**NOV Inc.**
10353 Richmond Avenue
Houston, TX 77042
PHONE: 713-375-3700

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

Re: Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations (PCAOB Release No. 2023-003, June 6, 2023; PCAOB Rulemaking Docket Matter No. 051)

Dear Ms. Brown:

NOV appreciates the opportunity to comment on the Public Company Accounting Oversight Board ("PCAOB" or "Board") Exposure Draft on Company's Noncompliance with Laws and Regulations ("Proposal") as part of the Board's agenda to revise PCAOB Auditing Standards ("AS").

NOV is a leading independent equipment and technology provider to the global energy industry. Founded in 1862, NOV serves major-diversified, national, and independent service companies, contractors, and energy producers in 62 countries, operating under three segments: Wellbore Technologies, Completion & Production Solutions, and Rig Technologies. NOV offers a broad array of products and services around the world and is subject to the laws and regulations of the many jurisdictions in which it operates.

Given our international footprint with employees, facilities and operations throughout the world, NOV fully understands the complexity of compliance with the laws and regulations promulgated and enforced in these jurisdictions. Without adequate justification or legal authority, the Proposal creates a broad unworkable and unwieldy audit standard that would radically change the role of auditors and the way in which audits are performed. It would also materially increase the cost of audits, compromise the attorney-client privilege, and undermine investor interests. For these reasons, we request the PCAOB withdraw the Proposal.

**<u>Absence of adequate justification or legal authority</u>**

The Proposal describes "Reasons for the Proposal" on page 17. First, the Proposal explains that current AS 2405 (originally "AU Section 317, Illegal Acts by Clients, ("AU 317")) was enacted in 2003 but was based on a standard issued in 1988. The Proposal observes that the Sarbanes Oxley Act (Sarbanes Oxley), which passed in 2002 (14 years after AU Section 317) requires "(i) audit committees to establish procedures for the receipt of complaints about accounting, internal control and auditing matters, and (ii) issuers to assess, and auditors to attest to, internal control over financial reporting." *See* Proposal at 18 (footnotes omitted). The Proposal states that companies have developed "more sophisticated ethics and compliance systems, of which auditors are required to obtain some understanding under PCAOB standards." *Id.* (footnote omitted). The Proposal then notes that the Department of Justice and SEC have adopted policies incorporating these systems into their decisions about whether and how to pursue organizational wrongdoing, particularly regarding the FCPA. All these existing practices under existing standards are then offered as a justification for the Proposal "to assist auditors in detecting noncompliance with laws and regulations by incorporating these developments in corporate governance into the Board's standards." Id.

This rationale provides no real basis for the Proposal. The PCAOB does not need to amend its standards to adopt Sarbanes Oxley, an existing law, or to prescribe well-established practices, which Boards and auditors have generally adopted and applied for two decades (because Sarbanes Oxley requires them to do so). The PCAOB Proposal will go far beyond synching auditing standards with existing laws. Rather, it will break new ground by radically changing existing practices.

The Proposal offers little substance to explain the basis to support the sweeping changes suggested therein. Specifically, the Proposal notes that: (i) certain groups have "recommended that the Board take on a project related to noncompliance with laws and regulations," ("NOCLAR") (ii) the Board believes that "auditors have disincentives that may keep them from playing a significant role with respect to identifying companies' noncompliance with laws and regulations" and (iii) "within and among firms there are disparate practices when considering noncompliance with laws and regulations in their audits." Proposal at 18-19. Taken individually or collectively, these concerns do not justify the vast changes contained in the Proposal. For example, the Proposal does not really address "disparate practices" in how individuals within firms are addressing this area. The appropriate mechanism to address Board concerns of "disparate practices" is for the Board to share with underperforming individuals or firms the nature and content of any shortcomings in their work, rather than change the audit standards in a sweeping fundamental way. Nor does the fact that groups have recommended "change," without more specific objections, make the Proposal a good or prudent undertaking. In fact, the Board offers virtually no justification for the drastic changes to existing practices contained in the Proposal.

**<u>Change in Auditor Role</u>.**

The Proposal would require auditors to take on new roles that are not fairly within the scope of GAAP or typical auditing practices. AS 2405.03 states: "Whether an act is, in fact, illegal is a determination that is normally beyond the auditor's professional competence." As AS 2405 expressly acknowledges, auditors have no specialized knowledge or training to evaluate laws and regulations. Of course, auditors should not engage in the unlicensed practice of law. Yet, the Proposal is likely to lead to a dramatic change to the composition of audit teams, i.e., the addition of vast numbers of lawyers. Afterall, the sufficiency of the audit team's work will be subject to hindsight review by a litigious Plaintiff's bar seeking new deep pocket defendants in the face of any adverse developments. Would Boeing's auditors be subject to liability for not identifying the risks in the 737 MAX? Would Bluebell's auditors be subject to liability for not identifying the risk of listeria contamination in its food processing facilities? Will the risk of *Caremark* liability becoming auditor liability result in unreasonable audit team responses to mitigate all risk?

Currently, AS 2405 distinguishes "illegal acts" with a "direct and material effect on the determination of financial statement amounts," *see* AS 2405.05, from "illegal acts" that "relate more to an entity's operating aspects than to its financial and accounting aspects, and their financial statement effect is indirect." *See* AS 2405.06. The Proposal abandons the "Direct" vs "Indirect" distinction and takes the view that a proper audit should seek to detect non-compliance with laws, apart from probable material impact on financial statements. This substantial expansion of what is expected of auditors will result in an extraordinary scope for future audits. As a result, the Proposal would require auditors to develop subject matter expertise in all areas of laws and regulation (or add lawyers or other subject matter experts to the audit team) and then apply the laws and regulations to the particular facts of a given company's operations "to assess the risks of material misstatements arising from a company's non-compliance with laws and regulations." Proposal at 21.

The Proposal would also require auditors to evaluate compliance regarding virtually every aspect of the company's day-to day business operations. **The Proposal does not articulate any limits on which laws and regulations are subject to audit**, such as customs, trade, anti-corruption, environmental, product liability, occupational safety, health, agency, securities, intellectual property, landlord/-tenant, tax, insurance, privacy, cybersecurity, antitrust, and many other areas.

**<u>Unwieldy and Unworkable Standard</u>**

The Proposal would establish requirements for the auditor to (i) plan and perform procedures to identify the laws and regulations with which noncompliance **could reasonably have a material effect** on the financial statements (ii) assess and respond to risks of material misstatement of the financial statements due to noncompliance with those laws and regulations, and (iii) identify whether there is information indicating that noncompliance with those laws and regulations **may have occurred**. The Proposal would also establish requirements for the subsequent evaluation and communication of instances on noncompliance with laws and regulations that have or **may have occurred**—**regardless of whether the effect of noncompliance is perceived to be material to the financial statements**—when the auditor identifies or otherwise becomes aware of information indicating noncompliance with laws and regulations.

Proposal at 20-21. The breadth of work needed to analyze these areas when applied to the operations of a company of any size will be staggering.

Further complicating the workability of this standard, the Proposal also leaves undefined what is meant by "could reasonably have a material effect on the financial statements." Instead, the Proposal glosses over the subjective legal judgment inherent to an analysis of laws and regulations as applied to a particular fact pattern, not to mention the difficulties posed in assessing enforcement practices, application of conflicting precedents, conflict of laws, and myriad other legal issues that are germane to a proper determination of whether noncompliance with laws or regulations "could reasonably" exist in particular circumstances. The Proposal also ignores the difficulty in making these determinations that are often very fact specific when the auditor does not have the day-to-day on the ground factual knowledge available to the company. Does the PCAOB anticipate that issuers will share the results of privileged interviews and lawyer work product with auditors who seek to assess NOCLAR? How will auditors seek to conduct their own fact-finding missions to assess the existence of noncompliance? It is one thing to have auditors act within their sphere of expertise and evaluate financial data and legal claims or fraud within the existing balanced framework for reporting and performing an audit of a company. It is quite another to attempt to have auditors act outside of their area of expertise and make what are unquestionably legal judgments without sufficient legal expertise regarding legal issues that may have non-material financial statement impacts. Moreover, the Proposal provides no clear framework for how auditors should carry out this function given the vast number of laws and regulations relevant to every day operations and, again, ignores that these difficulties are magnified many times over because of the ever evolving regulatory landscape.

As if this were not problem enough, the Proposal's statement that auditor's plans and procedures apply "whether [or not] the effect of noncompliance is perceived to be material to the financial statements" appears to require auditors to plan and perform procedures to address risks of noncompliance for immaterial risks. This would change the role of auditors and ignore well settled concepts of materiality established by the Supreme Court. *See TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976). . *See also* Statement on the Proposal by Board Member Duane M. Des Parte, June 6, 2023 ("This wording suggests the auditor would be expected and held accountable to identify any and all information that might indicate instances of noncompliance of any law or regulation across the company's operations, without regard to materiality.")..

**<u>Compromise of the Attorney-Client Privilege</u>**

In the United States, the attorney-client privilege is a bed rock principle designed to promote compliance with laws. Under the protection of the attorney client privilege, clients can seek legal advice to assure compliance with laws and regulations without fear or concern that seeking advice will adversely affect them. The Proposal does not offer any explanation of how the vastly expanded role of auditor assessment of compliance with all laws and regulations can be accommodated without the risk of loss of attorney-client privilege.

Companies with robust compliance programs often employ attorneys, or rely on outside attorneys, to assist in developing policies, investigating potential non-compliance, and formulating remedial measures where required. Requiring auditors to review and potentially second-guess this legal work may require companies to choose between divulging the substance of this advice and privileged attorney-client communications or facing adverse consequences with their auditors. Under the Proposal, companies could effectively be stripped of their ability to obtain confidential legal advice and engage in protected communications with legal counsel. The net effect may be to chill rather than promote compliance-related legal work. Once employees realize that they cannot obtain privileged legal advice, behavior that may not be compliant will be "driven below ground" exposing investors to more risk with no real benefit in return. If the goal is to encourage and promote compliance, invading the attorney-client privilege and impeding frank and open communications between attorneys and their clients is unquestionably counterproductive to that goal.

**<u>Increased Cost Contrary to Investor Interests</u>**

NOV's legal department and Compliance group have dozens of lawyers and non-lawyer personnel functioning daily to promote compliance with laws and regulations. NOV's business units have hundreds of personnel working every day to promote compliance with laws and regulations in myriad circumstances throughout the world. The costs of compliance are substantial. The costs of auditing compliance with laws and regulations and the costs of responding to auditors for the new standard in the Proposal would be material. Requiring auditors to effectively review this work and re-assess risk and re-evaluate the myriad day-to-day judgments made by lawyers and other compliance personnel already endeavoring to assure compliance with laws will add substantial costs for investors, but no material benefit.

**Conclusion**

In summary, NOV urges the PCAOB to withdraw the Proposal. As drafted, the Proposal is a substantial departure from the traditional function of auditors and would result in substantial negative consequences for investors.

NOV, Inc

Craig L. Weinstock

Craig L. Weinstock
Senior Vice President
And General Counsel