Cal CPA

March 18, 2024

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

Submitted via email: comments@pcaobus.org

RE: Comments on Proposed Amendments to PCAOB Auditing Standards Related to a Company's Noncompliance with Laws and Regulations (NOCLAR) – Docket 51

PCAOB Board:

On behalf of the California Society of CPAs Accounting Principles and Assurance Services (AP&AS) Committee, we are submitting comments on the PCAOB's proposed amendments to auditing standards concerning an auditor's responsibility for assessing a company's noncompliance with laws and regulations. While we support efforts to ensure the public has access to accurate and reliable financial information, we are concerned that this proposal would excessively expand the scope of financial statement audits and auditor requirements, making it extremely challenging and costly to implement.

The California Society of CPAs (CalCPA) represents the Certified Public Accountant profession and related professionals working in public accounting firms and businesses throughout California. As a leading voice of the profession, we collaborate with policymakers, state and federal agencies, regulatory bodies, and other key stakeholders to shape policies that advance the public interest and enable CPAs to effectively meet the needs of their clients and employers. We also provide our members with the latest information and practical guidance on various technical topics to enhance their ability to support their clients and employers.

The AP&AS committee consists of experienced professionals from practice and academia, specializing in audit and accounting services for public and private companies. The committee's primary role is to help inform the development and refinement of practical and relevant auditing and accounting standards. It does this by reviewing and, when necessary, providing feedback on proposed changes to standards that impact financial accounting, reporting, or assurance services.

We appreciate the PCAOB's extensive public engagement process, including its consideration of comments from the initial request in June 2023, the March 6 virtual roundtable, and the reopening of the comment period. We largely concur with other respondents to the PCAOB's initial request for comments and roundtable panelists who have raised fundamental and practical concerns about the proposal and its ability to be implemented. The proposal seems to expand the scope of audits, requiring auditors to identify and assess compliance with all relevant laws and regulations and determine how this may or may not impact the historical financial statements being audited. This would be a fundamental shift in audit objectives, requiring auditors to undertake procedures akin to those in compliance audits or forensic investigations, which marks a departure from traditional audit practices and potentially encroaching on the realm of legal and regulatory expertise beyond an auditor's core competencies. This could lead to questions about the unauthorized practice of law and require significant input from legal and regulatory specialists. Moreover, implementation of this proposal would impose substantial compliance and administrative costs on the entire financial system. Overall, we have serious concerns that this proposal introduces new auditor obligations that fundamentally change the scope of audits and the role of auditors, without a clear benefit to the public.

Specific to the roundtable, we appreciate the PCAOB's efforts to bring together diverse experts and offer a forum for public stakeholders to discuss key elements of the proposal. The roundtable discussions on how auditors identify and assess laws and regulations and the associated costs and benefits were comprehensive and insightful. However, the vigorous debate and distinct differences of opinion about the proposal's appropriateness and feasibility underscore the need for further examination of its implications, including a comprehensive cost-benefit analysis.

Regarding the discussion on identifying laws and regulations that "could reasonably have a material effect," we reiterate that this assumption falls outside the scope of auditors' competency or their license. It is primarily the responsibility of management, in collaboration with legal and other experts, to identify laws and regulations that, if not complied with, could have material adverse financial consequences for the reporting entity. Even if this responsibility were added to the scope of the auditor, the proposal is too broad and lacks clear guidance on determining which laws and regulations fit this criterion. Without clear guidance, auditors would need to identify all laws and regulations applicable to the company to reasonably attempt to provide assurance on the risk of material misstatement due to noncompliance with laws and regulations.

With respect to the auditor's assessment and determination of noncompliance, we also reiterate that this is a legal process outside the scope of an auditor and their license. Requiring auditors to make legal determinations and assess their impact on a company's financial statements would significantly alter their responsibilities. Even if auditors could acquire the specialized skills and knowledge needed for this task, they would still likely need to consult with legal counsel or other specialists to evaluate whether noncompliance has occurred. Additionally, auditors would need to conduct thorough inquiries with management or others to understand the circumstances of the noncompliance. This would be an immense and nearly impossible undertaking that we are not sure is achievable.

Lastly, we agree that detecting noncompliance earlier can help companies act swiftly to minimize harm to investors and the public. However, we believe a thorough analysis of the frequency and economic impact of such events is essential before considering such a significant change in the scope of financial audits and auditor responsibilities, which may exceed auditors' expertise and licensing. The proposal's economic and public implications must reasonably balance the substantial initial and ongoing costs of implementing the proposal. Auditors will face costs of developing new methodologies, training, and hiring specialists, including legal and fraud experts and companies will incur increased costs for their legal, finance, and accounting teams to provide more information and support external auditor inquires. These costs, which are challenging to estimate, will ultimately be borne by the audited companies and investors.

In conclusion, the AP&AS Committee believes it is essential to have further discussions with the PCAOB's advisory groups and public stakeholders before considering changes that could fundamentally change the role of auditors and financial statement audits. The significant challenges in effectively and efficiently identifying, determining, and assessing noncompliance with laws and regulations, and any impact on a company's financial statements, must be resolved before moving forward.

We appreciate the consideration of our comments and welcome the opportunity to continue to work together to develop a workable standard and advance audit quality. Thank you and please do not hesitate to contact us should you have any questions.

Sincerely,

Gary L. Krausz, Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants