



November 2, 2023

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

The Center for Audit Quality (CAQ) is a nonpartisan public policy organization serving as the voice of U.S. public company auditors and matters related to the audits of public companies. The CAQ promotes high-quality performance by U.S. public company auditors; convenes capital market stakeholders to advance the discussion of critical issues affecting audit quality, U.S. public company reporting, and investor trust in the capital markets; and using independent research and analyses, champions policies and standards that bolster and support the effectiveness and responsiveness of U.S. public company auditors and audits to dynamic market conditions. This letter represents the observations of the CAQ based upon feedback and discussions with certain of our member firms, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

### **Support for a Fair and Effective PCAOB Enforcement Program**

The CAQ appreciates the opportunity to share our views and provide input on the proposed amendments to Rule 3502, *Responsibility Not to Knowingly or Recklessly Contribute to Violations* (referenced herein as proposed Rule 3502, the proposed rule or the proposal) issued by the Public Company Accounting Oversight Board (PCAOB or the Board). The CAQ is supportive of the Board continuing to evaluate how it can best structure its rules and enforcement program in a manner that will protect investors and improve audit quality. The CAQ and our member firms are committed to promoting audit quality and appreciate that the Board's enforcement program plays a role in achieving that outcome.

As we discuss below, we believe that any project to modify the framework by which auditors can be held liable for violations of PCAOB rules and standards<sup>1</sup> should include a clear assessment of why that current

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<sup>1</sup> The PCAOB has the power to sanction any "violation of [the Sarbanes-Oxley Act of 2002], the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards." 15 U.S. Code § 7215(c)(4). We use the phrase "PCAOB rules and standards" for convenience



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framework exists and whether, in practical application, the current framework has impeded the PCAOB's effectiveness in bringing enforcement actions to fulfill its mission. This assessment should be performed considering all of the enforcement tools at the PCAOB's disposal and in light of the structure of other enforcement programs such as that of the U.S. Securities and Exchange Commission (SEC or Commission). That exercise is especially important in a situation like this one, where the Board in 2004 and 2005 considered, and then rejected, the very negligence standard in the context of contributory liability that it is now proposing. To that end, we offer our observations regarding both the current Rule 3502 and what we see as the likely key effects of the proposed rule. Our comments are intended to be constructive in nature, and we welcome the opportunity to discuss our comments with the Board and staff.

We discuss below several concerns about the proposal that we encourage the Board to consider as it evaluates whether to adopt the proposed rule.

### **Adoption of the Proposed Rule Could Have Unintended Consequences by Negatively Impacting Audit Quality**

As multiple Board Members suggested in statements accompanying the issuance of the Proposing Release, it is important to have confidence that reducing the standard for contributory liability under Rule 3502 from recklessness to simple negligence would not negatively impact the profession and, correspondingly, that audit quality would not be negatively impacted. We are concerned that there are at least three significant ways in which this proposal could have such unintended consequences.

#### *The Proposal Could Exacerbate the Accounting Talent Crisis*

We share the Board's concern (echoed by Board member Ho) that an unintended consequence of the proposal could be to discourage auditors from accepting important audit roles due to fear of being held liable under a simple negligence standard for good faith judgments.<sup>2</sup> This concern is particularly relevant in relation to key roles associated with a firm's quality control system, where the activities of the individual may touch numerous PCAOB engagements and be significant to a firm's overall quality system but may not involve the performance of audit procedures governed by the PCAOB auditing standards.

Another concern in this respect is the Board's proposal to amend Rule 3502 to permit sanctions against associated persons who contribute to a violation by a firm other than that with which they are associated. Individuals who conduct audit quality- or quality control-related activities that touch on the activities of another firm could reasonably fear that a negligence standard would permit the PCAOB to second-guess

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to refer to this entire body of laws, regulations, rules, and standards, as does the Board in the proposing release. See *Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability*, PCAOB Rel. No. 2023-007, page 9 fn.31 (Sept. 19, 2023) ("Proposing Release").

<sup>2</sup> See Proposing Release, page 26 ("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"); Ho Statement.



professional judgments that they make, and could be dissuaded from accepting roles designed to promote audit quality across registered firms.

In addition to these concerns, there is a risk that the proposal could also adversely impact the willingness of accounting professionals to enter or remain in the audit profession, which has been declining steadily in recent years, as noted by both the PCAOB and the media more broadly.<sup>3</sup> While it may not appear obvious that a change in a legal standard would impact the accounting pipeline, our research shows that 30% of undergraduate accounting majors who have chosen *not* to pursue, or are undecided on, CPA licensure cite as a *major* reason for such decision the belief that the “reg[ulatory] environment makes [the] profession unappealing.”<sup>4</sup> An additional 64% cite this belief as *part of the reason* for not planning to pursue, or being undecided on, CPA licensure. While we support appropriately holding professionals accountable and using enforcement where appropriate to improve audit quality, we believe the existing standard of liability under Rule 3502 already empowers the PCAOB to reasonably and adequately address violations of PCAOB rules and standards. By contrast, the change the Board contemplates in this release would likely be perceived negatively by those considering entering or staying in the profession as raising the likelihood of enforcement actions over good-faith judgments.

#### *There Is a Risk of Inefficient and Unproductive “Self-Protective” Behavior*

It is clear that audit quality has improved since the PCAOB’s inception due to enhanced auditing standards, a robust inspection program, and appropriate enforcement efforts, among other reasons. These improvements to audit quality have occurred even as efforts toward continuous improvement remain ongoing. Notably, audit firms have invested in enhancing their systems of quality control, leveraging technology, and developing delivery models – actions all aimed at supporting the performance of quality audits. At the same time, audits of public companies have become significantly more complex, with nuanced professional judgments taking an ever-greater role in the process of obtaining and evaluating audit evidence and otherwise performing required audit and quality control procedures.

In our view, the proposal likely would lead to scenarios where firm professionals engage in what the Board refers to as “excessive monitoring and self-protective”<sup>5</sup> behavior as they make good-faith professional judgments against the backdrop of a lower standard for liability. We are concerned that moving to a

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<sup>3</sup> See, e.g., “Technology and Talent – Audit Quality Challenges in the 21st Century,” Board Member Christina Ho (Sept. 15, 2022) (discussing “a more daunting pipeline challenge glaring right at us”); “Why No One’s Going Into Accounting,” Wall Street Journal (Oct. 6, 2023); “Accounting salaries rise as talent pipeline shrinks,” Accounting Today (Oct. 13, 2023); “Accounting Graduates Drop by Highest Percentage in Years,” Wall Street Journal (Oct. 12, 2023); “There’s an accountant shortage,” Fortune (Sept. 7, 2023); “Shortage of Accountants Adversely Impacting Early-Stage Companies,” Forbes (July 23, 2023); “The Accounting Shortage is Showing Up in Financial Statements,” Wall Street Journal (July 11, 2023).

<sup>4</sup> [Increasing Diversity in the Accounting Profession Pipeline: Challenges and Opportunities](#), page 31 of the Appendix (July 2023), Edge Research and the Center for Audit Quality.

<sup>5</sup> Proposing Release, page 26. Examples of “self-protective behavior” described in the Proposing Release include that “[i]ndividuals may spend more time on a task than is necessary to accomplish it at the appropriate level of due care” and that “individuals may excessively document the nature of their task performance to demonstrate compliance in a future proceeding.” *Id.*



negligence standard for contributory liability would inappropriately lead to sanctions of professionals who make judgments in good faith. If associated persons become subject to enhanced exposure for contributing to violations when the Board concludes that they have failed to exercise due care rather than only when they have acted recklessly, it will likely follow that professionals will engage, in the Board’s words, in “inefficient” and “unproductive”<sup>6</sup> steps that increase the length and cost of audits without a corresponding increase in quality, and perhaps even a reduction in quality as attention is diverted from more important aspects of the audit, to the detriment of investor protection. These considerations appear to have played into the Board’s overarching concern when it concluded in 2005 that a recklessness standard “strikes the right balance.”<sup>7</sup> Similarly, in the context of the present proposal, Board Member DesParte 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>8</sup> suggesting that a negligence standard might not be appropriate to that environment.

#### *The Proposal Could Have a Negative Impact on Small Firms and Reduce the Market for Audit Services*

These same types of concerns about generating inefficiency and “self-protective” behavior among professionals may present an especially acute threat to smaller firms. This possibility appears to have animated Board Member Ho’s statement that a consolidation of the market for auditing services could result from the application of the proposal to smaller firms.<sup>9</sup> Smaller firms might be most at risk from any misallocation of resources that results from “self-protective” behavior, because they may have fewer compensating resources to help ensure compliance with PCAOB rules and standards even with the inefficiencies created by such behavior. Additionally, smaller firms may be less able to insure or self-insure against costs arising from investigations and actions related to allegations of negligence, and may be more affected by any impact that the proposed rule has on the accounting talent crisis discussed above. To the extent that any individual PCAOB enforcement action can call into question for a particular smaller firm whether the benefits of an issuer or broker-dealer auditing practice outweigh the costs, a negligence standard for contributory liability could turn out to be a deciding factor in causing a firm to exit the market for public company and registered broker-dealer engagements, thereby reducing competition and audit quality.

#### **The Rationale for the Proposal Is Not Clear**

In light of the proposal’s potential negative impacts on audit quality, it is important that any modification of the recklessness standard in Rule 3502 be grounded in a clear and well-supported conclusion that the expected benefits of an amended Rule 3502 outweigh the expected costs. We have concerns that the proposal has not provided such a rationale. While the Board has suggested that the recklessness standard

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<sup>6</sup> Proposing Release, page 26.

<sup>7</sup> *Ethics and Independence Rule Concerning Independence, Tax Services, and Contingent Fees*, PCAOB Rel. No. 2005-014, page 13 (July 26, 2005) (“2005 Adopting Release”).

<sup>8</sup> Statement of Board Member Duane DesParte (Sept. 19, 2023).

<sup>9</sup> See Statement of Board Member Christina Ho (Sept. 19, 2023) (“Ho Statement”).



creates an “incongruity”<sup>10</sup> between the direct liability of firms and the contributory liability of associated persons, the release contains only a general discussion of the costs and benefits that might accrue under the proposed rule, without a comprehensive evaluation of the potential costs and unintended consequences.<sup>11</sup>

Four examples may help to illustrate the ways in which the Board’s proposal leaves open crucial questions about the completeness of the analysis on anticipated costs and benefits:

- First, the Board projects that the costs of its proposal will be reduced by the fact that the Commission already has the authority to sanction negligent conduct that contributes to another party’s violations.<sup>12</sup> As is discussed further below, however, the Board’s further statement that the Commission actually exercises this authority in practice to sanction negligent conduct cites exclusively to cases in which the Commission concluded that discipline of an associated person was appropriate under SEC Rule of Practice 102(e) or Securities Exchange Act of 1934 (Exchange Act) Section 4C, neither of which permits the Commission to charge a respondent based on a single instance of simple negligence.<sup>13</sup> To the extent that the Board plans to charge single instances of simple negligence for contributory liability, then, it is proposing to wield a power that its analysis does not demonstrate the Commission having exercised, which naturally raises questions about the costs and benefits that the Board articulates.
- Second, the Board’s proposal makes it very difficult to predict overall what incremental enforcement might result from its adoption of a modified Rule 3502, which in turn presents notable challenges for a thorough cost-benefit analysis.
  - On one hand, the Board seems to suggest in parts of the proposal that enforcement will not increase significantly under a modified Rule 3502. As the Board recognizes in its proposal, Rule 3502 “is not the exclusive means for the Board to enforce applicable Board rules and standards against associated persons.”<sup>14</sup> In fact, the Board already possesses a number of tools to hold individuals accountable for their roles in both individual audits and a firm’s quality control system as a whole, as it makes clear each time it initiates proceedings against an individual. As the Board notes in the proposal, it believes that these tools include the authority to impose limited sanctions for a single instance of

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<sup>10</sup> Proposing Release, page 3.

<sup>11</sup> Proposing Release, pages 21-27.

<sup>12</sup> Proposing Release, page 13 n.49 (citing Exchange Act § 21C(a), 15 U.S.C. § 78u-3(a) (authorizing the Commission to sanction “any other person that is, was, or would be a cause of [a violation of the Exchange Act or any related SEC rules or regulations], due to an act or omission the person knew or should have known would contribute to such violation”)).

<sup>13</sup> See SEC Rule of Practice 102(e) (defining “improper professional conduct” as recklessness, multiple acts of negligence, or “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”); 15 U.S.C. § 78d-3(b) (same).

<sup>14</sup> See Proposing Release, page 9 n.31 (quoting 2005 Adopting Release, page 14 n.25).



negligence that directly violates PCAOB rules or standards.<sup>15</sup> As such, it appears the Board may already be sanctioning associated persons for negligence – including a single instance of negligence – separate and apart from the proposed modified Rule 3502. That fact appears to underlie the Board’s acknowledgement that its modification might result in only “two to three” additional cases per year against individuals, though the basis of that statement in an estimate based on a consideration of enforcement proceedings from 2022 makes its accuracy uncertain.<sup>16</sup>

- On the other hand, the Board notes in Table 1 of the proposal that only 36 percent of firm enforcement orders from 2009 through 2022 were accompanied by a Rule 3502 charge.<sup>17</sup> This appears intended to suggest that the Board believes there may be room for significant growth in its contributory liability enforcement program. However, the 36 percent figure provides little guidance in practice because, as noted above, some PCAOB enforcement actions against firms appear to take advantage of the Board’s existing tools to initiate proceedings against associated persons for violations other than Rule 3502 (such as an individual’s direct violation of applicable auditing standards), meaning that a Rule 3502 charge in those instances would essentially be duplicative. The Board is also silent on whether it expects to allege individual contributory liability for firm violations as to which the Board alleges that the firm acted with recklessness, a situation in which contributory liability for mere negligence would seem to be inappropriate.

Because the Board lacks the benefit of supporting evidence for any conclusion about what its use of a modified Rule 3502 would be, it does not seem that either the costs or the benefits of the Board’s proposal have been adequately assessed.

- Third, as then-Board Member DesParte noted in opposing the Board’s recent proposal to replace AS 2405, *Illegal Acts by Clients*, with a broader standard, the Board has laid out an “ambitious standard-setting agenda...that will significantly expand the scope and cost of audits.”<sup>18</sup> That agenda includes proposed new standards on quality control<sup>19</sup> and the general responsibilities of an auditor,<sup>20</sup> among others. The true costs and benefits of amendments to Rule 3502 cannot be known until the Board determines the final shape of these other proposed standards, especially its quality control proposal given the additional responsibilities and obligations that proposal would place on certain personnel at registered firms.<sup>21</sup> The Proposing Release notes in passing

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<sup>15</sup> See Proposing Release, page 11.

<sup>16</sup> Proposing Release, page 25.

<sup>17</sup> Proposing Release, page 19.

<sup>18</sup> Statement by Board Member Duane DesParte (June 6, 2023).

<sup>19</sup> *A Firm’s System of Quality Control and Other Proposed Amendments to PCAOB Standards, Rules, and Forms*, PCAOB Rel. No. 2022-006 (Nov. 18, 2022) (“QC Proposal”).

<sup>20</sup> *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards*, PCAOB Rel. No. 2023-001 (Mar. 28, 2023).

<sup>21</sup> See, e.g., QC Proposal, page 67-74 (describing the modified roles and responsibilities for a registered firm’s quality-control system under that proposal).



that these other agenda items might have an effect on the estimate of “two to three” incremental enforcement actions against individuals that might result from its rule each year, but does not otherwise appear to include them in its cost-benefit analysis even though the effects could turn out to be quite substantial.<sup>22</sup>

- Fourth, the Board mentions in passing that, under the text of proposed Rule 3502, “‘directly and substantially’ would apply *only* to the sufficiency of the connection between an associated person’s conduct and a firm’s violation.”<sup>23</sup> Thus, it would be the case that “a person must have known, or should have known, that an act or omission by them would contribute—but not that it would directly and substantially contribute—to a firm’s violation.”<sup>24</sup> This would represent an important change from the present rule under which an alleged violator must know (or recklessly not know) not only that they are contributing to a violation but also that the contribution is direct and substantial.<sup>25</sup> Yet the Board does not appear to weigh the costs and benefits of this aspect of the proposed rule.

In light of the above, we are concerned that a final Board rule that tracks the proposal will be based on an inadequate cost-benefit assessment.

### **Individual Liability for Single Instances of Simple Negligence Would be Contrary to SEC Practice and Inappropriate**

As noted above, the Board’s proposal would permit an individual or entity to be held liable not only directly for a single instance of negligence that violates a Board rule or standard, but also secondarily for a single instance of negligence that is not itself a violation but directly and substantially contributes to the violation of another.<sup>26</sup> Although the Board notes the SEC holds similar power under Exchange Act Section 21C,<sup>27</sup> its conclusion that the proposed modification of Rule 3502 would merely put the PCAOB on par with the SEC is unsupported. First, the SEC enforcement precedent regarding auditors that the Board cites appears to involve cases where the SEC has charged an individual either with multiple acts of negligence

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<sup>22</sup> Proposing Release, page 25 (“this estimate may vary to the extent that there are modifications in other Board standards (e.g., adopting and implementing a new quality control standard) or changes in enforcement priorities”).

<sup>23</sup> Proposing Release, page 15 (emphasis added).

<sup>24</sup> Proposing Release, page 15.

<sup>25</sup> To be clear, the CAQ supports the Board’s decision to retain the requirement in Rule 3502 that the secondary liability concept present in this rule can result only from conduct that directly and substantially contributes to the firm violation. Any proposed liability for conduct that only indirectly or to a minor extent relates to a violation would exacerbate the concerns discussed herein to an even greater degree.

<sup>26</sup> Based on footnote 65, the Board even appears to imagine the possibility of tertiary liability, in which one associated person’s conduct contributes to the conduct of a second associated person, which in turn contributes to a registered firm’s violation. While the footnote appears to recognize that the first associated person’s conduct would still have to meet the criteria of “directly and substantially” contributing to the ultimate firm violation, the mere mention of such a scenario suggests that the Board may intend to stretch the definition of “directly” beyond the bounds of common usage.

<sup>27</sup> See 15 U.S.C. § 78u-3(a).



or with a heightened form of negligence, not with a single instance of simple negligence.<sup>28</sup> Second, the SEC’s authority to punish contributory conduct under Section 21C is limited to obtaining an administrative cease-and-desist order against the contributor, as well as certain additional sanctions such as the imposition of a penalty.<sup>29</sup> The SEC has no power to impose on a contributing individual all of the other sanctions that the Board can impose, including certain sanctions that do not require a finding of recklessness or multiple acts of negligence.<sup>30</sup> The Board does not appear to be correct, therefore, when it claims that its proposal would merely put it on par with the SEC; in practice, its proposal would appear to give it enforcement authority that is unprecedented.

Further, outside of the SEC context, the parallel civil concept of aiding and abetting liability generally requires knowing conduct, as set out in the Restatement (Third) of Torts:

The defendant is held liable because someone else committed a tort and the defendant gave **knowing** and substantial assistance to the wrongdoing. . . . **Negligence will not suffice**; nor is it enough to prove that the defendant should have known of the primary actor’s wrongful conduct but did not. The defendant’s knowledge must be actual.<sup>31</sup>

There is good reason for this restriction: When an individual acts in a manner that is not itself a violation of any PCAOB rule or standard, fairness dictates that derivative liability for the misconduct of another be held to a higher standard, given that the connection between the individual’s conduct and the alleged violation of PCAOB rules and standards is lower.

The Board appears to believe that derivative liability for negligence is appropriate because, in at least some of the cases where it will employ the revised Rule 3502, it will merely be holding a natural person associated with a firm responsible for the violations of the firm entity that are caused by that natural person, making it appropriate that the threshold for entity and personal liability be the same.<sup>32</sup> There is a reason, however, that PCAOB rules and standards place certain obligations on individuals and certain obligations only on the firm as a whole—namely, there may be instances where it is appropriate for a firm entity to be sanctioned for a violation but where no particular individual has played a sufficient role in

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<sup>28</sup> See David S. Hall, P.C., SEC Initial Decision Rel. No. 1114 (Mar. 7, 2017); Gregory M. Dearlove, CPA, SEC Rel. No. 34-57244 (Jan. 31, 2008); Philip L. Pascale, CPA, SEC Rel. No. 34-51393 (Mar. 18, 2005).

<sup>29</sup> See 15 U.S.C. § 78u-3(a); *id.* § 78u-2(a)(2)(B) (permitting civil penalties where a contributing actor “is or was a cause of the violation of any provision of this chapter, or any rule or regulation issued under this chapter”).

<sup>30</sup> Compare 15 U.S.C. §§ 78u-2, 78u-3 (SEC remedies) to 15 U.S.C. § 7215(c)(4) (PCAOB remedies).

<sup>31</sup> Restatement (Third) of Torts § 28. The SEC’s power to allege aiding and abetting liability is distinct from its power to charge causing liability. Compare 15 U.S.C. § 78t(e) (aiding and abetting) to 15 U.S.C. § 78u-3(a) (permitting cease-and-desist proceedings 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”).

<sup>32</sup> See Proposing Release, page 7 (“a registered firm can only act through the natural persons who serve as its agents, including its associated persons. Accordingly, a natural person’s actions may render both the firm primarily liable and the natural person secondarily liable”) (internal quotations, citations, and brackets omitted).





that violation to have their career permanently affected by a sanction on them personally. The Board should not use Rule 3502 to collapse this distinction.<sup>33</sup>

### **The Legal Basis for a Contributory Liability Standard Based in Negligence Is Not Clear**

As with any Board action, a modification of Rule 3502 must rest on the foundation of the Board's statutory authority. In its 2005 release adopting Rule 3502, the Board cited two sources: its authority under Section 103 of Sarbanes-Oxley "to set ethical standards;"<sup>34</sup> and the authority "inherent in, and necessary to," the Board's enforcement authority under Sarbanes-Oxley Section 105.<sup>35</sup> However, in approving the Board's adoption of Rule 3502 in 2006, the Commission cited only Section 103 as the statutory basis.<sup>36</sup> In its current proposal, the Board appears to rely again on Sections 103 and 105, though its argument under Section 105 now appears to be that the Board is permitted—in general—to bring enforcement actions based on a single act of negligence.<sup>37</sup> Neither of these provisions provides a basis for the proposed rule.

With regard to Section 103, the problem inherent in the Board's reliance on this provision as a basis for the proposed contributory liability rule is that it is not clear that the statutory power to regulate *ethical* conduct equates to a statutory power to punish *negligent* conduct. The Board appeared to acknowledge this fact in its recent quality control proposal, which would define "integrity" under proposed EI 1000 to mean in part "[n]ot **knowingly** or **recklessly** misrepresenting facts."<sup>38</sup> The concept, in the context of secondary liability, that ethics pertains to knowing or reckless action is similarly found in other professional standards, including the AICPA Code of Professional Conduct (which prohibits a member from "knowingly permit[ting] a person" under the member's control to violate the Code);<sup>39</sup> and the American

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<sup>33</sup> The Board acknowledged the distinction between the responsibilities of individual professionals and the responsibilities of the firm as a whole in 2011 when it released its proposed rule relating to the naming of the engagement partner on Form AP. In that context, the Board stated that it "remains sensitive to concerns about minimizing the role of the firm or suggesting that the engagement partner is solely responsible for the audit engagement and its performance...The engagement partner is not expected to fulfill his or her responsibilities alone." *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2*, PCAOB Rel. No. 2011-007, page 9 & fn.19 (Oct. 11, 2011).

<sup>34</sup> 2005 Adopting Release, pages 9-10.

<sup>35</sup> 2005 Adopting Release, page 12.

<sup>36</sup> See *Public Company Accounting Oversight Board; Order Approving Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees and Notice of Filing and Order Granting Accelerated Approval of the Amendment Delaying Implementation of Certain of these Rules*, SEC Rel. No. 34-53677 (Apr. 19, 2006) ("Proposed Rule 3502 establishes a standard of ethical conduct for persons associated with registered public accounting firms").

<sup>37</sup> Proposing Release, page 12 n.43. The Board also cites Sarbanes-Oxley Sections 101(c)(2), 101(c)(4), 101(c)(6), and 101(g)(1) for authority. See *id.* at 2 n.4. Those provisions speak to the Board's authority to sanction registered firms and associated persons, but not to the availability of contributory liability (let alone negligent contributory liability) as a permissible theory of violation.

<sup>38</sup> QC Proposal, page A4-5 (emphasis added). The QC Proposal also notes that liability for contributing to violations of proposed QC 1000 would only be based on knowing or reckless conduct under current Rule 3502, a statement which will not be accurate should the Board adopt the proposed amendment to Rule 3502. See QC Proposal, page 75.

<sup>39</sup> AICPA Code of Professional Conduct § 0.200.020.04.



Bar Association Model Rules of Professional Conduct (which prohibit “knowingly assist[ing] or induc[ing] another” to violate the Rules).<sup>40</sup> To the extent that the Board uses a modified Rule 3502 to sanction a professional for good-faith actions that the Board concludes after the fact to have been unreasonable, then, the Board has strayed from the scope of its remit under Section 103.

Section 105 provides no further basis to sanction contributory conduct. As the AICPA’s Center for Public Company Audit Firms (the predecessor to the CAQ) noted in connection with the Board’s adoption of original Rule 3502, the Supreme Court held in 1994 that the lack of an express statutory basis for aiding and abetting liability in the Exchange Act at that time precluded an aiding and abetting claim by private plaintiffs, and by extension the SEC.<sup>41</sup> Although Congress responded to the Supreme Court’s ruling by granting the Commission the express power to sanction aiding and abetting conduct,<sup>42</sup> it made no provision in Sarbanes-Oxley for the Board to exercise similar power. Instead, it permitted the Board to impose enforcement sanctions only upon a finding that

a registered public accounting firm or associated person thereof has engaged in any act or practice, or omitted to act, in violation of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards.<sup>43</sup>

None of these sources (with the exception of Rule 3502, which cannot be the basis for itself) expressly permits the Board to establish liability for negligently contributing to a firm violation. As a result, we believe that the Board should exercise caution in seeking to expand its authority in the area of contributory liability, especially to the extent that it seeks to sanction an associated person for conduct that falls short of the “knowing” or “recklessness” standards that have historically been applied. This expansion of the Board’s authority to single instances of negligence may invite legal challenges to the Board’s statutory authority related to pursuing secondary liability actions.

## **Other Recommendations**

### *The Board Should Clarify the Negligence Standard That It Proposes to Enforce in a Modified Rule 3502*

In its proposal, the Board articulates two different formulations of the mental state that might lead an associated person to face potential liability under its proposed rule. The proposed text of a modified Rule 3502 would permit sanctions if an associated person “should have known” that their conduct contributes to a violation (and if that contribution is direct and substantial).<sup>44</sup> The proposal also, however, uses the

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<sup>40</sup> Am. Bar Ass’n Model R. of Prof. Conduct 8.4(a).

<sup>41</sup> See Letter of American Institute of Certified Public Accountants Center for Public Company Audit Firms, PCAOB Docket No. 017 (Feb. 24, 2005) (citing *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 177 (1994)).

<sup>42</sup> See Private Securities Litigation Reform Act, P.L. 104-67, § 104 (Dec. 22, 1995) (establishing Exchange Act § 20(e), 15 U.S.C. § 78t(e)).

<sup>43</sup> Sarbanes-Oxley Section 105(c)(4), 15 U.S.C. § 7215(c)(4).

<sup>44</sup> Proposing Release, page A-1.



formulation that associated persons will be held to a negligence standard that entails “the failure to exercise reasonable care or competence.”<sup>45</sup> While both of these standards are familiar in the American legal system, the Board does not address whether there is any difference between them, and (if there is) how that tension should be resolved in enforcing Rule 3502. As an example, the Board’s own AS 1015, *Due Professional Care in the Performance of Work*, explains that due care does not require a professional to exercise perfect judgment at all times:

Every man who offers his services to another and is employed assumes the duty to exercise in the employment such skill as he possesses with reasonable care and diligence. . . . But no man, whether skilled or unskilled, undertakes that the task he assumes shall be performed successfully, and without fault or error; he undertakes for good faith and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith, or dishonesty, but not for losses consequent upon pure errors of judgment.<sup>46</sup>

In the event the Board moves forward in seeking to adopt its proposed Rule 3502, the Board should confirm that “pure errors of judgment” would not be subject to liability under Rule 3502, and should clarify in general how the standard of due care like that set out in AS 1015 interacts with the “should have known” mental state of the proposed rule.

#### *The Board Should Affirm That Modification of Rule 3502 Will Not Impact the Imposition of Heightened Sanctions*

Pursuant to Sarbanes-Oxley Section 105(c), the Board can impose heightened sanctions, including suspension or bar of a person from further association with any registered public accounting firm, only upon a finding that the respondent acted recklessly or engaged in “repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.”<sup>47</sup> Our understanding of the Board’s release, and specifically footnote 48,<sup>48</sup> is that, while its proposed modification of Rule 3502 would purportedly permit the Board in general to impose sanctions on an

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<sup>45</sup> Proposing Release, page 4 (quoting *In re S.W. Hatfield, C.P.A.*, SEC Rel. No. 34-69930, at 35 n.169 (July 3, 2013)).

<sup>46</sup> AS 1015.03, *Due Professional Care in the Performance of Work*. In a recent release, the Board has proposed to amend its standard relating to due professional care. Although the proposed new standard would not retain the above text, taken from a legal treatise, the Board appears to acknowledge that it remains an accurate description of the concept of due care. See *Proposed Auditing Standard – General Responsibilities of the Auditor in Conducting an Audit and Proposed Amendments to PCAOB Standards*, PCAOB Rel. No. 2023-001, page 22 (Mar. 28, 2023) (“We believe the reference to that treatise is unnecessary and are proposing to describe in plain language the concept of due professional care, **without changing its meaning**”) (emphasis added). In its comment letter relating to the Board proposal on this point, the CAQ recommended that certain of the concepts in the treatise should remain in any new auditing standard, to appropriately describe to investors what they can expect in the performance of an audit. See Letter of the CAQ, PCAOB Docket No. 049, page 6 (May 30, 2023).

<sup>47</sup> 15 U.S.C. § 105(c)(4), (5).

<sup>48</sup> See Proposing Release, page 13 n.48 (“However, the sanctions to which a contributory actor may be subject upon being found to have violated Rule 3502—including whether the Board may impose any of the heightened sanctions in Section 105(c)(5) of Sarbanes-Oxley—depend on the associated person’s conduct and not that of the firm that commits the primary violation”).



associated person based on a finding that that person acted negligently in a single instance, the modified rule would not permit the sanctions identified in Section 105(c)(5) unless the Board made one of the heightened findings described in Section 105(c)(5)—i.e., a finding that the associated person who violated Rule 3502 acted recklessly or committed multiple acts of negligence. The Board should clarify the statement in footnote 48 to confirm this assessment in the event it moves forward with a final rule to modify Rule 3502.

*The Board Should Consider Extending the Effective Date of Its Proposal*

We note that the Board proposes that the modified version of Rule 3502 should be effective sixty days after Commission approval, on the basis that such period of time would “allow associated persons to ensure that their conduct conforms to the applicable legal standards and to increase their diligence as necessary and appropriate.”<sup>49</sup> As we mention above, the impact of this proposal will depend to a significant extent on certain proposed auditing standards not yet adopted by the Board (such as QC 1000 and AS 1000). Therefore, we recommend that any modifications to Rule 3502 be implemented subsequent to the effective dates of those other standards (or subsequent to a determination by the Board not to adopt those standards), and with additional analysis by the Board concerning the expected costs and benefits of its proposal in light of those standards.

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<sup>49</sup> Proposing Release, page 31.

# CAQ

The CAQ appreciates the opportunity to comment on the Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability. In view of the concerns discussed above, at this time we do not believe that the Board's proposal is adequately supported. As the Board gathers feedback from other interested parties, we look forward to future engagement with the Board and would be pleased to discuss our comments or answer questions from the Board regarding the views expressed in this letter. Please address questions to Vanessa Teitelbaum ([vteitelbaum@thecaq.org](mailto:vteitelbaum@thecaq.org)) or Dennis McGowan ([dmcgowan@thecaq.org](mailto:dmcgowan@thecaq.org)).

Sincerely,



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Senior Director, Professional Practice  
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cc:

**PCAOB**

Erica Y. Williams, Chair  
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Christina Ho, Board member  
Kara M. Stein, Board member  
Anthony C. Thompson, Board member  
Barbara Vanich, Chief Auditor

**SEC**

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