

MEMO# 35376

July 13, 2023

PCAOB Proposes to Increase Auditor Responsibility Against Fraud and Other Forms of Legal and Regulatory Noncompliance; Member Call Scheduled for Friday, July 21st at 11 am ET

[35376]

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TO: Accounting/Treasurers Committee

SEC Rules Committee

Tax Committee SUBJECTS: Audit and Attest

Audit Committees

Compliance

Fund Accounting & Financial Reporting RE: PCAOB Proposes to Increase Auditor Responsibility Against Fraud and Other Forms of Legal and Regulatory Noncompliance; Member Call Scheduled for Friday, July 21st at 11 am ET

The Public Company Accounting Oversight Board (PCAOB) recently issued a proposal for public comment^[1], which would amend auditing standard AS 2405 pertaining to an auditor's responsibility in assessing a company's noncompliance with laws and regulations, including instances of fraud. While not explicitly stated in the release, we understand audits of registered investment companies would be included.

The proposal attempts to enhance and bolster an auditor's responsibilities in three principal areas:

- **Identification** – The proposal requires an auditor to actively identify, through inquiries and other prescribed procedures, all applicable laws and regulations that could reasonably have a material impact on the company's financial statements if not adhered to. This proposed standard goes further than the current standard which mirrors in substantial part Section 10A of the Securities Exchange Act of 1934, which requires the auditor to perform "procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts."^[2] Furthermore, the proposal explicitly recognizes financial statement fraud as a form of noncompliance with laws and

regulations.

- **Evaluation** – The proposal reinforces requirements regarding the auditor's evaluation of whether noncompliance with laws and regulations has transpired, and if so, the potential ramifications on the financial statements and other aspects of the audit. For instance, the proposed standard necessitates the auditor to consider whether specialized expertise or knowledge is required to assist in evaluating indications of actual or potential noncompliance and the effect on the financial statements for those matters that are likely noncompliance.
- **Communication** – The proposal clarifies that the auditor is obligated to promptly communicate to the appropriate management level and the audit committee once they become aware of instances or potential instances of noncompliance with laws or regulations. Additionally, the proposal introduces a new mandate requiring the auditor to communicate to management and the audit committee the outcomes of the auditor's evaluation of such information. Specifically, this communication should address the likely instances of noncompliance and their impact on the financial statements.

The deadline for submitting comments on the proposal is August 7, 2023.

ICI has set up a member call on Friday, July 21st at 11 am (ET) to discuss the impact of the proposal on funds, both as investors of companies whose financial statements may be impacted and as issuers with financial statements that may be impacted. and whether ICI should comment on the proposal. Please contact magen.rauch@ici.org to register for the call.

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Notes

[1] Proposing Release: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations, PCAOB Release No. 2023-003, available at https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket-051/pcaob-release-no.-2023-003---noclar.pdf?sfvrsn=fe43e8a_2.

[2] See 15 U.S.C. § 78j-1(a)(1) (emphasis added).