorneys or other legal experts, including attorneys from different legal disciplines or specializations, as auditor's specialists to assist them in identifying the population of relevant laws and regulations. These specialists could be costly to retain" (*emphasis added*).[14] Based on the expanded scope of the auditor's responsibilities to plan and perform audit procedures to proactively[8] identify the laws and regulations with which noncompliance could reasonably have a material effect on the company's financial statements, auditors will undoubtedly need to use the work of a large number of specialists, including attorneys and other legal experts across different legal disciplines or specializations, and across multiple jurisdictions in which the company operates, to comply with the proposed requirements.

4. The proposing release states[15] that "[s]imilar to the existing standard, the proposed amendments do not state that the auditor is required to make a definitive legal determination about whether noncompliance has occurred." However, we find this to be inconsistent with our interpretation of the proposed amendments that require the auditor to assess the likelihood of material misstatement to a company's financial statements due to noncompliance with applicable laws and regulations. In doing so,

[10] See Statement on Proposal to Amend PCAOB Auditing Standards Related to a Company's Noncompliance with Laws and Regulations and Other Related Amendments made by Board Member Duane DesParte on June 6, 2023.
[11] See pages 70, 74, 78, and 91 of the proposing release
[12] See existing AS 2405.06
[13] See existing AS 2405.03
[14] See page 79 of the proposing release
[15] See page 91 of the proposing release

the auditor may be viewed as making a judgment in areas that are outside of the auditor's expertise. As described in existing AS 2405.03, making such a determination is beyond the auditor's professional competence and, often, there is significant ambiguity such that a determination could only be made in a court of law. Without the contextual language such as that included in existing AS 2405.03 and .12, the proposed standard implies that the auditor is expected to make assessments related to noncompliance with laws and regulations independently of and with little regard to management's own assessment. The additional requirement under the proposed standard for the auditors to communicate their affirmative determination to the audit committee, which does not exist under Section 10A, further highlights this distinction.

C. Scalability of risk assessment procedures

We are supportive of the proposed amendments to AS 2110.11, specifically to add a note "that provides a list of sources of public information from sources internal and external to the company that would inform the auditor's assessment of the risk of material misstatement and may provide information indicating noncompliance with laws or regulations has or may have occurred."[16] However, we believe that elevating the auditor's responsibility from "should consider" to "should" in accordance with the proposed amendments will impede the scalability of the standards.

For example, in accordance with the proposed AS 2110.11, the auditor should read publicly available information about the company, including such information disclosed by the company or its executive officers. This includes "company-issued press releases; company-prepared presentation materials for analysts or investors; and public statements made or issued by the company or its executive officers, including on the company's website *or the company's or its executive officers' social media accounts*. Publicly available information about the company also includes information from sources external to the company, such as media reporting and analyst reports (*emphasis added*)." The auditor's ability to a) identify or obtain access to all such social media accounts described in the proposal, and b) perform a meaningful analysis from such data for purposes of the company's financial statement audit may be prohibitive. Therefore, further clarifications to the auditor requirements in proposed AS 2110.11 based on these points would be beneficial, including potentially changing this to "should consider."

D. *Complexity in evaluation*

As noted in the proposing release, "[c]ompanies are subject to a variety of legal and regulatory environments depending on a number of factors, including, among others, geographic location, the product or services provided, and the particular industry. As a result, companies are also subject to a range of consequences from noncompliance with laws and regulations."[17] Further, as acknowledged within the economic analysis to this

[16] See page 37 of the proposing release
[17] See page 4 of the proposing release

proposal, "[a]uditors may need to retain attorneys or other legal experts, including attorneys from different legal disciplines or specializations, as auditor's specialists to assist them in identifying the population of relevant laws and regulations. These specialists could be costly to retain."[18]

Assessing and responding to the risks of material misstatement of the financial statements due to noncompliance with those laws and regulations is complex because of the wide variety of legal and regulatory environments in which a company operates, and the range of consequences from noncompliance with relevant laws and regulations. The expanded requirements established by the proposing release do not align with the auditor's core competency.

To comply with the proposed requirements, auditors will undoubtedly need to use the work of specialists; however, an increase in the frequency and significance of the auditor's use of the work of specialists adds further complexities to an audit with respect to the auditor's ability to evaluate the work of either an auditor's specialist or a company's specialist, or to supervise the auditor's specialist, where applicable. Additionally, the limitations of the auditor's expertise in the area of law and regulations may limit the auditor's ability to properly evaluate or oversee the work of specialists, and therefore heighten the risk that the auditor would not sufficiently detect a material misstatement as an unintended consequence.

E. *Communication prior to evaluation*

Proposed AS 2405.12 will require that the auditor communicate with management and the audit committee as soon as practicable regarding becoming aware of information indicating that noncompliance with laws and regulations has or may have occurred, regardless as to whether or not that information is perceived to have a material effect on the financial statements and, potentially, prior to whether a determination as to the occurrence of the noncompliance has occurred.[19] The timing of this could reduce the quality in information that is being communicated, as it may not allow for appropriate due diligence.

Proposed AS 2405.12(b) does scope out matters that are "clearly inconsequential" or previously communicated in accordance with AS 2405.13 for communications with the audit committee. Page 49 of the release states that "clearly inconsequential" would be "significantly below the threshold of materiality when considering both qualitative and quantitative factors." The gap between whether or not something is "material" and "clearly inconsequential" is significant. The note to AS 2810.10 articulates the concept of "clearly trivial" and its relationship to materiality, which we believe the proposed standard could adopt for consistency amongst the standards, including proposed

[18] See page 79 of the proposing release
[19] See proposed AS 2404.12 footnote 17

amendment to AS 1215.12(h).[20] Additionally, clarity as to the use of the term "material effect" in relation to "clearly inconsequential" in proposed AS 1215.12(h) would be helpful. This lack of clarity with regards to the amount to be communicated coupled with the timing of the communications could lead to inconsistent communications.

We are supportive of the removal of the requirement to withdraw from an engagement. as these decisions can be complex and it allows for the application of judgment in those circumstances.

F. *Response to the expectation gap*

The proposing release states that "[t]o the extent that investors expect auditors to play a larger role in identifying noncompliance, *the proposed amendments would help reduce the expectations gap between investors and auditors (emphasis added).*"[21] While we acknowledge that auditors can and should play a more significant role in identifying, evaluating, and communicating noncompliance, we have concerns that the nature of proposed expansion in scope of auditor responsibilities in proposal could contribute to various unintended consequences described in Section IV.C.3 of the proposal, and widen the expectation gap. In this context, we note that:

1) The Board's proposed amendments appear to be based on a combination of the following considerations:
    - highly publicized matters have drawn attention to the role of the auditor in detecting violations of laws and regulations, including consumer, environmental, or other laws and regulations;[22]
    - anecdotal evidence that indicating that stakeholders expect auditors to play a larger role in identifying, evaluating, and communicating noncompliance;[23]
    - limited academic literature on the role of auditors in detecting noncompliance with laws and regulations by clients;[24] and
    - the oversight activities of the Board, including audit deficiencies identified in inspections related to noncompliance with existing AS 2405 and enforcement activities where the firm failed to adequately comply with existing AS 2405 or the provisions of Section 10A, or both.[25]

    The evidence cited in the proposing release does not appear to provide empirical evidence of the linkage between (a) expanding the nature and scope of auditors'

[20] See PCAOB Release 2008-006 October 21, 2008 "The proposed standard uses the term "clearly trivial," the term used in the IAASB standard, rather than "clearly inconsequential," the term used in the interim standards. The meaning of the two terms is the same."
[21] See page 73 of the proposing release
[22] See page 19 of the proposing release
[23] See page 70 of the proposing release
[24] See footnote 118 on page 63 of the proposing release (Section IV.A.2)
[25] See page 15 of the proposing release

responsibilities in the manner described in the proposing release, and (b) protecting investors from the resulting harm of noncompliance with laws and regulations when the effect of such noncompliance has a material effect on the financial statements.

2) The company's management, audit committees, the internal audit function, the external auditors, and regulators among other within the financial reporting ecosystem all play a distinct and important role in identifying and responding to risks of material misstatement of the company's financial statements due to noncompliance with laws and regulations and investor protection.

   We believe that expanding the auditor's responsibilities in the manner described within the proposing release may have the unintended consequences of creating ambiguity between the role and responsibilities between the auditor and management, who, under the oversight of the audit committee, is primarily responsible for ensuring that the company conducts its operations in accordance with all applicable laws and regulations.

G. Connectivity between the auditor's consideration of fraud and noncompliance with laws and regulations

We acknowledge that fraud and noncompliance with laws and regulations are highly interrelated, and appreciate the challenges associated with updating the auditing standards in one of these areas without impacting the other. We note that the Board currently has a project related to fraud on its mid-term standard-setting agenda.[26] Given this interrelationship, and considering the points described above, we suggest that the Board consider the two projects concurrently, rather than proposing changes to AS 2405 and AS 2401 separately. This approach will likely lead to a more cohesive suite of standards that complement each other and can be more easily interpreted and applied by auditors.

Effective Date

Based on the significance of our concerns raised in this letter with respect to the current proposed standard, we are unable to comment on the proposed effective date. We believe that implementing the proposed standard, in its current state, would require significant time and effort to develop methodology, tools, training, and hire additional resources with specialized skills or knowledge outside of auditing and accounting.

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[26] PCAOB website - Standard-Setting, Research, and Rulemaking Projects page (as of June 2023).

We appreciate your consideration of our comments and suggestions and would be pleased to discuss them with you at your convenience. Please direct any questions to Ashwin Chandran at 214-689-5667 (achandran@bdo.com), or James D'Arcangelo at 203-905-6234 (jdarcangelo@bdo.com).

Very truly yours,

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