Statement of Erica Y. Williams
Chair
Public Company Accounting Oversight Board

at a Hearing on

Examining the Agenda of Regulators, SROs, and Standards-Setters for Accounting, Auditing

Before the

United States House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets

2128 Rayburn House Office Building
December 12, 2023

Chairman Wagner, Ranking Member Sherman, Chairman McHenry, Ranking Member Waters, and Members of the Subcommittee:

I am grateful to have the opportunity to appear before you today as Chair of the Public Company Accounting Oversight Board (PCAOB or "Board") and discuss our shared commitment to protecting investors in U.S. markets.

I am obligated to note that I am testifying today on behalf of myself as Chair of the PCAOB and my comments do not necessarily reflect the views of other Board Members or PCAOB staff.

HISTORIC ACCESS IN CHINA

I want to start by thanking you for your commitment to holding China accountable.

Because of the leadership of the U.S. Congress in passing the Holding Foreign Companies Accountable Act (HFCAA), last year, the PCAOB secured complete access to inspect and investigate registered public accounting firms in China for the first time in history.

As a direct result of that access, on November 30, 2023, the PCAOB announced historic enforcement actions against three China-based audit firms and four individuals.

These sanctions, totaling $7.9 million, represent the highest civil money penalties the Board has ever imposed against firms in mainland China and Hong Kong, some of the highest penalties the Board has imposed against any firm around the globe, and the first time ever that the PCAOB has been able to bring an enforcement action against a mainland China firm based on its audit deficiencies.

The days of China-based firms evading accountability are over. The PCAOB is demonstrating that we will take action to protect investors in U.S. markets and impose tough sanctions against anyone who violates PCAOB rules and standards, no matter where they are located.

The first two orders against Chinese or Hong Kong firms include $4 million in penalties against PwC Hong Kong, which we inspected last year, and $3 million in penalties against PwC China, for a total of $7 million.

Before this action, the highest penalty imposed against a China-based firm was $50,000. This $4 million fine matches the second-highest penalty amount for any firm in PCAOB history, and the $3 million fine matches the third-highest amount.

The two PwC global network firms violated the integrity and personnel management elements of the PCAOB quality control standards by failing to detect or prevent extensive, improper answer sharing on tests for mandatory internal training courses.

From 2018 until 2020, over 1,000 individuals from PwC Hong Kong and hundreds of individuals from PwC China engaged in improper answer sharing – by either providing or receiving access to answers through two unauthorized software applications.

In addition to the financial penalties, both firms are required to take steps to prevent such violations from happening again and to report their compliance to the PCAOB so we can ensure investors are better protected.

The third order imposes $940,000 in fines against mainland-China based firm Shandong Haoxin and four of its auditors for falsifying an audit report, failing to maintain independence from their issuer client, and improperly adopting the work of another accounting firm as their own.

In early 2019, the firm violated the anti-fraud provisions of U.S. securities laws and independence rules in the audits of a China-based data analysis software company, Gridsum Holding, Inc.

Before even being engaged as Gridsum's external auditor, the firm told the company that it was prepared to issue a clean audit opinion on three years' worth of the company's financial statements.

Having received that commitment, Gridsum promptly dismissed its then current auditor and hired Haoxin. A day later, relying primarily on the prior auditor's draft work papers and performing little work of its own, Haoxin issued its clean audit opinion.

This egregious audit failure is unacceptable. To protect investors in U.S. markets, the order prohibits the firm from accepting new clients and bars four of its auditors from participating in U.S. issuer and registered broker-dealer audits.

The order also requires the firm to retain an independent monitor at its own expense to improve practices and ensure compliance – a first for any China-based firm and only the second time the PCAOB has required any firm that is not part of a global network to retain an independent monitor.

Together, these strong enforcement orders show the PCAOB will use every tool we have to hold China-based firms accountable and protect investors by deterring wrongdoing.

Our inspections team has completed fieldwork for 2023, with the complete access required under the HFCAA. And they are already making plans to begin our 2024 inspections early next year.

Together, the firms we inspected in 2022 and 2023 audited 99% of the total market cap of U.S.-listed companies audited by Hong Kong and mainland China firms, and we are on track to inspect firms that audited 100% of the total market cap by the end of 2024.

Under our current schedule, our teams will complete a full three-year cycle of inspections in just 27 months.

Separately, our enforcement team will continue to take action to protect investors.

Our inspectors and investigators are tough. They are thorough, and they demand the complete access the HFCAA requires without loopholes or exceptions.

As we conduct our work, we test that access constantly. Should authorities in the People's Republic of China obstruct the PCAOB's access – in any way and at any point – the Board will act immediately to consider the need to issue a new determination.

As long as our access remains complete, we will utilize it to the fullest in service of investors.

Investors in U.S. markets are more protected today because of Congress' leadership. Thank you for your support of our ongoing efforts to hold China-based audit firms accountable.

PCAOB'S MISSION AND GOALS

The PCAOB's mission is to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports.

We have three key tools to accomplish that mission: standards, inspections, and enforcement.

Modernizing Our Standards and Rules

When the PCAOB was first getting off the ground in 2003, it adopted existing standards that had been set by the auditing profession on what was intended to be an interim basis. Unfortunately, far too many of them have not been significantly updated in at least 20 years.

Our capital markets don't stand still. They evolve constantly. Practices change. Technology advances relentlessly. And new risks emerge.

To keep investors protected, our standards must keep up – which is why we are working to advance an ambitious agenda to modernize PCAOB standards and rules.

All but two of the standards covered under the PCAOB's current standard-setting agenda are among those 'interim standards,' which have not been significantly updated in 20 years. The other two, which are part of the proposal on data and technology, have not been significantly updated in more than 10 years.

Since I was sworn in as Chair nearly two years ago, the PCAOB has issued five standard-setting proposals and one rulemaking proposal and adopted two new standards and related amendments.

Adoptions

In 2022, the Board finalized a new standard and related amendments that strengthen requirements that apply to audits involving multiple audit firms by improving the lead auditor's supervision of other auditors' work and ensuring that sufficient appropriate evidence is obtained to support the lead auditor's opinion in the audit report.

In September 2023, the Board adopted a new standard and related amendments on auditors' use of confirmation, a process which touches nearly every audit. The new standard will help auditors detect fraud and better protect investors now and into the future.

Proposals

In 2022, the Board proposed a new quality control standard. I called it a watershed moment for the PCAOB, because firms' quality control systems lay the very foundation for how they approach audits.

This spring, we issued proposed changes to modernize and consolidate a suite of standards that address core auditing principles and responsibilities, including reasonable assurance, professional judgment, due professional care, and professional skepticism – known as AS 1000. Proposed AS 1000 provides a better-organized presentation with relevant language that is more consistent with other PCAOB standards.

As part of our AS 1000 proposal, we also proposed related amendments to other standards. For example, some of the amendments clarify the extent of the planning, supervisory, review, and documentation activities to be performed by the engagement partner as part of exercising due professional care. Other amendments would reduce the maximum period of time to assemble a complete and final set of audit documentation from 45 days to 14 days. Such proposed changes recognize advancements in the preparation of electronic audit documentation as the 45-day requirement was established in the early days of the PCAOB.

After 20 years of experience inspecting against the standards covered under the AS 1000 proposal, it is clear improvements could facilitate better investor protection.

This summer, we proposed amendments to give auditors additional direction addressing specific aspects of designing and performing audit procedures that involve technology-assisted analysis of information in electronic form.

We also proposed a new standard on noncompliance with laws and regulations, or NOCLAR. When auditors fail to identify noncompliance with laws and regulations that have a material impact on a company's financial statements – or fail to take the proper steps to evaluate and communicate that noncompliance – investors pay the price.

Unfortunately, the current standard is 35 years old, and we have seen far too many examples of investors getting hurt due to noncompliance with laws and regulations since it was adopted.

Well-publicized issues relating to Wells Fargo offer just one example. Earlier this year, Wells Fargo agreed to pay $1 billion to settle a class-action lawsuit from investors alleging it made misleading statements about compliance with consent orders imposed by federal regulators. A lawyer for those investors underscored just who gets hurt when these incidents happen: "state employees, nurses, teachers, police, firefighters and others – whose critical retirement savings were impacted by Wells Fargo's fraudulent business practices."

When these kinds of incidents happen, the question almost inevitably follows, "where was the auditor?" In fact, our PCAOB advisory groups, made up of investors and other stakeholders, have cited to at least one study that shows auditors are currently only finding about 4% of fraud – which is certainly not consistent with what most investors expect.

In the fall, we issued a proposal on a rulemaking project that would hold associated persons accountable when they negligently, directly, and substantially contribute to firms' violations. The proposal is designed to make sure PCAOB rules match what investors already expect: that when an associated person's negligence directly and substantially contributes to firm violations that can put investors at risk, the PCAOB has the tools to hold them accountable.

Public Comment

Although the PCAOB is not subject to the Administrative Procedure Act, the PCAOB has voluntarily agreed to submit proposed rules and standards to the public for notice and comment as part of our commitment to transparency and robust stakeholder engagement.

I strongly believe soliciting and incorporating public comment makes our standards and rules stronger, and we are committed to carefully considering all feedback we receive.

Enhancing Inspections

Our teams inspect roughly 800 audits in more than 30 jurisdictions around the world each year. Their inspections determine whether firms are complying with PCAOB standards meant to protect investors, and inspectors' work can also provide information that may lead to PCAOB investigations and enforcement actions.

The PCAOB's inspection reports provide valuable information to investors, audit committees, and others to help inform their decisions.

To make our inspection reports as valuable as possible to investors and others, the Board has set a goal of making those reports more transparent and getting them out more quickly.

To achieve that goal, the PCAOB had to first clear a backlog of reports from previous years. In 2022, the Board approved more than 280 inspection reports, representing a 73% increase over 2021 and the most reports the Board has approved in one year.

In May 2023, the PCAOB announced it enhanced its inspection reports with a new section on auditor independence and a range of other improvements to make more transparent, relevant, and useful information available for investors, researchers, and others. This includes more information related to fraud procedures and the identification and assessment of the risks of material misstatements, additional commentary in Part I.A for certain situations, and new charts to clearly show firm and engagement partner tenure.

In July 2023, the PCAOB [unveiled an array of website transparency enhancements] that allow stakeholders to better access and understand data from PCAOB inspection reports. Six new search filters, including a filter based on the Part I.A deficiency rate, went live on the PCAOB's [Firm Inspection Reports page], helping users to analyze and compare more than 3,700 inspection reports

Sharing our inspection results empowers audit committees and boards of directors – which are responsible for hiring and overseeing auditors of public companies – to hold audit firms accountable directly.

That is more important than ever, as we are seeing increased deficiency rates in our inspections for the second year in a row.

In July 2023, [the PCAOB released a staff report] presenting aggregate observations from the PCAOB's 2022 inspections of certain public company audits conducted by 157 audit firms. The report discussed the staff's expectation that approximately 40% of the audits reviewed in 2022 would have one or more deficiencies that will be included in Part I.A of the individual audit firm's inspection report, up from 34% in 2021 and 29% in 2020. This means audit opinions were signed without completing the audit work required to verify the accuracy of the financial statements. That is a serious problem, and a 40% deficiency rate is completely unacceptable.

Audit firms must do better, and I have called on firms to sharpen their focus and take full advantage of the PCAOB's remediations process to help improve their overall quality.

We have called on audit committees to review our inspection reports, make use of their findings, take note of which firms are consistently complying with PCAOB standards – and which firms are not – and apply that knowledge in assessing the auditors of companies where they serve on the board.

By the end of this year, PCAOB staff will have met with more than 200 audit committee chairs as part of the inspections process.

Strengthening Enforcement

The PCAOB will not hesitate to take action to hold those who put investors at risk accountable.

Removing bad actors from the profession and holding wrongdoers accountable protects investors, promotes deterrence, and bolsters trust in the vast majority of honest auditors who are working hard to live up to the trust investors have placed in them.

The recent historic sanctions against China-based firms detailed above offer some examples of the types of cases the PCAOB is pursuing to protect investors.

Other significant cases in 2023 involve extensive quality control violations and independence violations.

- In June 2023, the PCAOB [announced a settled disciplinary order] sanctioning a firm for violations of PCAOB rules and quality control standards. The order imposed a $3 million civil money penalty on the firm. The PCAOB's penalty was the largest it has imposed on a "non-affiliate firm," meaning an audit firm that is not a member of a global network, and the first time that a PCAOB settled disciplinary order required functional changes to the quality control supervisory structure of a registered firm.

- In another enforcement first, the PCAOB sanctioned a firm in August 2023 for auditor independence violations during two issuer audits. The PCAOB found that the firm violated independence requirements during its 2019 and 2020 audits of an issuer, because the firm audited valuations performed for the issuer by another accounting firm that sponsored an alliance of which the sanctioned firm was a member. The order marked the PCAOB's first-ever sanctions related to a firm's membership in an accounting alliance.

CONCLUSION

Protecting investors in U.S. markets drives everything we do at the PCAOB.

From workers saving for retirement, to families investing for their futures, to businesses creating jobs because they can raise money through sound, liquid markets, to anyone who depends on the integrity of the U.S. capital markets to realize their version of the American dream – quality audits protect people.

I want to thank the Subcommittee for the opportunity to address you today, and I appreciate your interest in the work of the PCAOB.

I would be happy to answer any questions you might have.

###