

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

Cc: comments@pcaobus.org

From: Richard H. Murray, CEO Liability Dynamics Consulting, LLC

Re: PCAOB Rulemaking Docket 051: Amendments to PCAOB Auditing Standards
Related to a Company's Noncompliance with Laws and Regulations

I submit this Letter of Comment in response to PCAOB Proposal (2023-03) to replace the long standing Illegal Acts regime of the US Securities Laws and to transform auditing from reasonable assurance to a guarantee of financial statement accuracy. I bring to the subject fifty years of senior global positions in and around the auditing profession. In this century I have also been:

- A Member of the US Treasury Department's Advisory Committee on the Audit Profession and Chair of its Concentration and Competition Sub Committee.
- A Member of the PCAOB Standing Advisory Group for two terms (2011-2017).
- The Founding Chair and Chair Emeritus of the Center for Capital Markets Competitiveness.

I urge the PCAOB to withdraw its NOCLAR Proposal to permit meaningful consideration of its terms, to enhance the clarity and transparency of presentation and to demonstrate the need for and feasibility of this capital markets sea change.

THE PROPOSAL IS NOT RIPE FOR CONSIDERATION

The Proposing Release is a dense document, involving numerous and often interactive and complex restatements of standards. *It is a very difficult document to read - the least editorially mature PCAOB Proposal of the last decade. The density of the material inhibits clarity and transparency that is essential to sound regulation.*

Obfuscation may not be the Board's intention. It may instead be a consequence of the speed and the abbreviated procedures by which NOCLAR was conceived and delivered. The concept did not appear in the Standards Agenda or the public comments of Board and staff members

prior to appearance in its final form as a "draft" on March 26, 2023, but was not published until June 6, 2023. The stealth with which the draft was prepared is out of character for a Board that has typically taken years to move its standards projects from inception to presentation.

More curious is the realization that the Proposing Release was not submitted to the Board's Standards and Emerging Issues Advisory Committee (SEIAG) until after the June 6 public announcement. It was discussed briefly at the SEIAG's meeting on June 22. The first presentation to the Investor's Advisory Committee (AIG) occurred on June 7. Moreover, neither advisory body was invited or permitted to study the document in depth or to provide a collective reaction to the Proposal. Bypassing the advisory groups violates the Sarbanes Oxley Act, and the Board's own proud declarations when recreating the advisory groups last year that their active involvement in the development of standards proposals is essential to the Board's regulatory responsibilities. The Proposal process must begin anew and proceed in accordance with the law.

NOCLAR IS INCOMPATIBLE WITH THE FUNDAMENTAL PRINCIPLES OF PCAOB AUDITING STANDARDS

The PCAOB wishes the NOCLAR proposal to be seen as an enhancement to existing standards, to be easily shoehorned into the long established framework of US auditing standards. That is at best misleading, and likely deceitful.

The fundamental elements of auditing standards are enshrined in AS 1015, including:

- 1. "No man, whether skilled or unskilled, undertakes that the task he assumes shall be performed successfully, and without fault of error; he undertakes for good faith and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith or dishonesty, but not for losses consequent upon pure errors of judgment." (AS 1015, Para .03)*
- 2. "The auditor neither assumes that management is dishonest nor assumes unquestionable honesty." (Para .09)*
- 3. "Due professional care allows the auditor to obtain reasonable assurance about whether the financial statements are free of material misrepresentation." (Para .10)*
- 4. "Because of the characteristics of fraud, a properly planned and performed audit may not detect a material misstatement." (Para .12)*
- 5. "...an auditor is not an insurer and his or her report does not constitute a guarantee. Therefore, the subsequent discovery that a material misstatement, whether from error or fraud, exists in the financial statements or a material weakness in internal control over financial reporting exists does not, in and of itself, constitute evidence of failure to obtain*

reasonable assurance...inadequate planning, performance, judgment, OR A FAILURE TO COMPLY WITH THE STANDARDS OF THE PUBLIC COMPANY ACCOUNTING STANDARDS BOARD OF THE UNITED STATES.” (Para. 13, emphasis added)

PCAOB Chair Erica Y Williams describes these as “...the core provisions and responsibilities of an auditor” (“Keynote-Fireside Chat” published July 31, 2023 in the CPA Journal). They have roots in the private sector auditing standards that precede the explosion of financial statement fraud litigation in the 1970s. They were adopted by the predecessor of the Financial Accounting Standards Board as the best available solution to the widening expectation gap between the assurance sought by institutional investors and the assurance possible under an affordable scheme of capital market sustenance. They were adopted by the PCAOB at its inception in 2003 as “interim standards” and were made permanent on July 10, 2023 by PCAOB Release No. 2022-02.

This “reasonable assurance” framework for the scope and depth of auditor responsibilities has served America well for more than fifty years. It enabled the US capital markets to become the largest, the strongest, the deepest and most efficient in the world. It also permitted Big Audit to survive, though barely, the scourge of class action liability litigation and gain the scale and technological competencies essential to twenty first century auditing challenges. These achievements of free market capitalism have served America well through even the most trying times. But that record of success and stability is under threat now from this ill advised sea change in auditing regulation.

The reasonable assurance framework will not survive if NOCLAR is adopted. It sets entirely different fundamental rules:

- 1. The PCAOB clearly intends to hold the audit profession liable for losses consequent upon pure errors of judgment, and wishes to do so with no assessment whatsoever of the potential for adverse consequences to the sustainability of auditing, the preservation of the assurance function or the orderliness and competitiveness of the US capital markets.*
- 2. NOCLAR requires the auditor to assume that any possible act of non-compliance with laws or regulations must be evaluated, and reported to management and the audit committee unless it has been determined to be “clearly inconsequential. Its adoption would convert the audit from a reasonable assurance obligation to a forensic audit designed and performed on the assumption that every management representation must be deemed false or misleading unless the audit evidence demonstrates otherwise.*
- 3. The Proposal would eliminate reasonable assurance as sufficient for the expression of an auditor’s opinion. Instead, an audit opinion could only be appropriately expressed after endless searches that demonstrate nothing is awry. The Board wants to accommodate investor demands for reducing investment risk. That goal is unlikely to benefit the functioning of the capital markets and America’s financial strength. With our*

national credit rating having just been lowered this is not the time to introduce a fundamental and hastily considered change to rile the economy. In any event, this is a major policy change that cannot be imposed without Congressional approval.

4. *The "characteristics of fraud" would remain unchanged by the adoption of NOCLAR. The Board makes no effort to assist the audit profession with these vast new responsibilities. Yet NOCLAR declarers that any undetected fraud or error in the financial statements would, ipso facto, demonstrate that the audit had not been properly planned and performed. The old standards would remain in AS 1015, wholly incapable of being blended into the new rules. Our litigious practices assure that confusion will ensue but will soon be followed by "cancellation" (in the vernacular) of any effect of the pre-NOCLAR concepts.*
5. *The Proposal will have the effect of making the auditor an insurer of the accuracy of the financial statements, and the audit report will constitute a guarantee against investor or third party losses, at least until Big Audit runs dry or elects to become "Big Anything But Audit."*

Beyond these specific rule overrides, NOCLAR changes the atmosphere and expectations surrounding public company auditing practice and regulation for these five decades. The Board declares that auditing standards will continue to be "principles based". But NOCLAR is primarily prescriptive, in provisions and in ambiance. The multitude of "must do's" have no corollary principles of limitation. The Proposal has no hint of a need for safe harbors keyed to the intrinsic limitations of the audit craft. "Due professional care" and "reasonable assurance" will no longer allow for audit actions and judgments to serve as a balancing influence.

It seems highly improbable that the Board is unaware of the indigestible conflict it will create by juxtaposing the NOCLAR strict liability regime with longstanding reasonable assurance model. But the absence of any recognition of problems created speaks loudly of a lack of transparency. The Board may have chosen to accept without comment a regulatory scheme that will be at war with itself, believing that all such matters can be resolved through ongoing staff guidance and the continuing practice of shaping standards through its inspection and enforcement authorities. Whatever the Board's reasons, the Proposal must not be adopted without the full attention of both the SEIAG and the IAG and, hopefully, an extensive public dialogue.

NOCLAR IS INCOMPATIBLE WITH FUNDAMENTAL PRINCIPLES OF US SECURITIES LAWS

The Proposing Release acknowledges that NOCLAR and Sec 10A of the PSLRA do not fit naturally together. The Board clearly wishes to harmonize the incompatibility by modifying Sec. 10A to drop its Illegal Acts foundation in favor of NOCLAR, but is surely aware that the Congressional action required to do this would not be possible in current political conditions.

Consequently, the Proposing Release tries to ignore the problem and let trial attorneys and Judges sort it t at the auditor's expense and the registrant's frustration.

The Board wrestles with this dilemma in discussing its proposed amendments to AS 2405 (PR, Page 91):

"Under exiting AS 2405 an auditor does not ordinarily have sufficient basis for recognizing violations of laws...and regulations" and that "the determination as to whether a particular act is illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.

WE CONSIDERED, BUT ARE NOT PROPOSING RETAINING THIS OR SIMILAR LANGUAGE IN PROPOSED AS 2405. SUCH LANGUAGE FOCUSES ON THE LIMITATIONS OF AN AUDITOR'S SKILL SET AND RESPONSIBILITIES AS OPPOSED TO THE AUDITOR'S AFFIRMATIVE OBLIGATIONS WITH RESPECT TO IDENTIFYING AND EVALUATING A COMPANY'S NONCOMPLIANCE WITH LAWS AND REGULATIONS. (Page 91, emphasis added)

A finer sleight of hand would be hard to find in the regulatory literature. The Proposal offers no hints for how an auditor is to overcome the intrinsic lack "of a sufficient basis" or the need for judicial determinations. Nor is there any protection offered for the ill equipped auditor who must make those judgments anyway. The Proposal merely declares that this is unimportant compared to the "auditor's affirmative obligations" etc - obligations that are treated here as established regulation but are in fact, nothing more than a bootstrap reference to other aspects of the NOCLAR proposed amendments. NOCLAR has not been harmonized with the securities acts. But it has been shoehorned into an unworkable alliance without any apparent consideration of the consequences.

ADDITIONAL OBSERVATIONS

The NOCLAR Proposal would have the reader understand that, as respects auditing, there is little distance between "Illegal Acts" and the totality of "Laws and Regulations". However, the Proposal does not articulate this premise, or contemplate the consequences of doing so. It assumes that there is sufficient congruency to assure that the effect on auditing will be so mild that no meaningful cost study is required. I find those assumptions to be highly suspect, and in any event to require more thoughtful consideration than they have apparently received.

Consider the vast expansion of audit scope. The Federal Government is unable to determine the total number of laws in the US Code, but acknowledges that they would occupy at least 300,000 pages. Regulations with the effect of law are much more numerous, with the latest available data disclosing that for fiscal year 2016 alone 95,894 new Federal regulations were issued. And there are state laws and regulations to

consider. The task would be impossible as respects the obligation of the auditor to evaluate the circumstances and report to the audit committee all matters that are not "clearly insubstantial." But the Proposal goes farther, requiring that all risks of noncompliance including those that are clearly inconsequential be reported to management. This might be a good idea, however daft it seems now. But a great deal of research, explanation, information and cost analysis would be required before it receives serious consideration.

Consider also the damage to our systems of corporate governance. Responsibility for preventing, identifying and disclosing illegal acts has always been a central duty of the registrant. But NOCLAR would transfer that responsibility to the auditor, or at least make the auditor responsible for overseeing the adequacy of a registrant's systems of compliance policies and practices. Putting the auditor thusly in a bunk bed with the audit committee will require extensive renovations of both Federal and state corporate governance schemes. A restatement of the independence rules against auditing ones own work would also be required.

When the assurance function becomes the guarantor of financial statement soundness, the assurance function as we know it will face extinction. The NOCLAR Proposal is not ready for consideration, nor is it suitable for adoption in its present form.

Respectfully submitted,

Rick Murray

A handwritten signature in cursive script, appearing to read "Rick Murray". The signature is written in dark ink and is positioned below the typed name.