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By email: [comments@pcaobus.org](mailto:comments@pcaobus.org)

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

**RE: PCAOB Rulemaking Docket No. 051: PCAOB Release 2023-003: *Proposing Release – Amendments to PCAOB Auditing Standards related to a Company’s Noncompliance with Laws and Regulations And Other Related Amendments***

Dear Office of the Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board’s (PCAOB or the Board) Release No. 2023-003, *Proposing Release – Amendments to PCAOB Auditing Standards related to a Company’s Noncompliance with Laws and Regulations And Other Related Amendments* (the Proposing Release). The proposed amendments to PCAOB standards included in the Proposing Release are herein referred to as the Proposed Amendments.

We welcome the Board’s efforts in taking on such an important topic to investors and understand the need to do so on an accelerated timeline. We are committed to protecting investors through the performance of high-quality audits, and we support the Board’s intent with the Proposing Release to protect investors through improvements to audit quality. As auditors, we understand and embrace this foremost objective and we stand ready to do more in evaluating noncompliance with laws and regulations (NOCLAR) as part of the financial statement audit. However, we are concerned about practical implications of the Proposing Release that may not serve to further audit quality and may, in fact, result in outcomes different from the Board’s intent. We are providing feedback in this letter and Appendix highlighting concepts we support, expressing our concerns, requesting clarification of certain areas, and providing suggested revisions for your consideration.

***Key Areas We Support***

**Alignment with Section 10A** - We support revisions to the auditing standards related to NOCLAR to align with the concepts of Section 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78j-1 (Section 10A). We believe the assessment of the possible effect of NOCLAR on the risk of material misstatement to the financial statements and the associated communication requirements are important procedures to protect investors.

**Enhanced focus on risk assessment** - We also support the enhanced focus on the auditor’s assessment of the risk of material misstatement to the financial statements resulting from NOCLAR and believe this will enhance audit quality. We believe the Proposed Amendments associated with obtaining an understanding of the aspects of management’s compliance process that specifically relate to financial reporting would help auditors better identify and focus their work on areas where risks of material misstatement of the financial statements resulting from NOCLAR exist. For example, the auditor’s risk assessment will be more robust through:

- Understanding management’s process for identifying, investigating, evaluating, and communicating NOCLAR, including receiving and responding to tips and complaints;

- Understanding management’s process for evaluating the related potential accounting and disclosure implications to the financial statements;
- Making inquiries of management, the audit committee, internal audit personnel, and others; and
- Considering certain relevant publicly available information that may indicate instances of NOCLAR.

Additionally, the specificity of procedures listed in paragraph .08 of proposed AS 2405 is helpful to promote consistency in how auditors approach those potential risks.

### *Key Concerns*

#### **Changes to auditing standards alone may not drive outcomes described in the Proposing Release**

- Certain of the potential benefits identified in the Proposing Release may not be achieved by the Proposed Amendments. The benefits discussed in the Proposing Release include protecting investors “from the resulting harm of noncompliance with laws and regulations when the effect of such noncompliance has a material effect on the financial statements” implying these changes to the standards can prevent such noncompliance from even occurring. Management, not the auditor, is responsible for and in a position to effectuate the prevention of noncompliance and the Proposed Amendments would not prevent noncompliance from occurring. Therefore, while the timely communication requirements in the Proposed Amendments could allow audit committees to interject and potentially mitigate the impact of any noncompliance, the Proposed Amendments will otherwise not protect investors from all the resulting effects of an entity’s noncompliance. Further, the Proposed Amendments’ removal of key concepts about the auditor’s responsibilities and reasonable assurance will likely increase the difference between investors’ perception of auditor responsibilities and those required by the standards.

Purported benefits of the Proposed Amendments also include “...improve[d] financial reporting quality”. However, the Proposed Amendments do not change or augment the accounting, disclosure, or internal control requirements of the Issuer and therefore are likely to have no effect on Issuers’ financial reporting related to NOCLAR. For example, like those circumstances cited in the Proposing Release where executive management made misrepresentations to investors on investor calls and in earnings releases about forward-looking statements, noncompliance<sup>1</sup> with Sections 17(a)(2) and (3) of the Securities Act would exist. However, while the eventual impact of this noncompliance may be material (e.g. due to the combined effect of the fines, penalties, or loss in market capitalization/value attributable to such noncompliance), it may not have an impact on the amounts recorded in the financial statements under GAAP if a loss is not yet probable or estimable. It also may not impact financial statement disclosures under ASC Topic 450, *Contingencies*, if it is not reasonably possible that a claim would be asserted or the if the associated risks or uncertainties are not determined to be near term under ASC Topic 275, *Risks and Uncertainties*. Additionally, the matter may not affect the auditor’s opinion on the company’s internal control over financial reporting because the misleading statement was not made in the financial statements. Accordingly, while the Proposed Amendments may require communication to the audit committee in this circumstance, they would not ultimately change the historical financial information available to investors.

Establishing new requirements about NOCLAR for auditors without corresponding changes in the accounting, disclosure or internal control requirements of Issuers will not improve financial reporting quality. Rather than addressing investors’ concerns about the impact of NOCLAR through changes to the auditing standards alone, we recommend the Board actively engage with the SEC and accounting standard setters to consider whether modifying Issuers’ NOCLAR requirements is necessary to more closely align with the Board’s views about what is necessary for investor protection. The Board could then

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<sup>1</sup> See sections 17(a)(2) and (3) of the Securities Act which prohibit engaging in “any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser”.

develop enhanced auditor performance requirements once the accounting and disclosure requirements for Issuers are updated.

**Scope of the proposal** –As described in our responses to questions 7 and 11, respectively, the Proposed Amendments would result in auditors needing to identify complete populations of all laws and regulations applicable to the Company and of all information in public media indicating that the entity may not have complied with each law and regulation that could have a material effect on the financial statements. As described in our response to question 10, the Proposed Amendments would result in auditors also needing to identify the innumerable ways in which noncompliance may occur in all relevant jurisdictions in which an issuer operates and to perform risk assessment procedures and respond to risks, where appropriate, for all such means of potential noncompliance. We are concerned that auditors may never be able to meet those requirements given the sheer number and variety of laws and regulations that impact companies, the complexities and uncertainties inherent in the interpretations thereof, the auditor’s inability to identify and validate all possible public media information about a company, and potential limitations in sufficient audit and specialist resources to evaluate noncompliance in the manner that would be required by the Proposed Amendments. The requirements, if adopted, would fundamentally expand the scope of the audit to one that is beyond an audit of historical financial statements. While we are prepared to meet investor needs through performing procedures to comply with enhanced requirements of the standards, these efforts may also unnecessarily overlap with examinations and other oversight activities performed by existing regulatory bodies at the federal, state, local, and foreign levels.

**Inconsistencies in ICFR requirements** - The Proposed Amendments do not change the internal control requirements of the Issuer as that is outside the remit of the auditing standards. Under the SEC rules<sup>2</sup> applicable to the Issuer, the definition of internal control over financial reporting extends only to those laws and regulations that directly relate to financial reporting. However, as implied in the Proposing Release text, the Proposed Amendments, if adopted, would result in new responsibilities for the auditor associated with the Issuer’s internal control over compliance instead of focusing on the controls related to the financial reporting impact of noncompliance. We are troubled that the responsibilities of the auditor would exceed those of management in an area of expansive reach that goes beyond the core financial statements. We are also concerned that the Proposed Amendments lack guidance directing auditors in how to evaluate internal control over compliance. This is of particular concern given that the Committee of Sponsoring Organizations (COSO) 2013 internal control framework, which is used by almost all Issuers to evaluate their internal control over financial reporting, is clear that, while interrelated, the objectives of internal control over compliance differ from the objectives of internal control over reporting. If the requirements of the Proposed Amendments related to understanding management’s processes over preventing and remediating noncompliance are retained, we respectfully request the Board to consider how those requirements differ from those of management and of the COSO framework and the impact of those differences on the expected auditor performance. We then request the Board to incorporate guidance in the final standard that provides clear direction to auditors about how to meet the requirements given the different objectives of controls over compliance and reporting.

**Need for further engagement with stakeholders** - While we support the Board’s commitment to standard setting to enhance investor protection and their initiative to modernize the auditing standards, we are concerned that the current pace of this project may affect the quality of the final standard. We believe that an open standard-setting process involving public meetings, discussion papers, and/or roundtable discussions with various stakeholders (investors, audit committee members, auditors, preparers, SEC counsel, etc.) is necessary when contemplating significant changes to the auditing standards, such as those contained in the Proposed Amendments, to develop a standard that provides

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<sup>2</sup> [Final Rule: Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports; Rel. No. 33-8238 \(sec.gov\).](#)

the optimal level of investor protection. We acknowledge that the Board may solicit feedback from the Investor Advisory Group (IAG) and the Standards and Emerging Issues Advisory Group (SEIAG) prior to beginning the standard setting process on a topic; however, audit quality and investor protection would benefit from soliciting feedback from these advisory groups and others on specific elements of a standard setting project throughout its lifecycle. Active public engagement with relevant stakeholders throughout the standard-setting process is an important element of the process that enhances the ability of final standards to achieve their objectives in the most effective and cost-effective manner.

We have provided comments based on our initial reactions, outreach, and data-gathering and have included our perspectives herein. However, due to the extent of the proposed changes and the 60-day comment period, there are several elements of the Proposing Release that we have not had the opportunity to fully evaluate, including unintended consequences. We also have not been able to fully evaluate the impacts to our costs and fees. However, given the vast scope of the Proposed Amendments and the expensive pool of professional specialist resources necessary to comply with them, our costs and fees will be significantly higher if the Proposed Amendments are adopted in final form.

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We appreciate the Board's consideration of our comments and observations and would be pleased to discuss our comments with the Board and its staff at your convenience. We look forward to continuing our engagement with the Board and its staff in support of our shared commitment to investor protection and audit quality.

Sincerely,

**KPMG LLP**

KPMG LLP

## Appendix

Below are responses to select questions in the Proposing Release for which we had specific input. For proposed revisions, language to be deleted is ~~struck through~~; language to be added is underlined.

### **Question 1: Is the proposed definition of “noncompliance with laws and regulations” sufficiently clear? If not, why not?**

The definition of NOCLAR only excludes personal conduct by the company’s personnel. We believe that all personal conduct unrelated to the business activities of the company should be excluded from the definition, including personal conduct by others that act in a company capacity or on the company’s behalf. We suggest the following revision:

.A2 Noncompliance with laws and regulations – An act or omission, intentional or unintentional, by the company whose financial statements are under audit, or by the company’s management, its employees, or others that act in a company capacity or on the company’s behalf, that violates any law, or any rule or regulation having the force of law. Noncompliance with laws and regulations includes fraud as described in paragraph .05 of AS 2401, Consideration of Fraud in a Financial Statement Audit. Noncompliance with laws and regulations does not include personal conduct ~~by the company’s personnel~~ unrelated to the business activities of the company.

### **Question 4: Is the introduction to proposed AS 2405 sufficiently clear? If not, how should the introduction be clarified?**

Like our comment on the proposed update to paragraph .01 of AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*<sup>3</sup>, we believe the reference to auditors having a “fundamental obligation to protect investors” may be interpreted to mean that the Board has a view on the legal liability of auditors to third parties that goes beyond what has already been clearly established by years of jurisprudence. Consistent with our comment letter on that proposal, we recommend either removal of the word “obligation” from proposed AS 2405 or a clear statement from the Board in the release that its language is not intended to express a view or otherwise advocate regarding the scope of legal duty owed by auditors. Alternatively, we recommend the use of the word “responsibility” instead of “obligation”.

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

The term *could reasonably* is used in paragraph .04a and numerous other times in proposed AS 2405. This term is not defined in the Proposed Amendments and where used in existing PCAOB standards it is tied directly to the risk of material misstatement concepts in AS 2110, *Identifying and Assessing Risks of Material Misstatement*. We suggest the following revisions to paragraph .04a to align with the concepts in AS 2110:

[.04]a. Identify laws and regulations with which noncompliance could reasonably ~~have a be~~ expected to result in a material misstatement of ~~material effect on~~ the financial statements;

Additionally, please refer to our response to question #8, below, relating to identification of laws and regulations with which noncompliance could reasonably have a material effect on the financial statements (Paragraph .04a).

Paragraph .04c of Proposed AS 2405 extends the auditor’s objectives to encompass that of a compliance audit by establishing an objective to identify all instances of noncompliance irrespective of the effect on

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<sup>3</sup> See page 1 of our comment letter, dated May 30, 2023, [RE: PCAOB Rulemaking Docket No. 049: PCAOB Release 2023-001: Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards](#).

the financial statements. We agree with Board member DesParte's statement that "auditors would be required to embed compliance attestation procedures into the financial statement audit. This is well beyond both the scope of the financial statement audit"<sup>4</sup> If the Board's intent is for .04c to apply only to those laws and regulations identified in .04a, we suggest the following revision to that paragraph:

[.04]c. Identify whether there are instances of noncompliance with laws and regulations identified in (a.) above, that have or may have occurred

Further, paragraph .04d needs clarification to the phrase "regardless of whether the effect of the noncompliance is perceived to be material" to align with Section 10A's anchoring to what is material to the financial statements. We suggest the following revision to paragraph .04d:

[.04]d. When the auditor identifies or otherwise becomes aware of information indicating that instances of noncompliance have or may have occurred, evaluate and communicate such instances of noncompliance (regardless of whether the effect of the noncompliance is perceived to be material to the financial statements).

If the Board intends auditors to evaluate and communicate instances of noncompliance that is perceived to be material using a materiality framework other than that used for the financial statements, we request the Board to provide additional guidance directly in the final standard on how the intended materiality concept is to be evaluated.

**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?**

In responding to this question, we also considered page 29 of the Proposing Release, which states "laws and regulations that may relate to the operations of a company with which the company's noncompliance could reasonably result in material penalties, fines or damages to the company". The proposed standard offers no guidance on how an auditor, who is not a legal specialist, would determine which of the myriad of "laws and regulations" relating to the operations of a company are those for which noncompliance "could reasonably" result in material penalties, fines, or damages to the company, and those that "could not" result in such penalties, fines, or damages. We acknowledge the perspectives of Chair Williams and Board member Thompson that the Proposed Amendments do not require auditors to consider every law and regulation relevant to a company. The Proposed Amendments are clear that the objective in paragraph .04b to assess and respond to the risk of material misstatement of the financial statements due to noncompliance is limited to those laws and regulations with which noncompliance could reasonably have a material effect on the financial statements. However, the population of laws and regulations for which auditors are responsible under the Proposed Amendments cannot be determined without starting from a complete population of laws and regulations relevant to a company given the conditional nature of the requirement. That is, a sub-population cannot be determined without first determining the complete population. Accordingly, we respectfully disagree that auditors would not be required to consider every law and regulation relevant to a company and agree with the view of Board member Ho that the Proposed Amendments would require a complete listing of laws and regulations as a starting point to achieving the objective of identifying those laws and regulations the Board intends to be relevant to the audit.

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<sup>4</sup> Statement on Proposal to Amend PCAOB Auditing Standards Related to a Company's Noncompliance with Laws and Regulations and Other Related Amendments from Duane M. DesParte, dated June 6, 2023.

If the Board believes that auditors do not need to consider a complete population of laws and regulations to achieve compliance with the objectives and requirements of the Proposed Amendments, we believe the final standard should provide explicit guidance to direct auditors on how to meet the expected performance requirements without considering a complete population of laws and regulations relevant to a company.

Further, assessing the potential impact of noncompliance would be particularly challenging given that penalties, fines, and damages can vary greatly and are determined by third parties. The proposed requirement is unclear as to whether the intent is for “material penalties, fines or damages” to be interpreted as being material to the financial statements and whether or how auditors should consider downstream impacts of noncompliance, such as to reputational risk or the valuation of the company’s stock. Additionally, there are certain regulations where a company may be subjected to lower fines and penalties if it were to self-report a matter. It is unclear how the auditor would consider these unknown and hypothetical factors in their risk assessment. Given that the Board has made clear that it is not intending to transform the audit of the financial statements into an audit of compliance with laws and regulations<sup>5</sup>, we believe the Board should provide explicit guidance in the final standard on the characteristics and aspects of potential noncompliance that an auditor should contemplate when assessing the significance of potential noncompliance.

**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?**

As stated above, without knowing the complete population of laws and regulations that apply to a company, the auditor would not be able to conclude that they had identified those required by the Proposed Amendments. This is impractical, and may not be possible, for the reasons below.

There is a vast breadth of laws and regulations potentially governing an entity’s operations, and the quantity of potentially applicable laws and regulations is exponentially greater when considering the number of jurisdictions in which the entity operates. Entities with domestic operations may be subject to thousands of laws and regulations and the number of laws and regulations that may impact an entity’s foreign operations would be expected to be exponentially greater.

The challenges posed by both the breadth and depth of applicable laws and regulations cannot be understated in any considerations of a final standard. We believe the language in the Proposing Release understates the potential quantity of specialists that may be necessary to comply with the Proposed Amendments, by not acknowledging the breadth (types of laws and regulations, number of jurisdictions) of laws and regulations, and their depth. To some readers of the Proposing Release, it may appear the auditor could obtain appropriate specialist knowledge to evaluate laws and regulations and obtain appropriate audit evidence by engaging a limited number or even a single specialist. In nearly all cases this is simply not possible given the broad expanse of applicable laws and regulations. The complexities of the legal and compliance environment require deep knowledge for each type and jurisdiction of law or regulation, and the legal profession has evolved to include specialists in specific laws and jurisdictions. This knowledge is necessary for an understanding of existing laws and regulations, when and how they change, and how a governing body or enforcement agency may interpret the application thereof, all of which are considerations relevant to auditors complying with the requirements of the Proposed Amendments. This required knowledge would be even more pronounced in certain foreign jurisdictions where laws and regulations are less refined compared to other jurisdictions. The complicated matrix of laws and regulations in many cases would lead to engagement of a substantial number of specialists by

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<sup>5</sup> See “these proposed procedures are not tantamount to a compliance audit in their scoping or objectives” on page 81 of the Proposing Release.

both the auditor and the Issuer and does not appear to be adequately contemplated in the costs associated with the Proposing Release nor in the necessary timeframe to comply with it. Further, the expanded availability of this specialist resource pool that would be necessary to fulfill the needs of all Issuers and auditors is a topic that requires significant outreach and planning.

Accordingly, guidance to help auditors identify the laws and regulations that could have a material effect on the financial statements is needed in the final standard; for example, by outlining specific procedures that auditors could perform to fulfill this requirement. Further, we believe the Board should clarify its intent as to whether the auditor should consider the effect of controls when making its assessment of whether the associated law or regulation *could reasonably* have a material effect on the financial statements under paragraph .05a of proposed AS 2405. Board member DesParte stated that “it is unclear whether auditors would make this likelihood assessment considering management compliance policies, programs, processes, and controls (i.e. on a residual risk basis) or on an inherent risk basis”<sup>6</sup>. While we interpret paragraph .05a to supplement the risk assessment required by AS 2110 which states that risk of material misstatement is based on inherent risk, without regard to the effect of controls, we believe clarity should be provided to remove any ambiguity. Further we believe the Board should provide clarity in the final standard as to whether, when and how the auditor should factor into the assessment of the risk of material misstatement an entity’s controls over compliance and their history and propensity for identifying and self-reporting violations, which may result in otherwise lower levels of fines and penalties.

Finally, the auditor’s logical starting point to meet the requirements of paragraph .05a of proposed AS 2405 in most cases would be to obtain and review a list of management’s complete population of applicable laws and regulations. However, tracking and documenting a complete population of laws and regulations is not something required of management nor is it usually common practice. This inconsistency not only creates confusion regarding the role of the auditor, but it results in practical challenges of implementation and additional time and expense for entities under audit that do not appear to be contemplated in the Proposed Amendments.

**Question 10: Is the proposed requirement for auditors to assess and respond to the risks of material misstatement due to noncompliance with laws and regulations sufficiently clear? If not, why not?**

The Proposed Amendments are unclear whether the auditor is expected to assess (and respond to) the risk that the entity has failed or will fail to comply (herein referred to as the “risk of failure to comply”) with a law or regulation, or rather, the risk of material misstatement of the financial statements because of the instance of noncompliance. If the Board’s intent is for auditors to respond to risks of failure to comply with laws and regulations, the resulting impact would be to fundamentally expand the scope of the auditor’s responsibilities beyond that of a financial statement or integrated audit, present significant challenges to meet such responsibilities, and potentially result in disclaimers of audit opinions or delays in the issuance of audit reports.

Like in our response to the proposed update to paragraph .01 of AS 1000<sup>7</sup>, we are concerned that if the objective of the proposal is to go beyond evaluation of whether the financial statements are presented fairly in conformity with the applicable financial reporting framework, then there is no longer an objective and consistent benchmark to be applied. This ambiguity will lead to inconsistent approaches among auditors, which will negatively impact audit quality and exacerbate the difference between investors’

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<sup>6</sup> Statement on Proposal to Amend PCAOB Auditing Standards Related to a Company’s Noncompliance with Laws and Regulations and Other Related Amendments from Duane M. DesParte, dated June 6, 2023.

<sup>7</sup> See page 5 of our comment letter, dated May 30, 2023, [RE: PCAOB Rulemaking Docket No. 049: PCAOB Release 2023-001: Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards](#).



expectations of an audit and the auditors' responsibilities contained in the auditing standards. To clarify its intent, and in instances where accounting and disclosures are referenced<sup>8</sup>, we recommend supplementing the proposed references to accounting or disclosures to specify that they are "in conformity with the applicable financial reporting framework".

Similarly, in an integrated audit the Proposed Amendments are also unclear as to the scope of relevant controls over NOCLAR. Some stakeholders may assume that the integrated audit includes the risks of failure to comply, which extends beyond internal control over financial reporting<sup>9</sup>. In addition to practical application concerns, under the Proposed Amendments the Issuer would have less responsibility than the auditor as it relates to laws and regulations with an indirect effect. Auditors would consider laws and regulations that have either a direct or indirect effect on the financial statements, however, the SEC rules are clear that the definition of internal control over financial reporting only encompasses controls over those laws and regulations that have a direct effect on the financial statements. We believe clarification is needed in the final standard about whether the scope of controls over NOCLAR the Board intends to be relevant to the audit is specific to those compliance controls that are designed to also meet internal control over financial reporting objectives. Additionally, guidance is needed in the final standard on how the controls the Board intends to be relevant to the audit might affect the auditor's assessment of the combined risk of misstatement of the financial statements and the nature, timing and extent of further procedures needed to respond.

A lack of clarification on scope of an auditor's responsibilities such as those discussed above and conflicts within the examples in the Proposing Release may also result in diversity in practice when responding to identified risks. To illustrate, one example refers to testing controls over compliance *or* performing substantive procedures to identify instances of noncompliance,<sup>10</sup> possibly implying that the Board is not expecting both a controls and substantive response; whereas another example<sup>11</sup> states that the design and operating effectiveness of controls over maintaining compliance would be part of the response. The examples in the Proposing Release should be clarified and aligned to avoid confusion on what may be an appropriate response based on the scope of an auditor's responsibilities in both a financial statement and integrated audit.

If the Board's intent is for auditors to respond to risks of failure to comply with laws and regulations, efforts to do so would result in significant incremental costs and auditors may not be able to comply. Company activities that have a direct effect on the financial statements are more straightforward given the associated financial transactions that can be analyzed. But activities that have an indirect effect often do not result in financial transactions. There is limited guidance on how the auditor should respond to risks of failure to comply that have an indirect effect, and how to obtain sufficient appropriate audit evidence that can be tested for relevance and reliability in a manner that complies with AS 1105, Audit Evidence. While some auditors have experience with these types of activities through compliance examination, those engagements are performed using a defined set of criteria. However, under the Proposed Amendments,

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<sup>8</sup> For example, see paragraphs .06a2, .09b, .10b&c, and .19c(2) of proposed AS 2405.

<sup>9</sup> AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, paragraph .03 specifically states the auditor's objective in an audit of internal control over financial reporting is to express an opinion on the effectiveness of the company's internal control over financial reporting.

<sup>10</sup> See pg 32 of the Proposing Release which states "test relevant controls that were put in place to maintain compliance with the FCPA, *or perform cash disbursement testing designed to identify potential bribes.*" [*emphasis added in italics*]

<sup>11</sup> See page 32 of the Proposing Release which states "the auditor would plan and perform procedures to understand management's process for maintaining compliance and test the design and operating effectiveness of relevant controls."

the laws and regulations are the criteria against which the auditor would have to evaluate the failure to comply and (1) not all laws and regulations would qualify as suitable criteria, and (2) applying a unique set of criteria for evaluating an entity's compliance with each law and regulation for which noncompliance could reasonably have a material effect on the financial statements is not practical.

Auditors may also face challenges when engaging or employing specialists with the requisite skill or knowledge to respond to the risks of failure to comply. As "an auditor does not possess legal skills and, therefore, cannot make legal judgments concerning information coming to his attention"<sup>12</sup> substantive procedures<sup>13</sup> would necessarily involve significant legal and other specialist resources. In certain more complex legal scenarios, such specialists' reports may include certain restrictions, disclaimers, or limitations that affect the auditor's use of the report or work, and auditors may not have the requisite skill and knowledge needed to perform the required additional procedures to reach a conclusion.<sup>14</sup>

To illustrate the challenges described above, consider a global manufacturer that sells its products in over 150 countries. The entity is likely subject to thousands of laws and regulations, including environmental and product liability, the individual violation of which could reasonably have a material effect on the financial statements under the Proposed Standards. The auditor would need to understand all such laws and regulations, in the relevant jurisdictions, and contemplate each way in which they could be violated, including that a matter not considered a violation in one jurisdiction may constitute noncompliance in another. Without a detailed framework, the auditor would need to perform risk assessment, control, and substantive procedures for each relevant law and regulation throughout the period under audit. The auditor would need to engage and supervise a substantial number of specialists that understand each of the relevant subject laws or regulation; with the auditor potentially unable to obtain sufficient audit evidence to comply with the audit standards as described above.

**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?**

**Question 12: Are there other specific procedures the auditor should be required to perform to assist them in identifying 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? If so, what are those procedures?**

We agree with auditors having a responsibility to perform procedures to identify whether information exists indicating noncompliance that could have a material effect on the financial statements, but believe clarification is needed to explain the requirement for auditors to "plan and perform procedures to identify whether there is information indicating noncompliance". The Proposed Amendments require auditors to identify all information indicating instances of noncompliance with any law or regulation that could reasonably have a material effect on the financial statements. We do not believe auditors would ever be able to meet this performance requirement because identifying a complete population of information indicating whether the entity may not have complied with each law and regulation that could have a material effect on the financial statements is not possible. For example, given the extent of information channels available with the widespread technology capabilities of the current environment, we do not believe any auditor would be able to identify during an audit all forms of media reporting, and other information that could indicate noncompliance has or may have occurred. Media reporting could include the articles published by major news organizations, but it could also be interpreted to include opinion

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<sup>12</sup> See paragraph .06 of AS 2505: *Inquiry of a Client's Lawyer Concerning Litigation, Claims and Assessments*

<sup>13</sup> See AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, paragraph .36.

<sup>14</sup> See paragraph .C7 of AS 1201, *Supervision of the Audit Engagement*.

pieces, podcasts, closed-API social media platforms, brief segments on television, video and imagery that is less searchable as compared to text, and other short-lived and inaccessible content. While information may become known to an auditor during the audit, auditors would never be able to identify all information that could be relevant in an audit. This requirement aligns with the Board's strategic goal objective to enhance its ability to enforce the standards and inspect for compliance because it allows the Board to hold auditors accountable for not identifying information real-time that later becomes known after the audit is completed. However, we do not believe it is appropriate to establish performance requirements that may not be possible to achieve.

Further, the Proposed Amendments provide insufficient direction as to how the relevance and reliability should be assessed for all such information obtained. While auditors are already familiar with considering relevance and reliability as described in AS 1105, it is unclear how the auditor would be able to apply those concepts to certain sources specified in the Note to paragraph .11 of proposed AS 2110. As an example, if noncompliance were alleged on a podcast or on a television broadcast, not only could the auditor have difficulty finding the podcast or broadcast, but it could be nearly impossible to assess reliability of the information particularly given a reporter's privilege. There could be a scenario where the information is relevant, but the auditor would be unable to use the information because the auditor was unable to ascertain its reliability.

While we have significant concerns about the proposed requirement not being able to be achieved, at a minimum, we believe the Board should incorporate the procedures from the Proposing Release that auditors "could take into account" in planning and performing audit procedures to identify information indicating noncompliance directly into the standard by adding to paragraph .05c of proposed AS 2405 as follows:

- c. Identify whether there is information indicating noncompliance with those laws and regulations has or may have occurred. In planning and performing the audit procedures to identify information indicating noncompliance, auditors could take into account:
  1. The identified laws or regulations and how noncompliance could be identified by the auditor and the company;
  2. The design of management's processes;
  3. Correspondence with the company's regulatory authorities;
  4. The results of any compliance reviews by the internal audit function;
  5. The results of the auditor's inquiries of management, the audit committee, internal audit personnel, and others; and
  6. The results of any tests of the operating effectiveness of relevant controls over the company's compliance, or the identification of noncompliance, with the laws and regulations that could reasonably have a material effect on the financial statements.

Additionally, the procedures we note above as well as the procedures in paragraph .06 of the proposed AS 2405 focus primarily on risk assessment and controls; however, it is unclear what substantive procedures would fulfill the requirements to 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. Without further explicit direction in the final standard, the Proposed Amendments appear to indicate procedures like those used in a forensic audit to discover information relevant to an investigation may be required in every financial statement audit. While we do not believe the objective of the Proposed Amendments was to convert the financial statement audit into a forensic audit, if that is the Board's intent, we believe it would only be appropriate to do so through a separate standard setting project focused specifically on the auditors' responsibilities for fraud identification and detection.

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

The Proposed Amendments broaden the scope to require the auditor to read all available public information irrespective of its relevance to evaluating risks of material misstatement. Extant paragraph .11 of AS 2110 includes a requirement to consider performing procedures relating to information, instead of an unconditional requirement. The Proposed Amendments also do not consider the types of procedures required to determine if a source of public information is reliable, which is important given media reports may come from various outlets, some of which may harbor biases in their reporting, have various degrees of editorial rigor, or may not have a strong emphasis on factual accuracy.

The note to paragraph .11 of proposed AS 2110 also extends the sources of publicly available information to executive officers' social media accounts. "Social media" is a broad term that encompasses many different platforms and formats, including text, image, and video, including short-lived videos. A few examples of the challenges this poses are identifying a complete population of social media accounts, likely impossible for the Issuer itself, requiring auditors to subscribe or follow each of those individuals across multiple platforms, accumulating information from social media posts that are temporary in duration and may not be available unless monitored constantly, and having the requisite knowledge to appropriately interpret whether statements available on social media indicate potential noncompliance. We recognize that risk assessment is iterative, but a requirement effectively resulting in the need for auditors to constantly monitor the volume of external information expected by the Proposed Amendments is not practical.

As such, we recommend the following revisions to proposed paragraph .11 of AS 2110:

.11 As part of obtaining an understanding of the company as required by paragraph .07, the auditor should perform the following procedures to understand the events, conditions, and company activities that might reasonably be expected to have a significant effect on the risks of material misstatement:

- Read publicly available information about the company included in analyst reports and, ~~including~~ such information disclosed by the company or its executive officers;

Note: Publicly available information disclosed by the company or its executive officers about the company may ~~includes~~ company-issued press releases; company-prepared presentation materials for analysts or investors; and public statements made or issued by the company or its executive officers, including on the company's website or the company's ~~or its executive officers'~~ official social media accounts. The auditor should consider reading Ppublicly available information about the company also includes information from other sources external to the company, such as media reporting and analyst reports.

[Remaining bullets excluded]

**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 believe the requirement to inquire about whether correspondence exists with the relevant regulatory authorities is clear. While we were unable to explore all types of regulatory authorities, in practice, auditors in certain highly regulated industries, such as banking, have communications directly with certain

regulators regarding an Issuer's compliance. We do not think the requirements in the Proposed Amendments would change this practice.

**Question 24: Is the proposed approach to evaluate instances of noncompliance that has or may have occurred sufficiently clear? If not, why not?**

In relation to the auditor's determination of the potential effect on the financial statements under paragraph .09b, and whether and to what extent auditors evaluate these effects, we believe it would be prudent for the PCAOB to provide a framework for how auditors should consider *qualitative* materiality factors relating to NOCLAR. The potential risk of material misstatement for NOCLAR relates in many cases to whether the disclosures to the financial statements are fairly stated in accordance with the applicable financial reporting framework. Adequate disclosure may necessitate qualitative information including the nature of the matter and an indication of probability. Furthermore, it is unclear how the auditor is expected to consider the materiality of current disclosures in relation to potential downstream impacts of noncompliance, such as to reputational risk or the valuation of the company's stock. Lastly, to avoid confusion in the broader financial reporting ecosystem we believe it would be necessary for the various standard setters and regulatory bodies (including FASB and the SEC, respectively) to be aligned on these elements of qualitative materiality considerations, to enable consistent application by stakeholders.

**Question 26: Are the procedures the auditor may perform to obtain an understanding of the nature and circumstances of potential noncompliance and to determine whether it is likely the noncompliance occurred sufficiently clear? If not, why not? What additional procedures, if any, should be added?**

We have concerns related to the inclusion of footnote 10 to paragraph .08f of proposed AS 2405 because of the interaction with the requirements of Section 10A. Under Section 10A the auditor is required to consider whether senior management has taken timely and appropriate remedial action, which generally would include determining whether similar transactions or events may have occurred, and to consider departure from a standard auditors' report or withdrawal if timely and appropriate remedial action was not taken. An auditor's performance of its own separate forensic auditing procedures to achieve the objective of obtaining this understanding could imply that senior management failed to take timely and appropriate remedial actions. More likely, as a practical matter, the auditor would shadow the company's process to obtain an understanding of and assess the nature and scope of the company or company's specialist's response to the matter, including assessing pervasiveness, and would not conclude on the matter before the company has done so. We recommend using language like the language in paragraph .09 of extant AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements*, that refers to testing the company's process.

Additionally, while we acknowledge Section 10A requires the auditor to determine whether it is likely that an illegal act has occurred and its possible effect on the financial statements, we highlight the reference within that section that this evaluation is done "in accordance with generally accepted auditing standards." Current paragraph .03 of extant AS 2405 recognizes that determining whether an act constitutes noncompliance with laws and regulations is dependent on legal judgment that is beyond the typical competence of an auditor. Today, those generally accepted auditing standards (e.g. extant AS 2405) define the audit procedures that should be performed in response to possible illegal acts and indicate that they are predicated on the actions that management has taken, including understanding the facts gathered by management and the analysis of the company's legal counsel as management's specialist about whether there has been or likely has been noncompliance. For example, paragraph .10 of extant AS 2405 indicates that if the auditor cannot get sufficient information from management to make such an evaluation, there are certain other procedures outlined that the auditor should perform. This includes consulting with the entity's legal counsel and may include performing additional procedures such as examining documents and records, confirming information with other parties, and considering whether

other similar transactions may have occurred. This sequence in extant AS 2405 emphasizes the importance of evaluating information from management first and then auditing management's conclusion, which is important to maintaining independence and to the auditor's role in Section 10A as discussed above. It is also important to avoid creating or exacerbating any expectations gap by implying that the financial statement audit may equate to a forensic audit.

Furthermore, in determining, as required by Section 10A, whether senior management and the audit committee have taken timely and appropriate remedial actions, the auditor may be able to conclude without there ever being a determination as to whether noncompliance occurred. For example, individuals responsible for actions that might have been noncompliant may be removed from their roles or terminated from employment before all the facts are determined. A company may also cease a practice or revise a policy that may have been noncompliant without conceding or a determination by counsel or a court that it was noncompliant. In such instances, the auditor would not need to have the legal expertise or obtain its own specialist to make a definitive legal judgment to satisfy its responsibilities under Section 10A.

Accordingly, we do not believe the Proposed Amendments should establish requirements for auditors that would require auditors to reach conclusions about the existence of noncompliance that are not required by the entity to comply with the relevant requirements of the SEC and the applicable financial reporting framework.

**Question 28: When evaluating information that may be indicative that noncompliance has or may have occurred, should the auditor consider the impact of that information on other information in documents containing the audited financial statements? If not, why not?**

We agree that the auditor should read the other information in the documents containing audited financial statements to determine if that other information contains a misstatement of fact or material inconsistency with the audited information, including due to NOCLAR, as is currently explicitly required by AS 2710, *Other Information in Documents Containing Audited Financial Statements*. However, we believe that the requirement to perform additional procedures, as described in paragraph .09b(2) of proposed AS 2405, is inconsistent with paragraph .04 of extant AS 2710, which states that the auditor has no obligation to perform any procedures to corroborate other information contained in a document. We are concerned that requiring an auditor to perform procedures over other information could be interpreted to imply that the assurance of the auditor's report extends beyond the financial statements.

As such, we recommend the following revisions to paragraph .09b(2) of proposed AS 2405:

- b. Perform additional procedures as necessary to determine whether the likely noncompliance ~~(4)~~ results in material misstatement of the financial statements (including omitted, incomplete, or inaccurate disclosures) ~~or (2) results in other information in documents containing audited financial statements, or the manner of its presentation, being materially inconsistent with information appearing in the financial statements or containing a material misstatement of fact;~~<sup>43</sup> and

**Question 31: Should the auditor's communication requirements differ when the information about noncompliance is identified by management, as compared to when identified by the auditor? Would the proposed exceptions for previous communications help in avoiding duplicative communications? Should the auditor communications be expanded or narrowed? If so, how?**

We agree with the note to paragraph .13 of proposed AS 2405 that allows the auditor to not repeat information that was communicated from management to the audit committee if the auditor participated in management's discussion with the audit committee about noncompliance. This note is like the note included in paragraph .12 of extant AS 1301, *Communications with Audit Committees*, regarding communication of accounting policies and practices, estimates, and significant unusual transactions.

We understand footnote 19 to paragraph .12 of proposed AS 2405 seeks to avoid needlessly duplicative communications to the source of the information but believe that it has the potential to cause more confusion than incremental benefit. In practice, a matter may be communicated at multiple times and multiple levels. For example, the controller may communicate the matter to the audit manager in their regularly scheduled meetings. The CFO may also communicate the matter to the lead audit engagement partner. In this case the controller, the CFO, or both would be considered the source of the information. The engagement team would subsequently need to discuss and assess whether the communication included all required communications pursuant to paragraph .13a and .13b of proposed AS 2405. If some of the required communications under paragraphs .13a and .13b were not made by one of the required sources to the auditor, the auditor would need to communicate any omitted information to that source. While we appreciate the desire to avoid duplicative communications, we believe removal of the proposed footnote would simplify the requirements and avoid confusion. We believe auditors would likely opt to perform the duplicative communication to limit the possibility of any missed communications.

**Question 33: Does the timing of the proposed communications (that is, “as soon as practicable”) to management and the audit committee pose any particular challenges to the auditor? If so, how should the proposed requirement be changed?**

We agree with the proposed language “as soon as practicable,” which is consistent with extant AS 2405. In practice, the audit team meets with management frequently once a potential instance of noncompliance is identified, so the communication with management would likely occur within days (or sooner, depending on the nature of the matter) after the information indicating that NOCLAR has or may have occurred is discovered. However, audit committees generally have scheduled meetings and an agreed upon communication cadence with the auditors. In practice, auditors inherently consider the importance of timing of the communication to the audit committee based on the requirement to perform the audit with due professional care as described in extant AS 1015, *Due Professional Care in the Performance of Work*. Depending on the facts and circumstances, auditors may request to communicate the matter immediately to the audit committee chair and then later to the full audit committee, at a special session of the audit committee, or at the next scheduled audit committee meeting.

We are concerned that the requirement to communicate the matter to the audit committee “when the auditor identifies or otherwise becomes aware of information indicating that noncompliance with laws and regulations (whether or not perceived to have a material effect on the financial statements), including fraud, has or may have occurred” could conflict with paragraph .03 of extant AS 1301, which states that the auditor’s objective is to “provide the audit committee with timely observations arising from the audit that are significant to the financial reporting process.” Although timely, the proposed requirement would not allow for the opportunity to assess whether the observation is of consequence to the financial reporting process and could distract from more important matters. Legal experts are already challenged in assessing the indirect effect of potential noncompliance on the financial statements, so it is unclear how communicating information to audit committees without the related communications about the possible impact on the financial statements would be decision-useful. We suggest that the communication to the audit committee be required only after the auditor has completed its assessment of whether the matter is clearly inconsequential or if the auditor is unable to complete its assessment before the financial statements are issued. We suggest the following revision to Footnote 17:

<sup>17</sup> Making this communication “as soon as practicable” could result in the auditor communicating the matter prior to the completion of the auditor’s evaluation of the information indicating that noncompliance has or may have occurred (see paragraphs .07-.11 of this standard). The timing may take into account the auditors’ assessment of whether the matter is clearly inconsequential, but communication should be made before the issuance of the auditor’s report.

**Question 34: Is it appropriate to require the auditor to have a subsequent communication to management and the audit committee to communicate the results of the auditor’s evaluation of information indicating noncompliance with laws and regulations has or may have occurred? If not, why not? Does this communication pose any particular challenges? If so, what are they?**

**Question 35: Does the requirement to communicate the results of the auditor’s evaluation of information indicating noncompliance with laws and regulations has or may have occurred pose any particular challenges? If so, how should the proposed requirement be changed?**

We agree that it is appropriate to require the auditor to subsequently communicate to management and the audit committee certain required information that was not initially communicated because the auditor was still evaluating it. However, we are concerned with the requirement included in paragraph .14a of proposed AS 2405 that requires the auditor to communicate to the audit committee “which of the matters, if any,...are likely noncompliance.” We recognize that the term “likely” is also used in Section 10A; however, it is used in the context of “the firm shall...determine whether it is likely that an illegal act has occurred” and that conclusion is not required to be affirmatively communicated to the audit committee. Paragraph .14a of proposed AS 2405 would require the auditor to affirmatively communicate to the Issuer whether a matter is likely noncompliance, which raises concerns regarding the potential for unauthorized practice of law.

The definition of the practice of law may differ from one jurisdiction to another. Requiring an auditor to communicate a conclusion that the matter is likely noncompliance would require the auditor to apply a set of laws against a specific set of facts and conduct and express an opinion on the legality of that conduct. Depending on the laws of the jurisdiction, this could constitute the practice of law. The Proposing Release states “the proposed amendments do not state that the auditor is required to make a definitive legal determination about whether noncompliance has occurred. Instead, the Proposed Amendments would also require the auditor to determine if it is likely that noncompliance has or may have occurred.” We are concerned that the requirement to explicitly communicate that a matter involves likely noncompliance could require the auditor to practice law without authorization, depending on the jurisdiction. Many jurisdictions have laws against the unauthorized practice of a profession in which a license is a prerequisite.<sup>15</sup> Requiring the determination and communication of the likely noncompliance by the audit firm, or its outside legal specialist, to the audit committee raises two concerns. First, Section 10A<sup>16</sup> prohibits a legal specialist functioning as a member of the audit engagement team (such as in this context) from providing a legal service to the entity under audit. Second, many states may view the audit firm as engaging in the unauthorized practice of law in violation of their licensing regimes for legal professionals.

We believe that the language in paragraph .03 of extant AS 2405 that states “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” should be retained. This is an important clarification that the auditor’s assessment is not a legal determination and should be retained.

We are also concerned about the requirement in .13b of the Proposed AS 2405 to communicate the possible effect of noncompliance on other information. As stated earlier in our response to Question 28, we are concerned with the inconsistency with extant AS 2710 and that the proposed standard may imply that the audit extends to the other information in documents containing the financial statements.

As such, we recommend the following revisions to paragraph .13b of proposed AS2405:

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<sup>15</sup> As an example, see [New York Education Law 6512, Unauthorized practice a crime](#).

<sup>16</sup> See Securities and Exchange Act of 1934, 15 U.S.C. § 78j 1 (g)(8).



b. If the auditor has determined that the matter is likely noncompliance, the possible effect of the noncompliance on the financial statements ~~and other information in documents containing the audited financial statements.~~

**Question 37: Is the proposed requirement for the lead auditor to obtain the written affirmations from the other auditor sufficiently clear? If not, why not?**

Paragraph .16 of proposed AS 2405 includes requirements for lead auditors to be the one to obtain written affirmations from other auditors. However, paragraphs .06E and .06I of amended AS 2101, *Audit Planning*,<sup>17</sup> allow for a first other auditor to assist the lead auditor with the procedures (including obtaining affirmations) in paragraph .06D and .06H, respectively. We believe that similar treatment for first other auditors to assist the lead auditor should apply to the procedures in paragraph .16 of proposed AS 2405 in a multi-tiered audit.

**Question 39: Are there additional auditor reporting considerations that should be considered? If so, what are they?**

We believe that paragraph .19c of proposed AS 2405 requires further clarification. The lead-in to paragraph .19 indicates the auditor determines the effect on the audit report as well as the ongoing relationship with the company; however, it is unclear how certain of the following circumstances would influence that relationship, if at all. For example, in paragraph .19c, we do not believe that NOCLAR that has a material effect on the financial statements (.19c(1)), or that results in changes to the auditor's assessment of the effectiveness of internal control over financial reporting (.19c(3)), would affect the ongoing relationship with the company if they were appropriately accounted for and/or disclosed. Additionally, we believe that the combination of proposed paragraph .19b and footnote 25, which references AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, may be confusing as written. We believe the following revisions would clarify the intent of paragraph .19:

- .19 The auditor should determine the effect on the engagement report [footnote excluded] and on the ongoing relationship with the company,[footnote excluded] if the auditor:
- a. Is precluded by the company or the circumstances from identifying noncompliance with laws and regulations, including fraud, that has or may have occurred or from obtaining sufficient appropriate audit evidence to evaluate whether it is likely that noncompliance with laws and regulations, including fraud, occurred;
  - b. Is unable to determine whether the likely noncompliance has a material effect on the financial statements because of limitations imposed by the circumstances rather than by the company or because of uncertainty associated with interpretation of applicable laws or regulations or surrounding facts; or
  - c. Concludes that the likely noncompliance with laws and regulations ~~(4)~~ has a material effect on the financial statements and, ~~(2)~~ has not been properly accounted for or disclosed, and/or ~~(3)~~ results in changes to the auditor's ~~assessment of opinion on the effectiveness of internal control over financial reporting.~~

**Question 46. What steps or procedures do auditors currently take or perform to comply with Section 10A obligations when information related to noncompliance is identified during an interim review?**

If during an interim review the auditor becomes aware of information indicating that fraud or an illegal act has or may have occurred, the auditor is required to respond in accordance with item (b) of Section 10A. Such response is predicated on whether the illegal act has a material effect on the financial statements and whether the Issuer has taken timely and appropriate remedial actions with respect to the illegal act. During an interim review, our required responses under Section 10A are no different than those required when performing an audit.

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<sup>17</sup> See AS 2101: *Audit Planning* (amended for FYE on or after 12/15/2024).

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

We recommend the following revisions to footnote 15A of paragraph .23 of proposed 4105, *Reviews of Interim Financial Information*, for consistency with paragraph .06 of proposed AS 2405 and to further clarify that procedures performed under AS 4105 are considered “other procedures” as contemplated by paragraph .06 of proposed AS 2405:

<sup>15A</sup> AS 2405.06 requires the accountant to use information obtained from other procedures performed that may ~~indicate~~ identify laws and regulations with which noncompliance could reasonably have a material effect on the financial statements or noncompliance with laws and regulations that has or may have occurred. The other procedures described in AS 2405.06 include those performed under ~~the~~ this standard.

**Question 50: Should an interim review requirement be added for the auditor to make specific inquiries regarding the company’s ongoing investigations related to noncompliance with laws and regulations? If so, what should those specific inquiries be?**

We recommend the following clarifying change to paragraph .18c of proposed AS 4105:

Their knowledge of instances, or alleged or suspected instances, of other noncompliance with laws and regulations that could reasonably have a material effect on the interim financial information, including developments related to previously identified instances of noncompliance.

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

While we recognize the difficulty of performing a cost-benefit analysis for such a scenario where the costs and benefits both have such a wide range of possible outcomes, we are concerned that the conclusion that the costs are justified by the benefits may not be supported.

As previously mentioned, we are concerned that changes to auditing standards alone may not drive the outcomes described in the Proposing Release. The conclusion that the benefits would justify the costs appears to be based on the fact that losses from noncompliance total billions of dollars annually, but does not consider what, if any, percentage of those instances of noncompliance would be avoided by following the proposed standard. Additional time needs to be dedicated to this portion of the cost-benefit analysis to assess historical cases of noncompliance and consider what proportion of losses could be expected to be reduced. Additionally, the benefits would only apply to the investors in companies that have instances of noncompliance.

Specifically, we believe the following aspects of the Proposed Amendments will result in substantial increases in cost for the reasons previously articulated:

- The need for auditors to contemplate a complete population of laws and regulations relevant to the entity and to engage multiple legal and regulatory specialists with knowledge in various areas of laws and regulations to comply with the Proposed Amendments.
- Paragraphs .07-.10 of proposed AS 2405 require auditors to perform certain procedures when information is identified that could relate to an instance of noncompliance with laws and regulations, thus representing a significant expansion of scope compared to current requirements that allow for consideration of management’s response. These proposed requirements will likely result in redundant costs incurred by both parties.
- The two proposed amendments to paragraph .11 of AS 2110 transition the performance requirement from “should consider performing” to “should perform” and explicitly include specific “publicly available information” that should be read by auditors, including media reporting and executive officers’ social media accounts. This represents a significant increase in scope.

While we believe these items each will result in a substantial increase in cost, due to the constraints of the limited comment period, we are unable to provide a reliable estimate of these costs for a range of engagements.

**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?**

Assessing whether noncompliance has occurred or may have occurred often requires considerable specialized skills and knowledge in the relevant laws and regulations. Since auditors typically do not possess the core competency of evaluating complex laws and regulations, they would need to engage legal or regulatory specialists. As the evaluation may involve various types of case law and regulations (e.g. banking regulations or FCPA), engaging multiple specialists might be required for reaching a conclusion. Additionally, legal and regulatory specialists may be unable or unwilling to determine if noncompliance has occurred barring a regulatory or judicial determination or ruling. Consequently, significant costs may be incurred only to find that a conclusion cannot be reached. In addition, investigations into potential instances of noncompliance often require the use of forensic and other specialists and given the increase in instances of potential noncompliance the auditor would be evaluating, would likely result in significant incremental costs to the auditors, which would be reflected in increased audit fees.

In addition, specialists hired directly by the auditor may not have access to certain witnesses or information of the Issuer due to the Issuer’s own counsel’s concerns about maintaining attorney-client privilege over their own investigation. This could lead to the unintended consequence of the auditor incurring significant costs in hiring specialists with little actual benefit to the identification of NOCLAR.

**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 have not had sufficient time to develop a comprehensive listing of unintended consequences. However, as mentioned in our responses to Questions 59 and 62, the Proposed Amendments would result in the involvement of a substantial number of legal and other specialist resources. Given potential limitations in sufficient available resources, we foresee a scenario whereby individual audit firms may secure a disproportionate number of specialist resources supporting audits in particular industries, resulting in further concentration of audit firms possessing the capabilities to perform a given entity’s audit. This reduction in market competition for audit services would not benefit investors.

**Question 67: The Board requests comment generally on the alternative approaches described in this release that we considered, but are not proposing. Are any of these approaches, or any other approaches, preferable to the approaches that we are proposing? What reasons support those approaches over the approaches we are proposing? Would any other alternatives better promote investor protection, efficiency, competition, or capital formation?**

Proposal section IV.D.1 *Why Standards Setting is Preferable to Other Policy-Making Approaches* concludes that “guidance alone would not be an adequate approach”. We believe that interpretive guidance issued by the Board could provide meaningful clarity by illustrating the types of recent material errors in US GAAP financial statements that went undetected by the auditor and providing methods to detect such errors under existing PCAOB auditing standards.

Proposal section IV.D.3.iv *Auditor’s Determination of Whether an Act is Illegal* states that consideration was given to the retention of certain existing AS 2405 language. Paragraph .03 of extant AS 2405 contains a fundamental premise that “Whether an act is, in fact, illegal is a determination that is normally beyond the auditor’s professional competence.” No amount of auditor training, support, or resources will

be able to completely fill this void for illegal acts, let alone the full breadth of noncompliance contemplated by this proposal. As such we believe it is appropriate for this or similar language to be retained in any amendments to AS 2405.

**Question 68: The Board requests comment generally on the analysis of the impacts of the proposal on EGCs. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made so that the proposal would be appropriate for audits of EGCs? What impact would the proposal likely have on EGCs, and how would this affect efficiency, competition, and capital formation?**

Auditors have a fundamental responsibility to protect the public interest and as it relates to NOCLAR, we do not believe that there is a difference in public interest concerns based on the status of an entity as an EGC or an established industry participant. We believe that, if the concerns noted in our letter are addressed, then the Proposed Amendments should also apply to audits of EGCs to protect the capital markets.

**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?**

**Question 70: How much time following SEC approval would audit firms need to implement the proposed requirements?**

The Proposed Amendments may result in extreme challenges for auditors, Issuers, and other stakeholders as described in this letter. Firms will need to thoroughly analyze existing relevant guidance, make any necessary updates to methodology, and develop and deploy training in a timely manner to comply with the new rules and positively impact audit quality. For global network firms, the Proposed Amendments will also need to be implemented and deployed consistently across the network. As the proposal would require significant incremental risk assessment and planning procedures, we believe firm guidance would need to be updated and auditors would need to begin applying the updated guidance shortly after issuance of the prior year's audit report.

With these challenges, their resulting uncertainties, and the brevity of the comment period, we are unable to provide a realistic view of the time needed to implement.

Consistent with the Board's strategic plan, the Board has accelerated its standard setting activity, resulting in several proposed new standards. We recommend the Board provide transparency about the expected timing of finalizing the various proposed standards and seek comment on the proposed effective dates. Without such clarity, we have limited ability to assess the aggregated efforts necessary to comply with the collective changes to the auditing standards.