



March 18, 2024

Via email: comments@pcaobus.org

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

Baker Tilly US, LLP
205 N Michigan Ave, 28th Fl
Chicago, IL 60601-5927
United States of America

T: +1 (312) 729 8000
F: +1 (312) 729 8199

bakertilly.com

Re: PCAOB Rulemaking Docket No. 51

Dear Office of the Secretary:

Baker Tilly US, LLP (“Baker Tilly” or “we”) appreciates the opportunity to submit this supplemental comment on the Proposed Amendments to PCAOB Auditing Standards related to a Company’s Noncompliance with Laws and Regulations and Other Related Amendments (the “Proposal”). Unfortunately, the timing of the March 6, 2024 Roundtable event (the “Roundtable”) and the very short comment period both come in the middle of the busiest audit period of the year, making a fulsome response more challenging, particularly for smaller firms.¹

In Baker Tilly’s August 3, 2023 comment letter, we raised the concern that the plain language of the Proposal will require auditors to undertake a legal compliance audit, which would mean identifying the universe of laws and regulations applicable to a particular company, assessing the materiality of hypothetical potential violations of any of those laws or regulations on the financial statements, and then undertaking procedures designed to uncover potential violations. All of those steps require knowledge and skills beyond auditors’ core competencies.

Numerous other commenters raised this concern in their comment letters, and the Board and staff appeared to acknowledge this problem, at least in part, when they posed the following question for the Roundtable: “Are there other thresholds besides ‘could reasonably have a material effect’ that would provide sufficient rigor to the auditors’ identification of laws and regulations relevant to the audit of a company’s financial statements?”

In response to this question, during the Roundtable, several of the auditor participants again raised the concern that the current wording of the Proposal essentially requires a legal compliance audit, while several of the non-auditor participants assured the auditors that the Proposal does not require either identification of the universe of potentially applicable laws (which at least one attorney panelist admitted is impossible, even for lawyers) or testing designed to identify *any* potential violation that may be material to the financial statements. For example, non-auditor panelists suggested that under the Proposal, an auditor would not be required to test whether a company is in material compliance with OSHA notification regulations, apparently regardless of any assessment of the historical magnitude of fines for violation of those regulations or whether fines in keeping with historical practice would be material to the company. Non-auditor panelists also appeared to agree that management’s compliance practices should be the starting point for the auditors’ procedures under the Proposal, though the Proposal contains no such limitation. These interpretations of the Proposal, to take just two examples, are far from clear from a plain reading of the proposed standard, and we urge the Board and staff to carefully consider the wide range of views and interpretations expressed on these points.

Additionally, regardless of the threshold used, noncompliance with indirect laws or regulations could still be material, so the question remains how an auditor will identify which specific laws and regulations are most

¹ Baker Tilly also joins in the supplemental comment letter submitted by the Center for Audit Quality.

relevant to the scope of a final standard. To that end, we also urge the PCAOB to include practical implementation guidance to illustrate how it expects auditors to comply with any incremental performance requirements, preferably in the form of an appendix accompanying the final standard, not a separate nonauthoritative publication.

The need for clear guidance is especially acute given the uncertainty over what problem the Proposal is intended to solve. The Roundtable revealed substantial confusion regarding the Proposal's objectives. For example:

- Panel I agreed that preventing NOCLAR is not and should not be an audit responsibility, and that an auditor's procedures should take management's work as a starting point. However, the Proposal as written not only contains no such limitation, but implies that auditors may be part of management's compliance or prevention processes. Companies – not auditors – are responsible for compliance with applicable laws and regulations.² The Roundtable exposed significant shortcomings in the Proposal on this point, and we believe it is in the interest of all stakeholders for the Board to clarify the proposed standard to narrow the expectations gap that appears to exist on this topic.
- Panel III focused disproportionately on high-profile frauds³ without acknowledging existing PCAOB standards, namely AS 2401, *Consideration of Fraud in a Financial Statement Audit*. If fraud detection is the true goal, the Proposal is markedly overbroad. As written, however, the Proposal is focused not on fraud but on other instances of NOCLAR, many of which are the result of unintentional human error, that may nevertheless be material to a company's financial statements.⁴ Plainly, the Proposal has created confusion between intentional financial reporting or asset misappropriation frauds subject to existing auditing standards and other instances of NOCLAR.
- Similarly, several Roundtable panelists pointed out, as did Baker Tilly's August 3 comment letter, that there already exist a number of standards requiring auditors to consider applicable laws and regulations in the planning and risk assessment process.⁵ The Proposal is not clear on how it fits into these existing standards.

The Roundtable resulted in more questions than answers. The panel discussions revealed a significant amount of confusion and uncertainty regarding (i) the objectives of the Proposal; (ii) the expectations of

² This point is affirmed in the PCAOB's own guidance for engagement letters between auditors and companies. AS 1301.C1.c.3 states: "Management is responsible for identifying and ensuring that the company complies with the laws and regulations applicable to its activities."

³ Board and staff commentary and some Roundtable panelists have referred to the Wells Fargo matter as a rationale for the need for the Proposal. If Wells Fargo's practices had been identified and reported in a more timely manner, fines and other legal settlements would likely still have caused material harm to investors, and it is far from clear whether the Proposal would have had a significant impact on the magnitude of that harm. Even if auditors had identified the company's practices, they (or even management) would still not be in a position to reasonably estimate the magnitude of the fines and penalties at the point of identification of noncompliance, years before those penalties were ultimately imposed. The PCAOB's assessment of the benefits of the Proposal should not be anchored to one unfortunate event.

⁴ Baker Tilly also incorporates our comment letter on PCAOB Proposal 2023-007 (Docket 053); that rule change, combined with the broad scope of the Proposal, will almost certainly contribute to the talent pipeline problem in the accounting profession.

⁵ See, e.g., AS 1301.08; AS 2101.07; AS 2110.13, .30-.31.

auditors in applying the new requirements; and (iii) the costs and benefits to investors. More clarity is needed on how the Proposal is intended to be different from existing standards and how the Board expects auditors to achieve its goals. Moreover, there has been little discussion of how PCAOB Inspections staff, who also lack legal and compliance expertise, will be able to evaluate auditors' compliance with the Proposal. Based on the Roundtable, we believe the PCAOB could consider focusing this project on clarifying or strengthening existing risk assessment and/or fraud consideration procedures instead of adopting entirely new standards. In any event, significantly more analysis of the Proposal's costs and benefits is required to conform to the PCAOB's 2014 Staff Guidance on Economic Analysis in PCAOB Standard-Setting.

Because the Proposal lacks clearly identified purported benefits, a serious analysis of the costs to companies, investors, or auditors, or clear guidance to auditors on how to comply, we are left with the concern that the Proposal is ultimately an attempt to scapegoat auditors for the misconduct of companies, their boards, management, or employees. If the Proposal is adopted as currently written, Baker Tilly will be forced to seriously consider discontinuing its public company audit practice.

We believe it is in the best interest of all stakeholders for the Proposal to be revised and repropose with another comment period. Revision should begin by clearly articulating the problem the Proposal is designed to remedy, why existing PCAOB standards are not fit for that purpose, and how the Board expects new audit procedures will address those concerns. The language of the standard must flow from this logic, rather than the other way around. We believe the only downside to revising the Proposal is taking more time to get this right.

Sincerely,

A handwritten signature in black ink that reads "Baker Tilly US, LLP". The signature is written in a cursive, flowing style.

Baker Tilly US, LLP