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Via E-mail: Comments at pcaobus.org

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

Re: PCAOB Rulemaking Docket No. 51

Further to my initial Comment Letter of August 11, 2023 regarding PCAOB Proposal 2023 - 003, I submit these further comments in response to the Staff Briefing Paper of February 26, 2024. My views are informed by my service as a member of the US Treasury Department's Advisory Committee on the Audit Profession and Chair of its Subcommittee on Concentration and Competition (2004-2008); as a Member of the PCAOB Standing Advisory Group (2011-2017); and as the Founding Chair and Chair Emeritus of the Center for Capital Markets Competitiveness (2007-present).

The NOCLAR Proposal landed with a loud splash of surprise on June 6, 2023. Seemingly out of nowhere, proposed abandonment of the long established "reasonable assurance" audit model. The proposed transformation of audit responsibility for detecting fraud from "direct illegal acts" to all "direct or indirect laws and regulations. The consequences of the proposed amendments to audition standards had pervasive impact on auditing and on the nature of investment risk. The proposed sea changes would blur the lines of responsibility between management and auditors. And it would transform much of our traditional corporate governance practices, blurring also the line between federal and state authority. .

The NOCLAR Proposal was a stealth missile sent to turn many of the foundation stones of the American economy into rubble. The PCAOB surely recognized the impact of the Proposal and provided a commensurate amount of the rationale and supportive evidence for doing so, but instead chose a different path. The Proposal repeatedly reminds the reader that most existing standards are old and are capable of being improved. I doubt anyone disputes that change is called for, since the PCAOB has been criticized for its pace of modernization. But change can be incremental, or moderately paced, without a military coup. The Proposal offers little insight into why the Board is proposing revolution. The Board's intention was made clear in the assignment of a legally minimum thirty day comment period. That was extended to 60 days

upon objection, still inadequate but a clear indication that the Board sought approval rather than advice.

Undue haste was not the only concern. The NOCLAR Proposal seemed to defy other precedent and prudential regulation.

- New initiatives by the PCAOB have been slowly developed by the Board throughout its twenty years of existence. Highly deliberative would be a fair description. A feature of that deliberative culture was the Board's use of frequent and detailed disclosure of its Standard Setting Agenda. Another was the practice of withdrawing complex proposals for reconsideration, if at all, in future years. But NOCLAR had no public history before last June's launch. There had been no public disclosure that such a step might be taken. There had been no suggestion in the voluminous Standard Setting Agenda that the financial statement bedrock of "illegal acts" might be replaced.
- More ominously, neither the SEIAG or the AIG, the newly constituted Advisory Bodies created by the Board in 2022 and early 2023, had been given warnings of what was coming, and neither was given an opportunity to consider and advise on the Proposal before it was issued. Ironically, in the same timeframe (2022 mid-2023) as the Board was selling reliance on its new advisory body model as the essential tool for sound regulation, it was secreting from those boards the most pervasive and revolutionary undertaking in its history.
- In September of 2022 the Board had, as it is required to do, sought public comment on its Strategic Plan for 2022-2026 prior to the Plan's submission to the SEC for approval. Several members of the IAG submitted comments and suggestions, but neither the Board's Plan nor the investor comments gave any hint of the NOCLAR storm to come. It seems curious that a bombshell of the NOCLAR magnitude would not have been a matter of strategic planning and budgeting significance.
- Is it possible that the NOCLAR idea hadn't been formed at that time I think not. The Board's files contain a full 146 page "Final Draft" of what became Docket 21, dated March 26 but for some reason it was withheld until the June 6 surprise. A product as long, as technical and as revolutionary as NOCLAR must have been under development for at least the whole of 2022.

Considering the importance of Docket 51, and with these procedural anomalies in mind, one would expect a strong presentation by the Board demonstrating the need for the NOCLAR Proposal as essential and urgent, and that is well documented and carefully explained. One would be disappointed. Indeed, by its revolutionary nature alone, the NOCLAR Proposal demanded a high impact showing of the immediate harms requiring correction. But there was no attempt to justify NOCLAR's necessity, nor the urgency of speedy approval.

In the absence of such a showing, we have only the economic and commercial conditions of this decade as guideposts, and they do not support the Board's objectives.

- The US capital markets are the largest, deepest and least volatile public investment vehicles in the world. That is a testament to the global appeal of the US capital markets, and it also suggests that we have the world's best regulated markets. This should be a cause for celebrations, not for renovation.
- The investment vehicles that dominate the US markets are awash in liquidity: So much liquidity that economists are concerned that the vast amount of cash chasing an insufficient supply of high risk-high reward investment opportunities is a dangerous force.
- The primary concern about the US markets has, for more than a decade, been the declining appeal of public company capital investment. The competitive position of the US capital markets are being eroded by the growth of US private equity and foreign sovereign wealth. The NOCLAR Proposal will surely increase the cost, profitability and stability of public equities, rendering them even less competitive.

Is there a secret sauce embedded in the NOCLAR model that will advantage investors and also serve the needs of the capital markets? Will investor advantage also be so great that it will overcome the hazards to the assurance function? Will it help or harm our national interests and our global authority?

Neither the Proposal nor the Staff Briefing Paper attempts to address these concerns. Instead they rely on the single presumption that, because the NOCLAR model might improve audit performance, it must be given the opportunity to do so. In effect, the Board declares that the need for reform is so self-evident to the investment community that it requires only superficial attention.

Chair Williams sets the tone in the opening paragraph of the Proposal: "We have had calls from investors to live up to OUR RESPONSIBILITY TO ENSURE THAT FINANCIAL STATEMENTS ARE PRESENTED FAIRLY IN ALL MATERIAL RESPECTS." (emphasis added) This is the Board's only executive statement about the justification for NOCLAR. It is notable that only investor influence is recognized. And that statement is, respectfully, neither fully accurate nor fair. The Board's responsibilities are considerably broader and more nuanced than this. Its statutory remit is not to "ensure" or "insure" financial statement accuracy but to maintain a stable and healthy marketplace for public equity formation and distribution. This may seem like picking a nit, but it is a window into the gulf of objectives long described as The Expectation Gap.

THE OPINIONS OF PCAOB BOARD MEMBERS

"The Board believes that the proposed amendments will enhance audit quality and, in doing so, better protect investors." (Proposal, page 8) It is correct that the Board can act by a simple majority of members. But where is the disclosure needed to make the totality of available

information not misleading? Wouldn't it be material to know that this is the first proposed standard in the Board's lifetime that has not been unanimous? Or that the Proposal was adopted by a one vote margin? Or that the divisions of view between Board members are deep and fundamental? That information is available by reading the Board member's statements, but it does not appear in the NOCLAR sales presentation. Further consideration and reconciliation seem clearly called for, but instead we have an unexplained rush to adopt and implement.

THE INFLUENCE OF THE COMMENT LETTERS

The NOCLAR Proposal triggered 140 Comment Letters, mostly quite animated. Only the ICFR proposal stirred more interest. The Staff Briefing Paper does not provide any objective information about the content of those responses. Instead, the Paper is replete with subjective statements that imply an essential equivalence between those who broadly favored the proposal and those broadly opposed. But the data suggests otherwise:

- Overall, the tally was Pro-35 and Con-105.
- By classification, the 34 commenters speaking as CPAs and attorneys opposed NOCLAR 33-1. The 69 public company voices (executives, directors and audit committee members) also opposed NOCLAR, in this case by 67-2.
- The Proposal implies that there was strong support from the investment community. However, of the 10 investment and investment advisor responses 6 were opposed. Similarly, of the 8 regulators and stock exchange replies, 7 were broadly opposed.

"EVIDENCE" BASED ON PCAOB INSPECTION AND ENFORCEMENT

"The Proposal is based, in part, on observations from oversight activities and understanding of current practice. (Proposal p. 15) This may, in fact, be correct, though the dissenting Board members do not seem to share that view. However, even if the majority view is exceptionally sound, of what value can inspection lessons be for public dialogue when only the Board and Staff have that information?

The difficulty here is broader than the NOCLAR issues. Any regulator that possesses both the authority to set performance standards and the power to investigate and punish ought to build fortress walls between them to prevent mission creep and overlap that ultimately turns them into the same procedures and people. That is especially true when the enabling statutes permit a high degree of secrecy about the inspection/enforcement component, as SOX does, easing the way for an outcome driven agenda to overcome a listening culture.

This difficulty awaits another day for attention, but for present purposes I note only that the PCAOB seems to welcome the weaknesses of due process in its prerogatives,

THE MYSTERIOUS CASE OF THE MIAG COMMENT LETTER

It is reasonable to suppose that the NOCLAR proposal originated among members of the IAG. That body is the principal voice of investor activism relating to PCAOB matters. By its constitution, the IAG is expected to initiate standard setting proposals for the Board, while the SEIAG is precluded from doing so. If the views of the IAG regarding NOCLAR are available they should be considered as a source of guidance on the need and urgency underlying the Proposal.

It initially appears that those views are available in the Comment Letter (No 121) submitted in response to the Board's Proposal by "Members of the IAG" (MIAG). It is a lengthy and Impressively footnoted statement of support, augmented by suggestions that the Proposal did not go far enough. Throughout the letter, the positions are described as being those ofm the IAG.

But appearances can be deceiving. Note 2 to the MIAG Comments explains that the views expressed are not those of the IAG but rather of some unidentified majority thereof. The Note also discloses that..."Several members objected to the views of the majority and are free to express them individually." It is not possible, on the information presented, to know what universe of members authorized the document or who opposed it. And it is not possible to discern which elements of the "MIAG" document were disputed.

I am not aware of why the members of the "MIAG" chose to communicate their views in this unusual manner, nor what circumstances would cause the dissenting IAG members to allow it. Similarly, why does the PCAOB seem unperturbed at receiving and publishing what is, in effect, an anonymous submission. This would not ordinarily be a topic appropriate for my comment. But this curious circumstance undermines the utility of the MIAG submission as insight about the need and urgency of the NOCLAR Proposal.

LESSONS FROM THE MARCH 6, 2024 ROUNDTABLE

I commend the Board and Staff for convening the Roundtable, which demonstrated that there is a potential for achieving agreement on many issues that would assist in narrowing the Expectation Gap and enhancing audit performance. But in my view, those worthy objectives can be brought within reach only if the discussions begin on the ground. That is, by identifying a range of potential improvements in standards and regulations that are linked by their roots in today's soil. Common ground would be much more easily identified, and no constituency would be frozen in fear of the unknown. Good ideas could be seeded in the bare spots for rapid germination.

By contrast, NOCLAR arrived as a powerful wind, intended to strip away most of the established vegetation, replacing it with a complex system of untested ambitious undertakings, most of

which would need to function in close coordination with each other to have a chance at success. The first round of such initiatives would carry the highest risk of failure and the lowest shared understandings. The likely result could become a largely barren landscape, incapable of holding the moisture and fertile soil required for the new roots to take hold.

That is a self-indulgent perspective, and perhaps not useful. But I saw the Roundtable as a group of highly competent people, united mostly by anger, confusion and apprehension, each standing on ladders of differing heights trying to attach an idea and its embodiment to separate ribbons blowing in the wind. I could not resist the thought that there is need for modernization and change, but we will not progress without first coming down from the skyhooks and getting better acquainted as we search for what is achievable.

CONCLUDING OBSERVATIONS

Regardless of the substantive merits or defects of the NOCLAR Proposal, it is not ripe for consideration and adoption. If these documents were instruments in the marketing of a registered security, they would fail to meet the "full and fair" disclosure requirements of the anti-fraud provisions of the US Securities Acts. If tested under UK law they would not be deemed "fit for purpose". While new drafting and further descriptions are required, that alone will not be sufficient. A revision of law and regulation of this scope and scale, including the high risk of unintended adverse consequences, deserves respectful study, broad consultation and cautious field testing if it is to meet the requirements of responsible regulation. Otherwise it could be perceived as a political act.

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