

November 3, 2023

Ms. Phoebe Brown
Office of the Secretary
Public Company Accounting Oversight Board
1666 K St, NW
Washington, DC 20006-2803

PCAOB Release No. 2023-0007, September 19, 2023: Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability

Dear Secretary Brown and PCAOB Board Members:

Johnson Global Accountancy is pleased to submit its comments on the proposed amendments to PCAOB Rule 3502, Responsibility Not to Knowingly or Recklessly Contribute to Violations, the Board's rule governing the liability of associated persons who contribute to a registered public accounting firm's primary violation.

Johnson Global Accountancy's mission is to be the most innovative and technically excellent advisory firm at the intersection of companies, auditors, and regulators, which improves investor decision-making confidence. We serve a diverse group of audit firms ranging from single office firms to more complex regional firms and the top 20 firms. We help firms interpret, respond, and comply with global auditing and financial reporting standards and regulatory requirements, including those standards set by the PCAOB. Our team of financial reporting quality advisors helps prepare firms to perform high-quality audits using innovative tools with a shared commitment to implement effective policies, procedures, and controls. We also provide firms with integrated software and service solutions to help them comply with audit quality standards.

Overall, we support the PCAOB's objective to improve audit quality, enhance investor protection, and further the public interest in preparing informative, accurate, and independent public audit reports. However, we are concerned with the Board's current proposal to expand the contributory liability of individuals involved in audits. We encourage the Board to continue considering the impact of such changes on the audit profession and whether these types of changes will lead to improved audit quality.

Detriment to the Appropriate Functioning of the Audit Team

Quality audits are predicated on a team performing audit work collaboratively. Each person and each step in the process contributes to that goal, with one being dependent on the other and all being important. We express serious concerns about whether allocating liability to one person in a team contributes to audit quality and encourages the brainstorming and sharing of information needed for success. Allocating responsibility to this level would increase risk aversion and can

encourage individualistic behavior; the focus could turn to protecting one's liability versus what is best for the audit.

We are also concerned that this will impede on-the-job training, an important element of building an auditor's professional judgment, due care and professional skepticism. It is not clear in the proposal, for example, whether less experienced staff making unintentional errors would be held to the negligence standard. In our view, the proposal needs to further clarify the definition of "associated persons" and narrow the application to protect the important benefit of on-the-job training. Otherwise, this will continue to contribute to dissuading individuals from entering the profession.

Focus on the Negative Detracts from Improving Audit Quality

Firms often express challenges they experience in hiring and retaining professionals to perform public company audits. This challenge exists today before this proposal – and this proposal has the potential to exacerbate this issue.

In our mentoring and coaching work, audit professionals often cite that they perform certain audit procedures due to the constant scrutiny of their work, regardless of whether it is required or contributes to an improved audit.

We are concerned that the Board's view of increasing "fear" in audit professionals with the threat of negative consequences will not result in more compliance and improve audit quality; rather, the Board should evaluate whether a focus on the growth mindset would much better achieve optimal performance. A focus on every error an audit practitioner makes will encourage auditors to focus on covering their liability and take their attention away from protecting investors' interests. This is an outcome that appears to be contrary of the Board's goal.

Consider Other Alternatives

The Board has many tools available to improve audit quality. We encourage the Board to use those existing tools further. Consider, for example:

Quality Control Proposal, QC 1000

Proposed QC 1000 includes sweeping changes to a firm's quality control system, including expanded and clearer roles and responsibilities. Section IV, C. Roles and Responsibilities on Page 67 states:

Expectations of individuals within the QC system are established through the assignment of roles and responsibilities that are essential to a well-functioning QC system. This aspect of the QC system is intended to create clearer lines of communication and decision-making authority and greater accountability for those assigned to such roles.

Once finalized, this proposal could address the accountability gap the Board references. We encourage the Board to consider the implications of this proposal and to delay any changes to Rule 3502 until proposed QC 1000 is finalized and implemented.

Root Cause Analysis

We encourage the Board to study the root causes of problematic audit professional actions in inspections and enforcement actions. Understanding these would help design controls or other steps to prevent or detect these actions.

In our work with auditors, they are continuously seeking further clarity and illustrations on how to apply the standards. Illustrating what could go wrong or has gone wrong through enhanced communications would help auditors better understand expectations.

It would be helpful for the Board to further communicate observations from their enforcement activities in a *Spotlight* publication similar to that issued for inspection results. The Board could speak to "close calls" or those actions where the Board could not establish accountability to the associated person. Such communications would aid in educating new or upcoming professionals and informing professions with illustrations.

Impact on the Market Place

We share Board Member Ho's concerns that *"The proposal further recognizes the possibility that some firms could ultimately decide to cease conducting issuer and broker-dealer audits, which "could further consolidate the market for issuer and broker-dealer audit services." I have previously expressed concern that investors and the auditing profession can ill afford a reduction of competition in the audit marketplace."* We hear from clients and the marketplace that firms are deciding to exit the issuer audit work or minimize their issuer audit work due to the ever-increasing risks and punishments. We are observing a reduction in the marketplace. We encourage the Board to further study the impact of audit regulatory changes on the availability of firms to serve the public interest.

We set out our comments on selected questions posed by the Board in the proposal in the attached Appendix.

We appreciate the opportunity to provide our comments and support the PCAOB's efforts to improve auditing standards to enhance audit quality and better protect investors. We would be pleased to discuss our comments with you at your convenience. Please direct any questions to Jackson Johnson, President (jjohnson@jgacpa.com) or Geoff Dingle, Managing Director and Shareholder (GDingle@jgacpa.com) or Santina Rocca, Managing Director (SRocca@jgacpa.com). They may be reached at (702) 848-7084.

Sincerely,


Johnson Global Accountancy

Appendix A

1. Are the regulatory concerns discussed above clear and understandable?

The regulatory concerns regarding the Board's challenge in attributing accountability for violations to specific individuals is clear. The proposal states on page 7 that the incongruity between the negligence standard for a firm and the reckless standard for an associated person has the "potential to dissuade associated persons from exercising the appropriate level of care in their audit work". It is not clear, however, how these two statements are linked and the support for one causing the other.

The proposal indicates that closing this regulatory gap should "incentivize associated persons to be more deliberate and careful in their actions. Indeed, "accountability frequently improves outcomes". It is unclear why this gap would, on its own, incentivize auditors to not exercise the appropriate level of care. Root cause analysis often cites numerous actions that contribute to violations, whether intentional or not.

The proposal refers to Colleen Honigsberg's article, "*The Case for Individual Audit Partner Accountability*" to support that "accountability frequently improves outcomes". Honigsberg's article also explains "why regulatory oversight, private enforcement, and firm-level reputational sanctions are unlikely to induce accountants to take optimal levels of care when auditing corporate financials. Instead, our best chance for improving audit quality lies in establishing a market for individual audit partners' brands – a market that can hold individual auditors responsible for their mistakes". The auditor reporting model and the identification of the auditor in Form AP appear to address that point. The proposal has not explained why the auditor's reporting model and naming auditors in Form AP has not improved the exercise of due care.

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?

We do not believe the proposal supports the statement that regulatory concerns would incentivize associated persons to fully comply with the applicable laws, rules and standards. The PCAOB has taken numerous steps over 20 years through robust inspections, enforcement actions, enhanced standards and stakeholder engagement and yet audit deficiencies and enforcement actions continue to increase. In our work with auditors, we see auditors taking many steps to improve their audit quality. Smaller auditors, in particular, express that they are being held to an inspections bar that constantly evolves. Uncertainty over expectations or a bar that keeps moving higher, may lead to apathy rather improved audit quality.

Furthermore, in our experience, nearly all auditors place compliance with laws, rules and standards as their top priority. Unfortunately, errors and mistakes still occur and will inherently continue to occur. Holding auditors negligent for normal expected human error or the exercise of prudent judgments that are subsequently second-guessed will not increase the incentive for

compliance, rather it would decrease the incentive for individuals from entering the auditing and accounting profession altogether. The Board's continued diligent inspections and enforcement programs, when considered together, working in tandem, sufficiently address lapses in compliance. In addition, the Board's outreach and open forum programs are effective in promoting compliance and these activities could be expanded.

4. Are there common types of cases or fact patterns not discussed above in which a negligent standard of liability would be particularly useful to promote greater individual accountability under Rule 3502?

The proposal notes the Board's implementation experience on pages 8 and 9. In the QC context, it cites "Rule 3502 also arises in sole-proprietorship cases, in which the sole owner and sole partner of a firm causes the firm to commit a violation. Yet for some types of violations, there is not always sufficient evidence of reckless behavior". It is not clear how this arises and it would be helpful to cite examples of the Board's experience.

12. Are there scenarios where an associated person's conduct might contribute to another individual's primary violation but the conduct would be outside the scope of any Board standard or rule (current or proposed), including the current and proposed versions of Rule 3502? If so, what are the scenarios?

We encourage the Board to better explain and define an associated person and how one is identified as an associated person and how this amended rule would be applied in practice. It is not clear how the proposed rule would be implemented, and in particular, the effect it would have on training that is "on-the-job" and provides/expects staff to make errors as they build their professional experience and judgment. Consider, for example, a staff with one- or two-years' experience that observes an inventory count and makes, through lack of experience, an unintentional error. It is not clear if such a staff would fall afoul of the proposed rule? In our view, the supervision and review standards and a firm's quality control policies, if followed correctly, should address this issue (i.e. the staff person gets more on-the-job training, and gets reprimanded.) Board member Ho also raised this point: "*If this Board (or future Boards) decide to routinely sanction associates or senior associates under the proposed negligence standard, the public company auditing profession will become even less attractive.*" This is a conversation that we are hearing daily as well.

15. Are there other academic studies that would inform our analysis of the expected economic impacts of the proposed amendments? If so, please provide citations for the studies.

We encourage the Board to consider evaluating the results of behavioral studies (including through root cause analysis) to better target the tools of the Board to those actions that will create meaningful audit quality improvements.

19. Are there other regulatory alternatives the Board should consider? If so, what are they?

Yes, we encourage the Board to share its oversight experience and a vision for the profession of what audit quality looks like. Additional illustrations of actions the Board views as effective and

those that are problematic would serve to bolster understanding and compliance. Detailed case studies and application of these examples during the inspection process can be an effective regulatory alternative. We have seen transparency of inspections and interpretation of laws, rules, and standards provide auditors direction in interpreting the guidelines when executing audit procedures.

See suggestions under question 20.

20. Are other regulatory alternatives preferable to the proposed amendments? If so, please explain the reasons.

Expand communications

We encourage the Board to consider expanding its communications to stakeholders to share the types of violations, “close-calls” or other scenarios that were unenforceable because the Board could not obtain evidence to support a “reckless” behavior. Communicating these in *Spotlight* briefs similar to inspections results would be instructive to audit professionals and could be effective in reducing problematic behaviors.

Deepen and share root cause analyses

We encourage deeper analysis and communication of the root causes of problematic auditor actions. Sharing more granular information would aid the profession in addressing some of the more systemic issues.

Define audit quality

The mission to improve audit quality will remain elusive until audit quality is defined and all stakeholders understand the definition and what it looks like.

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?

We encourage the Board to delay the effective date until further study is performed and proposed QC 1000 is finalized and its effect analyzed. Proposed QC 1000 has the potential to address many of the gaps identified in this proposal and we encourage waiting until that has been implemented.