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Phoebe W. Brown, Secretary
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
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3 November 2023

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

Dear Ms. Brown:

Ernst & Young LLP is pleased to submit to the Public Company Accounting Oversight Board (PCAOB or Board) its comments on the proposed amendments to PCAOB Rule 3502, *Responsibility Not to Knowingly or Recklessly Contribute to Violations* (the proposal).

We recognize the importance of an effective PCAOB enforcement program in holding individuals accountable when there are violations of rules and regulations. We also support the PCAOB's efforts to close gaps in its regulatory framework when they are consistent with its legislative mandate. However, we respectfully submit that there are currently no gaps related to secondary liability for associated persons that require closing.

The PCAOB today has a comprehensive toolkit for its enforcement program. The PCAOB can bring enforcement actions against individuals who violate the Sarbanes-Oxley Act of 2002, PCAOB rules or professional standards, and it can impose heightened sanctions when individuals engage in repeated instances of negligent conduct and in other circumstances. Additionally, under existing Rule 3502, the PCAOB can bring enforcement actions against individuals who substantially and directly contribute, knowingly or recklessly, to violations of registered firms of which the individuals are associated persons.

The PCAOB's authorities work in tandem with those of the Securities and Exchange Commission (SEC or Commission), which has its own active enforcement program, and auditors also are subject to discipline by state boards of accountancy and other regulators. These overlapping enforcement regimes address liability for a variety of conduct, including when the alleged misconduct was negligent rather than deliberate or reckless. That is, associated persons are currently subject to liability based on allegations that they departed from a standard of reasonable care, without a need for a regulator to establish anything regarding the intent of the individual, even when the evidence shows that the associated person was acting in good faith.

Despite the PCAOB's strong enforcement program and multilayered enforcement authorities, the proposal asserts that there is a "gap in the PCAOB's regulatory framework,"¹ and it would close that perceived gap by (1) lowering the threshold for secondary liability for associated persons to negligence from recklessness and (2) requiring that the primary violation be committed by "any" registered firm rather than by a registered firm of which the individual is an associated person.

We are concerned that the cost-benefit analysis contained in the proposal is insufficient to support the proposed changes. Our concerns are discussed below in our responses to selected questions in the proposal.

7. Are the proposed amendments to Rule 3502's liability language (as seen in Appendix A) clear, understandable, and appropriate?

We have several concerns about changing the standard for associated persons' contributory liability to negligence from recklessness.

First, the proposal creates a misimpression that associated persons currently can only be sanctioned for intentional or reckless misconduct. However, the Sarbanes-Oxley Act empowers the PCAOB to sanction associated persons for primary violations of applicable laws, rules and professional standards, including when their conduct was not intentional or reckless. In addition, the proposal acknowledges that "the Commission has the authority to discipline an individual for causing a registered public accounting firm to commit a violation, including when the individual acts negligently."² The fact that associated persons can be sanctioned for primary and secondary violations, including when their conduct is not intentional or reckless, means there is no significant regulatory gap requiring attention.

Second, the economic analysis in the proposal does not adequately support the proposed changes. Table 1 compares PCAOB enforcement actions against firms to PCAOB actions against individuals under Rule 3502. A more relevant comparison would be PCAOB enforcement actions against firms to PCAOB actions against individuals in general, although even that comparison would not shed meaningful light on the need for the proposed change.

Additionally, there is insufficient rigor in the assertions that Board "Staff estimates two to three instances in 2022 where an amended Rule 3502 would have prompted Staff to recommend a Rule 3502 charge,"³ and that "this number is likely a fair average representation across other years."⁴ Again, the more meaningful comparison would be to situations in which an enforcement action against an individual was an appropriate exercise of prosecutorial discretion, yet the Board didn't have the authority to bring such an action under either existing Rule 3502 or under the other charges it can bring directly against individuals.

¹ PCAOB Release No. 2023-007 at 4.

² *Id.* at 20.

³ *Id.* at 25.

⁴ *Id.*

Third, the proposal asserts that “[t]he proposed change in Rule 3502’s liability standard would . . . make the rule both a more effective deterrent and a more effective enforcement tool,”⁵ but it also asserts that “the proposed amendment to Rule 3502’s liability threshold would not subject auditors to any new or different standard to govern their conduct,”⁶ in part because the SEC already can sanction auditors for negligently contributing to audit firms’ violations. The proposal does not sufficiently explain how it would have a more effective deterrent effect, or would close a regulatory gap, if it is not supposed to change associated persons’ duties of care or subject associated persons to new liability.

Fourth, the proposal asserts that both the PCAOB and the SEC should be able to impose sanctions for secondary liability based on negligence, in the event there is an enforcement action against an associated person that the PCAOB would be inclined to prosecute but that the SEC would not be inclined to prosecute. However, there is no enforcement gap because the SEC already can sanction individuals for the same conduct at issue in the proposal. The proposal also does not suggest there have been any instances where the PCAOB encouraged the SEC to bring a negligence-based secondary liability charge that the PCAOB itself could not bring, and the SEC declined to do so.

Finally, the proposal asserts that “there is a mismatch between individuals’ and firms’ respective minimum culpability levels,”⁷ because “the current rule’s recklessness standard for imposing liability on an individual who contributes to a registered firm’s violation is a more stringent liability standard than the negligence standard for the primary violation.”⁸ However, the proposal does not address whether or when individual auditors would be held secondarily liable for negligent conduct if the primary violation was based on intentional or reckless conduct. As former PCAOB Board Member Duane M. DesParte suggested, it might not “be appropriate for the Board to hold an associated person accountable for contributory negligent conduct in instances where a firm acts recklessly or knowingly in committing the primary violation.”⁹ He also said “[a] ‘negligence’ rule is particularly ill-suited for retrospective judgments about compliance with ‘professional standards,’ and such a rule would operate as an invitation for after-the-fact attacks on conduct that was, at the time, objectively reasonable.”¹⁰ At a minimum, the proposal should explain whether the Board believes it would be appropriate to charge individuals for negligently contributing to a firm’s violation, where the firm’s violation is based on intentional or reckless misconduct – and if so, assess the benefits and costs of exercising such authority.

⁵ *Id.* at 11-12.

⁶ *Id.* at 14.

⁷ PCAOB Release No. 2023-007 at 19.

⁸ *Id.*

⁹ <https://pcaobus.org/news-events/speeches/speech-detail/statement-on-proposed-amendments-to-pcaob-rule-3502-governing-contributory-liability>.

¹⁰ *Id.* (citation omitted).

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?

We 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. These terms generally are clear, understandable and appropriate. As the Board explained when it adopted Rule 3502, these modifiers appropriately make sure that secondary liability attaches only to conduct that “contributed to the [primary] violation in a material or significant way,”¹¹ and to conduct that “either essentially constitutes the violation”¹² or “is a reasonably proximate facilitating event of, or a reasonably proximate stimulus for, the violation.”¹³ The Board further noted that secondary liability should not attach to “an associated person’s conduct that, while contributing to the violation in some way, is remote from, or tangential to, the firm’s violation.”¹⁴ These points remain valid, and the proposal does not identify a reason to depart from them.

10. Is the proposed substitution of “any” in place of “that” in Rule 3502 (as seen in Appendix A) clear, understandable, and appropriate?

The proposal does not identify a clear enforcement prerogative for the proposed substitution of “any” in place of “that” in Rule 3502. For example, the proposal acknowledges that it would be “rare” for there to be “potential” for “a mismatch to the extent that two people who similarly contribute to a registered firm’s primary violation might face different consequences solely by virtue of their ‘associated person’ status with respect to that firm.”¹⁵ We believe the Board should not amend Rule 3502 based solely on a “rare,” “potential” fact pattern. One would presume that in most, if not all, cases, if auditors negligently (or recklessly), directly and substantially contributed to the violations of firms with which they *were not* associated, that same conduct also would have negligently (or recklessly), directly and substantially contributed to the violations of the firms with which they *were* associated.

11. Should the Board expand the scope of Rule 3502 to encompass secondary liability for associated persons who contribute to violations by other associated persons (i.e., not just by any registered firm)? If so, what (if any) limits or conditions should the Board place on such secondary liability?

We believe the Board should not expand the scope of Rule 3502 to encompass secondary liability for associated persons who contribute to violations by other associated persons. At a minimum, it should support such a proposal with an additional cost-benefit analysis. Additionally, in practice, it is difficult to come up with realistic scenarios in which the PCAOB would not be able to hold an individual accountable despite that individual contributing to violations by other associated persons, because that individual neither committed primary violations nor contributed to violations by a registered firm.

¹¹ PCAOB Release No. 2005-014 at 13.

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ PCAOB Release No. 2023-007 at 20.

17. As noted above, associated persons may currently face secondary liability for negligent conduct in actions by the Commission. Notwithstanding that current possibility, could the proposal discourage participation by associated persons in the audit profession?

We agree with Chair Erica Y. Williams that there are circumstances where it is appropriate that “there are consequences when associated persons of PCAOB-registered firms contribute to violations committed by registered firms.”¹⁶ However, any PCAOB sanction against an individual, including for secondary liability and for simple negligence, can end that individual’s career. Accordingly, lowering the threshold to bring enforcement actions against personnel who serve in certain oversight roles will reduce the attractiveness of those roles. As PCAOB Board Member Christina Ho observed, the PCAOB’s investor protection mandate would not be served if the proposed change “unintentionally discourage[d] 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.”¹⁷

Expanding secondary liability to negligent conduct also could discourage individuals from entering or remaining in the accounting profession, out of concern that they could face career-ending enforcement proceedings arising from innocent mistakes while learning on the job. As Board Member Ho observed, there already is a “talent crisis facing the accounting profession,”¹⁸ and “[i]f this Board (or future Boards) decide to routinely sanction associates or senior associates under the proposed negligence standard, the public company auditing profession will become even less attractive.”¹⁹ Therefore, if the Board adopts the proposed change from recklessness to negligence, we believe at a minimum the adopting release should reiterate Chair Williams’ statement that “these updates are not intended to ensnare junior professionals.”²⁰ Most importantly, the rule itself should make it clear that associated persons cannot be charged for “single instances of negligence”²¹ to make sure that the updates do not unfairly “ensnare junior professionals,” or professionals at any rank making complex judgments in good faith. Indeed, as former Board Member DesParte suggested, Rule 3502 may not be a “workable and fair framework”²² if “contributory liability could be imposed on a potentially large number of individuals, including anyone who was in any way involved in the chain of events leading to a firm’s primary violation, even if acting in good faith or involved only remotely or tangentially.”²³

¹⁶ <https://pcaobus.org/news-events/speeches/speech-detail/chair-williams-statement-on-proposed-changes-to-board-rule-on-contributory-liability-for-firm-violations>.

¹⁷ [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)).

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ <https://pcaobus.org/news-events/speeches/speech-detail/chair-williams-statement-on-proposed-changes-to-board-rule-on-contributory-liability-for-firm-violations>.

²¹ *Cf.* PCAOB Release No. 2023-007 at 11.

²² <https://pcaobus.org/news-events/speeches/speech-detail/statement-on-proposed-amendments-to-pcaob-rule-3502-governing-contributory-liability>.

²³ *Id.*



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We want to again thank the Board and its Staff for their consideration of this letter. We would be pleased to discuss our comments with the Board or its Staff at their convenience.

Very truly yours,

Ernst & Young LLP