

August 22, 2023

By e-mail: comments@pcaobus.org

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

Re: Proposed 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)

Dear Ms. Brown,

Tapestry Networks is pleased to respond to the above-referenced proposal, *Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations and Other Related Amendments* (the 'proposed changes'). Since 2003, our firm has convened corporate directors through networks for peer learning and engagement with experts, regulators, and policymakers to foster dialogue, collaborate in problem solving, and enhance trust in the capital markets.

Audit committees play a critically important role in governance and society, establishing confidence and trust in capital markets by ensuring high quality, reliable financial reporting. We recently convened a selection of audit committee chairs (ACC) who participate in our US networks ([Audit Committee Networks](#) and [Audit Committee Leadership Network](#)) to discuss the PCAOB's proposed changes. A partial list of participating chairs can be found in the Appendix to this letter.

This letter captures the input gathered through our dialogue with these ACC. While we heard broad agreement from many of those who participated on many of the matters described below, this letter does not seek to provide a consensus view. All of the individual audit committee chairs' (hereafter referred to as 'audit chairs') quotes were recorded under the Chatham House Rule, so that neither individuals nor their organizations are identified. Any comments presented in this letter from an audit chair represent individual views and not necessarily those of any company connected to the audit chair. EY sponsors Tapestry's US

audit committee networks but did not participate in these discussions or contribute to the views expressed below.

Overarching themes

We begin with a series of broad themes that the ACC raised in our discussions; the second section of this letter identifies more specific concerns.

Although the ACC acknowledged the need to update existing auditing standards, many felt that the proposed changes would bring deeply negative consequences. One noted: *“I believe the PCAOB are getting at something, especially moving to a risk-based approach; but it needs to be done in better way.”* Another added, *“The challenge is the method chosen to execute the changes, which is not one we agree with.”* A third audit chair said, *“These changes do not improve the key considerations of the external audit process for an audit committee chair – being the effectiveness and efficiency of an audit.”*

Clarity of intent. Most ACC would like to see greater clarity from the PCAOB about the intent and focus of the proposed changes, and the issues that most need to be addressed. One said, *“It was not clear what the problem is that is being fixed.”* Another felt that the proposals could have been more sharply focused on fraud (*“which is what investors are most worried about”*) and that this had been blurred by the wide scope of proposed changes to the auditor’s responsibilities. The audit chair added, *“Any changes need to be more specific in consideration relative to the remit.”* Another had the view that this would be *“Another administrative burden that is not well-defined and it could distract companies from key missions and stakeholders.”*

ACC were mindful of the recent PCAOB inspection findings for 2022 and the increase in deficiencies in audits, but cautioned about changes that were too far reaching. An audit chair said that *“if there were specific areas where noncompliance with laws and regulations was an issue, then a focused effort to address those specific issues should be undertaken and not introduce more all-encompassing changes.”* An audit chair also provided a specific example, *“There are current processes and procedures for establishing loss contingencies, for which analysis of compliance to laws and regulations is a major component in establishing these reserves. If the PCAOB is concerned about a failure of the current processes, those concerns should be specifically addressed.”*

Another audit chair suggested that *“the PCAOB’s focus should not be on changes to the auditing standards but rather on more effectively implementing current auditing standards. This may be a more immediate resolution for continually increasing inspection findings rather than the burden of more requirements that have to be implemented.”* Another agreed, *“Maybe the focus should be on how to move to best practices being used by firms now. Are changes really needed because there is a lot that’s working very well?”*

Open discussions with the external auditor. An audit chair worried that “*these proposals could have a chilling effect on audit quality gains made in the last five to ten years and the stronger relationship between audit committees and the external auditor*” – specifically, about candor of discussions. The audit chair explained, “*Auditors may be overly skeptical because of what may be scoped in. Under current standards something may not be an issue, but if it is scoped in under the new requirements it could cause the auditor to question trust that has been established if not reported under the new standards. It may also impact the timing with which things are brought to the attention of the auditor, as well as the volume, which may also hinder the ability to surface potential issues. The result is potentially that in private sessions with the auditor, issues may not be raised by audit committees until they know there is a problem, and it could take years to be certain.*” There were also other concerns expressed, “*The proposed changes could put the audit committee in an uncomfortable position of resolving or interpreting differences between the external auditor and the general counsel and/or chief compliance officer.*”

Expectations gap. ACC felt that the proposed changes could further widen the gap between what auditors are required to do in a financial statement audit and what stakeholders expect auditors to do. An audit chair explained: “*There will be the expectation that now auditors will identify all issues with regard to compliance with laws and regulations.*” Another added, “*Compliance with laws and regulations is aggressively interpreted (rightfully or wrongfully), and often involves political bias. If there is an expectation that the auditor has complied with the requirements and not found anything when in fact there is an issue, there could be huge negative consequences because someone will say there is a violation and blame the auditor for not finding it. The audit committee will then be asked what they have been doing.*”

Role of the SEC. ACC asked whether the Securities and Exchange Commission (SEC) was better positioned to address the underlying issues, considering the nature of the issues to be addressed. An audit chair explained, “*Understanding how this wraps into enterprise risk management is important. Risks are evaluated and monitored by a company’s compliance function, and issues presented to the board in an understandable and insightful dashboard. Therefore, considering what is being reported on seems like more of an SEC matter—that is, you need an outside-in look on certain areas (such as cyber) and whether these areas are properly risk assessed, and the right controls in place and appropriately monitored.*”

Impact on the audit profession. An audit chair expressed concern about “*the effect of the proposed changes and the increase in the auditor’s responsibilities on the profession more broadly, which is already challenged for talent and skills.*”

Specific concerns

More specifically, many of the ACC said that:

- **The proposals do not take other regulators or existing compliance functions into account.** Several ACCs described the regulatory and compliance functions that their companies already have in place, especially in highly regulated industries such as insurance, banking, oil and gas, electric and natural gas utilities, and healthcare. ACCs emphasized the importance of the existing role of regulators in many of these industries, and did not want to see these roles usurped or duplicated. The ACC worried that blurring roles might make responsibilities less clear.
- **The proposals would require inordinate efforts to build new systems and procedures.** *“Complex companies already have robust compliance functions,”* said one audit chair: *“The changes appear to require SOX-like efforts for this, which would be immense.”* Another highlighted the additional work across the financial reporting ecosystem: *“The proposal will significantly expand the workload of management, internal audit and the external auditor. Therefore, I envision a major cost increase for all public companies (potentially millions and millions of dollars) with negligible benefits to any stakeholders. I also believe the proposal will lead to extensive internal time spent on the inevitable discussions and decision-making as the company goes down the many ‘rabbit holes’ of possible noncompliance.”*

Generally a risk-based approach that uses materiality to identify matters relevant to audit committees is followed. A number of ACC explained that, under the proposed changes, the processes and procedures to accommodate requests from the auditors would be a distraction for all. One noted that it would be *“a duplication of efforts and an administrative burden.”*

- **Legal matters are complex and constantly evolving, and there may be issues around privilege.** ACCs said that the proposed changes oversimplify the legal environment, *“Law is difficult to interpret and how we interpret it is changing depending on justices and prosecutors. Prosecutors have become more aggressive. I have seen cases where compliance becomes noncompliance where precedent is overturned or there’s a different lens. I am unsure how auditors, who are not legal experts, will be able to deal with this complex and changing environment.”*

The ACC also reflected on the potential loss of legal privilege: *“Audit Committees rely on General Counsel and the Chief Compliance Officer to assess whether there is a violation of laws and regulations. If there is, there may be self-reporting or retaining an attorney under privilege. Very often in complex cases, resolution of these matters could take months if not years. Under the proposed rules, the company would communicate with auditors and provide evidence needed on litigation matters, potentially sacrificing attorney-client privilege. The auditors will insist on seeing everything, and you can’t protect privilege that*

way. Presently there are ways of ‘threading the needle’ to provide auditors with enough information without harming the company's ability to fight something, however under the new proposed requirements for auditors this may not be sufficient.”

- **The proposals fail to take account of the committees’ existing scope and activities.** Audit committee members have an important role in overseeing financial reporting and related internal controls, risk, independence and internal auditors, and ethics and compliance. Audit committees’ scope has greatly expanded in recent years, and many boards are creating new committees or reassigning risks to relieve already overburdened audit committees. The audit chairs noted that the proposed changes could push compliance matters already transitioned outside of audit committees back into the audit committees’ remit, further challenging the oversight role of the audit committee.

An audit chair of a bank explained: *“Highly regulated companies are structured with a separate risk committee and compliance related matters go to that committee. Financial related matters go to the audit committee – this is something the audit committee is accustomed to and good at dealing with. The audit committee also deals with the auditor on financial reporting matters. Usually the risk committee brings relevant matters to the audit committee’s attention through a joint meeting. Different experts (not auditors) are used to deal with laws and regulations, including globally, and they report into the risk committee. It’s often complex and expertise is needed. Therefore, ongoing compliance-related matters is not what the audit committee is best suited to. Obviously, this depends on the nature of the company, but the board should decide where the oversight should be. If someone isn’t paying attention then something needs to be done, but the audit committee, the auditors, and the PCAOB aren’t the right constituents to oversee and opine on matters related to compliance with laws and regulations. I discourage against dropping something else onto the already overwhelming agenda of the audit committee.”* Another audit chair agreed, *“This is a whole different scoping and requires expertise that is not in the audit committee’s domain today. Others in the organization have the relevant knowledge and skills. If compliance matters get reported to the audit committee, it should only be those things that affect the financial statements and will have a material impact.”*

- **Auditors may not have the expertise to comply with the new requirements.** Several ACCs worried that their auditors are currently unable to perform procedures that the proposals would require. They noted that auditors could not be expected to understand laws and regulations in all jurisdictions: *“Auditors are not legal experts and cannot be expected to make legal determinations about interpreting what is non-compliance with laws and regulations, as this is often complex and can take years to resolve.”* Another audit chair emphasized the need for legal experts in a regulated industry: *“Without bringing a particular expertise in terms of compliance with specific regulations (such as state insurance regulations), what benefit will an outside audit firm bring other than duplicating work? Can we expect an outside accounting firm to understand incentives, unintended*

consequences, and practices that caused something to go wrong? If there is noncompliance with a specific law or regulation this should be picked up by the processes of the relevant regulator. Once the issue is identified it is investigated and evaluated – the current detection system kicks in. The auditors are involved at the appropriate time. These proposed new standards are asking the auditors to get involved much earlier in the issue’s life cycle. They are trying to push auditors to deal with a wider scope of matters and way upstream in the maturity of the potential issue, and without having the requisite expertise.”

Another audit chair provided an example: “There are specific laws around employment for people in retail in California. Compliance with wage and hour laws is a known and difficult issue for retailers there. Small technical violations can be serious. Plaintiffs can spot technical violations and extract healthy settlements because companies want to take risks off the table. It would be difficult for an accounting firm to evaluate compliance with wage and hour laws without appropriate expertise, as well as possible impacts of other laws and regulations like insurance and environmental laws. It would require a technical, detailed, and industry-specific compliance knowledge that would be overwhelming.”

An audit chair also noted, “The proposed changes will require accounting firms to impose judgements regarding compliance with laws and regulations – but they are generally not attorneys. So, if they are required to opine on laws, this may lead to the need to have a staff of attorneys to be involved in the procedures for this portion of the audit, and that will lead to potentially significant increased fees and expenses.”

* * *

We hope that these comments illustrate audit chairs’ commitment to improved audit quality, but also the practical issues that they deal with each day.

We would be happy to respond to any queries or requests for further information. Please do not hesitate to be in contact if we can be helpful.

Yours sincerely,

A handwritten signature in black ink that reads 'Jonathan Day'.

Jonathan Day
Chief Executive

A handwritten signature in black ink that reads 'Beverley Bahlmann'.

Beverley Bahlmann
Principal

Appendix

The following audit chairs participated in our discussions. A number of other audit chairs offered their views but asked that their names and companies not be listed, and are therefore not included here.

Name	Company
Jeff Boromisa	Wolverine World Wide
Prat Bhatt	-
Theodore Bunting	NiSource
Raman Chitkara	SiTime Corporation and Arteris, Inc
Art Garcia	ABM Industries
Ken Goldman	GoPro, Ringcentral, Fortinet, Inc and Zuora, Inc
Leslie Heisz	Edwards Lifesciences
Catherine Lego	Guideware Software
Jim Scilacci	Hawaiian Electric Industries
Phoebe Wood	Invesco and Leggett & Platt
Ray G Young	International Paper Company