

Via Email

August 3, 2023

Ms. Phoebe W. Brown  
Office of Secretary  
Public Company Accounting Oversight Board  
1616 K Street, NW  
Washington, DC 20006-2803

***Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations - And Other Related Amendments (PCAOB Release No. 2023-003, June 6, 2023: PCAOB Rulemaking Docket Matter No. 051).***<sup>1</sup>

Dear Secretary Brown:

The Council of Institutional Investors (CII) appreciates the opportunity to share our views and provide input on the Public Company Accounting Oversight Board's (PCAOB or Board) *Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations - And Other Related Amendments* (PCAOB Release No. 2023-003, June 6, 2023: PCAOB Rulemaking Docket Matter No. 051) (Proposal).<sup>2</sup>

CII is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately \$4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true “Main Street” investors through their pension funds. Our associate members include non-U.S. asset owners with about \$4 trillion in assets, and a range of asset managers with more than \$40 trillion in assets under management.<sup>3</sup>

## CII Policies

As the leading U.S. voice for effective corporate governance and strong shareholder rights, CII believes that accurate and reliable audited financial statements are critical to investors in making

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<sup>1</sup> Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations - And Other Related Amendments, PCAOB Release No. 2023-003 (June 6, 2023), <https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-051/pcaob-release-no.-2023-003---noclar.pdf>.

<sup>2</sup> *Id.*

<sup>3</sup> For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII's website at <http://www.cii.org>.

informed decisions, and vital to the overall well-being of our capital markets.<sup>4</sup> That belief is reflected in the following CII membership-approved policy on the **Independence of Accounting and Auditing Standard Setters**:

Audited financial statements including related disclosures are a critical source of information to institutional investors making investment decisions. The efficiency of global markets—and the well-being of the investors who entrust their financial present and future to those markets—depends, in significant part, on the quality, comparability and reliability of the information provided by audited financial statements and disclosures. The quality, comparability and reliability of that information, in turn, depends directly on the quality of the . . . standards that . . . auditors use in providing assurance that the preparers’ recognition, measurement and disclosures are free of material misstatements or omissions.<sup>5</sup>

This policy on **Independence of Accounting and Auditing Standard Setters** also importantly establishes the principle that “investors are the key customer of audited financial reports and, therefore, the primary role of audited financial reports should be to satisfy in a timely manner investors’ information needs.”<sup>6</sup> Our membership reaffirmed that principle in our policy on **Auditor Independence**.<sup>7</sup> That policy includes the following additional provisions that we believe may be relevant to issues raised by the Proposal:

**Audit Committee Responsibilities Regarding Independent Auditors:** The audit committee should fully exercise its authority to hire, compensate, oversee and, if necessary, terminate the company’s independent auditor. In doing so, the committee should take proactive steps to promote auditor independence and audit quality. Even in the absence of egregious reasons, the committee should consider the appropriateness of periodically changing the auditor, bearing in mind factors that include, but are not limited to:

- ....
- the quality and frequency of communication from the auditor to the audit committee
- ....
- the clarity, utility and insights provided in the auditor’s report and the auditor’s letter to management in relation to the audit
- the level of transparency and robustness of the audit firm with the audit committee and investors, including with respect to audit quality indicators, governance practices and underlying principles, and the financial stability of the audit firm

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<sup>4</sup> CII, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (updated Mar. 1, 2017), [http://www.cii.org/policies\\_other\\_issues#indep\\_acct\\_audit\\_standards](http://www.cii.org/policies_other_issues#indep_acct_audit_standards).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> CII, Policies on Corporate Governance, § 2.13 Auditor Independence (updated Mar. 6, 2023), [https://www.cii.org/corp\\_gov\\_policies](https://www.cii.org/corp_gov_policies).

- enforcement actions (in process or completed), inspection results and fines levied by the Public Company Accounting Oversight Board or other regulators

....

Investors are the “customers” and end users of financial statements and disclosures in the public capital markets. Both the audit committee and the auditor should recognize this principle.<sup>8</sup>

CII also has a long-standing, membership-approved policy on **Financial Gatekeepers**.<sup>9</sup> That policy explicitly identifies auditors as “financial gatekeepers.”<sup>10</sup> The policy indicates that it is imperative that auditors be subject to “[r]obust oversight and [have] genuine accountability to investors. . . .”<sup>11</sup> The policy also states that “[c]ontinued reforms are needed to ensure that the pillars of transparency, independence, oversight and accountability are solidly in place.”<sup>12</sup>

## The Proposal

In CII’s September 2022 letter in response to the Request for Public Comment, *Draft 2022-2026 PCAOB Strategic Plan*,<sup>13</sup> we recommended that the Board prioritize “as requested by [Securities and Exchange Commission] Chair Gensler, the Board’s standard setting project on ‘Interim Standards.’”<sup>14</sup> Our prioritization of the interim standards was based, in part, on our policy on the **Independence of Accounting and Auditing Standard Setters** that reflects the view that auditing standards should be the product of an independent standard setting process that focuses on investors’ information needs.<sup>15</sup>

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<sup>8</sup> § 2.13a Audit Committee Responsibilities Regarding Independent Auditors.

<sup>9</sup> CII, Policies on Other Issues, Financial Gatekeepers (adopted Apr. 13, 2010), [https://www.cii.org/policies\\_other\\_issues#fin\\_gatekeepers](https://www.cii.org/policies_other_issues#fin_gatekeepers).

<sup>10</sup> See *id.* (“Auditors, financial analysts, credit rating agencies and other financial ‘gatekeepers’ play a vital role in ensuring the integrity and stability of the capital markets.”).

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

<sup>13</sup> Request for Comment, Draft 2022-2026 PCAOB Strategic Plan, PCAOB Release No. 2022-003 (Aug. 16, 2022), [https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic\\_plans/2022-003-rfc-draftstrategicplan.pdf?sfvrsn=fde9859a\\_4/%202022-003-RFC-DraftStrategicPlan.pdf](https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/2022-003-rfc-draftstrategicplan.pdf?sfvrsn=fde9859a_4/%202022-003-RFC-DraftStrategicPlan.pdf); PCAOB, Strategic Plan, 2022-2026, Draft for Comment (Aug. 2022), [https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/administration/documents/strategic\\_plans/draft-2022-2026-strategic-plan.pdf?sfvrsn=65f830db\\_4/%20Draft-2022-2026-Strategic-Plan.pdf](https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/draft-2022-2026-strategic-plan.pdf?sfvrsn=65f830db_4/%20Draft-2022-2026-Strategic-Plan.pdf).

<sup>14</sup> Letter from Jeffrey P. Mahoney, General Counsel, CII to Office of the Secretary, PCAOB 5 (Sept. 15, 2022), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2022/September%2015,%202022%20PCAOB%20letter%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2022/September%2015,%202022%20PCAOB%20letter%20(final).pdf).

<sup>15</sup> *Id.* at 4 (referencing our policy on Independence of Accounting and Auditing Standard Setters in support for Securities and Exchange Commission Chair Gary Gensler’s statement regarding the need for the Public Company Accounting Oversight Board to update the “interim standards”).

As described by PCAOB Chair Erica Y. Williams, the Proposal replaces an auditing standard:

[A]dopted by the PCAOB in April 2003 based on a standard issued by the Auditing Standards Board of the American Institute of Certified Public Accountants in 1988.

In the 35 years since 1988, we've seen far too many examples of investors getting hurt due to noncompliance with laws and regulations. We've seen changes in federal securities laws. And we've heard calls from investors for auditors to live up to their responsibilities to ensure financial statements are presented fairly, in all material respects.<sup>[16]</sup>

It's time we answer those calls.<sup>17</sup>

Consistent with our policy on **Financial Gatekeepers**, we agree with Chair Williams that “auditors are gatekeepers in our capital markets, and that they have an important role to play” with respect to company noncompliance with laws and regulations (NOCLAR).<sup>18</sup> We further agree with Chair Williams that the Proposal could strengthen that role by improving how auditors as gatekeepers “identify, evaluate, and communicate” NOCLAR.<sup>19</sup> And by issuing the Proposal, we believe the Board is appropriately continuing to prioritize standard setting that

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<sup>16</sup> See CFA Institute Member Survey Report, Audit Value, Quality, and Priorities 13 (2018), <https://www.cfainstitute.org/en/research/survey-reports/audit-value-quality-priorities-survey-report> (Table 3: identifying “[a]uditor consideration of noncompliance with laws and regulations” as the third highest priority for audit standard-setters); see also How Pervasive Is Corporate Fraud? With Luigi Zingales, Voice of Corp. Governance (May 11, 2023), available at <https://podcasts.apple.com/us/podcast/how-pervasive-is-corporate-fraud-with-luigi-zingales/id1433954314?i=1000612649586> (recommending increasing the responsibility of auditor’s to identify when a fraud exists).

<sup>17</sup> Erica Y. Williams, Chair, PCAOB Open Board Meeting, Statement on Proposed New Standard Regarding Noncompliance with Laws and Regulations (June 6, 2023) (footnotes omitted), [https://pcaobus.org/news-events/speeches/speech-detail/statement-on-proposed-amendments-to-pcaob-auditing-standards-related-to-a-company-s-noncompliance-with-laws-and-regulations-thompson](https://pcaobus.org/news-events/speeches/speech-detail/statement-on-proposed-new-standard-regarding-noncompliance-with-laws-and-regulations#:~:text=The%20proposed%20standard%2C%20AS%202405.noncompliance%20with%20laws%20and%20regulations; see Anthony C. Thompson, Board Member, PCAOB Open Board Meeting, Statement on Proposed Amendments to PCAOB Auditing Standards related to a Company’s Noncompliance with Laws and Regulations (June 6, 2023), <a href=) (“Much has changed since [1988 and] . . . [i]t’s critical our standards change and evolve to remain fit for purpose.”); Kara M. Stein, Board Member, PCAOB Open Board Meeting, A Return to Roots: The Auditor’s Role in Uncovering and Reporting of Illegal Acts (June 6, 2023), <https://pcaobus.org/news-events/speeches/speech-detail/a-return-to-roots-the-auditor-s-role-in-uncovering-and-reporting-illegal-acts> (“The current interim standard was originally drafted in 1977 and last revised in 1988 [and] [i]t does not take fully into account a series of unfortunate events, including the failure of more than 745 financial institutions during the savings and loan crisis; the ‘Numbers Game’ and ‘earnings management’ problems of the 1990s; the seeming prevalence of accounting fraud that included the misdeeds of Enron and WorldCom, and Adelphia and Tyco at the beginning of this century, matched with over 900 corrections or restatements of financial reports; or the collapse and/or rescue of nine major financial institutions in 2007 and 2008, including Lehman Brothers, that sparked a global financial crisis.”).

<sup>18</sup> Erica Williams, Strengthening the Auditor’s Role When It Comes to Companies Breaking Laws and Regulations – Send Us Your Perspective (July 24, 2023) (on file with CII).

<sup>19</sup> See *id.*

benefits investors by replacing the interim standards with higher quality standards consistent with the recommendation in the September letter.<sup>20</sup>

While CII supports the Proposal, we believe the PCAOB should carefully consider potential improvements to the proposed requirements, including with respect to the auditor's responsibilities regarding the company's internal whistleblower program.<sup>21</sup> More specifically, we believe the Board should consider expanding the auditor's responsibilities to include:

- requiring the auditor to obtain an understanding of the audit committee's and management's policies, processes and procedures for the program;
- testing controls to determine if the process operates as it is expected to; and
- reviewing and assessing complaints that are reasonably likely to have a material effect on the financial statements.<sup>22</sup>

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We appreciate the opportunity to provide CII's investor-focused perspective on the Proposal. Please let me know if you have any questions about the content of this letter.

Sincerely,



Jeffrey P. Mahoney  
General Counsel

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<sup>20</sup> See, e.g., Letter from Jeffrey P. Mahoney, General Counsel, CII to Ms. Phoebe W. Brown, Office of Secretary, Public Company Accounting Oversight Board 3 (Feb. 15, 2023), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2023/February%2016%202023%20CII%20PCAOB%20Letter%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2023/February%2016%202023%20CII%20PCAOB%20Letter%20(final).pdf) (“We applaud the Board for issuing the Proposal because it would replace interim standard AS 2310, The Auditor’s Use of Confirmation (AS 2310) [and] [b]y replacing AS 2310, we believe the Proposal would generally be responsive to the recommendation in our September Letter.”).

<sup>21</sup> See PCAOB Release No. 2023-003 at ¶ .26f., A2-7, ¶ .56a.(7), A2-9, ¶ .56b.(4), A2-10.

<sup>22</sup> See generally Paul Munter, Acting Chief Accountant, Statement, The Auditor’s Responsibility for Fraud Detection (Oct. 11, 2022), <https://www.sec.gov/news/statement/munter-statement-fraud-detection-101122> (“For companies listed on an exchange, a whistleblower hotline or other means of anonymously reporting questionable . . . matters is required by the Sarbanes-Oxley Act of 2002 and is another good start; however, has the issuer simply checked the box on the requirement, or does the issuer have a culture that encourages whistleblowers who see something to actually say something? For example, an auditor may want to discuss with the audit committee the nature of the whistleblower hotline’s operation.”).