

August 4, 2023

Office of the Secretary
PCAOB
1666 K Street, NW
Washington, DC 20006-2803

By e-mail: comments@pcaobus.org

Re: Invitation to Comment— Proposing Release: Amendments to PCAOB Auditing Standards related to a Company’s Noncompliance with Laws and Regulations And Other Related Amendments, (Release No. 2023-003, Docket Matter No. 051)

The New York State Society of Certified Public Accountants (NYSSCPA), representing more than 19,000 CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the above-captioned invitation to comment (ITC).

The NYSSCPA’s Auditing Standards Committee deliberated the exposure draft and prepared the attached comments. If you would like additional discussion with us, please contact James White, Auditing Standards Committee Chair, at 516-747-2000, or Yigal Rechtman, Auditing Standards Committee Vice Chair, at 646-889-1610, or Keith Lazarus, NYSSCPA Staff, at 212-719-8378.

Sincerely,
N Y S S C P A

A handwritten signature in blue ink, appearing to read "Liren Wei".

N Y S S C P A

Liren Wei
President

Attachment



**NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS**

COMMENTS ON

**PROPOSING RELEASE: AMENDMENTS TO PCAOB AUDITING STANDARDS
RELATED TO A COMPANY'S NONCOMPLIANCE WITH LAWS AND
REGULATIONS AND OTHER RELATED AMENDMENTS**

(Release No. 2023-003, Docket Matter No. 051)

August 4, 2023

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New York State Society of Certified Public Accountants

Comments On

Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations And Other Related Amendments, (Release No. 2023-003, Docket Matter No. 051

General Comments

The proposed amendments have some strong points, namely the clarification of the terms “illegal acts” and changing the terminology to “non-compliance with laws and regulations” (heretofore: “NOCLAR”), and incorporating the fraud risk response by the auditor with the NOCLAR requirements. However, there are three major observations in the proposed amendments, making it deficient.

First, the authors of the proposed amendments appear to assume that auditors are *capable* of analyzing legal matters. The proposed amendments are ridden with terms such as “identify” and “evaluate” along with “auditor’s role.” This is a grave error by the rule makers as it appears the focus is on the need of stakeholders for a “gatekeeper” and less focused on the objectives of an audit only to provide a reasonable assurance on the financial statement taken as a whole. **Auditors are not lawyers, nor should they attempt to perform legal analysis.**

Second, the authors of the proposed amendments appear to assume that auditors are *incentivized* in analyzing legal matters and following up on them with procedures. Rather than place such undue pressure and fatal liabilities of financial auditors, the correct forum to make such identification and evaluation should rest with the legal profession, in well-established auditor procedure known as “legal confirmation” and sometimes referred to as a “legal letter.” Such a procedure should require a **legal opinion** by qualified attorneys on the risks of NOCLAR. Leaving legal conclusions that may translate also as legal opinion to financial auditors is simply a false sense of security by the aforementioned stakeholders seeking a gatekeeper.

Third, the evaluation of the implications of NOCLAR on the financial statement is management’s role, and auditors, of course, be attuned to the accuracy of such implications. But the authors of the proposed amendments err in thinking that the *entire implications* of NOCLAR can be evaluated. There should be a **scope limitation** of the abilities of the auditors – even with a reliable legal opinion – to evaluate all the seen, and reasonably foreseeable implications based on a NOCLAR. Such is the nature of fraud and illegal acts; they are not completely understood until they are in hind-sight.

Specific Comments

In this response we elected to address some, but not all of the 56 questions that the authors of the proposed amendments are asking. When not answered, the mostly likely inference is that we agree with the premise underlying the question, and as such we elect not to respond to it whereby focusing directly on the issues that the Proposed Rule have brought to the fore subject to the

General Comments above.

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?

Response: The proposed requirement for auditors as indicated by the question is not sufficiently clear because it appears that the auditors – financial experts by vocation – are now required to perform an evaluation of legal matter and arrive at conclusions thereof. If this is the intention of the authors of the proposed amendments, then this should be stated and there should be some sort of expressed statement to release to auditors by the PCAOB and each of the registered filers that such a legal analysis and legal conclusion cannot become a liability to the auditors because their trade is not one to perform legal services.

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?

Response: Auditors will not reasonably be expected to “identify” a legal liability and will likely not be able to reasonably identify *all* the effects of NOCLAR on the financial statements. This rule should be clarified to explicitly state that not all effects on the financial statements shall be identified in case of a NOCLAR specifically because auditors do not perform legal analysis or arrive at legal conclusions (or opinions thereof).

Question 9: Are there additional procedures that should be required for auditors to perform to identify those laws and regulations applicable to the company with which noncompliance could reasonably have a material effect on the financial statements? If so, describe.

Response: An additional procedure that should be included in all aspects of NOCLAR is the aforementioned legal opinion letter through the well-established legal confirmation process. An auditor should principally rely on such high quality evidence with respect to NOCLAR, and not rely on their own non-legal attempts to perform an identification and evaluation of a trade that is not audit or accounting, namely legal analysis.

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?

Response: The requirement, notwithstanding our response to the issue of legal analysis performed by non-attorneys, is sufficiently clear. However, the use of the word “likely” in connection with the auditor’s evaluation should be revised to read: “reasonably likely.”

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?

Response: The expectation that the auditor could identify *all* the material effects on a financial statement due to a NOCLAR is not reasonable. Auditors are not legal experts, and in the case they do identify a NOCLAR, it should be with the stated caveat that such identification may not be complete or accurate.

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?

Response: The auditors should rely on the highest level of audit evidence available to them which in the matter of NOCLAR should be a **legal opinion** by a qualified attorney. The auditors should place no reliance on their own, non-attorney work, and use such work by the auditors, management, and/or internal auditors only as corroborative evidence, not as the principal procedures that should be undertaken.

Question 14: Are there other procedures that auditors perform today that should be required to assist the auditor in (1) identifying laws and regulations with which noncompliance could reasonably have a material effect on the financial statements, (2) assessing and responding to risks of material misstatement due to noncompliance with those laws and regulations, or (3) identifying information indicating that noncompliance with those laws and regulations has or may have occurred? If so, what are they?

Response: With respect to sub-questions (1) and (3), an auditor could perform the following procedures:

Procedure 1: obtain a law degree or utilize the services of an attorney, which will in turn make them qualified to perform procedures (2), (3), and (4) below.

Procedure (2) *identify* laws and regulation related to NOCLAR, by reading the financial statement and completing a legal analysis, and

Procedure (3) *identify* information indicating that NOCLAR has or may have occurred, by interviewing management and applying the legal analysis performed in Procedure 1.

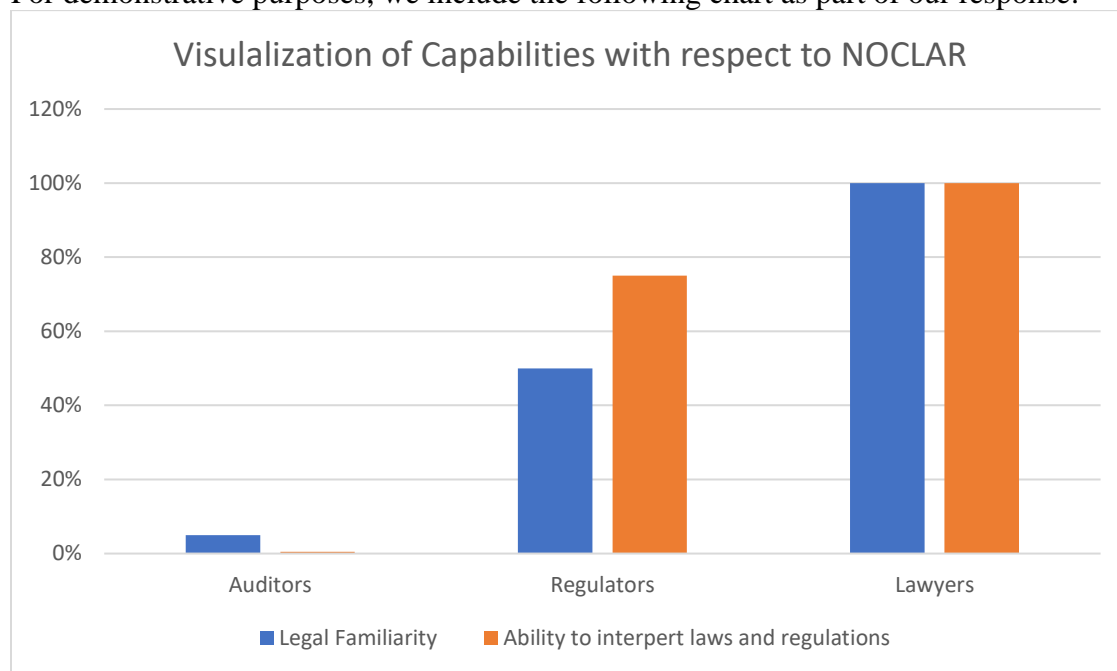
Procedure (4) document the extent in which the person performing the legal analysis complies with the relevant legal profession ethics rules, as would any attorney performing legal services to ascertain that the legal analysis performed in the above results in complete and accurate identification of NOCLAR.

Absence a law degree and legal experience in the relevant NOCLAR topics, the auditors should not be tasked with the requirements to perform legal services without a license, including interpretation of laws and regulations, or legal analysis whatsoever.

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?

Response: The requirement to place reliance on regulations is appropriate and necessary because it could place more, appropriate, reliance on agencies and people who understand the relevant laws and regulations under their respective jurisdiction, while reducing or eliminating, appropriately, the burden from auditors who are not familiar or are experts in the same laws and regulations.

For demonstrative purposes, we include the following chart as part of our response:



We further note that the knowledge of auditors is lay, and general without specific training, experience, or expertise that could be sufficient to address the lofty goals that the proposed amendments are purporting to convey.

Question 21: Are there other examples of the application of procedures that should be included for clarity? If so, please describe those examples.

Response: As discussed above, we reiterate that the common procedure of “legal confirmation” or obtaining a “legal letter” should be applied and heavily, if not solely, relied upon. Such a legal confirmation procedure by the auditor should require, specifically, that an attorney reasonably familiar with the subject company shall provide a **legal opinion** as to any NOCLAR that are reasonably likely to occur.

Any evaluation of such a legal opinion should be evaluated and disclosed along with the limitations of the process, both within the auditor's workpapers, and any communications thereof to other parties.

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

Response: The proposed approach to evaluate instances of NOCLAR is not sufficiently clear because it is unclear to what extent are auditors expected to dabble into laws and regulations, and to what extent are they expected to rely on their general, lay understanding of the law. Is the expectation by the authors of the proposed amendments that auditors, performing interpretative procedures on laws and regulations, be somehow protected from claims that they have performed legal services without a license? That too is unclear from the presumptuous position of the proposed amendments.

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?

Response: While the proposed standard refers to a "likely" NOCLAR and its effect on the financial statement, this question pivots and refers to "potential" NOCLAR. While this may be viewed by some as semantics, we generally view "potential" as a non-zero likelihood, while "likely" is read as at least a 51% chance of occurring. The question itself confuses the issue.

However, beyond the semantics, the answer is that the auditors will not be well situated nor well versed – even after performing procedures of obtaining a general understanding of NOCLAR from public sources – to properly evaluate such purported NOCLAR with the effects on the financial statements. Such an evaluation could lead to a false sense of security by auditors and stakeholders alike because the agency of evaluation of legal matters should not fall to non-attorneys, or in this case, auditors.

Question 27: Are there other procedures that the auditor should be required to perform when evaluating information indicating that noncompliance with laws and regulations has or may have occurred? If so, what are those procedures?

Response: As discussed herein, auditors should obtain a **legal opinion** from the relevant attorneys qualified and familiar with the registered company, and rely substantially, entirely on such a legal opinion.

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?

Response: When evaluation information that may be indicative of a NOCLAR has or may have occurred, the auditor should consider the impact on the audited financial statement, *provided* that such consideration shall be documented as limited in scope and capacity, as well as disclosed within the auditor’s workpapers as well as any communications to other parties that rely or refer to this consideration.

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?

Response: The auditor communications should be expanded to disclose and disclaim the following: (i) that the auditor’s evaluation is done as a lay, non-attorney person; (ii) that the evaluation itself may be limited to the non-attorney’s understanding and ability to interpret the possible NOCLAR; and (iii) that the effect of the NOCLAR may be unreliable as it was performed by a person or team that is not qualified to perform legal evaluations or arrive at conclusions or opinions thereof.

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?

Response: The proposed communication shall commence “as soon as reasonably practicable.” By inserting the word “reasonably,” the presumption shall be sustained that the auditor’s capacity to communicate shall not only be “practicable” by a subjective standard but should be tied to a reasonableness standard. Furthermore, we recommend that any *extension of time for communication* be agreed upon by the auditor and the registered company shall be deemed sufficient to comply with this requirement.

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?

Response: The requirements pose a challenge to auditors because they are asked to identify, evaluate, project, and conclude on the effect of possible, unknown, NOCLAR without having the credentials or capacity to perform such evaluation. The “general understanding” is already present in the audit standards and any attempt to load more responsibility on auditors in performing a job that they are neither qualified nor engaged to perform is a very risky challenge to both auditors and regulators thereof.

Question 38: Are the proposed communication requirements if either the lead auditor or other auditor identifies or otherwise becomes aware of any instances, or alleged or suspected instances,

of fraud or other noncompliance that may be relevant to the audit work being performed sufficiently clear? If not, why not? Should additional communication requirements be considered, and if so, what are the requirements?

Response: In proposing an “affirmation,” the authors of the proposed amendments show that they too struggled with the level of reliance and reliability that can be placed on financial auditors performing legal evaluations of NOCLAR. Because if the auditors were sufficiently reliable for such a performance of a legal evaluation, the proposed amendments should have stated an “opinion” shall be required in communication among auditors, similar to the opinion that is stated when a Service Organization Controls attest engagement is designed to be an auditor-to-auditor communication, among other things.

The watered-down “affirmation” is an attempt to skirt the topic. Instead, if auditors wish to communicate about NOCLAR, they should refer to the work of legal experts, qualified and licensed to do so, in the form of a **legal opinion**, and not some nebulous “general understanding” that the standards appear to promote.

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

Response: The engagement report should include language, that along with any reference to NOCLAR (or even if there are no instances of NOCLAR) shall communicate abundantly clearly that: (i) the identification, evaluation, assessment, and projection of this gathered knowledge on the financial statement, is performed by the **auditors who are not attorneys**; (ii) their work **does not constitute a legal analysis**; (iii) their **conclusions are lay, and not a legal opinion**; and (iv) may be **limited in scope** in terms of arriving at the right conclusions.

Question 41. Should specific requirements be retained related to an auditor's withdrawal or resignation from the audit engagement in circumstances when likely noncompliance with laws and regulations has been identified? If so, which requirements?

Response: The auditor’s withdrawal, if in connection with NOCLAR, should make reference to any legal opinion sought and/or provided. If the legal opinion has been sought but not provided, the auditor should state the scope limitation placed upon the auditors.

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?

Response: The auditor should incorporate a request for a legal opinion as a specific inquiry of the management during the interim review.

Question 56: In addition to the proposed conforming amendments in Appendix 3, are other conforming amendments necessary in connection with the proposed changes to AS 2405 and AS 2110?

Response: Beyond incorporating the proposed comments herein, specifically the (i) objection we state to tasking auditors in performing legal analysis, (ii) understanding that an existing process already exist in the audit process by way of obtaining a legal opinion, and (iii) the significant risk that the auditor’s so-called “evaluation” of NOCLAR will not be complete, the revisions to AS 2110 also dilute the nature of the proposed process to gain an understanding of the laws and regulations by the auditor. Reliance solely on **public records is not an effective process to understand internal compliance, and risks for NOCLAR.** Rather, as we stated in our general comments, it will create a false sense of security, lead to litigation against auditors, and overall reduce the level of confidence in the PCAOB as regulator and the capital markets.

Summary

In sum and substance, these proposed requirements of the auditor to perform legal analysis, evaluate legal matters, and do so by reliance on public sources and management, will most likely create a false sense of security, lead to litigation against auditors, and overall reduce the level of confidence in the PCAOB as regulator and the capital markets.