



August 9, 2023

VIA EMAIL

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

Re: PCAOB Rulemaking Docket Matter No. 51: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations

Dear Madam Secretary:

On behalf of the Colorado Public Employees' Retirement Association (Colorado PERA or PERA), thank you for the opportunity to file this public comment regarding the Public Company Accounting Oversight Board's (Board or PCAOB) proposed amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations (NOCLAR). PERA broadly supports the proposal and appreciates the Board taking further steps to improve investor protection. We will take this comment opportunity to highlight areas of the proposal that are particularly beneficial to investors or where we have concerns.

Our comments reflect the fiduciary duty we hold to the members and beneficiaries of Colorado PERA. Colorado PERA is the state's largest public pension plan, managing approximately \$60 billion in assets under the obligation to enhance the retirement security of over 670,000 current and former public employees and their beneficiaries. In fulfilling our fiduciary duty, we prioritize maximizing risk-adjusted returns to the portfolio, while focusing on the long-term financial sustainability of the fund.

We view auditors' oversight role as a critical function of healthy capital markets. This function should be expanded to explicitly cover a Company's Noncompliance with Laws and Regulations ("NOCLAR"), with both direct and indirect impacts on the financial statements. We often speak of the investor's auditing expectation gap, which includes the expectation that auditors are looking to protect investors from all financial misstatements, including those caused by fraud. For most investors, the risk of financial misstatements and NOCLAR far outweigh the costs of audits. Having more professionals proactively looking for NOCLAR would deter and detect more fraud and misconduct, with the clear benefit for individual companies and the capital markets.

We also believe that increasing auditors' knowledge of NOCLAR will increase the effectiveness of their standard financial statement audit procedures. An improved understanding of a business's regulatory framework and compliance programs will better help auditors understand where financial misstatement risk is the greatest. The proposed standard also requires more robust communication about NOCLAR between external auditors, management, internal auditors, and the audit committee, which we believe will help create a unified team working to bring NOCLAR

to light. Expanding auditors' responsibilities will improve their skillsets and knowledge base, leading to significantly improved audit quality and lower levels of fraud and misconduct.

The most critical aspect of this proposed standard is the clarification of auditors' responsibility around financial statement fraud, which will be an essential improvement long desired by the investor community. Reforms are needed to fortify investor trust in the independence and integrity of financial audits, and such reforms are long overdue. We appreciate that these reforms will impose a significant burden on auditors and preparers; however, the scale of the impact is primarily due to the length of time it has taken to modernize the auditing standards. Any further delay in modernization will only make implementing the reforms even more burdensome. However, the Board should consider a reasonable and phased implementation process to allow auditors and preparers time to implement the new standards, especially for smaller firms.

As others have noted, including Board member DesParte, the use of "could reasonably" as the threshold for NOCLAR does seem to be ambiguous and should either be clearly defined in the standard or replaced with the more commonly known standard of "is reasonably likely to".¹ However, no matter how it is stated, we still support that auditors should plan and perform audit procedures to proactively identify potential laws and regulations that could have a material impact on the financial statements and assess and respond to risks of material misstatement of financial statements due to NOCLAR.

We understand some of the concerns raised on the potential impact of escalating audit fees and litigation risk. For most larger firms, audit costs are immaterial. According to IFAC's 2022 Audit Fee Survey, auditing fees as a percentage of revenue for mega-cap stocks were only 0.06% of sales. For the average firm in the Russell 3000 index, the cost rose to 0.38%,² which still compares favorably to the cost of fraud and misconduct.

However, for micro-cap firms, audit costs were a material 0.69% of sales. If a micro-cap stock had 5% net margins, auditing fees could consume over 10% of its profitability, even before the expansion of NOCLAR responsibilities. We believe the Board should explore ways to reduce the cost impact for smaller reporters of expanding the auditor's responsibility to NOCLAR. As for the litigation risk of broadly expanding auditors' responsibility for NOCLAR, we believe the Board should consider providing a safe harbor or lower responsibility threshold for NOCLAR not linked to financial statement fraud.

¹ See Duane M. DesParte, Board Member, Public Accounting Oversight Board, *Statement on Proposal to Amend PCAOB Auditing Standards Related to a Company's Noncompliance with Laws and Regulations and Other Related Amendments*, www.pcaobus.org, June 6, 2023.

² See International Federation of Accountants, "Audit Fees Survey 2022: Understanding Audit Fees and Non-Audit Service Fees 2013-2020" (p.12), www.ifac.org, April 2022.

In closing, we again thank the PCAOB for proposing updates to the Auditing Standards related to a Company's Noncompliance with Laws and Regulations. On behalf of the public employees we serve, we appreciate the Commission's consideration of our perspective as an institutional investor prioritizing our fiduciary responsibilities.

Sincerely,

Amy C. McGarity
Interim Executive Director / Chief Investment Officer
Colorado Public Employees' Retirement Association