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August 1, 2023

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

Via email: comments@pcaobus.org

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

Dear Members of the Public Company Accounting Oversight Board (PCAOB):

The National Association of State Boards of Accountancy (NASBA) appreciates the opportunity to comment on the PCAOB's Proposing Release, *Amendments to PCAOB Auditing Standards Related to a Company's Noncompliance with Laws and Regulations and Other Related Amendments* (Proposal).

Founded in 1908, NASBA serves as a forum for the nation's Boards of Accountancy (State Boards), representing fifty-five jurisdictions. NASBA's mission is to enhance the effectiveness and advance the common interests of the State Boards that regulate all Certified Public Accountants (CPAs) and their firms in the United States and its territories, which includes all audit, attest and other services provided by CPAs. State Boards are charged by law with protecting the public.

In furtherance of that objective, NASBA offers the following comments.

General Comments

NASBA commends the PCAOB for their continued efforts to modernize and strengthen auditing standards, including those related to the auditor's consideration of a company's noncompliance with laws and regulations. As noted in the Proposal, a substantial amount of time has transpired since the standards concerning the auditor's responsibilities for detecting and responding to illegal acts were adopted by the PCAOB.

Both the International Auditing and Assurance Standards Board (IAASB) and the Auditing Standards Board (ASB) of the AICPA have updated their analogous standards. Leveraging the work performed by other standard setters and making standards uniform wherever possible helps avoid confusion and potential misapplication by the CPA and aids in enforcement from a regulatory perspective. Consistency among standard setters is in the public interest.

Identification

The Proposal places responsibility primarily on the auditors and not management for determining matters related to an expanded realm of noncompliance with laws and regulations. The Proposal is explicit in that the auditor's identification would not be limited to those matters identified by management. The heightened identification requirements will create an expectation gap as to the auditor's expertise and what auditors can realistically be expected to identify beyond management. Significant unresolved expectation gaps are not in the public interest.

It is in the public interest that along with enhanced auditor responsibilities there be a corresponding clear articulation of the responsibilities of registrants to identify and act upon those areas of noncompliance with laws and regulations that could reasonably have a material effect on the financial statements. It is currently not clear that there is alignment between SEC reporting requirements for registrants and the PCAOB standards for auditors. The absence of clear alignment could lead to unnecessary conflicts between auditors and registrants. Such conflicts are not in the public interest. Additional guidance that clearly articulates the responsibilities of both registrants and auditors should be provided.

The Proposal significantly increases audit scope by requiring consideration of matters that have an indirect effect on the financial statements. Historically such scope was limited primarily to those matters that have a direct effect on the financial statements. Additionally, the proposed changes in scope would create significant differences with ASB and IAASB standards and definitions on this topic. As noted previously, consistency in standards is clearly in the public interest. The Proposal also amends other standards such as risk assessment changing the context of the procedures from "should" to "must." For every audit, no matter how small or noncomplex, these procedures must be performed. Without providing more robust guidance on procedures to be performed, NASBA believes that there will continue to be significant diversity in practice among audit firms as well as the potential for diversity in interpretation of the standard by PCAOB inspection teams.

Evaluation

The Proposal states that when the auditor identifies or becomes aware of information indicating noncompliance with laws or regulations, including fraud, has or may have occurred, the auditor must obtain an understanding of the nature and circumstances and determine whether it is likely that such noncompliance occurred. In situations (particularly matters that may have an indirect impact on the financial statements) the ability to properly obtain such an understanding and perform an evaluation may require technical resources beyond those of the auditor. If not acquired or if those skills are unavailable, there is a risk audits may not be properly completed on a timely basis. This risk should be considered in establishing an implementation time horizon for the Proposal.

Communication and Reporting

When the auditor identifies or becomes aware of information indicating noncompliance with laws and regulations, including fraud, has or may have occurred, the auditor must communicate the matters as soon as practicable, which could result in communicating the matter prior to the completion of the auditor's evaluation of whether the noncompliance has or is likely to have occurred or its financial impact.

As proposed, when matters are identified, communication is to take place with management, the audit committee and potentially the full board of directors. A question arises where there is not a satisfactory resolution of a matter. Should communication with the auditors end with the audit committee and the board of directors?

The Proposal indicates that the auditor may have reporting or notification obligations regarding noncompliance with laws, rules and regulations to regulators or other third parties. From a public interest standpoint, there should be clarity on the next steps after communications with management, the audit committee and the board of directors are exhausted. NASBA recommends more robust guidance on procedures when there is not a satisfactory resolution or timely and appropriate remedial action by management with respect to the noncompliance.

Definitions

The Proposal replaces the term "illegal acts" with "noncompliance with laws and regulations." The proposed definition of "noncompliance with laws and regulations" includes fraud. The Proposal states that the Board intends "noncompliance with laws and regulations" to have a broad meaning and expects the auditor to focus on all types of noncompliance, whether the violations concern financial or operational issues or involve intentional or unintentional misconduct.

Many State Boards already include terms such as "illegal acts" and "noncompliance with laws and regulations" in their rules and regulations. Introducing further diversity in terminology can result in confusion and can negatively impact the enforceability of standards by regulators.

NASBA recommends, as a guiding principle, that any changes or clarifications to existing terminology or phrases be substantive with clear rationale for the change. Many definitions and terminology have long-standing legal precedent and several decades worth of court adjudication around them. The PCAOB should reconsider whether the new definitions or clarifications included in the Proposal are absolutely necessary.

Special Consideration for Emerging Growth Companies (EGC)

While the risk profile of an EGC is different from more mature entities, we agree that future enacted standards on noncompliance with laws and regulations should apply to EGCs. To exclude EGCs from the Proposal would be inconsistent with protecting the public interest.

Again, we appreciate the opportunity to comment on the Proposal.

Very truly yours,

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NASBA Chair

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