



Aug. 4, 2023

Erica Y. Williams, Chair, Public Company Accounting Oversight Board
Office of the Secretary
PCAOB
1666 K St. NW
Washington, DC 20006-2803
comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 051

Dear Ms. Williams:

The Accounting & Auditing Steering Committee (the committee) of the Pennsylvania Institute of Certified Public Accountants (PICPA) appreciates the opportunity to provide input on the Public Company Accounting Oversight Board's (PCAOB) Proposed Amendments to PCAOB Auditing Standards Related to a Company's Noncompliance with Laws and Regulations. The PICPA is a professional CPA association of about 20,000 members working to improve the profession and better serve the public interest. Founded in 1897, the PICPA is the second-oldest CPA organization in the United States. Membership includes practitioners in public accounting, education, government, and industry. The committee is composed of practitioners from both regional and small public accounting firms and members serving in financial reporting positions. The committee's comments are included below.

1. Scope of definition of noncompliance – The committee notes that the proposed definition of noncompliance with laws and regulations (NOCLAR) is either impossible to implement or unclear. The committee disagrees with the requirement to identify NOCLAR as it is defined because its definition is overly broad and potentially unlimited in scope. It is unclear how an auditor would determine the parameters of any audit work to be done and the regulatory expectations.
2. Proposed AS 2405.04 a. includes the objective to identify laws and regulations with which noncompliance could reasonably have a material effect on the financial statements. The committee notes that this is extremely broad in scope: companies are subject to thousands of laws and regulations, and noncompliance with any one of them could result in a material financial statement impact. The committee respectfully reminds the PCAOB that auditors are not qualified attorneys, and we believe that it would be unlikely that an attorney would be willing to provide a clear scope for an auditor to meet this objective.
3. Proposed AS 2405.04 c. includes an objective to "Identify whether there are instances of noncompliance with laws and regulations that have or may have occurred." The committee believes that this proposed requirement should be removed. Auditors cannot ensure that they have identified all instances of noncompliance that have, or may have, occurred using the proposed definition of

noncompliance. Any law or regulation has the potential to have a material impact on the financial statements. Therefore, the unlimited scope would be impossible to comply with.

According to a June 1, 2022, report on [nbcchicago.com](https://www.nbcchicago.com), violations of the Illinois Biometric Information Privacy Act resulted in 1.4 million people receiving payments from Facebook as part of a seven-year, \$650 million class action lawsuit. The payments will go to current or former Facebook users in Illinois who uploaded a selfie or were “tagged” in a photograph on Facebook after June 7, 2011. Since this relates to a 2008 change in the privacy law in Illinois, would all auditors since 2008, and prior to any notification of the pending lawsuit, be responsible for predicting this outcome and identifying this NOCLAR? The company still denies claims of wrongdoing and liability.

Due to the litigious business environment, the extensive regulatory environment and the unpredictability of the judicial system, there is no way of providing assurance to investors that there are absolutely no instances of noncompliance with all laws and regulations.

Here’s another example: according to a report on <https://supreme.justia.com>, the recent Supreme Court case *Mallory v. Norfolk Southern Railway Co.* upheld a Pennsylvania law requiring companies registered to do business in the state to litigate in its state courts. The outcome could represent a potential material exposure to liability due to a worker claiming that contaminants used on the job caused an illness. In the event that the plaintiff wins a material judgement against the company, or the company is found to have violated a law, should the CPA firm that audited the company during the period in which the employee was allegedly exposed to a contaminant be found liable for not identifying the noncompliance? The parameters of the auditor’s requirement with respect to noncompliance that may be unknown for long periods of time is not adequately defined in the proposed standard. Accountability for identifying noncompliance with laws and regulations should be placed on the companies and their boards of directors, not the auditors.

Furthermore, laws, rules, and regulations evolve. What constitutes noncompliance is often determined after the fact. It is unclear how an auditor would be in a position to predict future conclusions.

The proposal/discussion also talks about using the work of a specialist to assist with the identification and evaluation of NOCLAR. It is management’s responsibility for maintaining a system of internal control to prevent and detect NOCLAR. We do not believe that any attorney would be willing to indicate that a company didn’t commit any noncompliance. We also do not believe that a company’s legal counsel would be willing to provide a legal letter confirming that the company hasn’t committed any noncompliance, so it is unclear how the PCAOB expects auditors to provide this level of assurance.

Furthermore, discussions throughout the proposal document include inconsistencies in the auditor requirements for considering instances of noncompliance.

- a. The commentary on page 24 indicates that “as with the existing definition of ‘illegal acts,’ the Board intends ‘noncompliance with laws and regulations’ to have a broad meaning and to encompass violations of any law or any regulation having the force of law.

- b. On page 29, the discussion notes that the auditor’s identification of laws and regulations “would not be limited to those laws and regulations identified by management when fulfilling this obligation.”
If the auditor goes beyond management in identifying laws and regulations and discusses these laws with management, is this a nonattest service? Would the CPA be required to obtain a license to practice law to perform this work?
- c. On page 29, the discussion notes that “these laws and regulations would necessarily be relevant to the company or its operations but would not represent every law or regulation to which the company is subject.” The underlined clause is inconsistent with the previous statement in section a. above that the PCAOB intends NOCLAR to have a broad meaning and to encompass violations of any law or any regulation having the force of law.
- d. On page 32, the discussion provides several examples of the auditor’s procedures for certain types of laws and regulations that could reasonably have a material effect on the financial statements (e.g., Foreign Corrupt Practices Act violations, or FCPA). However, those same companies could violate other laws and regulations and end up with large civil fines. As written, the auditor would be responsible for identifying all NOCLAR. FCPA may be directly related to the entity being audited, but applying the definition of NOCLAR would require the auditor to endlessly search for potential noncompliance with all laws and regulations.
- e. On page 30, the commentary notes that “the auditor would be able to identify laws and regulations through obtaining an understanding of the company’s internal controls and management’s processes for preventing and identifying noncompliance with laws and regulations.” This is inconsistent with the comments on page 29 (in section b. above), in which the auditor’s identification of laws and regulations is not limited to those laws and regulations identified by management.
- f. On page 41, the discussion indicates that the threshold for the auditor’s evaluation of NOCLAR is similar to the Section 10A threshold, which is when the firm detects or otherwise becomes aware of information indicating that an illegal act has or may have occurred. The PCOAB threshold is more rigorous as it applies to all NOCLAR, requiring the auditor to identify, rather than simply follow up, when the auditor becomes aware of an illegal act. The committee does not support the PCAOB’s proposed language.
- g. On page 86, the commentary indicates that because the proposed changes to AS 2405 “would require auditors to evaluate all noncompliance that comes to their attention, auditors may retain legal counsel or other specialists, even when doing so is unnecessary,” and “auditors may overreact.” It then concludes with a statement that companies should just use the competitive marketplace to shop for more advantageous fees. This commentary is disingenuous: the requirement indicates that the auditor needs to identify noncompliance and not simply address NOCLAR that comes to their attention. Furthermore, auditors are not attorneys, and attorneys are needed to conclude on instances of NOCLAR. The committee agrees with the two dissenting votes that the proposed requirements are excessive.

The discussion continues to note that the potential increase in legal liability on the audit firms is unknown and would simply force auditors to do more work. The committee notes that the PCAOB is attempting to move the accountability of management and the boards of directors to the audit firm. Auditors are not responsible for a company's internal control system and cannot assume management's responsibility without breaching independence requirements. Management and its board are responsible for identifying, implementing, and operating an effective system of internal controls to prevent and detect NOCLAR. This responsibility cannot be transitioned to the auditor.

4. Auditor Evaluation

- a. Proposed AS 2405.04 d. (and AS 2405.07) indicates, "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)." The committee does not support the requirement to evaluate and communicate instances of noncompliance that are not perceived as material. Further, management is responsible for designing a system of quality control to prevent and deter fraud and noncompliance with laws and regulations. As the identification of the noncompliance is management's responsibility, the requirement for the auditor to perform an evaluation represents a nonattest service that would impair independence. The committee supports having management evaluate noncompliance in accordance with its internal control process and the auditor evaluate the client's considerations.
- b. Obtaining an understanding of the nature and circumstances of noncompliance – AS 2405.08 f. would require the auditor to determine whether similar transactions or events may have occurred. The committee notes that this requirement is superfluous and the use of the term "similar" is unclear.
- c. Determining the potential contingent liability – AS 2410.10 b. would require the auditor to consider the materiality of the likely noncompliance and the effect on the amounts and financial statement disclosures, including potential contingent monetary effects such as fines, penalties, damages, or provisions for allowances or returns. It is not clear how the auditor will obtain this information because, in many cases, amounts are unknown for a considerable period of time and legal counsel may not be able to project an amount or a range with any degree of certainty. It is often unclear whether an instance of noncompliance has occurred because the company may intend to dispute or appeal the conclusion.
- d. AS 2405.14 refers to the audit's evaluation. The committee supports the auditing of the client's evaluation rather than the auditor performing a nonattest service to assist with a management function.

- e. AS 2405.19 requires the auditor to consider the impact on the engagement report in the following instances:
- i. If the auditor 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.

Would the auditor necessarily be aware if they were being precluded from identifying NOCLAR that has or may have occurred? The committee believes that this wording should be revised to take into consideration if the auditor is aware of circumstances in which they are precluded from identifying NOCLAR. Furthermore, the committee does not support any requirement for the auditor to communicate confidential client information.

- ii. If the auditor is unable to determine whether the likely noncompliance has a material effect on the financial statements.

Similar to our comments above, determining the monetary impact of an instance of NOCLAR could take a significant period of time (e.g., years). Therefore, there may be instances in which the monetary impact is unknown. If footnote disclosures are adequate, why would the engagement report need to be modified.

5. Audit Committee Communication – The committee supports the communication of identified noncompliance with laws and regulations to the audit committee as soon as practicable. However, AS 2401.12 footnote 17 interprets this to mean potentially before the completion of the auditor’s evaluation of information indicating that noncompliance has or may have occurred. The committee believes that the auditor should have the right to obtain an understanding of the situation prior to communicating it to the audit committee to avoid unnecessary confusion, time, and expense.
6. AS 2110.11 discusses auditing external data for consistency with the financial statements. The committee does not support expanding the audit requirement to include reviewing the personal social media accounts of a company’s executive officers unless they are social media accounts maintained specifically for the company. The committee recommends that this be clarified.

The discussion on page 37 notes that AS 2110.11 will include a list of sources of public information that would inform the auditor’s assessment of the risk of material misstatement and may provide information that noncompliance has occurred (e.g., “company’s websites, company’s or its executive officers’ social media accounts, media reporting, and analyst report”). “Reading such information may bring to the auditor’s attention to statements made by the company and its executive officers, which may be contradictory to other information obtained by the auditor or within the financial statements,

and may indicate potential risks of material misstatement in the financial statements. Information from these sources may also assist the auditor in identifying and assessing risks of material misstatement related to accounts or disclosures in the financial statements or omitted, incomplete, or inaccurate disclosures.”

While it is appropriate to consider such information in risk assessment, the committee is concerned about the scope creep embedded in the requirement to monitor social media and news reports of the company’s executives. Will the auditors be held accountable for auditing the social media posts by the company and its executives? There have been material sanctions against companies for improper controls over social media posts; by extension this would have to be a potential NOCLAR that could have a material impact on the financial statements. Considering the large size of some entities, monitoring news and social media posts could take significant time and effort. The committee believes that removing the requirement to identify NOCLAR would help mitigate this excessive effort.

7. AS 2401.01 indicates that AS 2405 requires the auditor to plan and perform procedures to identify noncompliance with those laws and regulations, including fraud, that could reasonably have a material effect on the financial statements.

The committee believes that the PCAOB’s proposed changes to the audit standards for a company’s noncompliance with laws and regulations are excessive and could further erode the fragile state of the accounting firm’s pool of professionals. We are available to discuss any of these comments with you at your convenience.

Sincerely,



Rebecca Walck, CPA
Chair, PICPA Accounting and Auditing Steering Committee