

# SEC Reporting & Compliance Alert

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## Comments Raise Concerns About PCAOB's Proposal To Expand the Scope of Audits and the Role of Auditors

In June 2023, the Public Company Accounting Oversight Board (PCAOB) sweeping proposed amendments to its auditing standards. Comment letters raise serious questions about the consequences of the proposed changes.

If adopted, the amended standards would significantly expand the scope of audits and the role of auditors. The proposed amendments would, among other things, require auditors to:

- Identify laws and regulations with which noncompliance could reasonably have a material effect on the company's financial statements.
- Assess and respond to risks of material misstatements arising from noncompliance with laws and regulations.
- Identify whether there is information indicating noncompliance has, or may have, occurred.
- If the auditor becomes aware of information indicating that noncompliance with laws and regulations has, or may have, occurred, evaluate and communicate those matters to the company's senior management and audit committee.

## Common Concerns Regarding the Proposal

Nearly 140 comments were received, including some after the August 7, 2023, deadline, and the proposals have proven controversial. A number of accounting firms,<sup>1</sup> public companies, professional membership associations and other key stakeholders raised concerns.

In addition, in a rare occurrence, PCAOB board members Christina Ho and Duane DesParte — the only two certified public accountants on the board — issued public dissents when the PCAOB issued the proposal.<sup>2</sup>

Following is a summary of the key areas of comment.

<sup>1</sup> See e.g., comment letters submitted by Deloitte & Touche LLP, Ernst & Young LLP, Grant Thornton LLP, KPMG LLP and PricewaterhouseCoopers LLP.

<sup>2</sup> Statement on Proposal to Amend PCAOB Auditing Standards Related to a Company's Noncompliance With Laws and Regulations and Other Related Amendments by Duane M. DesParte (June 6, 2023) (Board Member DesParte's Statement); and Statement on Proposed Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations by Christina Ho (June 6, 2023) (Board Member Ho's Statement).

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## Expanding the Role of Auditors in this Manner Would Require Them to Undertake Analyses and Make Judgments Requiring Expertise Outside Their Core Competencies

According to the dissenting PCAOB board members, the proposed standards “contain a breathtaking expansion of the auditors’ responsibilities,”<sup>3</sup> and would “require legal acumen and expertise well beyond the auditor’s core competency.”<sup>4</sup> In fact, the PCAOB recognized in the proposing release that an auditor may determine that “specialized skill or knowledge outside of accounting and auditing” is needed to assist the auditor in evaluating potential noncompliance with applicable laws and regulations.<sup>5</sup>

The same concern was expressed in several comment letters, including one submitted by The Center for Audit Quality, which notes that carrying out the responsibilities proposed by the PCAOB “would require a deep level of legal and regulatory subject matter expertise and interpretation, which does not fall within the core competencies of financial statement auditors.”<sup>6</sup>

## The Proposal Would Substantially Increase Audit Costs Without Any Basis To Evaluate Whether the Changes Would Provide Commensurate Benefits

The PCAOB recognized in the proposing release that the amendments “would result in additional, potentially substantial costs to auditors and the companies they audit,”<sup>7</sup> but the board did not attempt to quantify the additional costs. Given the lack of quantitative data, many comment letters argued that the PCAOB’s economic analysis is inadequate and does not provide a meaningful basis for assessing the costs and benefits of the proposal.<sup>8</sup>

Some comment letters indicated that the additional costs would be significant. For example, the U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, noted in its comment letter that the proposal would “impose additional audit costs on issuers by an estimated \$36 billion dollars, far exceeding Sarbanes-Oxley 404(b) implementation,”<sup>9</sup> and The Society for Corporate Governance (Society) similarly stated in its comment letter that “the costs of the [p]roposal are likely to far exceed the costs of implementing Section 404.”<sup>10</sup>

KPMG LLP confirmed in its comment letter that, “given the vast scope of the [p]roposed [a]mendments and the expensive pool of

professional specialist resources necessary to comply with them, our costs and fees will be significantly higher if the [p]roposed [a]mendments are adopted in final form.”<sup>11</sup>

## Requests From Auditors Mandated by the Proposed Rules Could Compromise the Attorney-Client Privilege

Many commenters expressed concerns that the expanded audit scope would lead auditors to request information from clients that is subject to the attorney-client privilege, and that the disclosure of that information could constitute a waiver of the privilege in certain jurisdictions. For example, the U.S. Chamber of Commerce stated that “the [p]roposal would potentially require information to be provided to auditors in such a way to violate attorney-client privilege protections, thus opening the company to additional wide-ranging litigation and discovery risks.”<sup>12</sup>

Similarly, the Society explained in its letter that the auditor would include in its workpapers potentially privileged information shared by the client, which would be exposed to discovery through requests for audit work papers.<sup>13</sup>

Several commenters expressed concern that the destruction of privilege in this manner could undermine the purpose of the proposal by chilling open communications between companies and their legal counsel, including those involving legal advice on compliance.<sup>14</sup> This waiver of privilege also could result in increased litigation costs and harm shareholder value.<sup>15</sup>

## Next Steps

Any final rule changes based on the proposal will require approval by the PCAOB, which has not stated publicly the status of the proposal or the timing of any further action.<sup>16</sup> It remains unclear, therefore, whether or when the PCAOB might proceed with any final rule amendments. Based on the strong, negative feedback included in the comment letters, however, we anticipate that the PCAOB will proceed slowly and cautiously with the proposal.

Furthermore, certain comment letters contended that the PCAOB may lack statutory authority to expand auditors’ responsibilities to include evaluating potential noncompliance with laws and regulations. Accordingly, if adopted as proposed, the new standards could face legal challenges, which, at a minimum, could delay implementation. Whether the proposal would survive such legal challenges remains to be seen.

<sup>3</sup> See Board Member DesParte’s Statement.

<sup>4</sup> See Board Member Ho’s Statement.

<sup>5</sup> See the Proposing Release at page A1-4.

<sup>6</sup> See the Center for Audit Quality Comment Letter at page 5.

<sup>7</sup> See the Proposing Release at page 76.

<sup>8</sup> See *e.g.*, U.S. Chamber of Commerce, Center for Capital Markets Competitiveness’ Comment Letter at page 13.

<sup>9</sup> See the U.S. Chamber of Commerce, Center for Capital Markets Competitiveness’ Comment Letter at page 1.

<sup>10</sup> See the Society’s Comment Letter at page 7.

<sup>11</sup> See KPMG LLP’s Comment Letter at page 4.

<sup>12</sup> See the U.S. Chamber of Commerce’s Comment Letter at page 2.

<sup>13</sup> See the Society’s Comment Letter at page 11.

<sup>14</sup> See *e.g.*, Fortive Corporation’s Comment Letter at page 3.

<sup>15</sup> See *e.g.*, the Society’s Comment Letter at page 11.

<sup>16</sup> The PCAOB’s Short-Term Standard-Setting Projects agenda does not indicate when the PCAOB will take further action on the proposal.

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