

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 20, 2024, Virtual Meeting with the Society for Corporate Governance ("SCG") and several SCG Members

Attendees

PCAOB:

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

SCG:

- Andrew Fitzsimmons, Interim CEO
- Ted Allen, Vice President, Policy & Advocacy

SCG Members:

- Jared Brandman, General Counsel and Corporate Secretary, National Vision
- Brian Beheny, Partner, Skadden Arps
- Alana Griffin, Staff Vice President, Securities and Corporate Law, FedEx Corporation
- Amanda Thrash, Senior Counsel and Assistant Corporation Secretary, Williams Cos
- D. Keith Bell, Senior Vice President, Corporate Finance, Travelers
- Daniel Kim, Vice President, Associate General Counsel, Fortive Corp.
- Dana Eddis, Associate General Counsel, Corteva Agriscience
- Aaron Tehan, Legal Department, Travelers

Summary of Discussion

Board Member Ho advised that her views are her own and are not necessarily those of the PCAOB Board, other Board Members, or PCAOB staff.

Board Member Ho stated that she has been reaching out to diverse entities, because she is interested in hearing how the NOCLAR proposal improves or hinders the PCAOB's investor protection mission. She stated that she has read the comment letters but not the most recently received comment letters.

SCG stated that in its August 10, 2023, comment letter that the NOCLAR proposal should not move forward. It recommended a re-proposal given the legal issues revolving around costs and benefits. It asked Board Member Ho how her views have changed after reading the comment letters. Board Member Ho replied that she does not have a current position, which is why she is reaching out to stakeholders.

Board Member Ho stated that she was an auditor until 2009, and that she supports strengthening the PCAOB's auditing standards but that she could not support the NOCLAR proposal for the

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reasons described in her dissenting statement. She stated that when we invoke our mission of investor protection, we need to hear more from the following two groups of stakeholders: (1) an array of actual investors; and (2) those in charge of corporate governance.

SCG replied that not all investors are the same. An SCG Member stated that the current distinction in AS 2405 between “direct” effect and “indirect” effect still works. This SCG Member referenced its March 18, 2024, comment letter where, for example, in 2023 there were 5,100 changes in general insurance laws, regulations, and the like in the 50 states alone.¹ He noted that the scope of the proposal in covering all laws and regulations makes the auditor’s task impossible and would require the auditor to go beyond both its role of providing reasonable assurance and its competency level. He suggested that a risk-based focus would be more appropriate. He noted that since AS 2405 was adopted, companies have developed robust compliance programs. He suggested that a better standard than “could reasonably” would be “a substantial likelihood of noncompliance that would have a material effect on the financial statements.” He suggested that the PCAOB re-propose NOCLAR with such changes along with a cost-benefit analysis of the re-proposal, as described in the March 18, 2024, comment letter.

Board Member Ho then asked whether SCG Members have had any discussions with their auditors to quantify the costs of the proposal? One SCG member stated no, but that’s because the auditors are exploring what compliance procedures they may need to develop in becoming “detectives” and bringing in specialists. The SCG stated that it’s hard to put a number on it, but the costs would be staggering. The SCG stated that there are three buckets: (1) audit fees; (2) outside laws firms as specialists; and (3) the impact of small and mid-sized firms not being able to comply, which could impact auditor competition because smaller firms don’t have the resources to hire the same level of specialists as the Big 4.

Board Member Ho asked SCG Members whether they have heard from their investors on whether they find the proposal beneficial? One SCG Member stated that they reach out annually to investors holding about 80% of the outstanding equity and meet with about half of them and that NOCLAR has never come up. This SCG Member stated that one investor had expressed concern about the year over year increase in audit fees. Another SCG Member stated that they reach out annually to 40% of their investor base, and that investors have never raised concerns about the existing NOCLAR auditing standards; they have instead focused on financial performance. A different SCG Member stated that if we were to survey all SCG Members, he does not believe concerns about existing AS 2405 would come up.

Board Member Ho asked to what extent does the audit inform investor decisions; what are investors looking for from the companies’ auditors related to their non-binding ratification votes; and what have your investors told you about what they want from the audit (other than a clean audit opinion and no restatements)? One SCG Member stated they do not hear a lot from investors related to ratification. Another SCG Member who previously worked at Vanguard stated that these issues never came up. Another SCG Member stated that they have added

¹ https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-051/177_travelers.pdf?sfvrsn=af13cd86_2

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disclosures on auditor independence but have not heard from investors such as Vanguard or others, such as Glass Lewis, for additional disclosures. Another SCG Member stated that they hear about firm rotation but nothing related to audit quality, including gaps in auditing procedures under AS 2405. Another SCG Member said they have heard about auditor independence concerns from investors in the context of the creep of increased tax and consulting services and not audit quality concerns including a gap AS 2405.

An SCG Member stated that investors will always say they welcome more information if it is offered to them, but that does not translate into investors believing that something is missing. From a regulatory perspective, the fact that investors are not seeking more rigorous audit procedures under AS 2405 means that the costs associated with the proposal are unwarranted.

With regard to the question of “what do investors want from the audit,” one SCG Member stated that would be best taken up with FASB, because it sets accounting standards.

Another SCG Member stated that if adopted, NOCLAR will take a long time for firms to figure out how to implement – possibly years – with huge compliance costs because they will be waiting for inspectors to tell them what they did wrong. This Member stated that he was at the SEC during implementation of SOX section 404, and that he sees implementation parallels here. He stated that if adopted, the PCAOB should be clear on what we want auditors to do and how to do it before the PCAOB second guesses them and sanctions them.