



August 1, 2023

SUBMITTED VIA EMAIL

Erica Y. Williams, PCAOB Chair
Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803

RE: PCAOB Rulemaking Docket Matter No. 051 – Amendments to PCAOB Auditing Standards related to a Company’s Noncompliance with Laws and Regulations

Dear Chair Williams and PCAOB Board Members:

On behalf of Dow Inc. and its consolidated subsidiaries (“Dow”), we thank the Public Company Accounting Oversight Board (“PCAOB” or “the Board”) for the opportunity to comment on the proposal to amend PCAOB Auditing Standards related to a Company’s Noncompliance with Laws and Regulations (“NOCLAR”) set forth in the above-referenced release (the “Proposed Standards”).

We agree that auditors have a fundamental obligation to protect investors through the performance of an independent audit and issuance of the report. We also value the audit objective to obtain reasonable assurance that a company’s financial statements are free of material misstatement. Specifically, we commend the Board’s aim to strengthen the auditor’s understanding of management’s process around identification and evaluation of noncompliance matters.

We strongly support the Board’s efforts to enhance audit quality and better protect investors. However, as the Proposed Standards are currently written, we have significant concerns in two key areas:

- **Audit professionals are not adequately trained to navigate, assess and render judgment on complex laws and regulations or handle privileged information.**

We believe the proposal will significantly alter the audit profession by extensively expanding the role of the auditor to require substantial judgment, estimates and use of experts to complete the assessment. The proposal language can be translated to require auditors to provide independent validation of a company’s **compliance with all laws and regulations**, regardless of the limited impact on the credibility or reliability of the issuer’s financial statements.

Financial statement audit professionals should not be expected to identify and form a judgment of the various possible interpretations and future outcomes for all laws and regulations. Accountants are not trained to evaluate complex laws and regulations across multiple jurisdictions, which is likely to result in increased use of third-party specialists and experts to evaluate matters.

Audit firms will need to create additional training, education and certification requirements for auditors involved in review of NOCLAR matters. We expect this will lead to reduced competition and will further the concentration of auditing services among larger, more established audit firms that have the resources to attract/retain and/or develop professionals with the necessary skills to assess NOCLAR matters.

Additionally, the proposal requires further emphasis and clarity on management's responsibilities over NOCLAR to avoid potential conflicts with auditor independence rules.

- **We believe the high cost to implement the Proposed Standards as currently written will significantly outweigh the incremental value added for investors and other users of a company's audited financial statements.**

It is our view that any incremental disclosure and potential impact of NOCLAR issues realized through additional procedures and audit activities would be significantly outweighed by the relative cost to attain assurance due to the necessary involvement of various experts. As a result, the proposal would lengthen the time it takes to perform an audit, significantly increase cost, potentially divert an auditor's attention away from material issues, and likely provide limited, if any, additional value to the investor community.

Further, where material, existing risk assessment activities and other auditor activities as it relates to NOCLAR should already identify material recordable events of direct impacts. Therefore, the PCAOB must ask itself whether significant audit work to identify and measure incremental, potential indirect impacts is valued by the investor community.

The cost to perform such procedures and engage expertise to form such opinions would likely vary significantly by issuer, based on the complexity of their industry, their scale, and their global or multinational footprint. **Audit standards are designed to benefit investors and as currently scoped, the cost incurred to implement the Proposed Standards will reduce the ultimate benefit to the investor.**

If the Board proceeds to implement the Proposed Standards, in addition to addressing the concerns we have outlined above, we also see an opportunity to improve specificity through the proposal where expanded responsibilities are broadly defined as written, and to improve alignment with standards and thresholds already detailed in U.S. Generally Accepted Accounting Principles (US GAAP). To that end, we respectfully request the Board modifies the Proposed Standards to accommodate the following key considerations:

- **Consider the confidentiality of privileged information as essential to the management of litigation and legal risks.** As written, the Proposed Standards may create tension and privilege concerns that prevent disclosure and correction, rather than facilitating the process for auditors to identify non-compliance and fraud that may affect the company's disclosed financial positions.

- **Improve clarity and consistency with financial statements by aligning NOCLAR thresholds and materiality to established financial accounting and disclosure requirements.** We recommend using audit thresholds that more closely align with the existing thresholds established in US GAAP for guiding proper accounting and disclosure. Additionally, we believe audit quality and efficiency is improved when the auditor is focused on matters that have a “risk of material misstatement” to the financial statements and recommend the Board consider focusing on matters that could have a “material effect” within the Proposed Standards.
- **Ensure protection of auditor independence.** The Proposed Standards present potentially independence-impairing scenarios to the role of the auditor and do not address management’s responsibilities. If adopted, clarification regarding the requirements of independence and the means by which independence can be maintained should be provided. The Board should consider engaging other key stakeholders in evaluating the Proposed Standards, including: audit committees, the global legal and regulatory communities, the Financial Accounting Standards Board (“FASB”), the U.S. Securities and Exchange Commission (“SEC”), and the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”).

Company Background

Dow combines global breadth; asset integration and scale; focused innovation and materials science expertise; leading business positions; and environmental, social and governance leadership to achieve profitable growth and help deliver a sustainable future. The Company's ambition is to become the most innovative, customer centric, inclusive and sustainable materials science company in the world.

Dow's portfolio of plastics, industrial intermediates, coatings and silicones businesses delivers a broad range of differentiated, science-based products and solutions for its customers in high-growth market segments, such as packaging, infrastructure, mobility and consumer applications. Dow operates manufacturing sites in 31 countries and employs approximately 37,800 people. Dow delivered sales of approximately \$57 billion in 2022.

Additional Detailed Commentary

Our detailed commentary on the foregoing is respectfully submitted for the Board’s consideration in the Appendix to this letter.

We appreciate this opportunity to comment on the Proposed Standards referenced above and hope the Board finds this letter helpful. If there are any questions about any of our comments, we welcome an opportunity for further discussion. Please do not hesitate to contact Pamela Oberski, Vice President of Global Financial Accounting & Reporting for Dow Inc., at PKOberski@dow.com.

Sincerely,



Ronald C. Edmonds
Controller and Vice President of Controllers and Tax
Dow Inc.

APPENDIX

Additional Detailed Commentary

1. Confidentiality of privileged information is essential to the management of litigation and legal risks.

In today's audit structure, companies strike a delicate balance between providing the supporting information to auditors while also preserving privilege and confidentiality. This balance is essential to the audit process and the management of litigation and legal risks.

The attorney-client privilege is essential and encourages full and frank communications between attorneys – both internal and external – and the company. This frankness promotes broader public interests in observance of law and makes clients free to disclose wrongdoings¹.

In the U.S., companies risk waiver of the attorney-client privilege² by providing communications to outside auditors. And while attorney work-product protection for legal analysis may be broader, U.S. courts are inconsistent with preserving confidentiality³ over this material.

The situation in the U.S. is complicated enough, but the global situation is even more complex for a company like Dow who operates 104 manufacturing facilities in 31 countries, registers sales in approximately 170 countries, and has more than 11,000 global customers. Additionally, Dow manages litigation and disputes on a variety of legal issues, including but not limited to product liability, maritime, labor and employment, breach of contract, personal injury, statutory and consumer protection, warranty, real estate, tax, environmental, competition and antitrust, and constitutional litigation.

The proposed expansion of obligations could disrupt the delicate balance and undermine the trust and confidentiality that underpin the attorney-client relationship. Rather than enhancing or improving audits as the Board hopes, this could have the opposite effect.

- Company personnel could be more hesitant to disclose legal violations to their counsel if they fear that the communication will not be privileged as a result of expanded audit activities driven by this proposal.
- Attorneys may hesitate to prepare written analysis for their clients for fear that it would end up non-privileged and ultimately in the hands of a legal adversary.
- Litigants may become more aggressive in seeking discovery of these materials, thus driving up legal costs while also discouraging the frank, privileged discussions upon which our system relies.

We respectfully request the Board to consider how the Proposed Standards may create tension and concerns that discourage proactive disclosure and remediation of potential NOCLAR, rather than the intended positive facilitation of the process for auditors to identify non-compliance and fraud that may affect the company's disclosed financial positions.

¹ See *United States v. Zolin*, 491 U.S. 554, 562 (1989)

² *United States v. El Paso*, 682 F.2d 530, 540 (5th Cir. 1982).

³ Cf. *Medinol Ltd. v. Boston Scientific Corp.*, 214 F.R.D 113, 116 (S.D.N.Y. 2002) (waiver) and *Merrill Lynch & Co. v. Allegheny Energy Inc.*, 229 F.R.D. 441, 445-46 (S.D.N.Y. 2004) (no waiver)

2. Improve clarity and consistency by aligning NOCLAR thresholds and materiality to established financial accounting and disclosure requirements.

Thresholds

We recommend revising the Proposed Standards to create better alignment with the corresponding financial accounting and disclosure requirements that companies must apply under US GAAP.

Currently US GAAP establishes different accounting and disclosure frameworks that can apply to different types of NOCLAR, each with specific evaluation criteria (i.e., recognition, measurement, and disclosure thresholds). “Noncompliance” judgments and associated financial impacts are rarely black-and-white. Therefore, these frameworks establish parameters to guide judgments around likelihood and estimated financial impacts, based on the scope of the applicable accounting guidance. Common examples include:

ASC Topic	Accounting and Disclosure Thresholds
ASC 410-30 Environmental Obligations and ASC 450-20 Loss Contingencies	“Probable”, “reasonably possible”, and “remote”
ASC 740-10 Income Taxes	“More likely than not”

These accounting and disclosure standards have been purposefully written and tailored to address the unique circumstances associated with each potential type of NOCLAR. A company’s processes and internal controls should be designed to prevent, detect, evaluate, and appropriately record/disclose an actual or potential instance of NOCLAR (in accordance with the applicable accounting standards), in order to ensure the company’s financial statements and disclosures appropriately reflect its evaluation.

In contrast to the internal control, accounting, and disclosure processes described above that companies must apply to specific types of NOCLAR, the Proposed Standards introduce two new thresholds for identification and evaluation of all types of NOCLAR: “*could reasonably have a material effect*” and “*likely*.”

We recommend using audit thresholds that more closely correlate to the existing thresholds established in US GAAP for guiding proper accounting and disclosure. Key reasons for this approach include:

- We expect an extreme gap between the “*could reasonably have a material effect*” audit threshold and the applicable accounting and disclosure thresholds⁴ which will create inconsistency and fail to improve audit quality.
- We also anticipate that the requirement for auditors to evaluate whether it is “*likely*” that noncompliance has occurred to create an added layer of complexity when attempting to reconcile this determination to the thresholds⁴ that management must apply for accounting and disclosure purposes. Alternatively, the auditor should evaluate and

⁴ Financial accounting and disclosure thresholds are: “*probable*”, “*reasonably possible*”, and “*more likely than not*”.

render judgment regarding whether or not it concurs with management's evaluation of the NOCLAR, based on the applicable accounting and disclosure requirements.

- The Proposed Standards, as written, require the auditor to render judgement on instances of noncompliance with laws and regulations that have or may have occurred. We believe this requirement could result in premature judgements and potentially false and misleading outcomes rather than allowing the judicial process to fully unfold.
- Auditors are experts in financial accounting and reporting, not in law. Aligning the Proposed Standard more closely with US GAAP enables auditors to better apply their area of expertise.

Materiality and Management Accountability

Auditors are required to opine on financial statements by performing procedures and evaluating the results of audit evidence to a degree that they can reasonably state that the financial statements are free of material misstatements. The proposal seems to take this responsibility further by requiring an auditor to obtain a high level of certainty and comfort that either:

1. no violations of NOCLAR have occurred; or
2. if they have occurred, determine with absolute assurance that both direct and indirect impacts were not – and will not be – material to the financial statements.

The term “*material effect*” on the financial statements is used extensively throughout the new Proposed Standards. We expect there will be a significant deviation in the approach required for auditors to evaluate matters that could have a “*material effect*” on the financial statements versus matters that have a “*risk of material misstatement*” to the financial statements.

As an example, a company engaged in normal commercial business activities may have thousands of contracts with customers, vendors, and other parties. Noncompliance with terms of contracts by the company across this vast population of activity could result in NOCLAR (e.g., noncompliance with contract law) with potential to have a “material effect” on the financial statements. However, if the company appropriately identifies, accounts for, and discloses material instances of NOCLAR, the financial statements of the company will not be “misstated.”

We hold that management should continue to ascertain materiality and potential impact of NOCLAR, taking into consideration that a company's evaluation and disclosure of risk factors should already be present in financial reporting.

It is our view that management is in the best position to retain responsibility for these evaluations of potential future impact, as they do not impact the useability or validity of a current period financial report.

Further, it would be difficult to accurately determine the potential indirect impact additional NOCLAR might have on a company's financial statements, because relationships with customers, suppliers and other business partners often continue without interruption as they continue to do business together.

We respectfully submit that audit quality is improved when the auditor is focused on matters that have a “risk of material misstatement” to the financial statements and

recommend the Board consider aligning these matters and those that could have a “material effect” within the Proposed Standards. Auditor focus on matters that are immaterial to the financial statements and/or do not present a risk of material misstatement does not improve audit quality and distracts auditors from other important responsibilities of the audit.

3. Protecting the independent analysis of the auditor is essential.

As currently written, one may interpret the proposal to require the auditor to independently evaluate and assess whether there are any indications of NOCLAR. This could lead to scenarios where the auditor may be viewed as assuming a management role by reaching conclusions as to whether there are any indications of NOCLAR.

Using whistleblower claims as an example, the auditor may be compelled to review all whistleblower claims and identify all indications of potential NOCLAR. Given the complexity associated with certain laws and regulations, and the significant judgment and expertise required to evaluate them, potential differences in conclusions are to be reasonably expected. Where management does not identify the same indications of potential NOCLAR as the auditor, management may choose to reevaluate claims with differences in conclusions, and management judgment may be influenced by the auditor judgment that was applied. This could be viewed as an independence-impairing scenario, which may erode public trust and undermine the “gatekeeper” role with which independent auditors are entrusted.

Independence remains essential to an auditor’s effective analysis of a company’s financial statements:

The SEC’s Final Rule: Revision of the Commission’s Auditor Independence Requirements reads: “The federal securities laws require, or permit us to require, that financial information filed with us be certified or audited by ‘independent’ public accountants. To a significant extent, this makes independent auditors the ‘gatekeepers’ to the public securities markets. This statutory framework gives auditors both a valuable economic franchise and an important public trust. Within this statutory framework, the independence requirement is vital to our securities markets.”

17 CFR 210.2-01(b) notes: “(accountant cannot act as ‘director, officer or employee’ of audit client and remain independent for purposes of Regulation S-X).”

According to the AICPA’s Professional Ethics Division Plain English Guide to Independence: One of the key principles underlying the AICPA rules on nonattest services is that, “you may not assume management responsibilities or even appear to assume management responsibilities.”

We respectfully request that the Board consider the potential for the Proposed Standards to present independence-impairing scenarios to the role of the auditor. If adopted, clarification regarding the requirements of independence and the means by which independence can be maintained should be provided.

Addressing Specific Questions Posed in the Proposal

7 - Is the proposed requirement for auditors to identify laws and regulations applicable to the company with which noncompliance could reasonably have a material effect on the financial statements sufficiently clear? If not, why not?

No, it is not. The complexity and practicality of how management or the auditors could sufficiently ensure that all laws and regulations have been considered is unreasonable. Ensuring completeness of all laws and regulations with which the company must comply is a completeness issue that likely would never be satisfied; it is unlikely that any auditor would be willing to provide absolute assurance that all laws and regulations have been captured as part of their evaluation.

8 - Will auditors be able to identify those laws and regulations applicable to the company with which noncompliance could reasonably have a material effect on the financial statements? If not, why not?

The expectation that auditors can identify all laws and regulations that could reasonably have a material effect is unlikely. The proposal implies a one-size-fits-all approach to these activities, which is unreasonable, especially for a multinational company with extensive scale of operations and the number of legal / regulatory jurisdictions in which it operates. For multinational companies such as Dow, audit firms would need to have legal experts in each region and country who specialize in all NOCLAR aspects for those respective jurisdictions.

59 - Which proposed amendments are likely to be associated with more substantial costs? Are the costs quantifiable?

Any area where the auditor is being asked to perform more procedures than necessary to opine with reasonable assurance that the financial statements are not materially misstated should be considered a substantial cost that is not value added to the issuer or the investor community. Forcing auditors to form such opinions and engage the experts necessary to do so (since an auditor is typically a trained accounting professional, not a legal expert) is a request that should not be incorporated in the role of an auditor of the financial statements. For example, the requirement of identifying and measuring the potential indirect impact of NOCLAR is not necessary for determining whether the current period financial statements are fairly presented free of material misstatement. Potential indirect impacts are more forward-looking evaluations and therefore should not be part of the procedures of the auditor. The responsibility should be solely retained by management.

62 - Are there substantial costs associated with an increased need to use auditor's specialists to assist the auditor in evaluating noncompliance that has or may have occurred as a result of the proposed requirements? If so, are the costs quantifiable? Are there any applicable means of mitigating or reducing such costs?

Yes, there is a significant cost and it is not quantifiable. The cost could be significant due to the auditors' time necessary to identify, evaluate and conclude – not to mention the use of experts that would need to be engaged to complete or support these efforts. The audit profession is not required to identify all acts of noncompliance today; therefore, the work necessary is fully incremental both from an auditor perspective, the use of experts, and also the Company's time and resource impact. The costs are not quantifiable as the process to identify, evaluate and

conclude is open-ended. Since not all companies and issues of noncompliance are created equal, it is uncertain as to the actual cost of these activities that both a company and the audit profession would incur. Additionally, it is impractical to assume there will be a sufficient number of specialist resources (legal or otherwise), for auditors to engage across the entire spectrum of public company audits.

