

From the Office of PCAOB Board Member Christina Ho

PCAOB Docket 051: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations - March 6, 2024, Virtual Meeting with the Independent Directors Council (IDC) and Independent Directors

Attendees

PCAOB:

- Board Member Christina Ho
- Board Advisor Julie Edwards
- Board Counsel Steven D. Laughton

IDC:

- Tom Kim, Managing Director
- Lisa Hamman, Associate Managing Director

Independent Directors:

- Patty Louie, Independent Trustee, Oakmark Funds
- Garry Moody, Chair of AB Funds
- Greg Weaver, Chair of GS Asset Management Group of Funds

Summary of Discussion

Board Member Ho advised that her questions are her own and are not necessarily those of the PCAOB Board, other Board Members, or PCAOB staff. Board Member Ho also advised that the conversation would be summarized and included in the public comment file for purposes of transparency. Board Member Ho then stated that she has some questions about IDC's joint August 7, 2023, comment letter with the Investment Company Institute (ICI), but that she wanted to first cede the floor.

The IDC/Independent Directors stated that much of what they would discuss is already contained in the August 7, 2023, comment letter.

They stated that the IDC is part of the ICI, which represents the registered funds industry, and that the IDC's members serve on the boards of registered funds. These independent directors represent the interests of shareholders in mutual funds, exchange traded funds, and the like (hereafter, Funds).

They further stated that Funds generally have no employees and that everything is contracted out including accounting which is simpler than in a corporate environment. Unlike Funds, corporations have employees and manufacturing or service operations or both. Independent Directors of Funds have narrower responsibilities that are focused on Fund assets and making sure that quality services are provided at the best price to provide greater investment returns to investors.

Consistent with the comment letter, they stated that the PCAOB NOCLAR proposal does not recognize the different operating environments between Funds/investment companies and

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operating companies. They noted that the PCAOB has in the past recognized that Funds are different than operating companies by alluding to footnote 8 of the comment letter, which contains, for example, a citation to a PCAOB adopting release in which the PCAOB stated that “[a]fter consideration of the purpose and reporting characteristics of investment companies and the comments received . . ., the Board has determined not to require the communication of critical audit matters for audits of most investment companies”

Board Member Ho asked for greater elaboration on how the scope of audits for Funds differs from audits of public operating companies. The IDC/Independent Directors articulated two main differences: (1) Fund audits are required to do 100% testing of the existence of all investments and their valuations, and (2) risk assessment for Funds is much narrower.

They elaborated that Funds are legal entities that hold assets/investments but that if anything goes wrong, responsibility lies with a contractor, such as the investment adviser who decides how assets are to be invested and who may be contractually obligated to reimburse or indemnify the Fund(s).

Consistent with the comment letter, they stated that the proposal should not apply to registered funds because there exists an extensive compliance regime over such Funds. They alluded to page 2 of the comment letter describing the role of the chief compliance officer (CCO) who is overseen by each Fund’s board of directors, unlike CCOs for operating companies.

Referring to page 2 of the comment letter that Funds (and Business Development Companies) be excluded from the NOCLAR proposed amendments given their unique business and legal structure and the robust regulatory regime under which they operate, Board Member Ho asked whether their requested carve-out needs to be explicit? They replied that their auditors have advised that without an explicit carve-out, auditors would need to do additional work if the proposal is adopted. They stated that the costs for such additional audit work would be directly passed on to investors unlike public operating companies which could, for example, elect to pass on such costs to their customers. They also stated that they spoke to many different auditors of Funds and the auditors universally said audit fees would go up if the proposal is adopted.

Board Member Ho asked whether public company audit disclosures impact investment decisions. They replied that the ICI has done research on how shareholders use information and how they make investment decisions.

Given the robust regulatory framework under which Funds operate and their unique structure, Board Member Ho asked whether Funds are similar to bank holding companies which are also heavily regulated. They replied that bank holding companies are subject to a much broader set of regulations and that their customers, unlike customers of bank holding company subsidiaries, are different in that customers of Funds are investors in the Funds.