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November 3, 2023

Sent via e-mail: comments@pcaobus.org
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

RE: Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability; PCAOB Rulemaking Docket Matter No. 053

Dear Office of the Secretary:

Plante & Moran, PLLC and Plante Moran, P.C. (collectively, "Plante Moran") appreciate the opportunity to share our views and provide input on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") proposed amendments to PCAOB Rule 3502. Plante Moran has approximately 3,000 professionals, maintains offices in four states (Michigan, Illinois, Colorado, and Ohio), and is a significant provider of audit and other professional services to middle market companies.

We fully support the Board's efforts to improve audit quality and to reevaluate existing rules and auditing standards, including rules related to its enforcement program. As explained in detail herein, however, we are concerned that the current proposal to lower the standard for contributory liability under Rule 3502 from recklessness to negligence will not result in improvements to audit quality or additional protection for investors. We are also concerned that the costs of the proposed amendments—whether or not intended—will outweigh any potential benefits. We encourage the Board to maintain the recklessness standard of contributory liability under the current formulation of Rule 3502.

We share and join in the views expressed in the Center for Audit Quality's letter dated November 2, 2023, regarding the proposed amendments. We write separately, however, to emphasize our perspectives on the proposed change in the contributory liability standard.

I. The Costs of the Proposed Amendments Will Outweigh Any Potential Benefits.

As currently structured, the PCAOB has a suite of tools available to hold audit firms and individual auditors accountable for their actions—i.e., conducting inspections, making remediation determinations, defining auditing standards and PCAOB rules, and bringing enforcement actions for direct violations of auditing standards and PCAOB rules against firms and individual auditors. Rule 3502 is one of the tools at the PCAOB's disposal. As explained herein, we are concerned that amending the rule to lower the contributory liability standard will negatively impact audit quality, especially when considered in the context of the full suite of regulatory tools the PCAOB can access. We are also concerned that the costs of the change will exceed any potential benefits.

Prior to January 2022, it was the PCAOB's considered policy to deal with mistakes in auditor judgment—i.e., negligent conduct—through a robust inspections and remediation program. The inspection program, with its emphasis on root cause analysis and remediation of quality control

deficiencies, has long provided strong incentives for individual auditors and firms alike to meet their obligations under professional standards and applicable rules. The policy of relying on the inspections program and incentives to remediate quality control deficiencies was sensible in the context of regulating audits. Auditing requires firms and their associated persons to exercise significant professional judgment in complex, nuanced areas. In practice, the potential receipt of inspection comments and the consequences that flow from the receipt of such comments has placed substantial pressure on firms and their partners and staff to make good faith, well-considered auditing decisions. That pressure has in turn led to long-term, sustained improvements in audit quality over the last 20 years. The proposed change to Rule 3502, however, is likely to push audit quality in the wrong direction. We believe that lowering the standard for contributory liability will put an incremental amount of additional and unnecessary pressure on already difficult professional judgments and thereby upset the careful balance the PCAOB has struck in driving audit quality improvements through the inspections and remediation program. Stated differently, the costs of the incremental pressure put on individual auditors under a reformed Rule 3502 will exceed the intended benefits.

First, the contemplated change in the liability standard is likely to further disincentivize qualified and talented individuals from participating in public company and broker dealer audits, whether they are already in the profession or are considering joining. The current talent crisis in the accounting and auditing profession is well documented.[1] The crisis, however, is hitting small and middle-market firms far harder than large, global network firms, causing a re-evaluation of the markets in which they can and should compete. Many talented CPAs in the current environment are unwilling to serve public company and broker-dealer audit clients due to the potential exposure that already exists. This includes CPAs just beginning their careers, CPAs who have been members of the profession for decades, and CPAs in between. Their reluctance or unwillingness to participate in such audits is not unreasonable; the consequences of a PCAOB (or SEC) enforcement sanction can be, for many, career ending. When coupled with the existence of significant professional growth opportunities outside of the public company and broker dealer space, it is understandable that talented and qualified individuals would not want to risk their careers by agreeing to perform work within the public company and broker dealer space. This is particularly true when they can lose their careers over a potentially isolated single good faith mistake in judgment.

Concerns around potential liability exposure are especially acute for individuals serving in roles related to a firm's system of quality control, as such individuals are the most likely potential targets for Rule 3502 violations. The fact that an ordinary mistake made in good faith could end your career—when you potentially make hundreds of significant auditing and accounting decisions across dozens of clients each year—can be paralyzing and intolerable. Board Member Christina Ho well captured these concerns in her statement on the proposing release when she stated, "[i]f this unintended consequence comes to fruition, investors will in the long run be harmed if, as the proposal notes, less cautious or less qualified individuals rise to fill 'important audit roles."[2] In short, the proposed change to Rule 3502's liability standard threatens to further reduce the pool of qualified and talented CPAs to perform audits within the PCAOB's jurisdiction.

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[1] *See, e.g.*, "Why No One's Going Into Accounting", Wall Street Journal (Oct. 6, 2023); "Accounting Graduates Drop by Highest Percentage in Years", Wall Street Journal (Oct. 12, 2023); "The Accounting Shortage Is Showing Up in Financial Statements", Wall Street Journal (July 11, 2023).

[2] Christina Ho, *The Cost of Unintended Consequences: Accounting Talent, Audit Quality, Investor Protection* (Sept. 19, 2023) (available at https://pcaobus.org/news-events/speeches).

Second, we are concerned that the proposal will have a chilling effect on the PCAOB inspections program, arguably the most impactful tool in the PCAOB's toolbox. Take, for example, a situation in which staff from the PCAOB's Division of Registration and Inspections ("DRI") determine that an audit firm incorrectly concluded that a client's accounting treatment for a particular transaction complied with generally accepted accounting principles in a complex, nuanced area. As a result, DRI issues a comment form to the firm. Assume further that the decision at issue was the subject of a consultation involving the engagement partner, the engagement quality reviewer, and one or more representatives from the firm's professional practice group, each of whom directly and substantially contributed to the firm's position on the accounting treatment for the transaction. Assume also that the error was a mistake, made in good faith. Should the firm agree with the comment form DRI issued and the factual basis for it? Under a reformulated Rule 3502, agreeing with the comment form could expose each of the individual auditors who participated in the decision to a contributory liability charge under Rule 3502 for a mistake made in the good faith exercise of their professional judgment. Indeed, an admission by the firm that the decision was incorrect during the inspections process could serve as prima facie evidence of a violation of professional standards in any subsequent matter pursued by the PCAOB's Division of Enforcement and Investigations ("DEI") and provide a clear basis to impose Rule 3502 liability against each of the individuals.[3] That reality could well affect firms' appetite to engage in the type of productive back and forth with DRI that has served as the very foundation for the long-term success of the PCAOB's inspections program.

Third, we are concerned about the potential for an increase in so-called "over auditing" to mitigate actual or perceived risk associated with potential liability under a reformed Rule 3502. Such self-protective behavior is neither productive nor efficient and harms investors through an inefficient allocation of audit time and resources and potential distractions from important audit areas. This concern is particularly acute for smaller and middle-market firms, which overall have less available resources and a reduced ability to command increased audit fees in the marketplace. Such firms will find they are less able to compete, resulting in a further concentration of firms within the marketplace.

For these reasons, and those expressed in the CAQ's comment letter, we do not believe the potential benefits of the proposed change to the liability standard will exceed the costs and that the PCAOB should maintain the current standard for contributory liability.

II. Individual Contributory Liability Charges for Single Instances of Negligence Would be Contrary to SEC Practice.

We are also concerned that the change in the liability standard will put the PCAOB on a different footing than the SEC has historically operated on and that it will have a disparate impact on smaller firms through significantly greater enforcement exposure.

In considering the costs of the proposed amendments, the proposal suggests that because the SEC's existing enforcement authority for contributory liability already captures simple acts of auditor negligence, the Board's proposed changes are unlikely to have significant incremental costs. In practice, however, the SEC has not historically charged auditors with negligence-based contributory liability based on a single act of negligence. To be sure, none of the SEC enforcement cases cited in the proposal

[3] This concern is not merely theoretical. PCAOB Board members and staff have made public statements in recent months indicating that, as a matter of policy, DEI intends to pursue negligence-based enforcement actions. Furthermore, DEI has shown an increased willingness to bring charges against firms based on prior inspection findings, particularly where the firm has admitted to the factual basis that led to the original comment form(s).

involved the SEC charging an individual respondent with contributory liability based on a single act of negligence.[4] Rather, in each case, the SEC alleged multiple, separate acts of negligence by the relevant respondents (e.g., across multiple audits, audit areas, or audit years). To the extent the Board proposes a framework for contributory liability charges against individuals for single instances of negligence and then in fact charges single acts of negligence, doing so would cause it to use an authority the SEC has not used in practice.

Moreover, the impact of the proposed rule change and actions brought pursuant to it would be felt more acutely by non-global network firms. Twenty years of PCAOB enforcement experience has shown that such firms are statistically far more likely to be the subject of PCAOB enforcement investigations and sanctions, despite their miniscule overall share in auditing the market capitalization of U.S. issuers.

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Plante Moran appreciates the opportunity to comment on the Release: Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability. We would be pleased to discuss our comments or answer questions from the Board or PCAOB staff regarding the views expressed in this letter. Please address questions to Christina Moser (christina.moser@plantemoran.com) or Jeff Bailey (jeff.bailey@plantemoran.com).

Sincerely,

Plante & Moran, PLLC

Plante & Moran, PLLC

cc: **PCAOB**
Erica Y. Williams, Chair
Christina Ho, Board member
Kara M. Stein, Board member
Anthony C. Thompson, Board member
George Botic, Board member

SEC
Paul Munter, Chief Accountant
Diana Stoltzfus, Deputy Chief Accountant

[4] *See In re David S. Hall, P.C.*, SEC Initial Decision Release No. 1114 (Mar. 7, 2017) (ALJ Op.) (SEC alleged an engagement quality reviewer failed to conduct numerous engagement quality reviews in accordance with applicable professional standards), *decision made final*, SEC Release No. 34-80949 (June 15, 2017); *In re Gregory M. Dearlove*, CPA, SEC Release No. 34-57244 (Jan. 31, 2008) (SEC alleged engagement partner negligently caused multiple violations of securities law by firm's issuer client); *In re Philip L. Pascale, CPA*, SEC Release No. 34-51393 (Mar. 18, 2005) (SEC concluded that auditor failed to comply with GAAS in numerous areas of the financial statements across multiple years).