

November 3, 2023

By email: [comments@pcaobus.org](mailto:comments@pcaobus.org)

Ms. Phoebe W. Brown  
Office of the Secretary  
PCAOB  
1666 K Street, NW  
Washington, DC 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 053: *Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability* (PCAOB Release No. 2023-007)

Dear Ms. Brown:

Crowe LLP (“Crowe”) appreciates the opportunity to comment on the Public Company Accounting Oversight Board’s (PCAOB or “the Board”) proposed amendments to Rule 3502 Governing Contributory Liability (the “Proposal” or the “Proposed Rule”).<sup>1</sup>

We support a strong enforcement program as an important tool the PCAOB has available to penalize bad actors, deter poor conduct, and support strong audit quality. We have significant concerns, however, about the proposed changes to Rule 3502, *Responsibility Not to Knowingly or Recklessly Contribute to Violations* (the “Rule”), that are under consideration, including a lack of sufficient justification for the changes and substantial potential consequences that are likely to be detrimental to audit quality. In addition, we do not believe the statutory authority is clear. Based on these concerns, Crowe does not support the adoption of the Proposed Rule.

The Rule that was adopted in 2006 was first proposed as a negligence standard. However, after consideration of comments received, the PCAOB determined it was not appropriate to adopt a negligence standard. Instead, the PCAOB required that there be, at a minimum, recklessness to underlie an enforcement action under Rule 3502. Since the Rule’s adoption, the PCAOB has not indicated that the recklessness standard does not sufficiently protect investors. To adopt the Proposal and thereby change the well-established and well-reasoned Rule that the PCAOB adopted 17 years ago, under pertinent law,<sup>2</sup> the PCAOB should provide a justification for the change, including how a negligence standard will better enhance audit quality and protect investors. Yet, the Proposal does not provide such a justification, and certainly not one which demonstrates that the benefits outweigh the costs and potential consequences of the Proposal. Instead, adoption of the Proposal would be inconsistent with the findings that the PCAOB made when it adopted the Rule.

The SEC’s experience and implementation of Rule 102(e)(1)(iv)(B) provides additional reasons why the Proposal should not be implemented. That rule provides the SEC with authority to bring enforcement actions based on two types of negligent conduct. Because the SEC has the ability to bring enforcement actions based upon this negligence predicate, it follows that any change in auditor behavior that the PCAOB hopes to accomplish with the change to the Rule has already been accomplished by the SEC’s

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<sup>1</sup> Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability, Release No. 2023-007, Public Company Accounting Oversight Board (Sept. 19, 2023).

<sup>2</sup> See, e.g., *F.C.C. v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (noting such requirements when, as here, the Proposal is contrary to the finding made when present Rule 3502 was adopted, and people have relied upon the present Rule).

ability to bring such actions. On the flip side, if the PCAOB believes the SEC's ability to bring such actions has not successfully changed auditor behavior, the PCAOB should explain why the Proposal will successfully effect such change where the SEC rule has not. Further, given the SEC's authority under Rule 102(e)(1)(iv)(B) to bring action against auditors for negligent conduct, there is no clearly articulated need for the PCAOB to add another layer of regulatory authority to the panoply of rules already governing auditors of public companies.

Finally, while the Proposal notes that the SEC could bring an enforcement action based upon a single negligent act under 15 U. S. C. Section 78u-3(a), no matter has been proffered where this was actually done by the SEC, which instead has utilized the negligence rule set forth in Rule 102(e).<sup>3</sup> The SEC's lack of enforcement actions based upon a single act of negligence suggests that the SEC has concluded such actions either are not warranted or would not further the SEC's mission. We do not believe the PCAOB's standard should be different.

The potential ramifications of changing Rule 3502 to reflect a negligence standard could be severe. Among other things, these changes could exacerbate the growing shortage of CPAs entering or choosing to stay in the profession. Adoption of the Proposed Rule may further dissuade potential accountants from joining the profession based on the increased personal regulatory scrutiny or dissuade individuals from accepting roles in the firm's quality control system. Firms may be reluctant to accept certain issuers as audit clients due to the lower liability threshold and some firms may choose to exit the public company or broker-dealer audit space altogether. To enact a change in the law which may lead to less competition in the marketplace because individuals and firms will stay out of public auditing, in whole or in part, may further a trend that Section 701 of the Sarbanes-Oxley Act of 2002 ("SOX") reflected as concerning.

Finally, given the fact that the Proposal does not provide sufficient justification for the change to a negligence standard, and that the proposed new standard could have significant adverse consequences, there should be especially clear statutory authority for the adoption of the new Rule. Instead, neither Section 103 nor Section 105 of SOX provide such clear authority.

**I. Nothing Has Changed Since the Adoption of Rule 3502 That Justifies a Change in The Previously Adopted Rule and the Proposal Does Not Provide a Sufficient Basis for the Change**

In December of 2004, the PCAOB issued a proposed Rule 3502.<sup>4</sup> The proposed rule permitted associated person liability based on a negligence standard.<sup>5</sup> However, when the PCAOB issued its final Rule, a recklessness requirement was the minimal threshold for regulatory action.<sup>6</sup> In fact, the final rule was entitled "Responsibility Not to Knowingly or Recklessly Contribute to Violations." In adopting a minimal threshold of recklessness in the Rule, the Board confronted the same issue that it faces today, and decided not to adopt a negligence standard. The reasons that the PCAOB declined to adopt negligence liability then are fully applicable today. The Board summed it up this way:

After carefully considering the comments received, the Board has determined, however, to modify the scope of Rule 3502 to apply only when an associated person causes the registered firm's violation due to an act or omission the person "knew, or was reckless in not knowing, would directly and substantially contribute to such violation." ...

A number of commenters expressed concern that adoption of a negligence standard would allow the Board, or the SEC, to proceed against associated persons who in good faith, albeit negligently, have caused a registered firm to violate applicable laws or standards. For example, commenters suggested that the proposed rule could be used against compliance personnel

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<sup>3</sup> 17 C.F.R. §201.102(e), note 1 at 11-12.

<sup>4</sup> Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees, Release No. 2004-015, Public Company Accounting Oversight Board (Dec. 14, 2004).

<sup>5</sup> *Id.*

<sup>6</sup> SEC Release No. 34-53677, File No. PCAOB-2006-01 (April 19, 2006).

within a firm who inadvertently design a firm's compliance system in a flawed manner. Commenters also expressed concern that, because the SEC can enforce PCAOB rules under Section 3 of the Act, the Board's rule could have the practical effect of altering the state-of-mind requirement applicable in SEC enforcement proceedings against accountants.

It was not the Board's intention to establish a new standard for SEC enforcement of the securities laws and related applicable rules. The Board also recognizes that persons subject to its jurisdiction must comply with complex professional and regulatory requirements in performing their jobs. The Board does not seek to create through this rule a vehicle to pursue compliance personnel who act in an appropriate, reasonable manner that, in hindsight, turns out to have not been successful. Nor does the Board seek to reach those whose conduct, unbeknownst to them, remotely contributes to a firm's violation. At the same time, the Board continues to believe that it is necessary and appropriate for its ethics rules to apply when an associated person has engaged in an act or omission with knowledge that, or in reckless disregard of whether, it would directly and substantially contribute to a violation.<sup>7</sup>

The findings and conclusions made by the Board in 2006 in adopting Rule 3502 are still valid. Indeed, a number of Board members have recently raised concerns similar to the concerns that the Board expressed in 2006 when it did not adopt a negligence standard. For example, the 2006 Release noted that: "The Board also recognizes that persons subject to its jurisdiction must comply with complex professional and regulatory requirements in performing their jobs."<sup>8</sup> Similarly, Board Member DesParte recently noted that "[a]udits are complex and require significant input and judgment from a wide array of professionals with distinct responsibilities, expertise, and experience, all working collaboratively to comply with complex laws, professional standards, and rules."<sup>9</sup> Additionally, in 2006, the Board noted that "commenters suggested that the proposed rule could be used against compliance personnel within a firm who inadvertently design a firm's compliance system in a flawed manner"<sup>10</sup> and the Board in 2023 noted a similar concern.<sup>11</sup> These similarities show that the same concerns exist today as when the Board changed course from a negligence standard and instead adopted a recklessness standard in 2006.

Since the same reasons exist today as in 2006 for not adopting a negligence standard, there should be clear justification for the change. However, the Proposal does not provide justifications to support a change. The Proposal suggests that the recklessness standard creates an "incongruity" between the direct liability of the firm and the contribution liability of associated person.<sup>12</sup> That asserted "incongruity" would have been equally present in 2006 when the Rule was adopted but that incongruity did not justify adoption of a negligence standard.

Further, given the concerns noted in Section II below, the proposed change in rule should be supported by a clear rationale and basis. The Proposal does not provide that. The Proposal estimates that there will be few additional enforcement actions if the Proposed Rule is adopted.<sup>13</sup> In light of the substantial potential consequences (discussed below) of the Proposed Rule, it should not be adopted if it will be largely unused. The Proposal suggests that there will not be substantial cost from the proposed rule change because it will not be any different than SEC Rule 102(e). It is not clear what the need for this

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<sup>7</sup>SEC Release No. 34-53427, File No. PCAOB 2006-01 (March 7, 2006). While the Board's proposed rule tracked some of the language of Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), the rule, as adopted, differs significantly from, and should not be interpreted in pari materia with, that statutory provision.

<sup>8</sup> *Id.*

<sup>9</sup> Duane M. DesParte, Board Member, Statement on Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability, PCAOB Open Board Meeting (Sept. 19, 2023), <https://pcaobus.org/news-events/speeches/speech-detail/statement-on-proposed-amendments-to-pcaob-rule-3502-governing-contributory-liability>.

<sup>10</sup> SEC Release No. 34-53427, *supra* note 11 at 19.

<sup>11</sup> See Proposed Amendments to PCAOB Rule 3502, *supra* note 1 ("Excessive litigation risk could unintentionally discourage auditors from accepting important audit roles if they fear being held liable, leaving these roles to be accepted by less cautious or less qualified individuals.").

<sup>12</sup> *Id.*, see note 1 at 3.

<sup>13</sup> *Id.*, see note 1 at 25.

rule change is or what will be gained by the rule making if the SEC already has the authority to bring enforcement actions against auditors for negligent conduct.

## II. The Potential Consequences of the Proposed Rule Could Be Severe

Consequences of a rule change should be understood before implementing the change, including careful consideration of the costs of the proposed change. While the consequences associated with the Proposal may be difficult to predict and quantify, it is important for the PCAOB to undertake this effort to exhibit its commitment to thoughtful consideration of changing rules that may have significant negative impacts on audit firms and individual auditors.

The Proposed Rule may cause a decline in the number of firms willing to audit public companies or participate in public company audits conducted by other firms. Small and mid-sized accounting firms will need to consider whether the benefits of auditing certain public registrants, or participating in public company audits, is worth the additional risks to their partners and staff. Those firms may decide not to do such work at all.

When SOX was passed, Congress was aware of the downfall of Arthur Andersen LLP and other events in the market that affected competition in the public company audit market. Section 701 of SOX specifically required that there be a study to determine the effects of this lack of competition, and ways to address it. Given this expressed Congressional concern, it is especially appropriate to consider the effects of the Proposed Rule on competition for audit work in the marketplace. Indeed, the GAO Report that was issued pursuant to Section 701<sup>14</sup> noted that “the possible reduction in the number of accounting firms willing to audit public companies in the wake of the passage of Sarbanes-Oxley could further impact the availability and cost of capital for some smaller companies....” Given these concerns, Crowe suggests that the Proposed Rule be analyzed for its effect on audit firms which issue audit reports or participate in other firms’ audits (and on the individuals at those firms who will be working on those audits). If the effect of the Proposal would be to decrease access to auditors, that would be contrary to the concern Congress expressed in requiring the report referenced in Section 701.

The Proposed Rule is also likely to further exacerbate the decline in individuals pursuing the CPA license and discourage highly qualified individuals from accepting roles on more challenging audits or in the firm’s quality control system. As noted above, this risk was identified in the 2006 adoption of the present Rule, when the Board noted that “commenters suggested that the proposed rule could be used against compliance personnel within a firm who inadvertently design a firm’s compliance system in a flawed manner.”<sup>15</sup> Indeed, similar concerns have been expressed today.<sup>16</sup> There is significant publicity around the PCAOB’s adoption of new policies, and its strengthened enforcement posture and the regulatory environment is of course known to individuals who are contemplating a career in public accounting. With that backdrop, students or junior auditors may reconsider a career in audit if that career is subject to being taken away at any time based on a single act of negligence, particularly if a new negligence standard is used to question judgment calls based on the clarity of hindsight. The Board appeared to recognize this concern when the Chair noted that the Proposal was not “intended” to be used against junior auditors.<sup>17</sup> But that “intent” is not in the Proposal, and as Board Member Ho noted, that “intent” could change with a future board (or even this Board).<sup>18</sup> Certainly, the Board needs to take action against

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<sup>14</sup> Report to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services, “Mandated Study on Consolidation and Competition,” GAO-03-864 July 30, 2003.

<sup>15</sup> Proposed Amendments to PCAOB Rule 3502, *supra* note 11 at 19.

<sup>16</sup> See Proposed Amendments to PCAOB Rule 3502, *supra* note 1 (“Excessive litigation risk could unintentionally discourage auditors from accepting important audit roles if they fear being held liable, leaving these roles to be accepted by less cautious or less qualified individuals.”).

<sup>17</sup> Erica Y. Williams, Chair, Statement on Proposed Changes to Board Rule on Contributory Liability for Firm Violations (Sept. 19, 2023), <https://pcaobus.org/news-events/speeches/speech-detail/chair-williams-statement-on-proposed-changes-to-board-rule-on-contributory-liability-for-firm-violations>.

<sup>18</sup> Christina Ho, Board Member, The Cost of Unintended Consequences: Accounting Talent, Audit Quality, Investor Protection, PCAOB Open Board Meeting (Sept. 19, 2023), [https://pcaobus.org/news-events/speeches/speech-detail/the-cost-of-unintended-consequences-accounting-talent-audit-quality-investor-protection-\(statement-on-proposed-amendments-to-pcaob-rule-3502-governing-contributory-liability\)](https://pcaobus.org/news-events/speeches/speech-detail/the-cost-of-unintended-consequences-accounting-talent-audit-quality-investor-protection-(statement-on-proposed-amendments-to-pcaob-rule-3502-governing-contributory-liability)).

bad actors; however, we do not believe that a person who acts negligently should necessarily be considered a bad actor, such as when their actions involve a single act of non-compliance with the professional standards. To the extent the Proposal exacerbates the shortage of auditors or a reduction in registered firms, adoption of the proposed changes could lead to issues of audit quality rather than improvements.

Finally, a premise of the rulemaking seems to be that auditors will act with more care if they are subject to an enforcement action based on a negligence standard.<sup>19</sup> Since auditors are already subject to negligence actions by the SEC, state regulators, and perhaps third parties, including their clients, the Proposal should provide some empirical evidence to support how auditor's behavior is going to change under the Proposed Rule. Moreover, even if this point has some validity, we believe the risk is greater that auditors will be "overly careful" to protect themselves by performing additional, unnecessary auditing procedures. If every judgment made in the context of an audit was subject to individual sanction, an auditor may, out of necessity, shy away from difficult decisions which will lead to less effective auditing or, at a minimum, will increase audit costs. Either way, this will not lead to enhanced audit quality.

### III. Statutory Authority for the Change in the Rule is Not Clear

The Proposal references a number of provisions<sup>20</sup> as the basis of authority for the proposed new rule, with the focus on Sections 103 and 105 of SOX as authority for adoption of a negligence standard.<sup>21</sup> However, it is not clear that either of these provisions permits the Board to promulgate this change to Rule 3502. The Release first references the Board's authority "to set ethical standards" in Section 103 as the basis for adopting a negligence enforcement standard. This provision cannot serve as a basis for the Proposed Rule. Section 103 provides the PCAOB with the authority to set ethical standards (i.e., what is and what is not ethical conduct). The Release does not address ethical conduct at all; it only addresses negligent conduct which may relate to an ethical obligation or may relate to another obligation established by the PCAOB. Negligence is broader than just ethical conduct. Accordingly, the power to regulate ethical conduct does not encompass disciplinary authority over all conduct and it therefore does not provide clear support for the Proposed Rule.<sup>22</sup>

In addition, Section 105 does not clearly provide a basis for the Rule change. Section 105 is titled "Investigations and Disciplinary Proceedings"<sup>23</sup> with Section 105(c)(4) providing the authority for sanctions. The Release suggests this section gives the PCAOB the ability to bring a disciplinary action for negligence; however, nowhere in that language does one find a basis for establishing liability for negligently contributing to a firm violation. The fact that Congress specifically gave this authority to the SEC, but not the PCAOB, in the Private Securities Litigation Reform Act, U. S.C. 78 t (e), to regulate aiding and abetting liability, is evidence that the PCAOB does not have this authority. Again, Sections 103 and 105 do not give the PCAOB clear authority to do what the Proposal contemplates and is an additional reason why the Proposal should not be adopted.

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<sup>19</sup> Proposed Amendments to PCAOB Rule 3502, *supra* note 1 at 21 ("The proposed amendments, by increasing the likelihood that individuals take more seriously their audit, quality control, and other compliance responsibilities, will make it more likely for registered firms to comply with PCAOB standards.").

<sup>20</sup> Proposed Amendments to PCAOB Rule 3502, *supra* note 1 at 2 n.4, 12 n.43.

<sup>21</sup> *Id.* at 12 n.43.

<sup>22</sup> 15 U.S.C. § 7213.

<sup>23</sup> 15 U.S.C. § 7215.

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We appreciate the opportunity to share our perspectives on the Board's Proposal. We would be pleased to discuss our comments with the Board or its staff. If you have any questions, please contact Jennifer Kary or Matthew Schell.

Sincerely,

Crowe LLP

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