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Via Electronic Submission
March 28, 2024

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

Re: PCAOB Rulemaking Docket Matter No. 051
Proposing Release: Amendments to PCAOB Auditing Standards related to a
Company's Noncompliance with Laws and Regulations and Other Related
Amendments
Reopened Comment Period

Dear Ms. Brown,

This letter is submitted on behalf of the American Bar Association's Business Law Section¹ (the "Section"), as a supplement to its letter dated August 23, 2023 (the "Comment Letter"), in connection with Release No. 2023-003, *Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations and Other Related Amendments* (the "Release") issued June 6, 2023 by the Public Company Accounting Oversight Board ("PCAOB" or the "Board").² The views expressed in this letter have not been reviewed or approved by the House of Delegates or Board of Governors of the American Bar Association (the "ABA") and should not be construed as representing the position of the ABA. In addition, this letter does not necessarily reflect the views of all members of the Section, the drafting committee or their respective firms or clients. We appreciate the opportunity to provide additional comment on the Proposed Standards.

The Release proposes new and amended auditing standards setting forth responsibilities of auditors with respect to a company's noncompliance with laws and regulations (the "Proposed Standards"). Following the Board's March 6, 2024 Roundtable Discussion of Proposed Amendments to PCAOB Auditing Standards Related to a Company's Noncompliance with Laws and Regulations ("NOCLAR"), the Section is providing this letter primarily to emphasize the core comments

¹ This letter was prepared by the Section's Law and Accounting Committee (Chaired by Alan J. Wilson), with the assistance of the following members of the drafting committee: Joshua F. Bonnie, James Cotton, Kimberley Drexler, Bob Dow, David H. Engvall, Stanley Keller, Jay Knight, Lisa Kohl, David Petron, Michael Scanlon, and Thomas W. White.

² The Section's previous Comment Letter to the PCAOB dated August 23, 2023, which still accurately states the Section's views with respect to the Release, is available at https://www.americanbar.org/content/dam/aba/administrative/business_law/2023/comments/aba-bls-comment-letter-pcaob-release.pdf.

reflected in our Comment Letter in light of the discussions at the Roundtable and to further underscore the importance of these points. We would welcome the opportunity to further engage with the Board on these critically important topics.

Tailoring the Standard to Reflect an Effective and Balanced Approach

As stated in our Comment Letter, we believe that ensuring and enhancing compliance by companies with applicable laws and regulations is an important objective that benefits investors, shareholders and other stakeholders. We also recognize the PCAOB's goal to modernize and enhance its standards regarding the role of auditors with respect to matters involving noncompliance by companies with laws and regulations that have a material effect on a company's financial statements ("material noncompliance"). We believe, however, that the Proposed Standards take an overly broad approach to what auditors can and should reasonably be expected to do in auditing financial statements. We believe the Board can address this concern and develop effective standards by adopting a more tailored approach that (i) better aligns with the expertise, capabilities and core competencies of financial statement auditors and (ii) recognizes the critical roles of company management and legal counsel with respect to legal compliance. Such an approach can and should build upon existing standards and financial statement auditor capabilities.

Established auditing standards already require auditors to plan the scope of the financial statement audit by identifying matters that deserve focused attention (e.g., AS 2110.30 regarding consideration of business processes designed to ensure compliance with laws and regulations). The Board should recognize that these existing standards are a critical element of a financial statement audit with respect to NOCLAR. Rather than adopting a standard that suggests auditors in auditing financial statements are responsible for identifying "all laws and regulations" with which noncompliance "could reasonably have a material effect on the company's financial statements," any new or amended standard could specify that auditors shall, in planning the audit, seek to identify those laws and regulations as to which a company is most at risk of experiencing material noncompliance based on the company's particular industry and circumstances. This procedure could be incorporated within existing risk-assessment frameworks with which auditors are familiar and skilled at applying. Such a standard should make clear that, in performing risk assessments focused on NOCLAR, auditors may rely on information from management, legal counsel and the auditors' own experience in the industry or with similar companies. The standard also should make clear that this procedure is neither an exercise in examining "all laws and regulations" that could be applicable to a company nor a legal compliance audit. The standard should further state that, like other financial statement audit procedures, auditors would be permitted to exercise reasonable professional judgment as to those matters that create a risk of a material misstatement in the financial statements and therefore deserve enhanced audit attention to achieve reasonable assurance.

We also think the Proposed Standards should be modified to remove the “could reasonably have a material effect ...” standard and refer to a more traditional materiality standard. It would then be appropriate to provide that, when an auditor becomes aware of material noncompliance with laws and regulations, it must take further action to (i) determine the impact of the noncompliance on the financial statements (applying the standards of ASC 450-20), (ii) bring the noncompliance to the attention of the appropriate level of management, and (iii) if the auditor is not satisfied with the response, bring it to the attention of the audit committee. The standard also could require the auditor, as part of its communication responsibility, to appropriately summarize all noncompliance matters (above a threshold of materiality) to the audit committee so that the audit committee will be in a position to take appropriate remedial action. The standard should provide, however, that it does not require an open-ended inquiry by the auditor to detect and investigate possible noncompliance regarding any material laws and regulations identified by the auditor. The standard should also provide that it does not, as a general matter, create an expectation that the auditors will engage their own legal “specialists” to advise them on questions about whether or not a company is in compliance with applicable laws and regulations.

Through a more tailored standard, the PCAOB can enhance the role of auditors with respect to material noncompliance matters in auditing financial statements in a way that aligns with the expertise and capabilities of auditors, promotes legal compliance by maintaining the integrity of our legal system, strengthens company internal compliance control systems, and meets the needs of users of financial statements by providing reasonable and realistic expectations for financial statement audits.

The Proposed Standards Undermine Attorney-Client Communications

Under the current framework, auditors interact with and obtain information from in-house and external lawyers when evaluating matters that involve NOCLAR. The standard should clarify that this is an appropriate action for auditors to pursue when necessary to evaluate material noncompliance matters. In doing so, however, the standard should make clear that it does not require any actions or communications on the part of companies or their counsel that would be inconsistent with a lawyer’s ethical duties to preserve and protect client confidences or that would impair the attorney-client privilege or the work product doctrine. In addition, the standard should state expressly that it does not alter the American Bar Association Statement of Policy Regarding Lawyers’ Responses to Auditors’ Requests for Information and the related auditing standard, AS 2105 (collectively, the “Treaty”), which remain in effect and applicable.

To further underscore the importance of our concerns as lawyers about the potential impact of the Proposed Standards, if they were to be adopted, we again emphasize that the confidentiality of attorney-client communications is a bedrock principle of the United States legal system. Lawyers are bound by professional

obligations to maintain the confidentiality of all information relating to the representation of their clients subject to limited, narrow exceptions. The fundamental value of these protections accrues to the benefit of a society governed by respect for the rule of law.

In requiring financial statement auditors to assess noncompliance with any laws or regulations—even where such noncompliance might have only an indirect effect on a company’s financial statements—the Proposed Standards as drafted could dramatically expand the obligations of auditors to obtain from their audit clients information and analyses that are protected as confidential or privileged under the Rules of Professional Conduct, the evidentiary attorney-client privilege or the attorney work product doctrine, in addition to laws, regulations and protections in foreign jurisdictions that may also apply. The Proposed Standards would do so without any grounding in the existing accounting standard framework for loss contingencies and without any recognition of the long-standing Treaty that has for nearly five decades governed auditor-attorney communications. As explained more fully in our Comment Letter and during the Roundtable discussion, such an expansion would place significant pressure on companies and their counsel, in order to respond to auditor inquiries, to waive confidentiality and privilege protections over a significantly broader range of information and communications. The Proposed Standards are particularly worrisome because they would require companies and counsel to provide otherwise confidential and privileged information, documents and communications that are unrelated to litigation or regulatory action, in which case the protections of the attorney work product doctrine may not be available to protect sensitive information from third parties following a disclosure to the auditors. Such an outcome would expose public companies to serious litigation discovery risk, seriously undermine the fairness of our adversarial justice system and undermine the effectiveness of protections that foster legal compliance, promote the efficiency of the legal system, and encourage respect for the law—all of which the Proposed Standards identify as key objectives for a company but that the Proposed Standards threaten to undercut.

We appreciate the Board’s willingness to hear our views at its recent Roundtable. We believe, however, that the comments to the Proposed Standards, as amplified at the Roundtable, identify fundamental concerns with the proposed NOCLAR standard, particularly the expansive scope of the auditor’s obligations to consider which laws and regulations “could reasonably have a material effect” on the financial statements and the scope and substance of the proposed auditor obligations to identify and evaluate possible material violations of those regulations. We urge the Board to revisit these aspects of the proposal. It is essential that the Board devise workable financial statement audit procedures that will not compel auditors to undertake legal analysis and judgments that they lack competency to make. We do not think that these concerns can be addressed simply by tweaking the language of the Proposed Standards or adding commentary in an adopting release. The Proposed Standards are completely silent on their potential implications for the confidentiality and privilege protections that foster compliance

with laws and regulations, and commenters need to be able to assess how the Board proposes to address this critical issue.

Accordingly, we respectfully urge the Board to withdraw the Proposed Standards and issue a new proposed standard on which all constituencies will have the opportunity to provide comment before any new standard is finally adopted by the Board. In light of the potential for the NOCLAR standard to fundamentally alter the scope of the financial statement audit and to expand auditors' responsibilities into areas beyond their existing competencies, potentially impairing audit quality and value to investors, we believe it is incumbent upon the Board to "get it right" when a standard is adopted.

Conclusion

We strongly encourage the Board to reconsider the Proposed Standards in light of the Section's and other similar comments raising serious concerns about the Proposed Standards as originally proposed and to repropose any revised standards that the Board determines merit consideration. Also, the lack of an adequate economic analysis of the Proposed Standards and the anticipated impacts on the legal and accounting professions and to their public company clients and investors cannot be understated. As this letter and our Comment Letter highlight, we have serious concerns about the scope and impact of the Proposed Standards. We support the general proposition that ensuring and enhancing company compliance with applicable laws and regulations benefits investors, shareholders and other stakeholders, but we remain convinced that the competing interests at issue in the Proposed Standards can be more carefully, effectively and efficiently balanced. We would be happy to discuss these matters with the Board and PCAOB staff.

Very truly yours,



Nicole F. Munro
Chair of the ABA Business Law Section