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August 7, 2023

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

Via Email to comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 051, *Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations and Other Related Amendments*

Dear Board members and staff:

Grant Thornton LLP appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB's or Board's) proposing release of Rulemaking Docket Matter No. 051, *Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations and Other Related Amendments* (the Proposal). We respectfully submit our comments and recommendations herein and have included, as an Appendix to this letter, responses to certain of the questions posed in the Proposal.

We support the Board's objective to modernize and clarify its auditing standards. We believe that such an undertaking can improve audit quality and ultimately protect the public interest. We also acknowledge and support the Board's desire to bring clarity to the auditor's role relative to noncompliance with laws and regulations (NOCLAR) and fraud. We believe that enhancing certain risk assessment concepts as well as communications with management and audit committees will benefit audit quality and, in turn, protect the public interest. Nevertheless, we share the same reservations expressed by Board Members Duane DesParte and Christina Ho in their individual public statements. We have considerable concerns with the proposed risk assessment and performance requirements, including their feasibility, as well as how such requirements appear to fundamentally change the auditor's role in a manner that ultimately could be detrimental to the public interest.

Companies are bound by the financial reporting framework and by securities laws and regulations in determining whether and how to record or disclose contingencies, such as fines and penalties, resulting from NOCLAR. We support clarifying the auditor's responsibilities regarding NOCLAR, and such clarifications will be most effective when

executed within the confines of the auditor's expertise and within the context of the financial reporting framework used by management to prepare and present the financial statements. As such, we are concerned that the more extensive audit work regarding NOCLAR contemplated in the Proposal is neither sufficiently tied to the existing financial reporting framework nor aligned with the auditor's core competencies and, accordingly, will not yield the enhanced transparency to, or protection of, investors that the Board seeks. In particular, we believe the Proposal will (i) inappropriately expand the scope of an audit in a manner that is ill-defined; (ii) impose requirements on auditors that are beyond the auditors' current competencies, thereby necessitating the extensive use of legal specialists and potentially imposing responsibilities on management that do not exist in the current regulatory environment; and (iii) substantially increase the cost of financial reporting as well as the cost of an audit, without cost-justified benefits.

Scope of the audit

The objective of a financial statement audit is to obtain reasonable assurance about whether the financial statements are materially misstated, whether due to fraud or error. We believe the requirements described in the Proposal would vastly expand the scope of a financial statement audit. We agree with Board Member DesParte's observation that the Proposal "expands the scope of the audit to incorporate extensive new compliance attestation procedures" and that "auditors would be required to embed compliance attestation procedures into the financial statement audit."

Currently, auditors can perform compliance audits in conjunction with an audit of the financial statements, but the objectives of a compliance audit are substantively different from those of a financial statement audit. For example, compliance audits are more clearly defined and are generally limited to the consideration of specific laws, statutes, regulations, rules, or provisions of contracts or grant agreements. Likewise, tests of compliance that might be performed are similarly defined and limited. We do not believe the Proposal is clear enough to enable auditors to design compliance-related procedures because of the expansive nature of the proposed definition of NOCLAR and related requirements.

Identification of laws and regulations

We are concerned that the scope of the Proposal is not sufficiently narrow to enable auditors to effectively perform the requirements proposed therein. We share Board Member Ho's concern that "to identify the laws and regulations with which noncompliance could reasonably have a material effect on financial statements, an auditor must first identify all the laws and regulations applicable to the public company." In other words, to operationalize the proposed requirements to the extent we believe is expected by the PCAOB, the auditor will need to first ascertain an exhaustive list of all laws and regulations to which the company is subject, regardless of the risk of material misstatement. Auditors are not lawyers and accordingly are not well suited in the first instance to identify all laws and regulations with which NOCLAR could reasonably have a material effect on the financial statements. The operational challenges with identifying all relevant laws and regulations are exacerbated by the auditor being required to equally consider laws and regulations that "could reasonably have" a direct or an indirect effect on the financial statements.

Auditor competencies and responsibilities

We are concerned that the proposed requirements extend beyond auditor competencies, as described in the Board's proposed AS 1000, *General Responsibilities of the Auditor in Conducting an Audit* (discussed further below). Our concerns exist with regard to both the performance requirements proposed and also the existing requirements related to using the work of specialists. We believe that sufficient context regarding the auditor's competencies related to NOCLAR is lacking. Currently, paragraph .03 of AS 2405, *Illegal Acts by Clients*, states:

Whether an act is, in fact, illegal is a determination that is normally beyond the auditor's professional competence. An auditor, in reporting on financial statements, presents himself as one who is proficient in accounting and auditing. The auditor's training, experience, and understanding of the client and its industry may provide a basis for recognition that some client acts coming to his attention may be illegal. However, the determination as to whether a particular act is illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.

We believe this language is essential to appropriately address the auditor's role regarding NOCLAR in the context of the audit of the financial statements as a whole, and we encourage the Board to reinstate this introductory discussion, appropriately adjusted for the terminology changes, within the Proposal.

Without the language above, the Board risks exacerbating the expectations gap between the assurance that an investor may believe an auditor can provide versus the assurance that the auditor can, in fact, provide. We expressed similar concerns regarding the expectations gap in our response to the Board's proposal of AS 1000. Despite our reservations with certain aspects of proposed AS 1000, we do believe that the extant language in AS 2405 reinforces the competency requirements contained in proposed AS 1000, which includes the following requirement and related note:

The audit must be performed by an auditor who has the competence to conduct an audit in accordance with applicable professional and legal requirements...

Note: Competence includes knowledge and expertise in accounting and auditing standards and SEC rules and regulations relevant to the company being audited and the related industry or industries in which it operates.

Auditor core competencies may not be adequate to address (i) laws and regulations that indirectly impact the financial statements; (ii) identification of instances of NOCLAR that have or may have occurred; and (iii) appropriate evaluation and use of the work of legal specialists. We provide further insight on these concerns in the Appendix.

We believe that Section 10A of the Securities Exchange Act of 1934 and the current application of these requirements sufficiently and appropriately direct the auditor to matters that could impact investors most, thus protecting the public interest. We also believe it could be confusing to stakeholders and detrimental to the public interest if auditing standards are inconsistent with relevant securities laws.

Consideration of management's responsibilities

We agree with Board Member Ho's concern that the Proposal "introduces ambiguities regarding auditor obligations to investors, by transforming the auditor's role from one of providing reasonable assurance to one of performing a management function.... This approach could undermine the long-established accountability framework whereby management prepares and discloses financial information, auditors provide an independent certification on the disclosures, and regulators provide oversight of the public companies and auditors." We are particularly concerned that the Proposal requires the auditor to "go beyond" what management is responsible for in both the preparation and presentation of the financial statements and compliance with SEC rules and regulations.

In addition, the Proposal appears to indirectly impose responsibilities on management that neither Congress nor the SEC has seen fit to impose directly under current statutes or regulations. To operationalize the Proposal, the auditor might be forced to compel management to identify all laws and regulations to which the entity is subject and to provide the auditor with a regularly updated inventory of such laws and regulations. In many cases, this will require both management and the auditor to engage multiple legal specialists to assist with the compilation and evaluation of this inventory. Such actions introduce a new and potentially significant burden on entities subject to PCAOB audits, as management's current responsibilities under SEC Regulation S-K will not produce an inventory sufficient for the auditor's purposes; indeed, page 29 of the Proposal acknowledges that "the auditor's identification would not be limited to those laws and regulations identified by management when fulfilling this obligation" of identifying and disclosing material risks related to laws and regulations in periodic filings made under federal securities law.

Cost implications

We agree with Board Member Ho's observation that the "new requirements will significantly expand auditors' need for expertise from lawyers, legal experts, and possibly other specialists, resulting in a substantial increase in audit fees."

As drafted, the Proposal appears to require that both management and the auditor consider, on a quarterly basis, whether any law or regulation to which the entity is subject could impact the financial statements—either directly or indirectly and both quantitatively and qualitatively. This would be a significant undertaking given the extensive laws and regulations, both foreign and domestic, that issuers are subject to and the possibility that any one of these laws or regulations could impact the financial statements in any given period. Preparing a current inventory of all such laws and regulations, considering whether any one of these could have been violated, and assessing the financial statement impact of any such violations (or possible violations) will require both management and the auditor to devote significant additional time to the audit and to engage multiple legal specialists, likely at significant additional cost.

While we expect that increased costs will impact all PCAOB audits to varying degrees, depending on the size and complexity of each individual entity, we believe there will be baseline costs incurred by auditors because of the nature of the proposed requirements and our observations that (i) auditors will be required to first identify all laws and regulations to which the entity is subject before determining whether any of them could

reasonably have a material effect on the financial statements; and (ii) the auditor will likely be unable to meet the proposed requirements without extensive assistance from legal specialists.

Because no requirement currently exists for management to address laws and regulations to the extent described in the Proposal, the imposition of creating an inventory of laws and regulations will come at a significant cost and will be borne by investors of all entities subject to PCAOB audits. The possibility also exists that issuers could miss filing deadlines due to the considerable time that could be needed for management to gather the information and for auditors to meet their obligations under the Proposal.

We recognize that larger issuers may already have robust compliance programs in place, which could minimize their additional costs. However, many issuers may not have as robust or sophisticated programs, particularly less complex or smaller issuers who could be disproportionately impacted by costs required to build and maintain additional processes and controls, which may not be commensurate with an entity's risk profile and/or management's risk assessment in the context of internal control over financial reporting (ICFR). We are concerned that the Proposal's economic analysis does not sufficiently consider costs that could be incurred by issuers as well as costs that could be proportionately higher for companies that do not have sufficient compliance programs to address the requirements imposed by the Proposal.

In light of the concerns expressed above, we believe that the economic analysis contained in the Proposal neither sufficiently acknowledges the actual costs that will be imposed on issuers and auditors nor adequately quantifies how the intended benefit to investors will exceed such costs. Such detailed, quantitative economic analysis is essential for all stakeholders—in particular, the investors who will bear such costs—to evaluate whether the benefits of the Proposal outweigh its costs.

We provide additional commentary regarding other cost considerations, including those associated with certain proposed changes to the risk assessment standard, in the Appendix.

Intended outcomes

We acknowledge that the extant standard is outdated and that enhanced audit procedures related to NOCLAR could better protect the public interest. However, we are concerned that the unintended consequences of the Proposal, including increased time and costs, would outweigh the perceived benefits. We do not believe the Proposal provides compelling clarity related to the Board's basis for such far-reaching audit requirements or the related intended outcomes. Because existing AS 2405 predates Section 10A, we agree that modernization of the standard would be beneficial. However, it is unclear why the Board is proposing requirements that not only go beyond the scope of Section 10A but also lack a clear connection to the financial reporting framework, including the auditor's overall objectives in an audit of financial statements. The Proposal offers minimal inspection and enforcement findings, which suggests that a broad problem requiring such significant action does not exist.

What is more, under existing US GAAP, we feel the Proposal is ill-suited to increase transparency for investors. Under the Proposal, auditors and issuers will expend

significant time and incur significant costs to identify a broad set of laws and regulations that will be used to search for instances of NOCLAR that ultimately might not affect the amounts and disclosures contained in the company's financial statements. This is because under US GAAP, and in particular under ASC 450, *Contingencies*, a loss contingency is recorded in the financial statements only when it is both probable and reasonably estimated. When a loss contingency is probable but cannot be reasonably estimated, only disclosure is required. In light of these reporting and disclosure requirements, it is reasonable to expect that a significant portion of the time and effort spent by entities and auditors—even efforts that identify NOCLAR—will not enhance transparency for investors unless the identified NOCLAR meets the ASC 450 requirements.

Recommended approach to enhancing auditor's NOCLAR procedures

Despite our reservations with the requirements as proposed, we support the development of enhanced procedures related to NOCLAR. We believe the goal of those additional procedures should be to increase the likelihood that matters that have an indirect material effect on the financial statements will come to the auditor's attention, which might help prevent material NOCLAR from negatively affecting investors. Section 10A would then obligate the auditor to perform requisite procedures and conclude on such matters, as it does today. Toward that end, we recommend the following:

- Retain extant AS 2405 with minimal terminology updates that remain consistent with the auditor's obligations under Section 10A.
- Require the auditor to obtain an understanding of management's process for identifying and addressing NOCLAR matters.
- Require enhanced NOCLAR-related inquiries of management, internal audit, legal counsel, and compliance officers during audit risk assessment and reviews of interim financial information. In addition, require the auditor to consider whether such inquiries should include individuals outside the accounting and financial reporting function.
- Require enhanced NOCLAR-related discussions with, and inquiries of, the audit committee, such as more robust communications regarding the results of the auditor's inquiries of management and others as well as procedures performed and the results thereof.

We encourage the Board to consider these alternatives because we believe these procedures will enhance the auditor's work related to NOCLAR in the context of the financial statements taken as a whole, while minimizing the potential unintended consequences described throughout our letter.

Further outreach

Because of the unprecedented changes proposed by the Board regarding auditor responsibilities for NOCLAR, we believe it is necessary for the PCAOB to undertake further outreach with a variety of stakeholders, including audit committees, financial statement preparers, and those in the legal profession. We also encourage the Board to consider coordinating field testing efforts to obtain a deeper understanding of how the proposed requirements could be operationalized as the Board intends. Such field

testing could provide valuable insights into the practical application of the proposed requirements, including estimated hours and costs, resulting communications with management and those charged with governance, and the impact on the financial statements.

We would be pleased to discuss our comments with you. If you have any questions, please contact Jeff Hughes, National Managing Partner of Audit Quality and Risk, at 404-475-0130 or Jeff.Hughes@us.gt.com.

Sincerely,

/s/ Grant Thornton LLP

Appendix: Responses to certain questions within the Proposal

Definitions

Question 2: Is the rationale for including fraud, as described in AS 2401, within the proposed definition of noncompliance with laws and regulations sufficiently clear? If not, why not?

While we understand the rationale for including fraud within the proposed definition, we believe that it could create confusion when auditors operationalize the related requirements to which the definition relates. Auditors generally understand how their obligations related to fraud interact with the current requirements regarding illegal acts, meaning that identified or suspected fraudulent financial reporting or misappropriation of assets would be subject to the auditor's responsibilities for illegal acts. We are concerned that incorporating fraud into the definition of NOCLAR in the manner proposed might pose the risk that auditors could either inadvertently misapply certain requirements within AS 2401 and AS 2405 or misunderstand how to apply NOCLAR-specific requirements to fraud matters.

In recent years, the Board has worked to streamline and combine standards where they determined audit quality may have suffered from multiple standards addressing the same or similar topics, such as the auditing estimates project, which combined three estimates-related standards into one comprehensive standard. We believe the estimates project and the resulting standard significantly enhance the readability and applicability of the requirements. We are concerned that the proposed treatment of fraud within the NOCLAR definition could create an environment where auditors are again looking to multiple standards to address a significant audit topic, potentially de-emphasizing the auditor's critical focus on how and where the financial statements might be susceptible to material misstatement due to fraud. In addition, it is unclear whether the Board intends to elevate the auditor's responsibilities related to fraud and expand the definition of fraud without specifically amending AS 2401.

We strongly encourage the Board to consider the potential unintended consequences of the proposed approach in light of historical standard-setting projects and the goal of rendering the standards easier to navigate and understand in order to enhance audit quality. Further, we believe that due consideration of the proposed amendments to AS 2401, including the related economic implications, is missing from the Proposal.

Introduction and objectives

Question 5: Are the objectives for proposed AS 2405 sufficiently clear? If not, how should the objectives be clarified?

We describe, in the body of our letter, various aspects of the proposed standard that appear unclear or could be problematic. In the context of the objectives, we offer the following observations for the Board's consideration:

- We do not believe the phrase "could reasonably have a material effect" is well defined or adequately discussed in the Proposal to enable auditors to understand the expectations and to focus their work related to laws and regulations in a reasonable manner.
- Numerous legal specialists may be necessary in order for the auditor to identify, assess, and respond to risks of material misstatement because auditors might be unable to reasonably determine what NOCLAR could result in a material misstatement.
- Auditors may be unable to determine whether NOCLAR has or may have occurred without the assistance of legal counsel. We are also concerned that the objective inappropriately requires the auditor to make these determinations prior to management reaching such determinations at the advice of their own legal counsel or, in some cases, prior to resolution by a court.
- We believe the use of the term "information" in objective (d) is overly broad. While the related performance requirements provide some context with regard to the Board's intended meaning of "information," we are concerned that the definition may not be clear enough to promote consistent application.
- We believe objective (c) is outside the purview of auditors and their competencies. In addition, objectives (c) and (d) are irrespective of materiality, which inappropriately broadens the scope of a financial statement audit. We also believe these objectives will significantly increase the time invested and costs incurred by the auditor, and could distract audit committees and management, to matters that ultimately do not materially impact the financial statements.

We are concerned that infusing vague compliance requirements into the financial statement audit could divert auditors away from focusing on matters related to financial statement misstatements, including fair presentation, because of the substantial time and attention that may be necessary to address the NOCLAR procedures.

Plan and perform procedures related to NOCLAR

Question 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?

We are concerned that the proposed requirement is not sufficiently clear and poses a variety of challenges in the operationalization of the requirement, including:

- The requirement goes beyond the auditor's competence and, therefore, will require extensive use of legal specialists. We expect such use will be widespread given the

various specializations within the legal field. For example, an attorney that specializes in the Foreign Corrupt Practices Act (FCPA) would likely be unable to evaluate or address matters related to rules under the Occupational Safety and Health Administration (OSHA) or under privacy laws.

- We are concerned that any NOCLAR matter could be perceived as qualitatively material to the financial statements; therefore, it could be difficult for the auditor to determine a complete population of laws and regulations for purposes of this requirement.
- Laws and regulations are open to interpretation, and these interpretations can evolve over time. The auditor is unable to anticipate the evolution of legal interpretations and applications in the context of the financial statements. Rather, the auditor remains grounded in the financial reporting framework and evaluates matters and their impact on the financial statements based on accounting requirements and the company's policies and practices.
- As noted in our response to Question 5, we believe that the meaning of the phrase "could reasonably have a material effect" is not well explained in the Proposal, and that there is insufficient guidance to enable auditors to perform this procedure.

Question 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?

We believe it will be difficult for auditors to identify all the laws and regulations under which noncompliance could reasonably have a material effect on a company's financial statements. As noted in the body of our letter, we agree with Board Member Ho's observation that the Proposal appears to require an auditor to first identify all laws and regulations to which the company is subject, which will require significant involvement of legal specialists and additional effort by management and their legal experts.

The requirement to identify and consider matters that could have an indirect impact on the financial statements further exacerbates the challenge of executing this requirement. Matters that could indirectly impact the financial statements significantly broaden the scope of laws and regulations that will require the auditor's time and attention. We are concerned that the perceived benefit will not outweigh the investor-borne costs incurred by each entity subject to a PCAOB audit.

Question 11: Is the proposed requirement that auditors identify whether there is information indicating that noncompliance (with those laws and regulations with which noncompliance could reasonably have a material effect on the financial statements) has or may have occurred sufficiently clear? If not, why not?

We believe this requirement lacks sufficient clarity for auditors to execute appropriately and, therefore, raise the following concerns that we believe the Board would need to specifically address in order to make the requirement more operational.

First, the procedure lends itself to strict compliance as opposed to being a risk-based audit procedure that is used to determine whether the financial statements are in conformity, in all material respects, with the financial reporting framework.

Second, this requirement, in particular, seems to place the auditor in the role of management with regard to identifying potential instances of noncompliance. The auditor is neither equipped to assess what conduct might constitute noncompliance, nor to conclude on whether the specific conduct the auditor is confronted with during an audit is, in fact, noncompliance. The proposed requirements lack an explanation of management's role in identifying and addressing instances of NOCLAR, which does not provide appropriate context with regard to the auditor's role in identifying and concluding on NOCLAR.

Finally, it is unclear what encompasses "information" in this circumstance. We acknowledge that proposed paragraph .06 provides the procedures from which "information" is obtained, but it too lacks sufficient clarity to appropriately focus the auditor. This lack of clarity also raises questions of how the auditor would evaluate the relevance and reliability of the "information," including, when applicable, its completeness and accuracy.

Assessing risks of material misstatement

Question 17: Is the proposed approach to include the requirements related to understanding management's related processes for identifying laws and regulations with which noncompliance could reasonably have a material effect on the financial statements and for preventing, identifying, investigating, evaluating, and communicating compliance in AS 2110 sufficiently clear? If not, why not?

We support enhancing the auditor's understanding of management's process for identifying the risks of material misstatement due to NOCLAR. In addition, we support requiring the auditor to obtain an understanding of the company's process of receiving and responding to tips and complaints, as described in proposed paragraph .26(f). However, we believe understanding management's process is most effectively obtained when performed in conjunction with the current requirement included in extant paragraph .26(a) of AS 2110, as opposed to a separate understanding, which is implied by how the new requirements are proposed. That is, we believe the auditor should obtain an understanding of management's process for identifying risks associated with NOCLAR in the context of the company's financial reporting objectives, which would more closely align with the existing definition of ICFR.

In order to provide greater clarity and connection to the audit of the financial statements and management's ICFR, we encourage the Board to reconsider incorporating proposed sub-bullets (d), (e), and (g) into the existing requirements, similar to how fraud risks are currently addressed in extant paragraph .26. In turn, the auditor's understanding and resulting identification of and response to risks of material misstatement related to NOCLAR are more clearly connected to the auditor's conclusion that the financial statements are free from material misstatement, whether due to fraud or error.

Without such changes, we believe there is a risk that the current definition of ICFR will be unworkable, particularly with respect to audits of ICFR. We strongly believe that NOCLAR-related procedures need a distinct connection to the financial statements. Otherwise, it is unclear when or where it would be appropriate for the auditor to complete their understanding and documentation of management's internal controls. This is another example of where operational challenges could arise from the Proposal

requiring more from the auditor than the securities laws require from management. We are unsure how an auditor would go about obtaining an understanding of processes and controls that (i) may not exist at the company because they are outside the scope of the company's ICFR or the company is otherwise not required to have them, or (ii) are not adequately expansive to address the proposed expanded definition of NOCLAR and the related auditor's performance requirements.

Question 18: Are the proposed requirements related to reading publicly available information about the company sufficiently clear? If not, why not?

While we support enhancing aspects of the auditor's risk assessment, we are concerned that the proposed changes to paragraph .11 of AS 2110, *Identifying and Assessing Risks of Material Misstatement*, are not sufficiently clear to provide adequate guidance to auditors on the expected nature and extent of the risk assessment procedures. Currently, this paragraph lists actions the auditor should consider taking, allowing the auditor to choose procedures that are most relevant to the engagement's circumstances, and which will yield the most pertinent information for purposes of the financial statement risk assessment.

As proposed, this requirement could transform into an extensive, time-consuming checklist that might not result in enhanced or more informed risk assessments. In particular, we believe the revisions to the language in the lead-in to the bullet points is not clear due to the use of the phrase "might reasonably be expected to have a significant effect." As alluded to elsewhere in our letter, we are concerned that the phrase "reasonably be expected" will not be understood sufficiently to allow auditors to appropriately and consistently execute the requirements that contain this language.

Further, we believe the use of the word "might" in this particular requirement sets an impracticably low bar of what type of information auditors would be expected to gather and document in order to address all bullets within paragraph .11. For example, in order for the auditor to read publicly available information about the company that might reasonably be expected to have a significant effect on a company's risks of material misstatement, the auditor could, based on how the requirement has been redrafted, first need to gather all publicly available information about the company.

In the interest of enhancing risk assessment procedures, we support requiring auditors to read publicly available information about the company. However, we encourage the Board to consider more specific or targeted language to focus the auditor on the types of information that is most relevant. For example, the note to the first bullet in paragraph .11 could focus on **official** social media accounts of the company. Auditors could also consider whether executive officers have a significant social media presence that would meaningfully inform risk assessment. This would help narrow the extent of effort auditors would need to expend to identify relevant and/or reliable social media activity. We are also concerned that identifying all "public statements made ... by the company or its executive officers" could be extremely challenging, as not all public statements are recorded. We recommend narrowing this language to statements **issued** by the company or its executive officers.

Question 20: Is the requirement to inquire about whether correspondence exists with the company's relevant regulatory authorities regarding instances, or alleged or suspected instances, of fraud or other noncompliance with laws and

regulations that could reasonably have a material effect on the financial statements and the nature of such correspondence sufficiently clear? If not, why not? Would this requirement change auditors' current practices of communicating directly with regulators about the company when appropriate and necessary? If so, how?

We do not believe it is common practice today for auditors to directly correspond with regulators regarding these types of matters. We are concerned that actions beyond management inquiries could be impracticable. We believe it is imperative for the Board to perform outreach to various regulatory agencies to determine whether those agencies feel the proposed requirements could impact their current policies and processes on disseminating company information directly to the auditors. It is unclear whether any agencies, including the SEC or FDIC, could feasibly undertake such communications.

We also foresee similar operational challenges related to the use of the phrase "could reasonably have a material effect" as described elsewhere in our letter.

Evaluating NOCLAR

Question 25: Is the proposed requirement for auditors to consider whether specialized skills or knowledge is needed to assist the auditor in evaluating noncompliance that has or may have occurred sufficiently clear? If not, why not?

While we do not object to the auditor considering whether to use a legal specialist, we anticipate that the Proposal will make legal specialists necessary for all PCAOB audits. The extent of how such specialists are used may vary, depending on (i) the sophistication of the issuer's existing compliance programs; (ii) the complexity of the legal environment in which the issuer operates; and (iii) the nature of potential or known NOCLAR.

The Proposal presents a potential risk that auditors will be unable to source qualified legal experts willing to undertake the role of a specialist who will be asked to make conclusions about whether noncompliance has or may have occurred, particularly if the company has not first made such determination. We do not believe the PCAOB has sufficiently explored whether, in the current US legal environment, attorneys would be willing or able to provide such definitive views on matters that can often be open to wide interpretation. As noted in the body of our letter, we believe it is essential for the Board to perform deeper outreach with legal organizations and professionals that could better inform what opportunities and, most importantly, what barriers might be encountered if auditors operationalize the requirements as proposed.

We also believe that the requirement to consider the need for a legal specialist merits its own requirement rather than including it within a "note" to another requirement.

Communicating NOCLAR

Question 30: Are the proposed communication requirements sufficiently clear? If not, why not?

We support robust and meaningful communications between audit committees and auditors. Such communications enhance audit committee oversight and ensure auditors are informed about the audit committee's views on the risks to the financial statements

and their understanding of the outcomes of the auditor's procedures. However, we believe that the proposed communication requirements pose a variety of practical application challenges, including the following:

- Requiring communications regardless of whether there is a perceived material effect on the financial statements could be onerous and might distract both the audit committee and the auditor from matters that are material to the financial statements. We do not believe the level of required communication in the Proposal is commensurate with the duties of audit committees or the requirements imposed by the SEC.
- The proposed changes to the standards regarding the phrase "clearly inconsequential" inappropriately lower a well-understood and time-tested threshold so that the extent of documentation necessary to "prove" a matter is clearly inconsequential might not be commensurate with the importance of the matter to both the audit itself and the auditor's conclusion about the fair presentation of the financial statements in all material respects.
- Generally, the work performed, and the evaluations made, by auditors occur subsequent to the work and conclusions of the entity's legal counsel or engaged forensic specialists. The proposed communication requirements imply that auditors will lead the process and, therefore, could inappropriately require the auditor to prematurely draw conclusions that they may not be in a position to make considering their competencies prior to management making their conclusions.
- We are concerned with the implications of the note to proposed paragraph .13, which states, in part, that "The auditor must communicate any omitted, incomplete, or inadequately described information regarding the noncompliance to the audit committee." It is unclear what basis the auditor would use to determine whether information is omitted, incomplete, or inadequate. We believe clarification such as "based on the knowledge obtained during the audit" or "based on information provided" is necessary at the end of that sentence. As noted above, auditors are generally the recipients, not the original source, of information related to legal matters, and communications are focused on what impact, if any, such information has on the financial statements.

There is a risk that audit committee communications could become ineffective given the potential volume of NOCLAR-related matters that have little or no corresponding impact on the financial statements. As the Board deliberates how best to legislate the communications between the auditor and audit committee, we believe it will be important to perform direct outreach with audit committees. We expect the Proposal might compel audit committees to become more rigorous in executing their responsibilities and duties. It may also be necessary for audit committee composition to include an individual with enhanced legal acumen, similar to the role of the financial reporting expert, in order to adequately exercise oversight over aspects of the entity's compliance with laws and regulations as well as the compliance-related procedures of a financial statement audit.

Reporting considerations

Question 41: Should specific requirements be retained related to an auditor's withdrawal or resignation from the audit engagement in circumstances when likely noncompliance with laws and regulations has been identified? If so, which requirements?

On page 41 of the Proposal, the Board states that PCAOB auditing standards "generally recognize that the decision to accept or withdraw from an engagement with a company is dependent on the circumstances and the auditor's judgment." However, in the context of NOCLAR, we believe it is essential for AS 2405 to continue to specifically address requirements for withdrawing from an audit engagement. We believe the existing requirements provide clear and necessary direction to auditors in such instances.

Amendments to other standards and proposed rescissions

Question 43: Is the proposed documentation requirement in AS 1215.12h sufficiently clear? If not, what changes are necessary and why? Are there any specific challenges related to this documentation requirement? If so, please describe.

We believe the proposed documentation requirements further exacerbate the challenges presented by the definition of NOCLAR and the performance requirements proposed in AS 2405. Additionally, we are concerned that the level of prescription in the proposed requirement goes beyond the documentation principles long held by PCAOB auditing standards. We believe it is not in stakeholders' best interest for auditors to be mired in documentation efforts related to matters that ultimately do not materially impact the financial statements, the company's ICFR, or the auditor's opinion(s) thereon. It is possible that an extreme focus on NOCLAR could foster an environment where matters that are material to the financial statements are not identified and addressed appropriately.

Question 44: Are the proposed requirements to amend the understanding with an auditor's specialist – whether employed or engaged by the auditor – sufficiently clear? If not, why not?

We understand the Board's objective in proposing to amend the auditor's understanding with an auditor's specialist. However, the proposed changes regarding auditor's specialists represent another area where we believe that additional outreach is necessary in order to evaluate whether the proposed requirements would be operational. We encourage the Board to specifically discuss the proposed requirements with legal groups, such as the American Bar Association, to obtain a more robust understanding of whether specialists who support audits would be willing and able to provide written affirmations, as proposed, to the auditor.

There may also be broader implications for when specialists in other jurisdictions are engaged by audit firms. Applicable foreign laws, regulations, or standards might dictate whether these specialists could or would provide the proposed written affirmations. A potential unintended consequence of not fully exploring the implications with legal experts directly is that such requirements could cause increased scope limitations in

audits. There also may be cost implications for obtaining these types of affirmations, which would need to be considered in the broader landscape of the Proposal.

Question 48: Is the proposed amendment to AS 4105.23 sufficiently clear? If not, what changes are necessary and why?

We are concerned that referring to AS 2405 could result in the inconsistent application of requirements and trigger unintended consequences in the financial markets. Therefore, we do not believe the proposed amendment to paragraph .23 of AS 4105 is sufficiently clear.

Since the objective of an interim review is to obtain limited assurance, we do not believe the proposed requirements provide sufficient guidance as to how the auditor would, in fact, determine their responsibilities under AS 2405 in the context of an interim review.

As currently proposed, the amendments imply that the auditor could be expected to reach conclusions, make communications, and complete documentation on NOCLAR matters prior to the company filing Form 10-Q. Such implications could inadvertently result in an increase in the number of delinquent filings for NOCLAR matters that ultimately might not change the interim financial information. We do not believe delaying quarterly filings for matters that generally do not have a material impact on the financial statements is in the public interest. If the Board moves forward with amendments to AS 4105, we suggest that such requirements be clearly commensurate with the limited assurance the auditor obtains on the interim financial information.

Question 51: Is rescinding AS 6110 appropriate? Does this standard continue to be used by auditors? If so, what are the specific provisions that are used by auditors and when is this standard used?

We support rescinding AS 6110. We are unaware of circumstances where auditors would use this standard under the PCAOB's jurisdiction and do not believe there are provisions that need to be retained.

Question 55: Are the proposed conforming amendments in Appendix 3 appropriate and clear? Why or why not? What changes to the amendments are necessary?

With regard to AS 1301.25, we are unable to determine whether the proposed conforming amendment in Appendix 3 is intended to be a meaningful change regarding how the auditor documents audit committee communications. We are concerned that removing the reference to "matters in this standard" unnecessarily and inappropriately broadens the documentation requirement. Because Appendix B to AS 1301 lists the other standards that contain audit committee communication requirements, we believe the following could provide clearer direction to auditors (suggested changes from extant marked in bold italics):

The auditor should communicate to the audit committee the matters in this standard, ***including those matters contained in the standards listed in Appendix B***, either orally or in writing, unless otherwise specified in this ***or other standards***.

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

We have considerable concerns with the cost implications of various requirements within the Proposal, which we have outlined throughout our letter. While we are unable to quantify the expected costs, we believe additional outreach to various stakeholders could provide further insight to the Board.

Question 60: Is the expansion of the auditor’s responsibilities to identify information indicating noncompliance with laws and regulations has or may have occurred without regard to the effect of such noncompliance on the financial statements practical and cost effective to implement? Are small/medium firms equipped and capable of implementing these new requirements? If not, why not?

We do not believe the expansion of the auditor’s responsibilities is practical. As discussed throughout our letter, we believe the expanded responsibilities go beyond current auditor competencies and might require considerable support from various legal specialists., which will increase the time and costs of the audit.

We are concerned that auditors’ need for legal expertise created by the proposed requirements could disproportionately affect small- and medium-sized firms. Similarly, we believe smaller or less complex issuers as well as broker-dealers will also incur additional costs to implement or revise compliance programs that would be deemed acceptable based on the proposed audit requirements.

Question 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?

We believe the costs associated with an increased need for auditor’s specialists will be substantial, although, as noted above, we are unable to quantify the costs. Generally speaking, legal expertise comes with a significant cost, and each layer of expertise (for example, federal, state, local, securities, foreign, FCPA, OSHA, etc.) could be incrementally higher than costs associated with more generalized legal counsel. These costs will be incurred for every single PCAOB audit, and the extent of those costs may depend on the size and complexity of an audit firm’s PCAOB audit client base and the clients themselves. Regardless, there will be an exponential impact to audit cost overall that will be borne by investors.

We believe the Board could mitigate or reduce these costs by more closely aligning the requirements with the auditor’s existing responsibilities under Section 10A and enhancing certain risk assessment procedures that could increase the likelihood that indirect material NOCLAR comes to the auditor’s attention. We describe recommended procedures in the body of our letter. The Board could also limit the required procedures to those that most concern the PCAOB; however, the Proposal is unclear with regard to what those areas of concern may be.

Question 64: The Board requests comment generally on the potential unintended consequences of the proposal. Are the responses to the potential unintended consequences discussed in the release appropriate? Are there additional potential unintended consequences that the Board should consider? If so, what

are the potential unintended consequences and what responses should be considered?

While we agree that quantifiable evidence may be unavailable, we are concerned that the economic analysis included in the Proposal does not sufficiently acknowledge the extensive use of legal specialists that will be needed if the requirements are adopted as proposed. The Board has introduced a significant expansion of the scope of the audit such that the auditor might be unable to execute the requirements on audits subject to PCAOB standards without in-depth legal assistance.

Other potential unintended consequences, and potential cost increases, that do not appear to have been fully explored in the Proposal are as follows:

- Given the significance of the proposed changes, we believe it will take considerable time for the academic curriculum to catch up to the proposed changes. Careful consideration will be necessary in order to determine whether and, if so, how additional legal-related content is added to higher education curriculum.
- Likewise, the content of the CPA exam itself will require reevaluation. Because the breadth of information eligible for CPA exam content is already vast, we are concerned that adding incremental legal-related content could prove difficult.
- Lack of sufficient auditor competencies could also create challenges with regard to the engagement partner's ability to adequately evaluate and use the work of legal specialists.
- There is a risk that the audit talent pipeline will be further curtailed by the lag between the adoption of the new requirements and the resulting impact on academia.
- We question whether there would be sufficient legal resources available (both domestically and in foreign jurisdictions) to auditors to adequately address the proposed requirements within existing financial statement filing deadlines. It is possible that the Proposal will necessitate a level of work for which resources simply do not exist.
- It is unclear what effect the Proposal would have on the American Bar Association's current statement related to litigation, claims, and assessments. Collaboration between auditors and the legal profession is needed in order for legal resources to assist auditors to meet their obligations under professional standards.

Question 65: The Board also requests comment on the potential unintended consequences of the proposal on competition in the market for audit services. How and to what extent could competition be affected by the proposal? How would smaller firms be affected? Would audit fees be meaningfully affected by the proposal? Would the availability of qualified auditors in the market be meaningfully affected by the proposal?

We agree with Board Member Ho's concern that the Proposal "would create additional barriers to entry" for audit firms. We further agree with her observation that the "significant expansion of auditor responsibilities could therefore further reduce competition and exacerbate the power concentration in the audit marketplace." As noted above, we believe small- to mid-size firms could be disproportionately impacted

by the costs required by the Proposal. In consideration of the potential fiscal impact of other standard-setting projects, such as QC 1000, these firms may be forced to make a business decision to exit auditing issuers and/or broker-dealers, thus reducing the amount of competition among firms that are equipped to perform the work. Reduced competition might also negatively impact audit quality.

Question 69: Would requiring compliance for fiscal years beginning after the year of SEC approval provide challenges for auditors? If so, what are those challenges, and how should they be addressed?

The Proposal represents a fundamental shift in auditor responsibilities in an audit of the financial statements. We anticipate that considerable effort and resources will be necessary to implement comprehensive firm policies and processes to ensure compliance with the requirements, as proposed.

In order for firms to adopt updated standards into their methodologies appropriately and thoughtfully, sufficient implementation time must be given, and each project cannot be viewed in a silo. As the Board continues issuing proposals at record pace, we are concerned about firms' ability to dedicate sufficient resources within compressed implementation periods to adequately address changes in the auditing standards.