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November 3, 2023

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street NW
Washington, D.C. 20006-2803

Re: Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability

Dear Office of the Secretary:

We, RSM US LLP (RSM), value the opportunity to offer our comments on the Public Company Accounting Oversight Board's (PCAOB or the Board) *Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability* (the proposal). RSM is a registered public accounting firm serving middle-market issuers, brokers, and dealers.

As auditors, we are committed to the highest standards of integrity and audit quality, and we are proud to play a role in protecting investors' interests. We believe the proposed rule would do more harm than good in that endeavor, and therefore we request the Board carefully consider the negative consequences this proposal could have on investor protection.

The proposal is a departure from established Securities and Exchange Commission (Commission) precedent acknowledging that it is bad policy to penalize a single error in judgment. The proposal imposes career-ending penalties for associated persons who fail to recognize their conduct may be one of several causes that contribute to a future firm violation of laws or professional standards. The associated person's conduct alone does not need to violate any law or professional standard but merely contribute to a violation. This allows the PCAOB to take severe disciplinary action in a wide set of circumstances, constrained only by its own discretion.

RSM does not support the proposal. Expanding Rule 3502 to target conduct that an associated person "should have known would contribute" to a later-discovered firm violation only creates uncertainty that does not promote compliance with specific laws and standards. We address the reasons for RSM's position below.

The Board Should Not Lower the Liability Threshold for Rule 3502 and Create Disparity with Existing SEC Enforcement Policy

The Board should not lower the existing standard to a single error in judgment. The proposal imposes an overly vague and broad rule that will not further the Board's mandate. Further, it is contrary to prosecutorial restraints that the Commission has imposed on itself in Rule 102(e) proceedings.

The Board proposes to penalize an associated person when the associated person "should have known" that an act or the failure to act "would contribute" to a firm violation of laws or standards. The proposal would allow the PCAOB to second-guess the decisions of associated persons in numerous situations involving the application of professional judgment to general rules, undefined concepts, and new regulator interpretations. Firm personnel apply professional judgment daily in these types of situations. As examples, associated persons (1) are responsible for making judgment calls on fact patterns that implicate the general rule of the independence regulation; (2) design controls to obtain reasonable assurance that the firm is complying with undefined terms in regulations and standards; (3) advise firm

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leadership and auditors on the application of novel interpretations of rules;[1] (4) evaluate the effectiveness of controls and corrective measures when controls are not effective; (5) design audit methodology, consultation requirements, and guidance applicable to high-risk decisions, such as evaluation of errors and application of qualitative factors; and (6) consult on the application of Generally Accepted Accounting Principles and PCAOB auditing standards. These decisions are made in good faith and based on knowledge, available information, reasonable inferences from guidance, and professional experience. Yet under the proposal, if a single decision becomes a direct and substantial contributing factor of a firm violation of laws or standards (among other causes), the associated person stands to lose their livelihood.

There are numerous policy reasons for not adopting the proposal, among those are the following.

> The proposal exposes associated persons to hindsight second-guessing that may lead to career-ending sanctions. The Board understates this increased liability risk as "modest."[2] Sadly the opposite is true: audit clients will not accept an accountant whose record reflects a Board censure or fine; firms will not risk placing such an individual in client service or in a position to influence firm policy; state boards of accountancy will investigate and potentially take action against the individual's license; and the individual will suffer the collateral consequences of a person who has violated the Securities Exchange Act of 1934.[3]
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> The proposal does not provide fair notice of specific conduct that violates the rule. Because the proposal does not mandate or proscribe specific conduct, it does not incentivize compliance. Instead, it creates a trap for the unwary. Nor does the proposal effectively deter conduct. Penalties are not an effective method to deter one-time mistakes, inadvertence, and errors in judgment.[4] As long as firm personnel engage in a good faith process employing reasonable diligence to reach a professional judgment, the Board should not second-guess the decision and impose severe penalties.
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> The proposal does not impose an obligation of due professional care; instead, it imposes a penalty when a person "should have known" action or inaction "would contribute to" a firm violation of law or standards. That is, the associated person's conduct provides a basis for imposing sanctions because of its relationship to the wrongful conduct of the firm. This framework creates unfair and unlawful results. For example, an associated person could be held responsible even though another person intentionally exploited a weakness in Quality Control (QC) designed by the associated person. This is unfair. In tort law, this is referred to as a

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[1] *Compare,* Revision of the Commission's Auditor Independence Requirements, 65 F.R. 76008 (Final Rule Dec. 05, 2000) ("One of the so-called 'middle tier' accounting firms expressed concern that the proposed definition would reach the 'alliance' it has arranged with other accounting firms and service providers across the country. In light of these comments and after careful consideration, we have decided not to adopt the definition of 'affiliate of the accounting firm' we proposed."), *with*, *In the Matter of Warren Averett, LLC*, PCAOB Release No. 105-2023-022 (Aug. 29, 2023) ("Warren Averett lacked any policies or procedures designed to detect or prevent auditor independence violations that might arise in connection with its membership in the BDO Alliance or any similar alliance of public accounting firms.").

[2] SOX allows the Board to censure and fine an associated person up to $100,000. 15 U.S.C. §7215(c).

[3] "A violation by any person of . . . any rule of the [PCAOB] shall be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934 . . ., and any such person shall be subject to the same penalties, and to the same extent, as for a violation of that Act or such rules or regulations." 15 U.S.C. § 7202(b).

[4] For this reason, "[p]unitive damages are not awarded for mere inadvertence, mistake, errors of judgment and the like, which constitute ordinary negligence." Restatement (Second) of Torts § 908 (1979).

> superseding cause, and such circumstances relieve the negligent party of liability. Also, an associated person could be held responsible when the firm willfully or intentionally violates a law. For example, an associated person who declines to create a policy imposing required consultations for suspected noncompliance with laws may be held responsible if the firm through an engagement leader willfully failed to comply with Section 10A. It is unprecedented (and unlawful) to impose secondary liability for a negligent act when the primary violation involves intentional or willful conduct.[5]
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> The proposal's broad and vague language could ensnare an audit engagement team member whose conduct alone is not a violation of standards. This is a significant change from current PCAOB enforcement policy. Currently, the mistake of one person that does not result in a violation could be aggregated with the mistakes of others to form the basis of a firm violation. However, that person would not be penalized for the mistake while the firm is held responsible. Under the proposal, an engagement team member, no matter the level of experience, could face severe penalties for a mistake. That is, the proposal, which is intended to reach the conduct of associated persons involved in ensuring compliance with firm-specific standards such as independence and quality control standards, could be applied beyond its intent. There are more narrowly tailored and effective methods to improve the quality of firm personnel involved in the design and operation of a firm's system of quality control.[6]

Recognizing that penalizing singular mistakes may have unintended consequences, the Commission has declined to impose sanctions for improper professional conduct when the conduct involves a single instance of ordinary negligence or a single error in judgment.[7] The Commission found that "[c]reating an undue fear that an isolated error in judgment would result in a 102(e) proceeding could be counterproductive." Therefore, Rule 102(e) "does not permit the Commission to evaluate actions or judgments in the stark light of hindsight." The rule imposes a limitation that the accountant's conduct involve (1) "a single instance of highly unreasonable conduct in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted," or (2) "repeated instances of unreasonable conduct . . . that indicate a lack of competence." 17 C.F.R. § 201.102(e).

The PCAOB should heed the warnings of the Commission and avoid disparity in enforcement. Regulatory restraint is appropriate when harshly sanctioning individuals for failures to comply with rules and standards that are complex, ambiguous, outdated, and the subject of inconsistent and new (sometimes nonauthoritative) interpretations by overlapping regulators. There is a better forum to address errors in judgment of associated persons that do not rise to violations of laws or standards. As former Acting Board Chair Daniel Goelzer aptly put it: "violation-causing conduct that is only negligent can best be dealt with through [the PCAOB's] inspection program and [its] ability to require firms to strengthen

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[5] *See Invs. Rsch. Corp. v. Sec. & Exch. Comm'n*, 628 F.2d 168, 178 (D.C. Cir. 1980) ("Where sanctions can be imposed, the negligence standard provides insufficient protection for those persons whose involvement in securities law violations is in one respect substantial, yet wholly innocent.").

[6] If the PCAOB seeks to regulate the conduct of associated persons involved in designing and operating a firm's system of quality control, it can employ more direct and effective measures to accomplish this goal. The Board can promulgate standards specifically addressing roles of associated persons not directly involved in an audit but involved in designing and monitoring compliance with firm policies. This will create more certainty and provide predictability in enforcement of standards. Further, it will more effectively accomplish the PCAOB's goals of deterrence, accountability, and investor protection.

[7] Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 F.R. 57164 (Final Rule Oct. 26, 1998).

quality control and other internal procedures."[8] For these reasons, RSM recommends that the Board keep the current framework requiring actual knowledge or reckless disregard.

The Proposal Is Different Than Section 21C of the Exchange Act, Which Requires a Finding of Harm

The Board cites Section 21C of the Exchange Act to bolster its argument that associated persons are already subject to sanctions for negligent, violation-causing behavior. *See* 15 U.S.C. § 78u-3. This argument misconstrues the purpose of the statute, the elements, and the history of how the Commission has enforced Section 21C.

In 1990, the Commission sought the authority in Section 21C as part of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990.[9] The purpose of the Commission's newly requested authority was to allow the Commission to quickly impose injunctive relief administratively without the showing of imminent harm necessary in lengthy judicial injunctive relief proceedings.[10]

Importantly, the elements of Section 21C require the Commission to "find[], after notice and opportunity for hearing, that a[] person is violating, has violated, or is about to violate a[] provision of [the Exchange Act], or any rule or regulation thereunder;" after such a finding, the Commission can issue an order against "any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation." 15 U.S.C. § 78u-3(a). That is, there must be harm to the public that was in part caused by a negligent act of a secondary actor and a finding on the primary actor's violation of the law.

Outside of stipulated consent orders, the Commission has used its Section 21C authority in limited situations involving violations of independence rules and other rule violations that directly lead an issuer to make a filing in violation of securities laws.[11] And, the Commission has noted in court filings that Section 21C proceedings are substantially different proceedings than Rule 102(e) actions which levy career-ending penalties, justifying the lower level of culpability.[12]

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[8] Daniel L. Goelzer, Open Meeting: Rules Concerning Independence, Tax Services, and Contingent Fees (July 26, 2005).

[9] *See generally* Andrew M. Smith, *SEC Cease-and-Desist Orders*, 51 Admin. L. Rev. 1197, 1199-205 (1999) (discussing the background and legislative history of Section 21C).

[10] Although Congress later added a penalty sanction for Section 21C, the Supreme Court has granted certiorari to determine whether the penalty section is unconstitutional. *See Jarkesy v. Sec. & Exch. Comm'n*, 34 F.4th 446, 465 (5th Cir. 2022), cert. granted, 143 S. Ct. 2688 (2023) ("The SEC's judgment should be vacated for at least two reasons: (1) Petitioners were deprived of their Seventh Amendment right to a civil jury; and (2) Congress unconstitutionally delegated legislative power to the SEC by failing to give the SEC an intelligible principle by which to exercise the delegated power.").

[11] *See, e.g., KPMG, LLP v. S.E.C.*, 289 F.3d 109 (D.C. Cir. 2002).

[12] "In fact, the nature of the two proceedings is different (one is a professional disciplinary proceeding designed to protect the integrity of the Commission's processes while the other is a law enforcement proceeding), and they involve fundamentally different remedies (Rule 102(e) sanctions include permanent denial of the opportunity to practice before the Commission). *It is not surprising that a lower standard of culpability would govern the milder remedy of a cease-and-desist order*." SEC Br., *KPMG LLP, Petitioner, v. S.E.C., Respondent.*, 2001 WL 36038953, at 46 (C.A.D.C.) (emphasis added).

The differences between Rule 3502 and Section 21C proceedings counsel against using Section 21C to justify lowering the threshold for Rule 3502. Section 21C was intended to quickly enjoin conduct that may lead to securities law violations, not to impose disciplinary action. Section 21C requires a showing of harm to the public through securities law violations. In contrast, a Rule 3502 violation under the proposal could involve a firm violation of QC standards, yet not a material misstatement in a public company financial statement. For these types of violations with no associated harm, the Commission has chosen to use a higher level of culpability under Rule 102(e).[13] The PCAOB should do the same.

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RSM addresses certain specific questions presented in Sections II through VI of the proposal in the enclosed Appendix. We would be pleased to respond to any questions the PCAOB or its staff may have about our comments. Please direct any questions to Jamie R. Klenieski, Audit Quality and Risk Leader, at 215.648.3014, or Sara Lord, Chief Auditor, at 612.376.9572.

Sincerely,

RSM US LLP

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[13] "The Commission does not need to show that the accountant's behavior actually caused harm; an accountant can demonstrate a lack of competence even if his conduct did not result in the filing of a false or misleading document." Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 F.R. 57164, 57168 (Final Rule Oct. 26, 1998).

Appendix

Comments on Specific Questions Posed by the Board

RSM addressed most of the questions posed in the proposal in its comment letter. We submit this Appendix to provide responses to certain specific questions presented in Sections II through VI of the proposal.

> 3. Would addressing the regulatory concerns discussed above incentivize associated persons to more fully comply with the applicable laws, rules, and standards that the Board is charged with enforcing against registered firms?

No. We do not believe there is a gap or incongruity in regulatory enforcement. The PCAOB currently has the authority to discipline violations of its standards. This coupled with standards that impose specific or principles-based obligations on the associated persons will incentivize associated persons to comply with such standards. In contrast to an accountability framework that sets forth clear expectations, the proposal imposes a vague rule that penalizes conduct an associated person “should have known” would contribute to a future firm violation of laws and standards. Because the proposal does not provide notice of specific conduct that may lead to a violation, we do not believe it will incentivize compliance with applicable requirements.[14]

If the Board seeks to promote its mandate of investor protection, there are more narrowly tailored methods it could employ to incentivize quality audits and improved firm quality control. The Board has done just this by recently commencing a standards-setting effort and enhanced inspection process to target audit quality, improved firm quality control, and increased accountability for those responsible for the firm’s system of quality control. These include (1) proposed QC 1000, which vests ultimate responsibility over the system of quality control on the firm’s principal executive officer, and operational responsibility over the QC system as a whole, over ethics and independence, and over monitoring and remediation on other firm personnel, (2) proposed Auditing Standard (AS) 1000 and other audit standard amendments imposing new obligations on associated persons, and (3) new transparency enhancements to firm inspection reports. The Board should wait for these improvements to operate in practice and evaluate their effect on audit quality and firm quality control before imposing a new vague rule.

> 8. Should the Board retain the “directly and substantially” modifier to describe the connection between an associated person’s contributory conduct and a firm’s violation? Are the meanings of each of “directly” and “substantially,” respectively, clear and understandable?

The “directly and substantially” modifier is not defined in the proposed rule itself or in the standards. The Board expressed its views on the modifier in no less than a paragraph. The “conduct must ‘either essentially constitute[ ] the [firm’s] violation’ or be ‘a reasonably proximate facilitating event of, or a reasonably proximate stimulus for, the violation;’” “but it need not ‘be the final step in a chain of actions leading to the violation.’” And the “conduct must ‘contribute[ ] to [a] violation in a material or significant way,’ though it need not be ‘the sole cause of the violation.’” But, the Board does not intend to “reach an

[14] The Board itself has recognized that vague standards do not incentivize quality audits. *See Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards*, PCAOB Release No. 2023-001 (Mar. 28, 2023) (“Overall, therefore, there is a spectrum of possible approaches to audit regulation that lies between excessively vague principles and excessively specific requirements. In practice, effective auditing standards may fit into the middle of that spectrum by emphasizing core principles while including some specific requirements to help support skeptical judgment and skeptical action.”).

associated person's conduct that, while contributing to the violation in some way, is remote from, or tangential to, the firm's violation."

The Board's view introduces the concepts of materiality, significance, reasonably proximate facilitating event, reasonably proximate stimulus, remote, and tangential, and the meaning of these concepts must be derived from the facts of a limited number of Board orders issued since 2009. This lack of clarity will make the application of "directly and substantial" inoperable. There are established legal doctrines of causation that are better suited, especially considering the administrative and judicial process for subsequent review of Board decisions. These include the substantial factor test, and legal or proximate cause, both of which are restated and analyzed in the Second Restatement of Torts, Sections 430-431 and 435-461. These restated standards address superseding and intervening causes, foreseeability of harm, and other policy reasons to not impose liability for a but-for cause in a chain of events, even when direct and substantial.

9. Are there other phrases or terms that the Board should consider to modify "contribute," or other limitations that the Board should incorporate into the proposed rule? If so, what are they?

The Board should consider imposing a limitation that the conduct of the associated person be a substantial factor in bringing about, and a proximate cause of, the firm's violation of laws or standards. It will help in the scenario of a rogue employee or partner that exploits a gap in controls to engage in intentional misconduct. A proximate cause requirement should prevent the Board from using proposed Rule 3502 to penalize violation-causing conduct in situations where the primary violator engaged in intentional conduct. The Board could also consider specifically exempting violation-causing conduct when a primary violation involves intentional conduct.

11. Should the Board expand the scope of Rule 3502 to encompass secondary liability for associated persons who contribute to violations by other associated persons (i.e., not just by any registered firm)? If so, what (if any) limits or conditions should the Board place on such secondary liability?

No. The board should not impose secondary liability for associated persons who contribute to violations by other associated persons for the same reasons stated in our comment letter and this Appendix.

16. Are there additional unintended consequences that might result from the proposed amendments?

The proposal may lead to other unintended consequences not already addressed in our comment letter. For example, a firm may decline to serve as referred-to auditor for a non-substantial portion of the engagement to avoid uncertainty over PCAOB enforcement jurisdiction over associated persons at the firm. Further, a vague standard focused on a hindsight critique of professional judgments creates an uncertain enforcement environment that will lead to inefficiencies, second-guessing, and a dearth of talent necessary in important decision-making roles.

17. As noted above, associated persons may currently face secondary liability for negligent conduct in actions by the Commission. Notwithstanding that current possibility, could the proposal discourage participation by associated persons in the audit profession?

Yes. Although the Board references Section 21C of the Exchange Act in its question, this section of the Exchange Act requires a showing of harm to the public not currently required in the proposal, and the section's imposition of penalties and disgorgement has been held unconstitutional. Therefore, at this point, associated persons *do not* face secondary liability from the Commission for a single error in judgment, and certainly not in circumstances where the public was not harmed.

Because of this, the proposal creates a new category of career-ending penalties for a hindsight critique of professional judgment. The fear of entering a perilous occupation will exacerbate an already dire need for public accountants.[15] We agree with Board Member Ho's comments that the Board should not make the audit profession "so risk-ridden that the best and the brightest pursue careers elsewhere," and that doing so, would be "doing a disservice for investors in the long run."

We are also concerned about the potential trickle-down effect this could have on the availability of talent to serve public registrants. The audit profession operates in an apprenticeship model, developing talent for multiple areas of the capital markets ecosystem. Only a minority of accountants hired into the audit profession remain in the audit profession for their entire career. The majority apply the training, skills, and expertise they develop in the audit profession in other roles within the capital markets ecosystem, such as roles in accounting and finance for public registrants. We are concerned that faced with ambiguous judgment and hindsight critique, talented professionals may choose to not only leave the audit profession but also leave the public company accounting ecosystem entirely. Public registrants may be also impacted by the lack of qualified talent to serve necessary roles in the accounting, finance, internal audit, and other departments. Pushing more talented professionals out of the public registrant ecosystem entirely would cause harm to investors.

24. Is the proposed effective date (sixty days after Commission approval) appropriate? If not, what would be an appropriate effective date for the proposed amendments?

No. Given the significant concerns raised by the proposal, we believe the Board must respond to the concerns of stakeholders by redeliberating and re-proposing any amendments to Rule 3502. We believe the proposal in its current form should not be declared effective, thus are unable to comment on an appropriate effective date.

[15] *See* Lindsay Ellis, *Many Accountants Call It Quits*, Wall Street Journal (Dec. 29, 2022).