



CAQ Analysis of PCAOB Rule 3502 Comment Letters

June 2024

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Comment Letters Received re Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability

On September 19, 2023, the Public Company Accounting Oversight Board (PCAOB or Board) proposed to amend 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:

- + First, the Board proposed to change from *recklessness* to *negligence* the standard of conduct for associated persons' contributory liability.
- + Second, the Board proposed to amend the rule to provide that an associated person contributing to a violation need not be an associated person of the registered firm that commits the primary violation (i.e., that an associated person of one firm can contribute to a primary violation of another firm).

27 comment letters were submitted in response to the proposed amendments (as of June 10, 2024).¹ The CAQ reviewed all 27 comment letters for purposes of this analysis.

Stakeholder Type	Submitted Comment Letter	% of Total Comment Letters
Accounting Firms (and Related Groups)	18	67%
Investors	2	7%
Academics	1	4%
Other	6	22%
Total	27	100%

¹ While 28 comment letters were submitted, one was withdrawn.

OVERALL THEMES

1. There is mixed support for updating the contributory liability standard to a negligence threshold.
 - + Accounting firms and related groups, academics, and some other commenters do not support the negligence threshold.
 - + Investors and some other commenters support the negligence threshold.
2. There are mixed views on whether the proposed amendments will positively impact audit quality.
 - + Several commenters believe that the costs of the proposed amendments outweigh any potential benefits (accounting firms and related groups, academics, and some other commenters).
 - + Investors believe that the proposed amendments will improve audit quality.
3. Most commenters agree with the Board's concern that the amendments could have significant unintended consequences on the attractiveness of the public company audit profession.
 - + The proposed amendments could further discourage students from pursuing a career in public company audit and may drive experienced auditors out of the profession or discourage them from taking on leadership roles (accounting firms and related groups, academics, and some other commenters).
4. Most commenters agree with the Board's concern that the proposal could disproportionately impact small- and medium-sized firms.
 - + The proposed amendments will have an outsized impact on smaller firms and may lead small and mid-sized firms to exit the market for public company audits (accounting firms and related groups and some other commenters).
5. There are mixed views on the need to close the regulatory gap between PCAOB and the U.S. Securities and Exchange Commission (SEC) enforcement authority, and whether the proposed amendments achieve that objective.
 - + The incongruity between PCAOB and SEC enforcement authority existed when the PCAOB Board first adopted PCAOB Rule 3502 in 2005. The proposal does not provide a compelling reason to update the rule now (accounting firms and related groups and some other commenters).
 - + As proposed, the amendments establish a lower threshold for PCAOB enforcement than current SEC enforcement rules. SEC Rule 102(e) requires repeated instances of negligent conduct whereas the proposed amendments to PCAOB Rule 3502 would allow the PCAOB to sanction individuals for a single act of simple negligence (accounting firms and related groups and some other commenters).

Most commenters agree with the Board's concern that the amendments could have significant unintended consequences on the attractiveness of the public company audit profession.

- + The proposed amendments appropriately address the regulatory gap (investors and some other commenters).
6. There are mixed views on the Board’s legal authority to establish a negligence threshold.
- + Several commenters do not believe that the Sarbanes-Oxley Act (SOX) provides the PCAOB Board authority to bring enforcement actions based on a single act of simple negligence (accounting firms and related groups, academics, and some other commenters).
 - + Other commenters believe that establishing a negligence threshold is consistent with the provisions of SOX (investors and some other commenters).

LOOKING AHEAD

In our comment letter, we provide the following recommendations:

1. The Board should clarify the negligence standard that it proposes to enforce in a modified Rule 3502;
2. The Board should affirm that modification of Rule 3502 will not impact the imposition of heightened sanctions; and
3. The Board should consider extending the effective date of its proposal.

The PCAOB will hold an Open Meeting on June 12, 2024 to consider adoption of its final rule. Subsequent to Board adoption, the rule will require SEC approval. We will monitor the final standard and review how the Board addresses stakeholder comments and recommendations.

Continue reading for our detailed summary of comment letters by stakeholder group.

THE WAY WE SEE IT

We are concerned that there are at least three significant ways in which this proposal could have such unintended consequences.

1. The Proposal Could Exacerbate the Accounting Talent Crisis - The proposal could discourage auditors from accepting important audit roles due to fear of being held liable under a simple negligence standard for good faith judgments.
2. There Is a Risk of Inefficient and Unproductive “Self-Protective” Behavior – Moving to a negligence standard for contributory liability would inappropriately lead to sanctions of professionals who make judgments in good faith.
3. The Proposal Could Have a Negative Impact on Small Firms and Reduce the Market for Audit Services - Smaller firms might be most at risk from any misallocation of resources that results from “self-protective” behavior.

COMMENT LETTERS BY STAKEHOLDER GROUP

Accounting Firms (and Related Groups):

Ref#	Respondent	Type
1	National Association of State Boards of Accountancy	Accounting Organization
2	PricewaterhouseCoopers LLP (PwC)	Accounting Firm
3	Illinois CPA Society	Accounting Organization
4	Center for Audit Quality (CAQ)	Accounting Organization
5	RSM US LLP	Accounting Firm
6	Pennsylvania Institute of Certified Public Accountants (PICPA)	Accounting Organization
7	Baker Tilly US, LLP	Accounting Firm
8	Florida Institute of Certified Public Accountants	Accounting Organization
9	Ernst & Young LLP	Accounting Firm
10	Grant Thornton LLP	Accounting Firm
11	Moss Adams LLP	Accounting Firm
12	Plante & Moran, PLLC; Plante Moran, PC	Accounting Firm
13	KPMG LLP	Accounting Firm
14	Johnson Global Accountancy	Consulting Firm
15	BDO USA, P.C.	Accounting Firm
16	Deloitte & Touche LLP	Accounting Firm
17	Crowe LLP	Accounting Firm
18	Mazars USA LLP	Accounting Firm

1. No accounting firms (and related groups) support updating the liability standard to a negligence threshold as proposed in the amendments to PCAOB Rule 3502.
2. The proposed amendments would reduce the attractiveness of the profession for students and would reduce the likelihood that qualified CPAs will remain in the profession and take on leadership positions within firms (16 accounting firms and related groups).
3. The proposed amendments could increase “excessive monitoring and self-protective behavior” (as described in the Proposing Release).
 - ✦ The proposed amendments could reduce audit quality by diverting professionals’ attention away from important aspects of the audit and could have the unintended consequence of reducing collaboration and consultation within accounting firms (PwC, CAQ, RSM, PICPA, Moss Adams, Plante Moran, KPMG, Johnson Global Accountancy, BDO, Crowe, and Mazars).
4. The proposed amendments may negatively impact smaller firms and reduce the market for audit services.

The proposed amendments do not achieve the objective of eliminating the regulatory gap.

- ✦ The impact of the proposed amendments may be even more significant for smaller firms and may lead to the unintended consequence of smaller firms exiting the market for public company and registered broker-dealer engagements, which would reduce competition and negatively impact audit quality (CAQ, PICPA, Grant Thornton, Moss Adams, Plante Moran, Johnson Global Accountancy, Crowe, and Mazars).
 - ✦ The proposed amendments may also increase the potential that foreign firms will decline to participate in a group audit of an issuer or broker-dealer (RSM, Grant Thornton, KPMG and Mazars).
5. There is not a compelling reason for the proposed amendments.
- ✦ The incongruity between PCAOB and SEC rules was already understood and considered when PCAOB Rule 3502 was adopted in 2005. The proposal does not provide adequate support for updating the rule now (NASBA, PwC, CAQ, RSM, Grant Thornton, Johnson Global Accountancy, and Crowe).
6. The cost-benefit analysis included in the proposal is not sufficient and does not fully consider all the potential costs and unintended consequences (PwC, CAQ, PICPA, EY, Moss Adams, KPMG, and BDO).
7. The proposed amendments do not achieve the objective of eliminating the regulatory gap.
- ✦ The proposed amendments establish a lower threshold for PCAOB enforcement than current SEC enforcement. SEC Rule 102(e) requires the regulator to demonstrate either “repeated instances of unreasonable conduct” or “a single instance of highly unreasonable conduct” by the respondent to satisfy the minimum threshold for sanctions (PwC, CAQ, RSM, Moss Adams, Plante Moran, BDO, Deloitte, and Crowe).
8. The legal basis for the Board to modify Rule 3502 is not clear.
- ✦ The Board cites SOX sections 103 and 105 regarding its authority to bring enforcement actions based on a single act of negligence, however, neither of those provisions provide a basis for the proposed rule (CAQ, Moss Adams, and Crowe).
9. The effective date of the proposed rule should be after the adoption or effective dates of the Board’s other active proposals (such as proposed QC 1000, *A Firm’s System of Quality Control*, and proposed AS 1000, *General Responsibilities of the Auditor in Conducting an Audit*) as firms will need to consider the implications of this proposal in relation to those other ongoing standard setting projects (NASBA, PwC, CAQ, Grant Thornton, Moss Adams, Johnson Global Accountancy, and Mazars).
10. The Board should redeliberate and repropose any amendments to Rule 3502 (RSM).

Investors:

1 [Council of Institutional Investors \(CII\)](#)

2 [Members of the IAG](#)

1. Investors support updating the liability standard to a negligence threshold as proposed in the amendments to PCAOB Rule 3502 (CII and Members of the IAG).
2. The proposed amendments will improve audit quality as auditors will be more careful about their work (Members of the IAG).
3. The proposed amendments achieve the objective of eliminating the regulatory gap and it is within the Board's authority to do so.
 - + The proposed amendments are consistent with the provisions of SOX and address the regulatory gap in the current framework (CII and Members of the IAG).
 - + Investors believe that the PCAOB will exercise its "prosecutorial" discretion appropriately when the underlying conduct is negligent, as the SEC has done historically (CII and Members of the IAG).

Academics:

1 [Nathan Cannon, Associate Professor, Texas State University; Melissa Carlisle, Assistant Professor, Case Western Reserve University; Brant Christensen, Associate Professor, Brigham Young University; et al.](#)

1. Not supportive of updating the liability standard to a negligence threshold as proposed in the amendments to PCAOB Rule 3502.
2. The proposed amendments would reduce the attractiveness of the profession for students and would reduce the likelihood that qualified CPAs will remain in the profession and take on leadership positions within firms.
3. Academic research suggests that the PCAOB enforcement resources would be most effective when reserved for excessive auditor misbehavior that has resulted in actual investor harm or that threatens the PCAOB's regulatory oversight.
4. The costs of the proposed rule change outweigh any potential benefit.
5. The Board does not have legal authority to sanction individuals for a single instance of negligent conduct.
 - + The negligence-based approach would contradict the approach outlined in SOX section 105(c)(5), which states that "the sanctions and penalties described [in SOX] shall only apply to (A) intentional or knowing conduct, including reckless conduct...; or (B) repeated instances of negligent conduct."

The proposed amendments achieve the objective of eliminating the regulatory gap and it is within the Board's authority to do so.

Other:

1	Thomas H. Spitters, C.P.A.
2	Chamber of Digital Commerce
3	Center for American Progress
4	U.S. Chamber of Commerce, Center for Capital Markets Competitiveness
5	Better Markets, Inc.
6	North American Securities Administrators Association, Inc. (NASAA)

There are mixed views on the impact that the proposed amendments will have on the attractiveness of the public company audit profession.

1. There is mixed support for updating the liability standard to the negligence threshold.
 - + Four commenters support the negligence threshold (Thomas Spitters, Center for American Progress, Better Markets, Inc., and NASAA).
 - + The U.S. Chamber of Commerce Center for Capital Markets Competitiveness does not support the negligence threshold.
2. There are mixed views on the impact that the proposed amendments will have on the attractiveness of the public company audit profession.
 - + The proposed amendments may contribute to the decline in the attractiveness of the accounting profession and may exacerbate challenges in attracting, retaining, and promoting professionals at all levels, including in leadership roles (U.S. Chamber of Commerce Center for Capital Markets Competitiveness).
 - + The proposed amendments might not discourage participation in the profession given that firms will assure incoming personnel of compliance. Firms will adapt to new rulemaking (Thomas Spitters).
3. The proposed amendments could increase “excessive monitoring and self-protective behavior” (as described in the Proposing Release).
 - + The PCAOB should further consider the concerns about self-protective behavior, which are dismissed in the economic analysis but could be very impactful for firms (U.S. Chamber of Commerce Center for Capital Markets Competitiveness).
4. The proposed amendments may negatively impact smaller firms and reduce the market for audit services.
 - + The PCAOB should further evaluate how the proposed amendments may negatively impact smaller firms, potentially leading to the unintended consequence of market consolidation (Chamber of Digital Commerce and U.S. Chamber of Commerce Center for Capital Markets Competitiveness).
5. There is not a compelling reason for the proposed the proposed amendments.

- ✦ The incongruity between PCAOB and SEC rules was already understood and considered when PCAOB Rule 3502 was adopted in 2005. This does not provide compelling justification to update the rule now (U.S. Chamber of Commerce Center for Capital Markets Competitiveness).
6. There are mixed views on whether the proposed amendments achieve the objective of eliminating the regulatory gap.
 - ✦ Under SEC’s rule 102(e) a single instance of negligence is not actionable. Proposed Rule 3502 is contrary to SEC practice and is not appropriate (U.S. Chamber of Commerce Center for Capital Markets Competitiveness).
 - ✦ Proposed Rule 3502 is appropriately narrow by focusing solely on individuals who “directly and substantially contributed to a firm’s violations of the laws, rules, and standards that the Board enforces.” The scope of the rule is narrow and is not intended to entrap unsuspecting auditors for minor mistakes (Better Markets, Inc.).
 7. There are mixed views regarding the legal basis for a contributory liability standard based on negligence.
 - ✦ SOX provides the PCAOB with the authority to sanction registered firms and their associated persons for negligent conduct (Center for American Progress, Better Markets, and NASAA).
 - ✦ SOX does not provide the Board with authority to impose secondary liability on the basis of a single negligent act. Specifically, section 105(c)(5), “Intentional or other Knowing Conduct,” limits the Board’s ability to levy sanctions and penalties for certain violations of law only to “intentional or knowing conduct, including reckless conduct” or “repeated instances of negligent conduct” (U.S. Chamber of Commerce Center for Capital Markets Competitiveness).
 8. Given the Board’s aggressive enforcement agenda and newly revised (or proposed) auditing standards, the proposed rule is premature, and the proposal should be withdrawn (U.S. Chamber of Commerce Center for Capital Markets Competitiveness).

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About the Center for Audit Quality

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.

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