August 7, 2023

Phoebe W. Brown
Secretary
Public Company Accounting Oversight Board
1666 K Street NW
Washington, DC 20006-2803

Re: Amendments to PCAOB Auditing Standards related to a Company’s Noncompliance with Laws and Regulations (PCAOB Release No. 2023-003; PCAOB Rulemaking Docket Matter No. 051)

Dear Ms. Brown:

The American Property Casualty Insurance Association (APCIA) appreciates the opportunity to comment on the Public Company Accounting Oversight Board’s (PCAOB) proposal to amend PCAOB auditing standards related to the auditor’s responsibility for considering a company’s noncompliance with laws and regulations. APCIA is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members represent all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe.

The proposal would significantly expand auditors’ responsibility for considering a company’s noncompliance with all laws and regulations. First, the proposal changes the threshold from the current standards’ requirement of identifying noncompliance with laws and regulations that have a direct and material effect on the financial statements to identifying noncompliance that could reasonably have a material effect on the financial statements. Secondly, the proposal would substantially broaden auditors’ responsibility by eliminating the distinction between laws and regulations with which noncompliance could have a direct effect on the financial statements and those with which noncompliance would have an indirect effect. The impact of these two significant changes on our member companies and their auditors is discussed below.

APCIA urges the PCAOB to withdraw this proposal. We are concerned that the proposal would substantially increase the cost of an annual audit for publicly traded companies by compelling significant additional work by auditors and third-party experts that would be necessary to fulfill the requirements of the amended standard. The proposal would also significantly increase the direct costs of company management to produce the requisite documentation in order to validate the assertion of compliance with the amended standard. Companies will also incur costs if they take remedial actions to improve their internal controls over financial reporting as a result of the significantly broader scope of the proposed amendments. The additional complexities and subject matter expertise to address the proposed expanded scope requires identification of laws and regulations that could reasonably have a material effect on the financial statements – direct
or indirect – with limited guidance on when the instance of noncompliance has an indirect effect on the financial statements.

The increased costs imposed by the amended standard would disproportionately impact insurance companies because the insurance industry is highly regulated. The primary responsibility for insurance regulation in the U.S. resides with the states. Each state maintains its own comprehensive framework for regulating all aspects of the insurance business, including compliance with state insurance laws and regulations. The functions of state insurance regulation include regulating the licensing and operation of insurance organizations and insurance agents, reviewing and approving product forms and rate filings, and market conduct regulation such as claims settlement and marketing practices. States also regulate and supervise insurers’ solvency through capital standards, financial reporting and disclosure requirements, detailed restrictions on the types of assets that can back reserves and required capital, and periodic examinations.

Since insurers are subject to voluminous state and federal statutory, regulatory, and other requirements, we question whether it is even possible for an auditor to meet the very broad requirements of the proposal. The expansive breadth of the proposal would also subject every act of insurers’ producers, third-party claims administrators, and other service providers to scrutiny under the new standard. Mandating auditors to broadly assess “noncompliance” with individual state, federal, and other regulatory requirements under the proposal’s threshold of “could reasonably have a material effect on the financial statements” would necessitate hiring experts in every jurisdiction at an untenable cost to the company being audited. In addition, authoritative opinions on compliance questions may not be available unless granted directly by the regulatory authority in the specific jurisdiction, e.g., a ruling regarding compliance with a specific law or regulation by a state insurance department that is issued to an insurer but not made publicly available including interpretive letters, opinions, and memoranda from a department’s general counsel. As a result, opinions granted by “experts” may or may not be relevant given agency jurisdictional deference existing in most regulatory jurisdictions, and auditors would be forced to subjectively evaluate “expert” opinions to ultimately opine on the financial statements of the insurer. Furthermore, it should be recognized that auditor assessments of noncompliance will be subject to discovery, so the question of whether legal advice received by auditors will be privileged must be examined and considered.

Proposed AS 2405 also presents significantly increased risk to the legal privileges of companies due to the increased sharing of information between companies and auditors that would be required if the new auditing standard were adopted. The combination of an active plaintiffs’ bar and liberal discovery rules could have disastrous effects if companies are found to have waived privilege by responding to auditors’ inquiries under proposed AS 2405. It is critical that the long-standing approach in this area – which was developed with the American Bar Association and has served investors, companies, and the public interest well – not be disrupted or undermined.

APCIA is also concerned that the proposed standard would create duplication of effort with every regulatory authority charged with enforcing state, federal, and international laws and regulations. For example, the proposed standard ignores the significant efforts of state insurance regulators with respect to state market conduct activities such as the Market Conduct Annual Statement, which provides regulators with a uniform system of collecting market-related
information to assist states with monitoring the market conduct of insurance companies. In addition, state insurance regulators are statutorily required to perform periodic financial examinations of insurers. These financial audits are already comprehensive assessments of company operations and require the fulfillment of very broad and detailed requests for information, including information submitted previously to regulatory bodies. Requiring auditors to engage in similar or otherwise duplicative exercises will result in a massive overlay of effort with little or no offsetting benefit.

Additionally, the interpretation of what constitutes “noncompliance” under the proposed standard could vary by and among different audit firms. Since auditors are not subject matter experts in all laws and regulations, we are concerned auditors will have inconsistent interpretations of what constitutes noncompliance. This concern is exacerbated by the lack of clear standards regarding how “noncompliance” is defined in the proposal.

Although the proposed standard is intended to increase investor protection, it would ultimately have the opposite effect by increasing the scope of the audit so significantly that the financial statement opinion would be diluted rather than enhanced. Every audit conducted under the proposed standard would likely disclose real and potential noncompliance of a nature that would not likely impact the financial position or stability of the organization, which is the primary purpose of the audit. It is also unclear what impact this proposal will have on the timing of the release of earnings and financial statement audit opinions. Given the uncertainties and significant new costs associated with this proposal, APCIA urges the PCAOB to withdraw or substantially amend the proposal to address the issues described above.

Thank you for considering the points addressed in this letter, and please do not hesitate to contact us if you have any questions.

Sincerely,

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