



Members of the Investor Advisory Group

Via Email

October 26, 2023

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

PCAOB Rulemaking Docket Matter No. 053, Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability, PCAOB Release No. 2023-007.

Dear Secretary Brown and Members of the Public Company Accounting Oversight Board (PCAOB or Board):

The Members of the Investor Advisory Group (MIAG)¹ appreciate the opportunity to comment on the PCAOB's "*Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability*" (Proposal).² We understand the Proposal would amend PCAOB Rule 3502, *Responsibility Not to Knowingly or Recklessly Contribute to Violations* (Rule 3502).³

Rule 3502 was issued in 2005 and for "well over a decade now, . . . [has served as the Board's basis for bringing] enforcement proceedings against associated persons . . ." ⁴ And we agree with the observation of PCAOB Chair Erica Y. Williams that:

Like many of the standards this Board has voted to modernize, Rule 3502 is nearly 20 years old. Things have changed since it was first adopted in 2005.

The [Securities and Exchange Commission (SEC or Commission)] SEC now has the ability to seek civil money penalties in enforcement actions against associated persons when they negligently cause firm violations. The way that firms operate has changed. And the expert staff at

¹ This letter represents the views of Investor Advisory Group (IAG) and does not necessarily represent the views of all of its individual members, or the organizations by which they are employed. IAG views are developed by the members of the group independent of the views of the Public Company Accounting Oversight Board (PCAOB) and its staff. For more information about the IAG, including a listing of the current members, their bios, and the IAG charter, see <https://pcaobus.org/about/advisory-groups/investor-advisory-group>.

² PCAOB, Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability, PCAOB Release No. 2023-007 (Sept. 19, 2023), available at https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/053/pcaob-release-no.-2023-007-rule-3502-proposal.pdf?sfvrsn=7d49cc51_9#:~:text=As%20discussed%20above%2C%20the%20Board,the%20registered%20firm%20that%20has as.

³ Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees, PCAOB Release No. 2005-014 at 9 (July 26, 2005), available at https://pcaobus.org/Rulemaking/Docket017/2005-07-26_Release_2005-014.pdf.

⁴ PCAOB Release No. 2023-007 at 3.

the PCAOB who have seen how Rule 3502 plays out in the real world are recommending this update.⁵

At the outset, the MIAG notes the role of state accountancy boards, which can discipline accountants for violations of statutory, regulatory and professional standards. Federal securities and state law also provide causes of action that result in sanctions against accountants for related conduct. Therefore, accountants are already subject to liability and disciplinary schemes that encourage them to comply with applicable statutory, regulatory and professional standards.

The MIAG supports the PCAOB's proposed amendments to Rule 3502. We agree that the Proposal would strengthen the existing rule by changing the liability standard for contributory actions by associated persons from recklessness to negligence and by clarifying the relationship between the contributory actor and the primary violator.⁶

We agree with the Board that the proposed amendments would better align Rule 3502 with the scope of the Board's enforcement authority under the Sarbanes-Oxley Act of 2002 (SOX) and address the regulatory gap within the existing framework, which can lead to anomalous results.⁷

As Board Member Kara Stein explained:

The PCAOB currently cannot bring an action against negligent auditors whose direct and substantial contributions furthered an audit firm's violations. This creates an obvious gap in the Board's ability to protect investors and public markets, as Table 1 in the economic analysis suggests. Today's proposal would close this oversight gap, thus emphasizing the obligations under the auditing standards that auditors act with reasonable care and competence.⁸

⁵ Erica Y. Williams, Chair, PCAOB Open Board Meeting, Chair Williams' Statement on Proposed Changes to Board Rule on Contributory Liability for Firm Violations (Sept. 19, 2023), available at <https://pcaobus.org/news-events/speeches/speech-detail/chair-williams-statement-on-proposed-changes-to-board-rule-on-contributory-liability-for-firm-violations>.

⁶ See PCAOB Release No. 2023-007 at 4 ("we detail the reasons for the proposed amendments to modernize and strengthen the rule").

⁷ See Sarbanes-Oxley Act §105(c)(5)(A)-(B), 15 U.S.C. § 7201 (2002), available at https://pcaobus.org/About/History/Documents/PDFs/Sarbanes_Oxley_Act_of_2002.pdf ("The sanctions and penalties described in subparagraphs (A) through (C) and (D)(ii) of paragraph (4) shall only apply to— (A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or (B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard."); see also S. 2673, PUBLIC COMPANY ACCOUNTING REFORM AND INVESTOR PROTECTION ACT, S. Rep. No. 107-205, § 105(b) (2d Sess. 2002), available at <https://www.govinfo.gov/content/pkg/CRPT-107srpt205/html/CRPT-107srpt205.htm> ("Section 105(b) authorizes the Board to impose a full range of sanctions if it finds that a registered firm, or its partners or employees, have engaged in any act or practice that violates the Act, the Board's rules, professional standards, or the portion of the securities laws (and SEC rules) relating to audits of public companies . . . [and] the Board's ability to suspend or bar an associated person from the auditing of public companies, and the Board's ability to impose civil money penalties above a certain amount, is limited to situations involving intentional, knowing, or reckless conduct, or repeated negligent conduct.").

⁸ Kara M. Stein, Board Member, PCAOB Open Board Meeting, Statement on Responsibility and Accountability for Persons Contributing to a Registered Audit Firm's Violations of Law or Professional Standards, Proposed Amendments to PCAOB Rule 3502 (Sept. 19, 2023), available at <https://pcaobus.org/news-events/speeches/speech-detail/responsibility-and-accountability-for-persons-contributing-to-a-registered-audit-firm-s-violations-of-law-or-professional-standards-proposed-amendments-to-pcaob-rule-3502>; see Erica Y. Williams, Chair, PCAOB Open Board Meeting, Chair Williams' Statement on Proposed Changes to Board Rule on Contributory Liability for Firm Violations (Noting that "firms don't make the decisions or take the actions that lead to these violations [of quality control or independence standards] on their own [,] people participate in these decisions and actions."); Anthony C. Thompson, Board Member, PCAOB Open Board Meeting, Board Member Thompson's Statement on Proposed Changes to Board Rule on Contributory Liability for Firm Violations (Sept. 19, 2023), available at <https://pcaobus.org/news-events/speeches/speech->

We believe updating Rule 3502's liability threshold from recklessness to negligence will bring it in line with the existing requirement for auditors to exercise a standard of reasonable care during the performance of their professional responsibilities.⁹ As indicated by Chair Williams' statement, since 1998 SEC rules have provided the Commission the ability to bring enforcement actions against associated persons if they engage in negligent acts that result in a violation of statutory, regulatory or professional standards.¹⁰ And as indicated, since 2002 the PCAOB has the same authority under SOX. We believe this supports the Board's expectation that the economic impact of the Proposal will be modest.¹¹ And like the SEC has done historically, we believe the PCAOB will exercise its prosecutorial discretion appropriately when the underlying conduct is negligent.

We also believe that the language in SOX was written to be consistent with the SEC's rules. As such, we believe the Board should adopt the following language contained in the adopting release for those rules: "Because of the importance of an accountant's independence to the integrity of the financial reporting system, circumstances that raise questions about an accountant's independence always merit heightened scrutiny."¹² Therefore, if an accountant's conduct with respect to an independence issue, results in a violation of statutory, regulatory or the Board's auditor independence standards, that accountant's conduct may be subject to a disciplinary proceeding under Rule 3502.

Finally, we note that the Proposal includes several questions that appear to be directed at, or otherwise of interest to, investors. Those questions and our specific responses follow:

[detail/statement-on-proposed-amendments-to-pcaob-rule-3502-governing-contributory-liability-thompson](#) ("The PCAOB can hold a firm accountable for negligently violating PCAOB rules and standards; however, an associated person who directly and substantially contributes to such violations is held to a recklessness standard, which is a higher threshold [and] [t]his discrepancy is inconsistent with our investor protection mission.").

⁹ See PCAOB Release No. 2023-007 at 11 (Noting that the current "liability threshold serves a dual function: It incentivizes auditors to conduct their work knowing that reasonable care is the standard for assessing it . . .").

¹⁰ See Amendment to Rule 102(e) of the Commission's Rules of Practice, Securities Act Release No. 7,953, Exchange Act Release No. 26,929, Public Utility Holding Company Act Release No. 26,929, Trust Indenture Act Release No. 2,639, Investment Advisers Act Release No. 1,771, Investment Company Act Release No. 23,489, 63 Fed. Reg. 57,164, 57,172 (Oct. 19, 1998), *available at* <https://www.federalregister.gov/documents/1998/10/26/98-28466/amendment-to-rule-102e-of-the-commissions-rules-of-practice> ("§201.102 Appearance and practice before the Commission. . . . (e) Suspension and disbarment. (1) Generally[] (iv) With respect to persons licensed to practice as accountants, 'improper professional conduct' under §201.102(e)(1)(ii) means: (A) Intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; or (B) Either of the following two types of negligent conduct: (1) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted. (2) Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission."). We note that the adopting release for the Amendment to Rule 102(e) states that "most of the accounting and auditing practiced before the Commission is 'conducted by the 'Big Five' firms' and that 'three of the largest five accounting firms * * * suggested that the Commission could appropriately adopt' the Standard." *Id.* at 57,187. We also note that in a 2002 decision of United States Court of Appeals for the District of Columbia the court indicated that even prior to the 1998 Amendment of Rule 102(e) the Securities and Exchange Commission had the authority to bring enforcement actions against individual auditors for negligence. See *KPMG LLP v. SEC*, No. 01-1131 (D.C. Cir. 2002), *available at* [KPMG LLP v. SEC, No. 01-1131 \(D.C. Cir. 2002\) :: Justia](#) ("the Commission properly could use a negligence standard to enforce violations of . . . Commission rules").

¹¹ See PCAOB Release No. 2023-007 at 13 ("associated persons already are subject to potential liability—including money penalties—for negligently contributing to registered firms' violations of numerous laws and rules governing the preparation and issuance of audit reports via the Securities Exchange Act of 1934").

¹² 63 Fed. Reg. at 57,168.

5. Is it clear and understandable how the proposed amendments to Rule 3502 advance the Board’s statutory mandate to protect investors?¹³

We believe it is clear and understandable how the proposed amendments to Rule 3502 advance the Board’s statutory mandate to protect investors. We note that our September 2022 letter in response to the PCAOB Draft Plan 2022-2026¹⁴ expressed support for the Board’s goal of strengthening enforcement.¹⁵ That letter stated:

Goal 3: Strengthen Enforcement

Rigorously Enforce PCAOB and Other Applicable Standards, Laws, and Rules.

Impose More Significant Penalties and Other Relief.

Increase Transparency in Enforcement Actions.

Collaborate With Other Regulators to Bring Concurrent Actions.

We support the Board’s inclusion of all four of these objectives, as stated. In fact, these objectives are the most granular steps outlined in the Plan¹⁶

We agree with the PCAOB that the “proposed amendments to Rule 3502 are consistent” with Goal 3.¹⁷

In addition, we agree with the Board that the Proposal is consistent with the investor protection provision of SOX which “plainly contemplates that disciplinary proceedings can be instituted for a violation based on a single negligent act.”¹⁸ Moreover, and as indicated, the Proposal brings the PCAOB in line with the statutory provisions of SOX, existing SEC rules with respect to unprofessional conduct, and judicial precedent.¹⁹

6. Beyond the dual purposes of deterrence and accountability, are there other ways that the proposed amendments would protect investors?²⁰

We believe that beyond the dual purposes of deterrence and accountability, there are other ways that the proposed amendments would protect investors. For example, we believe the Proposal will:

- Remove limits to actions the PCAOB may bring under its statutory authority for conduct that results in violations of statutory, regulatory, and professional standards.
- Improve “audit quality as auditors become more careful about their work”²¹, and as audit quality improves, the likelihood of auditors being subjected to meritorious litigation, and the risks and costs to

¹³ See PCAOB Release No. 2023-007 at 12 (emphasis added).

¹⁴ See Request for Public Comment, Draft 2022-2026 PCAOB Strategic Plan, PCAOB Release No. 2022-003 (Aug. 16, 2022), available at https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/2022-003-rfc-draftstrategicplan.pdf?sfvrsn=fdc9859a_4.

¹⁵ Letter from the Members of the Investor Advisory Group to Office of the Secretary, PCAOB 3 (Sept. 15, 2022), https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/strategic-plan-comments-2022/10_iag.pdf?sfvrsn=f24d0e63_4 (emphasis added).

¹⁶ *Id.*

¹⁷ PCAOB Release No. 2023-007 at 11.

¹⁸ Rules on Investigations and Adjudications, PCAOB Release No. 2003-015, at A2-58 (Sept. 29, 2003), available at <https://pcaobus.org/Enforcement/Documents/Release2003-015.pdf> (“The Act plainly contemplates that disciplinary proceedings can be instituted for a violation based on a single negligent act.”).

¹⁹ See KPMG LLP v. SEC, No. 01-1131, *supra* note 10.

²⁰ PCAOB Release No. 2023-007 at 12 (emphasis added).

²¹ *Id.* at 21.

investors resulting from that litigation, as well as misstatements and omissions in audited financial statements, should be reduced.

- Result in firms that “will be more likely to comply with their respective legal requirements”²²
- “[E]nhance investors’ confidence in the information provided in companies’ financial statements.”²³
- “[H]ave an incremental positive effect on capital market efficiency.”²⁴

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?²⁵

We do not believe the Board should retain the “directly and substantially” modifier to describe the connection between an associated person’s contributory conduct and a firm’s violation. We note that the modifier does not appear in either the SEC rules or the provisions and related legislative history of SOX that provide the SEC and the PCAOB, with the ability to bring enforcement actions against associated persons if they engage in negligence. As indicated, we believe the Board should bring Rule 3502 proceedings against accountants whose conduct demonstrates their lack of competence and violates applicable statutory or regulatory requirements or the Board’s professional standards.

Thank you for carefully considering the comments of the MIAG and other investors—the primary customers of audited financial reports. If you, any members of the Board, or your staff have questions or seek further elaboration of our views, please contact Amy McGarrity at amcgarrity@copera.org.

Sincerely,

Members of the Investor Advisory Group

Members of the Investor Advisory Group

²² *Id.* at 22.

²³ *Id.* at 23; *cf.* Anthony C. Thompson, Board Member, PCAOB Open Board Meeting, Board Member Thompson’s Statement on Proposed Changes to Board Rule on Contributory Liability for Firm Violations (“This rulemaking seeks to ensure that persons who orchestrate or facilitate firm violations cannot continue to perpetuate such conduct uncharged and unsanctioned [and] [a]s we know, such conduct can erode investors’ perception of the quality of audits and their confidence in the capital markets”).

²⁴ PCAOB Release No. 2023-007 at 24.

²⁵ *Id.* at 16 (emphasis added).