August 11, 2023

Phoebe W. Brown
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street
Washington, DC 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 051

Dear Ms. Brown:

Nasdaq, Inc. (“Nasdaq”)\(^1\) appreciates the opportunity to comment on the Public Company Accounting Oversight Board’s (“PCAOB”) proposed amendments to its auditing standards related to a company’s noncompliance with laws and regulations (the “Proposal”).\(^2\) Nasdaq operates regulated entities in the United States, Canada, the Nordics, and Baltics, which are home to over 5,300 listings worldwide that drive the global economy and provide investment opportunities for institutional and Main Street investors. Nasdaq also operates The Nasdaq Stock Market LLC (the “Nasdaq Stock Market”), which is a self-regulatory organization mandated to protect investors and the public interest. Additionally, as a public company, Nasdaq itself would be directly impacted by the Proposal. Thus, Nasdaq brings a unique, global perspective to provide feedback on the Proposal.

It is through this lens that we carefully consider the Proposal. Nasdaq is concerned that the Proposal is poorly thought out and not grounded in reality. Specifically:

- The Proposal massively expands the scope of an audit and drastically re-writes what is relevant to financial reporting, which impacts federal securities law, attorney client privilege, and other critical common law protections far outside the purview of the PCAOB.

---

\(^1\) Nasdaq (Nasdaq: NDAQ) is a global technology company serving corporate clients, investment managers, banks, brokers, and exchange operators as they navigate and interact with the global capital markets and the broader financial system. We aspire to deliver world-leading platforms that improve the liquidity, transparency, and integrity of the global economy. Our diverse offering of data, analytics, software, exchange capabilities, and client-centric services enables clients to optimize and execute their business vision with confidence.

\(^2\) Proposing Release: Amendments to PCAOB Auditing Standards related to a Company’s Noncompliance with Laws and Regulations and Other Related Amendments, PCAOB Release No. 2023-003 (June 6, 2023), PCAOB Rulemaking Docket Matter No. 051 (the “Proposal”).
• Auditors lack the expertise to provide the level of legal analysis required under the Proposal, which effectively would require them to analyze everything, everywhere, all at once.

• The Proposal would drive up costs for public companies and investors, thereby incentivizing firms to stay private and curtailing access to capital, yet the PCAOB has made no meaningful effort to quantify the cost, impact or value from the Proposal.

• The Proposal disproportionately impacts smaller companies and audit firms, which would stifle competition and further concentrate an industry already frighteningly dependent on a small number of mega-firm points of failure.

• The Proposal would require auditors to perform or duplicate management’s duties.

The sweeping breadth of the Proposal cannot be understated. It would establish the PCAOB as the overseer of all corporate compliance and responsibility, which it lacks statutory authority to do. Further, this type of “expert will solve all problems approach” has been repudiated in the past, for example, with rating agencies in the financial crisis and audit firms in the accounting scandals of the early 2000s. We address each of the above concerns below, following a brief summary of the Proposal.

A. Proposed Amendments

Currently, Section 10A of the Securities Exchange Act of 1934 requires an auditor to perform “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.” For example, compliance with, or changes to, tax laws and IRS regulations likely have a direct and material impact on financial statements. Auditors have established procedures to understand whether a company is in compliance with applicable tax laws, and in our experience, may inspect our tax returns, analyze our tax provisions, and speak with our internal tax team, among other things, when carrying out their duties.

The Proposal would vastly expand the auditor’s role and responsibilities beyond the current federal securities laws and auditing standards by requiring them to identify all laws and regulations “with which noncompliance could reasonably have a material effect on the financial statements.” The auditor would also be required to present any findings of potential noncompliance to management and the audit committee as soon as practicable, regardless of whether the event is likely to occur or would have a material effect on the company’s financial statements.


4 Proposal, supra note 2, at 5.

5 Proposal, supra note 2, at 23.
B. The PCAOB Lacks Statutory Authority to Enact these Sweeping Reforms

Federal securities laws and Nasdaq Stock Market rules require a company’s financial statements included in its initial registration statement or annual report to be audited by an independent public accountant that is registered with the PCAOB. Although company management is responsible for preparing the company’s financial statements, the Nasdaq Stock Market and investors rely on the work of auditors to provide reasonable assurances that those financial statements are free of material misstatements. The Nasdaq Stock Market and investors further rely on the PCAOB’s critical role in overseeing the quality of the auditor’s work.

While Nasdaq supports the PCAOB’s goals of modernizing auditing standards and enhancing investor protection, we believe that any modernization efforts must promote efficiency, competition and capital formation, and therefore any incremental benefits to investors must be balanced against incremental costs and burdens to companies. This belief forms a pillar of our blueprint to revitalize the U.S. capital markets—a series of proposals we issued in 2017, with continuous input from our issuer community, to build on the efficiency of the capital markets and help fuel the U.S. economy through reconstructing the regulatory framework, modernizing market structure and promoting long-termism.

Over the past several years, we have seen progress around many issues we outlined in Revitalize, including modernization and simplification of Regulation S-K, simplifying certain Regulation S-X requirements about acquisitions and dispositions of businesses, and relieving certain smaller companies from the SOX 404(b) requirement to obtain an independent auditor’s attestation of management’s assessment of the effectiveness of internal control over financial reporting (“ICFR”). Each of these modernization efforts was within the purview of the SEC, and illustrate that oversight of financial

---


7 See Nasdaq Listing Rule 5210(b) (“Each Company applying for initial listing must be audited by an independent public accountant that is registered as a public accounting firm with the Public Company Accounting Oversight Board, as provided for in Section 102 of the Sarbanes-Oxley Act of 2002 [15 U.S.C. 7212].”) and Rule 5250(c)(3) (“Each listed Company shall be audited by an independent public accountant that is registered as a public accounting firm with the Public Company Accounting Oversight Board, as provided for in Section 102 of the Sarbanes-Oxley Act of 2002 [15 U.S.C. 7212].”).


statement disclosures and audits is not exclusively within the purview of the PCAOB. By expanding the scope of audits beyond the mandates of federal securities laws, the PCAOB is exceeding its authority.

The Proposal would exceed the bounds established for auditors under the Sarbanes Oxley Act, which explicitly prohibits auditors from performing “legal services and expert services unrelated to the audit.” 12 Sarbanes Oxley placed this responsibility squarely within the domain of lawyers, by directing the SEC to establish rules of professional responsibility for attorneys that require “an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof).” 13 This indicates that Congress intended the legal profession, armed with the requisite expertise, to make legal assessments regarding noncompliance, and did not intend to turn the audit profession into parallel, unlicensed, attorneys at law.

Absent a legislative mandate, auditors may be engaging in the unauthorized practice of law in their states if they interpret and generate conclusions of laws as required by the Proposal. Further, for lawyers supporting these auditors, there are potential ethical, professional, and liability considerations related to how their client is defined and who can rely on their conclusions; in addition, law firms advising auditors or assisting in audits could face complex conflict waiver considerations when also performing work for audit clients.

In effect, the Proposal would create a ripple effect across auditing standards, securities laws, the scope of ICFR, and ethical and professional responsibility standards for auditors and lawyers, which would dramatically increase the risks and costs to public companies and auditors without a corresponding benefit to investors. Nasdaq agrees with Board Member Ho that the Proposal “contain[s] a breathtaking expansion of the auditors’ responsibilities,” which will ultimately “hurt investors.” 14 We also agree with Board Member DesParte that the Proposal “unreasonably and at great cost expands the scope of the audit to incorporate extensive new compliance attestation procedures and will require legal acumen and expertise well beyond the auditor’s core competency.” 15

The laws and regulatory framework surrounding different industries are vastly different—so different that global law firms have entire practice areas devoted to separate legal and regulatory specialties, and lawyers spend decades developing expertise in one area. Any attempt by an auditor to develop this level of expertise before the effective date of the Proposal (one fiscal year after the Proposal

---


13 15 U.S.C. § 7245(1); see also 17 CFR § 205.3(b)(1).


is approved by the SEC) would run afoul of the auditor’s duty of due professional care in the performance of work.\textsuperscript{16} It is not feasible for auditors to develop the expertise required by the Proposal, and without such expertise, auditors will be forced to rely on external legal services to fulfill these duties, to the detriment of smaller audit firms, as further described below.

If the PCAOB decides to move forward with the Proposal, it must file the proposed amendments with the SEC, which “shall approve a proposed rule, if it finds that the rule is consistent with the requirements of [the Sarbanes-Oxley Act of 2002] and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors.”\textsuperscript{17} As described above, the Proposal is not only inconsistent with existing securities laws, it attempts to drastically rewrite them without a legislative mandate or authority.

\subsection*{C. Auditors Lack the Expertise to Analyze Everything, Everywhere, All At Once}

In practice, identifying all laws and regulations “with which noncompliance could reasonably have a material effect on the financial statements” will require auditors to understand and analyze every local, state and federal law and regulation that a company, its management, its employees or its agents could possibly be subject to in the United States, as well as any changes to such laws and regulations. For multinational companies, auditors would need the same level of understanding and analysis of every local and national law and regulation in every country in which the company operates.\textsuperscript{18} The Proposal would effectively replace law firms and other advisors in analyzing companies globally, by requiring auditors to develop or hire legal expertise in niche areas in each jurisdiction in which the company operates, including, for example, employment, intellectual property, environmental and privacy laws, in addition to regulatory expertise specific to the company’s industry and relevant regulator (e.g., USDA, FTC, FDA, DOE, CFPB, etc.). It may be challenging—near impossible—to define the universe of laws and regulations applicable to multinational companies, because determining which laws actually apply to a company often involves jurisdictional questions and principles of international law.

The primary means that companies use to manage risks related to violations of laws and regulations are risk-based compliance programs. In addition to preventing violations, appropriately designed compliance programs are a critical factor in whether a regulator will choose to take enforcement action in the event of potential noncompliance and, if it does, the nature/amount of such enforcement. While it is tempting to see compliance as a “yes or no” topic, compliance programs are best assessed using a maturity scale – does the maturity or sophistication of the program match the risks to a business in a compliance area? For example, the health and safety program for a company involved in professional services would differ greatly from a retail business which in turn would differ greatly from a company involved in building maintenance. In any jurisdiction, each of these companies may be subject to the same workplace safety laws but implement them in vastly different ways. Tasking an auditor to understand

\begin{footnotesize}
\textsuperscript{16} See PCAOB, AS 1015: Due Professional Care in the Performance of Work (“Engagement team members should be assigned to tasks and supervised commensurate with their level of knowledge, skill, and ability so that they can evaluate the audit evidence they are examining.”)

\textsuperscript{17} 15 U.S.C. § 7217(3).

\textsuperscript{18} Proposal, supra note 2, at 24: “[T]he Board intends “noncompliance with laws and regulations” to have a broad meaning and to encompass violations of any law or any regulation having the force of law.”
\end{footnotesize}
those laws, the potential exposure for non-compliance, and whether that exposure exists because the risk-based compliance program is not effective, is simply too much to ask.

Further, when companies are navigating a myriad of laws and regulations—especially new or recently updated laws—what constitutes “compliance” may not be precisely defined. Companies, in good faith, may enact compliance programs that they believe meet requirements. The sufficiency of those programs may not be clear until an agency enforcement and judicial history is developed over the course of years. Even where a company is alleged to have violated a law or regulation, it has the constitutional right to defend itself and its interpretation of a regulation; these rights could be undermined by the Proposal, especially where it would have auditors conduct investigations that are not subject to attorney privilege.

In addition, the new requirements imposed on auditors under the Proposal may conflict with other laws that apply to a multinational company’s non-US operations. For example, non-compliance with laws typically arises from actions of management, employees or agents of the company. The new duties imposed on auditors to investigate such matters may run counter to employment, whistleblower and privacy laws in countries where the company operates. It is not clear under the Proposal how the company’s auditors and legal and compliance team would reconcile any disagreements regarding applicable laws, or noncompliance with such laws. Ironically, given potential penalties under such laws, the new audit standard itself could induce a reportable event related to noncompliance that could reasonably result in a material effect on the financial statements.19

D. The Proposal Creates Significant Costs that the PCAOB has not Quantified

Nasdaq receives valuable feedback from companies listed on the Nasdaq Stock Market, companies seeking to access the public markets and their investors about issues that are important to them. We collaborate with the public companies that have chosen to list on the Nasdaq Stock Market in the United States, and communicate with these companies and their investors about the public company model. While these companies may have different perspectives on many issues, one topic regularly raised by them is a concern about the increasing compliance costs and regulatory burdens faced by public companies. Companies increasingly question whether these burdens outweigh the benefits of the public company model. In recent years, a growing number of companies have been choosing to remain private—and some public companies are reversing course and going private—with Audit Analytics observing that the total number of public companies has fallen from a high of 10,114 in 2006 to 7,133 in 2021, a difference of almost 3,000 companies.20

19 There is enormous “inflation” in the administrative and civil fines authorized in certain regulations. For example, many new laws on privacy express maximum penalties as 2-4%, or more, of total global revenue of a group of companies. While the maximum penalty is not likely to be assessed except in egregious cases, the practical range of fines cannot be immediately determined. As a result, an auditor would need to assume that a violation would result in the maximum or near maximum fine amount in assessing any violation. This would lead to over reporting of matters and over estimation of the practical risk to a company.

Nasdaq is concerned that the Proposal will impose substantial costs on auditors, companies and investors, thereby incentivizing firms to stay private and curtailing access to capital. The PCAOB recognizes that “the costs associated with the proposed amendments nonetheless may be substantial;”\(^{21}\) however, the PCAOB has made no meaningful effort to quantify the cost, impact or value from the proposal. Alarmingly, Section C.2 of the PCAOB’s economic analysis, Economic Impact—Costs, contains no actual numbers, which completely untethers it from reality.

We recognize that audit fees may differ among our public companies depending on company size, industry and maturity. Companies listed on the Nasdaq Stock Market span across all sectors, including biotechnology, biopharmaceutical, technology, and community banking, among many others. Audit Analytics estimates that the average audit fees for a public company in 2021 were $2,176,000 and ranged from a low of $1,312,000 for companies in the agriculture industry to a high of $3,015,000 for companies in the transportation industry.\(^{22}\) The Proposal will dramatically increase the cost of audits in these industries, just as an example, because each auditor will have to develop or hire legal and regulatory specialists in areas relevant to each industry. The U.S. Chamber of Commerce (the “Chamber”) estimates that companies will incur costs “far exceeding Sarbanes-Oxley 404b implementation.”\(^{23}\) While Audit Analytics estimates that “[t]he additional audit work required by SOX 404 resulted in audit fees per million dollars of revenue increasing by over 34% between 2003 and 2004,”\(^{24}\) we believe this is a conservative estimate, with the Chamber noting that “[f]ees more than doubled from 2002 to 2004 with the implementation of SOX Section 404.”\(^{25}\) Further, in 2019, the SEC estimated that it could cost a company $210,000 annually to comply with SOX 404(b),\(^{26}\) and the Biotechnology Innovation Organization observed studies that found costs of SOX 404(b) compliance ranging from $800,000 to $849,276 annually for biotech companies.\(^{27}\) The breadth of this range, and the potential to impact smaller companies and certain industries by various magnitudes, reinforces the need for a comprehensive cost-benefit analysis.

This analysis is glaringly absent from the Proposal, even though the Sarbanes Oxley Act of 2002 requires the PCAOB to establish rules that “may be necessary or appropriate in the public interest or for the protection of investors.”\(^{28}\) and the PCAOB has itself determined that a “[h]igh-quality economic

---

\(^{21}\) *Proposal*, supra note 2, at 23.

\(^{22}\) See Audit Analytics, supra note 20, at 17-18.

\(^{23}\) See Letter from Tom Quaadman, Executive Vice President, U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, to Ms. Phoebe W. Brown, Secretary, PCAOB, dated August 2, 2023, available at: https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-051/22_chamber.pdf?sfvrsn=a67832d5_4./.

\(^{24}\) See Audit Analytics, supra note 20, at 8.

\(^{25}\) Id.

\(^{26}\) See *Accelerated Filer and Large Accelerated Filer Definitions*, supra note 11, at 30.


analysis helps the Board meet this statutory obligation.\textsuperscript{29} Without a robust economic analysis, the PCAOB is not able to demonstrate that the Proposal promotes the public interest or investor protection, and therefore the Proposal falls short of this essential statutory requirement.

E. The Proposal Disproportionately Impacts Smaller Companies and Audit Firms

The Nasdaq Stock Market and investors rely on a company’s auditors to provide reasonable assurances that the financial statements provided by a company are free of material misstatements and do not, for example, overstate the company’s equity, assets or revenues, which are core components of the Nasdaq Stock Market’s quantitative listing standards. Our listed companies span across all sizes, ranging from microcap, pre-revenue companies to the five largest public companies in the U.S., as well as mature, well-established companies that have recently launched IPOs.

The auditor engaged by each company may depend on the company’s size, maturity and geographic locations. Yet Audit Analytics observes that the market share of audit fees among auditors is highly concentrated among the Big 4 auditors, with PwC, EY, Deloitte and KPMG accounting for 29\%, 26\%, 21\% and 17\% of audit fees in 2021. The remaining 7\% of audit fees were shared among auditors outside of the Big 4. However, only 47\% of companies listed on the Nasdaq Stock Market (1,704 listed operating companies) use Big 4 auditors or their affiliates—the remaining 53\% (1,904 listed operating companies) use auditors outside of the Big 4.\textsuperscript{30}

While auditors of all sizes will incur additional costs through training or hiring legal experts to carry out the work required by the Proposal, these costs would disproportionately impact smaller auditing firms that over half of our listed companies rely upon. Smaller auditors will be competing with larger auditors for scarce legal expertise in niche fields, and with billing rates for top lawyers ranging from $1,000 to $2,000 an hour, they may not have the resources to hire such experts.\textsuperscript{31} If they do win this war for talent, they would inevitably need to pass those costs on to companies, and ultimately, shareholders. And that is an optimistic view—most likely, smaller firms will lose this talent war and need to merge with other auditors to stay afloat, which would result in further concentration and stifle competition in the auditing industry, which is already frighteningly dependent on a small number of mega-firms. Worst case scenario, we see smaller auditors shutter their doors, creating a ripple effect among thousands of companies that Nasdaq would need to delist if they are unable to find, or afford, another PCAOB-registered auditor, which would destroy billions of dollars in shareholder value.

F. The Proposal Encroaches on the Duties of Management

The level of legal expertise that auditors would need to develop or hire demonstrably shows that the work required under the Proposal simply falls outside the domain of auditors. Indeed, many of the requirements of the Proposal already fall under the purview of a company’s general counsel, legal and


\textsuperscript{30} Based on an internal analysis by Nasdaq of 3,610 companies with publicly available auditor data.

Companies of all sizes are subject to a vast array of laws and regulations with which they must comply, including federal, state, and local laws in each domestic and foreign jurisdiction in which they operate. These laws and regulations continually evolve, and cover a myriad of areas including corporate governance, securities, markets, trade, contracts, taxes, consumers, employment, health, safety, environmental, privacy, intellectual property, mergers, acquisitions, and foreign corrupt practices among others. The applicability and significance of each law will change as the company’s business changes, and each law or regulation may have different effects on different business units or divisions.\(^{32}\)

Several of these areas are relevant to Nasdaq and, similar to other public companies, we have hired and developed in-house legal, compliance, regulatory and risk experts to ensure that we are complying with current, or able to comply with anticipated, laws and regulations relevant to our business. Generally, with this expertise, a company’s legal team determines which matters to bring to the attention of its accounting team, and its accounting team will then assess those legal matters for the impact to the company’s financial statements. During the course of the company’s audit, its auditors routinely ask management, including the legal team (and send confirmations to outside counsel that is retained by the company), if they are aware of any noncompliance with laws or pending fines or judgments with regulators. Determining whether a probable contingent liability can be reasonably estimated, and if it is required to be reflected within the financial statements, requires management judgment. This is a significant area of focus for the auditors.

The Proposal would require auditors to duplicate a significant amount of work already done by a company’s legal and compliance team, forcing them to dive into complex regulatory matters without the requisite knowledge, expertise or time to do so. In addition, it would require Nasdaq and other public companies to provide documents to its auditors that may be protected by attorney-client privilege so that auditors can make their own determination of compliance with laws and regulations that have already been assessed by management. This level of scrutiny will not provide additional information to investors, because each public company is already required to disclose “any material pending legal proceedings, other than ordinary routine litigation incidental to the business,” in its annual report under Item 103 of Regulation S-K.\(^{33}\) This is an obligation that we, and other public companies, do not take lightly—companies could be liable under federal securities fraud laws if disclosures omit material information. Yet the Proposal would not require public companies to disclose any new information; it would simply require auditors to sift through documents that management has already determined to be immaterial, and communicate these immaterial matters to the company’s audit committee. This will increase costs to the company, its auditors and its investors, and distract the audit committee from their core responsibility to focus on the company’s financial statements.

G. Conclusion

Nasdaq believes that investors, issuers and other market participants will benefit from healthy capital markets that promote trust and transparency. While Nasdaq supports the PCAOB’s goals of

\(^{32}\) See supra note 15.

\(^{33}\) 17 CFR § 229.103.
modernizing auditing standards and enhancing investor protection, the Proposal goes too far—it massively expands the scope of an audit and drives up costs for public companies and investors, thereby incentivizing firms to stay private and curtailing access to capital. The Proposal also represents a sweeping expansion of auditors’ duties and drastically re-writes what is relevant to financial reporting. Auditors will need to develop or hire legal experts in every area of law in virtually every country and jurisdiction in the world in order to fulfill their duties under the Proposal. If they are not able to, they will need to merge with other auditors or go out of business. This could have a deleterious effect on smaller audit firms, smaller companies, and ultimately, investors. We strongly encourage the PCAOB to withdraw the Proposal and conduct a comprehensive cost-benefit analysis before reissuing any proposed rules, with careful consideration to the impact to smaller and newly-public companies and smaller audit firms.

***
Thank you for your consideration of our comments. Please feel free to contact me with any questions.

Sincerely yours,

John A. Zecca