PCAOB
PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

1666 K Street NW
Washington, DC 20006

Office: 202-207-9100
Fax: 202-862-8430

www.pcaobus.org

PROPOSED AMENDMENTS TO PCAOB RULE 3502 GOVERNING CONTRIBUTORY LIABILITY

PCAOB Release No. 2023-007
September 19, 2023

PCAOB Rulemaking
Docket Matter No. 053

Summary: The Public Company Accounting Oversight Board (PCAOB or "Board") is proposing to amend in two respects 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 is proposing to change from recklessness to negligence the standard of conduct for associated persons' contributory liability. Second, the Board is proposing 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).

Public Comment: Interested persons may submit written comments to the Board. Comments should be sent by e-mail to comments@pcaobus.org or through the Board's website at www.pcaobus.org. Comments also may be submitted by mail to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. All comments should refer to PCAOB Rulemaking Docket Matter No. 053 in the subject or reference line and should be received by the Board by November 3, 2023.

Board Contacts: James Cappoli, Acting General Counsel, Office of the General Counsel (202/591-3105, cappolij@pcaobus.org);
Drew Dropkin, Senior Associate General Counsel, Office of the General Counsel (202/591-4393, dropkind@pcaobus.org);
Vincent Meehan, Associate General Counsel, Office of the General Counsel (202/591-4208; meehanv@pcaobus.org);

Damon Andrews, Assistant General Counsel, Office of the General Counsel (202/591-4363; andrewsd@pcaobus.org)

Staff Contributors:

Martin Schmalz, Chief Economist and Director, Office of Economic and Risk Analysis (202/591-4645, schmalzm@pcaobus.org);
Michael Gurbutt, Deputy Director, Office of Economic and Risk Analysis (202/591-4739, gurbuttm@pcaobus.org);
Federico Garcia, Senior Financial Economist, Office of Economic and Risk Analysis (202/591-4519, garciaf@pcaobus.org)

I. EXECUTIVE SUMMARY

Through the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or the "Act"), Congress established the Board in the wake of a series of high-profile corporate collapses that laid bare auditor misconduct and the need for a new type of oversight of the public accounting industry.[1] As part of its comprehensive, multipronged approach to such oversight, Congress authorized the Board to investigate, bring charges against, and sanction (when appropriate) registered public accounting firms and associated persons[2] thereof for violations of the laws, rules, and standards that Congress charged the Board with enforcing.[3] That enforcement authority covers a wide array of auditor conduct, including negligent conduct.

Congress also authorized the Board to promulgate rules and standards to govern auditor conduct.[4] To that end, in 2005, the Board codified auditors' longstanding obligation not to contribute to firms' violations in PCAOB Rule 3502, *Responsibility Not to Knowingly or Recklessly*

---

[1] Pub. L. No. 107-204, 15 U.S.C. § 7201 *et seq.*; *see* S. Rep. No. 107-205, at 3 (2002) ("The purpose of [Sarbanes-Oxley] is to address the systemic and structural weaknesses affecting our capital markets which were revealed by repeated failures of audit effectiveness and corporate financial and broker-dealer responsibility in recent months and years."). As the Senate Report notes, "the frequency of financial restatements by public companies ha[d] dramatically increased" in the run up to the passage of Sarbanes-Oxley. S. Rep. No. 107-205, at 15; *see id.* ("From 1990-97, the number of public company financial restatements averaged 49 per year, but jumped to an average of 150 per year in 1999 and 2000.").

[2] An associated person is "any individual proprietor, partner, shareholder, principal, accountant, or professional employee of a public accounting firm, or any independent contractor or entity that, in connection with the preparation or issuance of any audit report . . . (1) shares in the profits of, or receives compensation in any other form from, that firm; or (2) participates as agent or otherwise on behalf of such accounting firm in any activity of that firm." PCAOB Rule 1001(p)(i). The definition of an "associated person" does not include persons engaged only in clerical or ministerial tasks. *See id.*

[3] *See* Sections 105(b) & (c) of Sarbanes-Oxley.

[4] *See id.* § 103(a)(1); *see also, e.g.*, *id.* § 101(c)(2), (c)(4), (c)(6) & (g)(1).

Contribute to Violations.[5] For well over a decade now, the Board has brought enforcement proceedings against associated persons pursuant to Rule 3502.

Yet Rule 3502's current formulation contains an incongruity that places negligent contributors to firms' violations beyond the rule's reach. That incongruity stems from the fact that registered firms, like any legal entity, can act only through natural persons. It logically follows that when a registered firm is found to have acted negligently, it is likely that such negligence is attributable to a natural person's negligence.

Rule 3502, however, at present requires a level of culpability higher than negligence—at least recklessness—before the Board can impose sanctions against associated persons who contribute to firms' negligence-based violations. Put another way, Rule 3502 requires a showing of more than negligence by individuals for the Board to sanction conduct resulting in negligence by firms. Thus, under the current Rule 3502, associated persons who do not exercise reasonable care and contribute to firms' violations may escape liability and accountability—even while the firms committing the violations do not. As a result, the Board believes that the proposed Rule 3502 would address this incongruity, and therefore better protect investors and promote quality audits.

Rule 3502 also conditions contributory (or secondary) liability on the relationship between the firm that commits a violation and the individual[6] that contributes to that violation by requiring that the individual be an associated person of that firm. Given the complexity of many contemporary audits and the multiple firms involved in them, we are proposing to amend the rule to apply to individuals' contributions to primary violations committed by "any" registered public accounting firm.

For these reasons, the Board is proposing to amend Rule 3502 in two ways. First, the Board is proposing to change from recklessness to negligence the liability standard for associated persons' contributory conduct. Second, the Board is proposing to amend the rule to provide that an individual contributing to a registered firm's primary violation need not be an associated person of the firm that commits the violation so long as the individual is an associated person of some registered firm. As explained in greater detail herein, the Board

---

[5] *Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees*, PCAOB Release No. 2005-014, at 9 (July 26, 2005) ("2005 Adopting Release"), *available at* https://pcaobus.org/Rulemaking/Docket017/2005-07-26_Release_2005-014.pdf ("The Board proposed [Rule 3502] to codify the ethical obligation of associated persons of registered firms not to cause registered firms to commit [ ] violations.").

[6] For ease of reference, this release sometimes refers to associated persons who are the contributory actors for purposes of Rule 3502 as "persons" or "individuals." The Board notes, however, that both natural persons and entities can be associated persons, and therefore Rule 3502 charges can be brought against both natural persons and entities, consistent with the meaning of the term "person associated with a registered public accounting firm." *See supra* footnote 2.

believes, based on its experience, that these proposed amendments would better align Rule 3502 with the scope of the Board's enforcement authority under Sarbanes-Oxley, thus further advancing the Board's mission of investor protection.

II. BACKGROUND

PCAOB Rule 3502 provides grounds for secondary liability when an associated person of a registered firm acts at least recklessly to directly and substantially contribute to a violation by that firm of a law, rule, or standard that the Board is charged with enforcing. Although the rule as adopted in 2005 incorporated a recklessness standard, the rule as proposed in 2004 required that individuals only negligently contribute to a firm's violation to be subject to liability.[7] Whereas negligence "is the failure to exercise reasonable care or competence,"[8] recklessness requires "an extreme departure from the standard of ordinary care for auditors" that "is either known to the actor or is so obvious that the actor must have been aware of it."[9] Indeed, Sarbanes-Oxley characterizes "reckless conduct" as a subspecies of "intentional or knowing conduct,"[10] whereas negligence is an "objective" standard that is not measured by "the intent of the accountant."[11]

The Board is now proposing that negligence be the liability standard for actionable contributory conduct under Rule 3502. And for good reason: The proposed negligence standard is based on the Board's extensive experience with Rule 3502 since the rule's adoption nearly two decades ago, it aims to shore-up a gap in the PCAOB's regulatory framework that can lead to anomalous results, and it advances certain objectives in the Board's 2022-2026 Strategic Plan in furtherance of the Board's overall mission.

In the first subsection below, we review the Board's 2004 proposal and 2005 adoption of Rule 3502. Then, we detail the reasons for the proposed amendments to modernize and strengthen the rule.

---

[7] *See Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees*, PCAOB Release No. 2004-015, at 18 & n.40 (Dec. 14, 2004) ("2004 Proposing Release"), *available at* https://pcaobus.org/Rulemaking/Docket017/2004-12-14_Release_2004-015.pdf.

[8] *In re S.W. Hatfield, C.P.A.*, SEC Release No. 34-69930, at 35 n.169 (July 3, 2013) (citation and quotation marks omitted).

[9] *Marrie v. SEC*, 374 F.3d 1196, 1203 (D.C. Cir. 2004) (citation and quotation marks omitted); *see also* 2005 Adopting Release at 13 ("[T]he phrase 'knew, or was reckless in not knowing' is a well-understood legal concept, and the Board intends for the phrase to be given its normal meaning.").

[10] *See* Section 105(c)(5)(A) of Sarbanes-Oxley.

[11] *In re Melissa K. Koeppel, CPA*, PCAOB File No. 105-2011-007, at 166 (Dec. 29, 2017) (quoting *In re Kevin Hall, CPA*, SEC Release No. 34-61162, at 12 (Dec. 14, 2009) (quotation marks omitted)).

A. History of Rule 3502

As part of a package of proposed ethics and independence rules, the Board proposed PCAOB Rule 3502 in 2004.[12] In issuing the proposal, the Board observed that "[w]hile certain types of violations, by their nature, may give rise to direct liability only for a registered public accounting firm, the firm's associated persons bear an ethical obligation not to be a cause of any violations by the firm."[13] Accordingly, through Rule 3502, the Board sought to "codify that obligation" and "make it clear that the obligation is enforceable by the Board."[14] Using language "intended to articulate a negligence standard," the proposed version of Rule 3502 subjected associated persons to potential contributory liability if they "knew or should have known" that an act or omission by them would contribute to a firm's primary violation.[15] And although not stated expressly, the 2004 Proposing Release implied that the individual contributing to a violation must be an associated person of the firm that commits the primary violation.[16]

Following a notice-and-comment period,[17] the Board adopted Rule 3502 with two modifications from the proposal. First, while affirming its authority to promulgate a negligence-

---

[12] *See generally* 2004 Proposing Release at 18-19. As proposed (and adopted), Rule 3502 was entitled *Responsibility Not to Cause Violations*. *See id.* at A-4; 2005 Adopting Release at A-5. Shortly after adoption, however, the Board changed the title of the rule to its current title, *Responsibility Not to Knowingly or Recklessly Contribute to Violations*. The Board made the change "[a]fter discussions with the SEC" and "to avoid any misperception that the rule affects the interpretation of any provision of the federal securities laws." *Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees*, PCAOB Release No. 2005-020, at 2 (Nov. 22, 2005), *available at* https://pcaob-assets.azureedge.net/pcaob-dev/docs/default-source/rulemaking/docket017/2005-11-22_release_2005-020.pdf?sfvrsn=69338fcd_0. In so doing, however, the Board clarified that "[t]he rule, as amended, should be interpreted and understood to be the same as the rule adopted by the Board." *Id.*

[13] 2004 Proposing Release at 18.

[14] *Id.*

[15] *Id.* at 18 n.40; *see id.* at A-4 (proposed rule text).

[16] *See id.* at 18 ("[T]he firm's associated persons bear an ethical obligation not to be a cause of any violations by the firm").

[17] "Several commenters supported the rule as proposed and noted that they saw the rule as essential to the Board's ability to carry out its disciplinary responsibilities under the Act," 2005 Adopting Release at 9, while others did not fully endorse it. Their objections were based principally on the view that negligence might be an ill-suited liability standard "in light of the complex regulatory requirements with which auditors must comply" and out of concern that such standard "would allow the Board, or the SEC, to proceed against associated persons who in good faith, albeit negligently, have caused a registered firm to violate applicable laws or standards." *Id.* at 9, 13. Certain commenters "also questioned the Board's authority to adopt the proposed rule, or at least the proposed rule with a negligence standard." *Id.* at 9.

based contributory liability rule,[18] the Board revised the liability standard from negligence to recklessness, which the Board at that time believed would "strike[ ] the right balance in the context of th[e] rule."[19] Second, the Board modified "contribute"—the verb that describes the connection between the associated person's conduct and the firm's primary violation—with "directly and substantially."

The latter modification was made due to commenters expressing concern that, because of the collaborative nature of accounting work, each individual involved in formulating a decision or other action that ultimately leads to a firm violation could be held liable for causing the violation.[20] The Board explained that the addition of "directly" means, among other things, that an associated person's conduct must "either essentially constitute[ ] the [firm's] violation" or be "a reasonably proximate facilitating event of, or a reasonably proximate stimulus for, the violation." But, the Board clarified, "directly" does not place outside the scope of Rule 3502 contributory conduct "just because others also contributed to the violation, or because others could have stopped the violation and did not." "Substantially," the Board explained, means that associated persons' conduct must "contribute[ ] to [a] violation in a material or significant way," though it need not be "the sole cause of the violation."[21]

Finally, the 2005 Adopting Release clarified expressly what the 2004 Proposing Release implied regarding the relationship between associated persons who contribute to a violation and the firms that commit the violations: "Rule 3502 applies only when an associated person causes a violation by the registered firm with which the person is associated."[22]

B. Reasons for the Proposed Amendments

As the Board previously recognized, when an associated person causes a firm to commit a violation, such conduct "operates to the detriment of the protection of investors."[23] The following subsections explain why the proposed modifications to Rule 3502 are appropriate in furtherance of the Board's mission to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports.

---

18 *See id.* at 12 n.23; *see also infra* footnote 43.

19 2005 Adopting Release at 13; *see id.* at 12 & n.23.

20 *See id.* at 9, 13.

21 *Id.* at 13.

22 *Id.* at 11 n.20.

23 2005 Adopting Release at 10.

1. Aligning Rule 3502 With the Board's Enforcement Authority

As the Board previously has explained, a registered firm "can only act through the natural persons who serve as its agents, including its associated persons."[24] Accordingly, "a natural person's actions may render both the [firm] primarily liable and the natural person secondarily liable."[25] Yet under the current formulation of Rule 3502, there exists an incongruity between the respective requisite mental states for liability of a registered firm resulting from an associated person's conduct and for liability of the associated person: A firm can commit a primary violation of certain laws, rules, or standards by acting *negligently*, but an associated person who directly and substantially contributed to that violation must have acted at least *recklessly* to be secondarily liable.

This incongruity has the potential to dissuade associated persons from exercising the appropriate level of care in their audit work. They may not exercise reasonable care (the standard for negligence) if they know that they cannot be held individually liable by the PCAOB for a firm's primary violation unless an act or omission by them amounts to an "an extreme departure from the standard of ordinary care for auditors" (the standard for recklessness).[26] The proposed modification to Rule 3502's liability standard from recklessness to negligence is intended to close this regulatory gap, which should incentivize associated persons to be more deliberate and careful in their actions. Indeed, "accountability frequently improves outcomes."[27]

In addition to the discrepancy in liability standards, uncertainty may exist with respect to the enforceability of Rule 3502, as it pertains to *who* can violate the rule. Currently, to be subject to potential liability under Rule 3502, an associated person of a registered public accounting firm must at least recklessly, directly, and substantially "contribute to a violation by *that* registered public accounting firm," meaning the firm of which the individual is an

---

[24] 2004 Proposing Release at 18; *see* 2005 Adopting Release at 12 ("[Registered] firms . . . can only act through the natural persons that comprise them, many of whom are 'associated persons' subject to the Board's ethics standards and disciplinary authority.").

[25] *In re Timothy S. Dembski*, SEC Release No. 34-80306, at 13-14 n.35 (Mar. 24, 2017) (quoting *SEC v. Koenig*, 2007 WL 1074901, at *7 (N.D. Ill. Apr. 5, 2007)).

[26] *Marrie*, 374 F.3d at 1204; *see* Russell G. Pierce & Eli Wald, *The Relational Infrastructure of Law Firm Culture and Regulation*, 42 HOFSTRA L. REV. 109, 129 (2013) (explaining how rules from the legal industry's governing body that would restrict lawyers' limited liability "will encourage lawyers to devote more energy to maintaining the quality of the firm because they could potentially face personal liability for poor quality services"); *see also* Colleen Honigsberg, *The Case for Individual Audit Partner Accountability*, 72 VAND. L. REV. 1871, 1885 (2019) (arguing that "existing deterrence mechanisms have failed to produce optimal audit quality" and "are ineffective").

[27] Honigsberg, *supra* footnote 26, at 1902.

associated person—and only that firm.[28] Yet it's possible that an associated person of a registered firm—who by virtue of that designation is subject to the Board's enforcement authority[29] and is required to comply with all applicable standards that the Board is charged with enforcing[30]—could contribute to a second firm's violation in such a way that there may be doubt as to the application of current Rule 3502. In such circumstance, regardless of the individual's degree of departure from the standard of reasonable care (i.e., even if the individual acted intentionally or recklessly), there may be uncertainty as to the availability of a charge under Rule 3502 against the individual due to the nature of the individual's relationship with the firm committing the primary violation (although other charges potentially might be available).

Questions:

1. Are the regulatory concerns discussed above clear and understandable?

2. Are there other regulatory concerns related to the current formulation of Rule 3502? If so, what are they and how should the Board address them, if at all?

3. Would addressing the regulatory concerns discussed above incentivize associated persons to more fully comply with the applicable laws, rules, and standards that the Board is charged with enforcing against registered firms?

2. The Board's Implementation Experience

Although the Board viewed Rule 3502's recklessness liability threshold as "strik[ing] the right balance in the context of th[e] rule" at the time of the rule's adoption in 2005, the threshold had not yet been tested in practice by the PCAOB, and experience has shown that it prevents the Board from executing its investor-protection mandate to the fullest extent that Congress authorized in Sarbanes-Oxley.

In the instances in which the Board has instituted proceedings against firms for negligence-based violations, the Board has not been able to charge Rule 3502 violations against the individuals that contributed to those firms' violations. Although the decision not to bring charges against individuals varies case-by-case and is at the Board's discretion, it remains that the Board has been legally barred by the current formulation of Rule 3502 from holding

---

[28] PCAOB Rule 3502, *Responsibility Not to Knowingly or Recklessly Contribute to Violations* (emphasis added).

[29] *See* Section 101(c)(6) of Sarbanes-Oxley.

[30] *See* PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*.

accountable under Rule 3502 individuals who negligently, directly, and substantially contributed to the firms' violations, given the absence of reckless conduct.[31]

The Board's interactions with Rule 3502 in various contexts supply experience-based reasons for the proposed amendment to the liability standard. For example, when dealing with the design and implementation of firm quality control (QC) policies and procedures under applicable QC standards, the Board has observed that registered firms that commit a QC violation often have multiple individuals with overlapping QC responsibility but that no single individual was reckless in failing to act, and thus no individual can be held personally accountable for the firm's QC failure. And yet, individuals with QC responsibility at a firm are often in some of the most important, decision-making roles within the firm because a compliant QC system serves as the backstop to ensure that all *other* professional standards are followed.[32]

In addition to the QC context, Rule 3502 also arises in sole-proprietorship cases, in which the sole owner and sole partner of a firm causes the firm to commit a violation. Yet for some types of violations, there is not always sufficient evidence of reckless behavior. A negligence standard thus would promote greater accountability by the sole proprietor and prevent that person from being shielded from individual liability under Rule 3502.

Regarding the other aspect of the proposal, contributory liability for an associated person who directly and substantially contributes to a firm's primary violation shouldn't be contingent upon the individual's formal role or relationship with that firm, so long as the individual is an associated person of *any* registered firm.[33] To be sure, an individual who "directly and substantially" contributes to a firm's violation (consistent with the meaning of that phrase[34]) in all instances likely also will have "participate[d] as agent *or otherwise on behalf of* such [ ] firm in *any* activity of that firm" "*in connection with* the preparation or issuance of

---

[31] As the 2005 Adopting Release notes, however, Rule 3502 "is not the exclusive means for the Board to enforce applicable Board rules and standards against associated persons." 2005 Adopting Release at 14 n.25.

[32] *See* QC § 20.03, *System of Quality Control* ("A firm has a responsibility to ensure that its personnel comply with the professional standards applicable to its accounting and auditing practice. A system of quality control is broadly defined as a process to provide the firm with reasonable assurance that its personnel comply with applicable professional standards and the firm's standards of quality.").

[33] Indeed, the U.S. Securities and Exchange Commission ("Commission") has even broader secondary-liability authority—it may hold accountable auditors for causing primary violations not only by firms, but by any other person, including issuers. *See, e.g.*, *In re James Fitts, CPA*, SEC Release No. 34-97259 (Apr. 6, 2023); *In re Steven C. Avis, CPA*, SEC Release No. 34-95071 (June 8, 2022); *see also infra* pages 13-14 (discussing the Commission's secondary-liability regime).

[34] *See* 2005 Release at 13; *see also infra* pages 14-15.

any audit report," and thus be an "associated person" of that firm.[35] Moreover, PCAOB rules acknowledge that an individual can be an associated person of multiple registered firms at the same time.[36] The Board, however, believes that amending the rule to provide that a contributory violator need not be an associated person of the registered firm that commits the primary violation would eliminate any doubt about which individuals are within proposed Rule 3502's scope.

The Board also notes—as it has observed through its oversight activities—that varied roles and creative work arrangements for certain personnel are becoming increasingly common in the industry.[37] In light of these arrangements, the Board believes that amending the rule as described above would clarify that associated persons of *any* registered firm are potentially subject to liability under proposed Rule 3502, regardless of an individual's formal role or relationship with the firm that commits the primary violation.

Question:

4. Are there common types of cases or fact patterns not discussed above in which a negligent standard of liability would be particularly useful to promote greater individual accountability under Rule 3502?

3. Advancing the Board's Investor-Protection Mandate

In the Board's 2022-2026 Strategic Plan, the Board expressed a rejuvenated focus on the PCAOB's investor-protection mandate and stated its intent "to modernize and streamline our

---

[35] *See* Section 2(a)(9) of Sarbanes-Oxley (emphases added); PCAOB Rule 1001(p)(i)(2).

[36] The Board's definition of an "associated person" expressly contemplates that a person may be primarily associated with one registered firm while also being associated with another firm. Rule 1001(p)(i)'s definition of an "associated person" provides that if a firm reasonably believes that one of its associated persons is primarily associated with another registered firm, then that person is excluded from the definition of an "associated person," but only "for purposes of completing a registration application on Form 1, Part IV of an annual report on Form 2, or Part IV of a Form 4 to succeed to the registration status of a predecessor." For all other purposes, that carveout does not apply, thus underscoring that, in the context of Rule 3502's reference to an "associated person," a person can be associated with two or more registered firms at once. *See* PCAOB Rule 1001(p)(i).

[37] *See, e.g.*, Hannah L. Buxbaum, *The Viability of Enterprise Jurisdiction: A Case Study of the Big Four Accounting Firms*, 48 U.C. DAVIS L. REV. 1769, 1798 (2015) (detailing how some of the larger firm networks "have interposed additional coordinating organizations between the global entity and the individual affiliates that provide client services" via "a regional structure"); *see also* Honigsberg, *supra* footnote 26, at 1903 ("The incentive effects of individual accountability are particularly important given the changes in audit design over the past decade. . . . For multinational firms, presumably over half of audit hours are frequently performed overseas.").

existing standards . . . where necessary to meet today's needs."[38] The Board also expressed an intent to "engag[e] in vigorous and fair enforcement that promotes accountability and deterrence," including by "tak[ing] a more assertive approach to bringing enforcement actions" and "hold[ing] accountable" those who commit "violations that result from negligent conduct."[39] The proposed amendments to Rule 3502 are consistent with those goals.

When Congress enacted Sarbanes-Oxley, it empowered the Board to promulgate and adopt certain standards and rules, to inspect registered firms for compliance with those standards and rules, and to enforce compliance by firms and their associated persons. Among the tools that Congress provided to the Board for enforcement is the ability to sanction negligent conduct, including single instances of negligence.[40] That liability threshold serves a dual function: It incentivizes auditors to conduct their work knowing that reasonable care is the standard for assessing it, and it allows the Board to publicly discipline auditors who were found to have not exercised an appropriate degree of care.[41] Each of those functions—one *ex ante* to auditors' conduct and the other *ex post*—goes to the core of the Board's mission of protecting investors and promoting high-quality audits.

The current formulation of Rule 3502, however, stops short of deploying the negligence standard to its fullest extent by requiring at least reckless conduct before an associated person can be held secondarily liable. The proposed change in Rule 3502's liability standard would

---

[38] PCAOB, Strategic Plan 2022-2026, at 10, *available at* https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/strategic-plan-2022-2026.pdf?sfvrsn=b2ec4b6a_4/.

[39] *Id.* at 3, 13; *see also id.* at 8 ("[W]e are focused on aggressively pursuing all statutory legal theories for charging respondents and remedies available in executing our enforcement program, which is central to protecting investors and promoting the public interest.").

[40] *See* Sections 105(c)(4) & (c)(5) of Sarbanes-Oxley; *Rules on Investigations and Adjudications*, PCAOB Release No. 2003-015, at A2-58 (Sept. 29, 2003), *available at* https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket_005/release2003-015.pdf?sfvrsn=35827b4_0 ("The Act plainly contemplates that disciplinary proceedings can be instituted for a violation based on a single negligent act.").

[41] *See* Honigsberg, *supra* footnote 26, at 1899 ("Individual accountability could provide a counterweight to the current incentive structure. . . . [A]udit partners do not internalize the full consequences of an audit failure. Promoting individual brands will better address this inefficiency and reduce externalities by causing audit partners to internalize these failures."); *see also* Gina-Gail S. Fletcher, *Deterring Algorithmic Manipulation*, 74 VAND. L. REV. 259, 268-69 (2021) ("[I]f the applicable laws are narrow, only capturing the most blatant misconduct, wrongdoers may not be deterred from breaking the law. . . . [D]eterrence is effective if regulators have strong, suitable tools to enforce the regime and market actors know whether they are violating the law.").

remove this self-imposed constraint and make the rule both a more effective deterrent and a more effective enforcement tool, and in so doing, better align the rule with Sarbanes-Oxley.[42]

The proposal to amend Rule 3502 with respect to *who* can violate the rule is also intended to align the rule with the PCAOB's statutory mission. Proposing to amend Rule 3502 so that liability is not contingent upon a person's formal role or relationship with the firm that commits the primary violation would be an appropriate modification to the rule—what matters is whether a person has directly and substantially contributed to a firm's violation of the laws, rules, and standards that the Board enforces.

Questions:

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

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

III. DISCUSSION OF THE PROPOSED AMENDMENTS

As discussed above, the Board is proposing to amend PCAOB Rule 3502 in two ways: (1) changing the liability standard from recklessness to negligence, and (2) providing that, to be subject to potential liability under the rule, a contributory actor need not be an associated person of the registered firm that has committed a primary violation. Consistent with prior Board interpretations, the Board is proposing these amendments pursuant to its authority under Sarbanes-Oxley.[43] The details of these amendments are discussed in the following subsections.

A. Changing the Liability Standard

As seen in Appendix A, the Board is proposing to modify Rule 3502's liability standard by deleting the phrase "knowing, or recklessly not knowing" (and certain ancillary surrounding

---

[42] *See* PCAOB, Strategic Plan 2022-2026, at 10 ("Effective auditing, attestation, quality control, ethics, and independence standards advance audit quality and are foundational to the PCAOB's execution of its mission to protect investors.").

[43] Consistent with the original proposal and adoption of Rule 3502, the Board is proposing the amendments to Rule 3502 pursuant to the Board's authority in Sections 105 and 103 of Sarbanes-Oxley. *See* Sections 105(c)(4) & (c)(5) of Sarbanes-Oxley (authority to sanction single instances of negligent conduct); *id.* § 103(a)(1) (authority to promulgate ethics standards); *see also* PCAOB Release No. 2003-015, at A2-58 ("The Act plainly contemplates that disciplinary proceedings can be instituted for a violation based on a single negligent act."). Section 101, moreover, also authorizes the proposed amendments. *See* Sections 101(a), (c)(2), (c)(4), (c)(5), (c)(6), (f)(6) & (g)(1) of Sarbanes-Oxley (establishment, duties, powers, and rules of the Board).

text) and inserting elsewhere into the rule the phrase "knew or should have known" (and certain ancillary surrounding text). The current phrase describes conduct that amounts to at least recklessness,[44] whereas the proposed phrase sets a negligence standard using "classic negligence language."[45] Consequently, the Board is proposing to change the standard for secondary liability from an "extreme departure from the standard of ordinary care"[46] (recklessness) to "the failure to exercise reasonable care or competence" (negligence).[47]

Such a change would address the incongruity and related issues noted above. Specifically, it would align the requisite mental states for liability of a registered firm and for liability of an associated person whose conduct directly and substantially contributed to the firm's violation.[48] In so doing, the proposed modification should incentivize associated persons to exercise the appropriate level of care, thus promoting investor protection.

In furtherance of administering this new rule, the Board notes two aspects of today's proposal.

First, 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 ("Exchange Act"). Specifically, among other things, the Exchange Act authorizes the Commission to institute cease-and-desist proceedings against any "person that is, was, or would be a cause of [a] violation [of the Exchange Act or any rule or regulation thereunder], due to an act or omission the person knew or should have known would contribute to such violation,"[49] and further authorizes the Commission to "impose a civil penalty" upon finding

---

[44] *See* 2005 Adopting Release at 12 n.23.

[45] *In re KPMG Peat Marwick LLP*, SEC Release No. 34-43862 (Jan. 19, 2001) ("Ordinarily, the phrase 'should have known' . . . is classic negligence language."), *pet. for review denied*, *KPMG*, 289 F.3d at 112; *see also Erickson Prods., Inc. v. Kast*, 921 F.3d 822, 833 (9th Cir. 2019) ("'[S]hould have known' . . . is a negligence standard. To say that a defendant 'should have known' of a risk, but did not know of it, is to say that he or she was 'negligent' as to that risk."); *KPMG*, 289 F.3d at 120 ("knew or should have known" is language that "virtually compel[s]" a negligence standard).

[46] *Marrie*, 374 F.3d at 1204 (citation and quotation marks omitted).

[47] *S.W. Hatfield*, SEC Release No. 34-69930, at 35 n.169.

[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.

[49] 15 U.S.C. § 78u-3(a); *see also* 15 U.S.C. §§ 77h-1(a), 80a-9(f)(1), 80b-3(k)(1).

that such person "is or was a cause of [such] violation."[50] Section 3(b)(1) of Sarbanes-Oxley, in turn, provides that "[a] violation by any person of . . . any rule of the Board shall be treated for all purposes in the same manner as a violation of the [Exchange Act] or the rules and regulations issued thereunder." Thus, the proposed amendment to Rule 3502's liability threshold would not subject auditors to any new or different standard to govern their conduct.[51] And indeed, Commission proceedings under the Exchange Act have resulted in sanctions (including civil penalties) against auditors for negligently contributing to primary violations by firms and issuers.[52]

Second, the Board is proposing to retain the "directly and substantially" modifier to describe the connection between a contributory actor's conduct and a registered firm's primary violation.[53] Thus, for conduct to "directly" contribute to a primary violation, it must "either essentially constitute[ ] the violation"—in which case it necessarily is a direct cause of it[54]—or

---

[50] 15 U.S.C. § 78u-2(a)(2). The Commission's Section 21B authority to impose civil penalties for violations in Section 21C cease-and-desist proceedings was added in 2010 as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act. *See* Pub. L. 111-203.

[51] Nor does the Commission's authority to sanction associated persons' negligent contributory conduct detract from the proposed amendment's deterrent effect, as an increase in the number of regulators on the lookout for the same or similar violative conduct increases the likelihood of that conduct being detected and, consequently, the likelihood that the conduct would be sanctioned. *See* Anton R. Valukas, *White-Collar Crime and Economic Recession*, 2010 U. CHI. LEGAL F. 1, 12 (2010) ("One of the most powerful deterrents to misconduct is an increased threat of prosecution. . . . A 'can do' accountant is less likely to provide questionable opinions if there is a substantial certainty that he will be caught and punished."); *see also* Fletcher, *supra* footnote 41, at 268 ("Certainty of punishment"—including "the possibility of detection, apprehension, conviction, and sanctions"—is one of two "primary factors" that drive deterrence.).

[52] *See, e.g.*, *In re David S. Hall, P.C.*, SEC Initial Decision Release No. 1114 (Mar. 7, 2017) (ALJ Op.) (cease-and-desist order and $10,000 civil penalty against engagement quality reviewer for negligently causing primary violations by registered firm and firm's issuer client, respectively), *decision made final*, SEC Release No. 34-80949 (June 15, 2017); *see also In re Gregory M. Dearlove, CPA*, SEC Release No. 34-57244 (Jan. 31, 2008) (cease-and-desist order against firm engagement partner for negligently causing violations by firm's issuer client); *In re Philip L. Pascale, CPA*, SEC Release No. 34-51393 (Mar. 18, 2005) (same).

[53] *See* 2005 Adopting Release at 13. As discussed above, the "directly and substantially" modifier was added in response to commenters' concerns that a negligence standard might sweep too broadly. *See supra* pages 5-6 & n.17; *see also* 2005 Adopting Release at 13. Because the Board is retaining "directly and substantially," as explained herein, the guardrails that the Board put in place in 2005 in response to such concerns would remain under this proposal.

[54] *Cf. Paul F. Newton & Co. v. Tex. Commerce Bank*, 630 F.2d 1111, 1118 (5th Cir. 1980) ("[C]ommon law agency principles, including the doctrine of respondeat superior, remain viable in actions brought under the Securities Exchange Act and provide a means of imposing secondary liability

be "a reasonably proximate facilitating event of, or a reasonably proximate stimulus for, the violation"; but it need not "be the final step in a chain of actions leading to the violation."[55] Moreover, "directly" does not excuse an associated person who negligently "engages in conduct that substantially contributes to a violation, just because others also contributed to the violation, or because others could have stopped the violation and did not."[56] Nor would it necessarily excuse an associated person's conduct when another actor engages in intentional misconduct that might otherwise break the chain of causation—in particular where the associated person should have realized the potential for, and likelihood of, such third-party intentional misconduct.[57]

For its part, "substantially" continues to require that the associated person's conduct "contribute[ ] to the violation in a material or significant way," though it "does not need to have been the sole cause of the violation."[58] The Board stresses that Rule 3502 is not intended to "reach an associated person's conduct that, while contributing to the violation in some way, is remote from, or tangential to, the firm's violation."[59]

The Board further notes that, based on the proposed rule text, "directly and substantially" would apply only to the sufficiency of the connection between an associated person's conduct and a firm's violation. Thus, to be liable under proposed Rule 3502, 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.

Questions:

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

---

for violations of the Act independent of § 20(a). The federal securities statutes are remedial legislation and must be construed broadly, not technically and restrictively.").

[55] *See* 2005 Adopting Release at 13.

[56] *Id.*

[57] *See* RESTATEMENT (SECOND) OF TORTS § 448 ("The act of a third person in committing an intentional [violation] is a superseding cause of harm to another resulting therefrom, although the actor's negligent conduct created a situation which afforded an opportunity to the third person to commit such a [violation], unless the actor at the time of his negligent conduct realized or should have realized the likelihood that such a situation might be created, and that a third person might avail himself of the opportunity to commit such a [violation].").

[58] 2005 Adopting Release at 13.

[59] *Id.*; *see also id.* at 14 (The Board does not "seek to reach those whose conduct, unbeknownst to them, remotely contributes to a firm's violation.").

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?

9. Are there other phrases or terms that the Board should consider to modify "contribute," or other limitations that the Board should incorporate into the proposed rule? If so, what are they?

B. Clarifying the Relationship Between Contributory Actor and Primary Violator

As seen in Appendix A, the Board is proposing to amend Rule 3502 by changing the word "that" to "any" immediately before the reference to the registered public accounting firm that commits the primary violation. The relative pronoun "that" generally is understood to refer back to a specific preceding noun,[60] which, in the current formulation of Rule 3502, means that the registered firm of which the contributory actor is an associated person must be the same firm that commits the primary violation. The Board confirmed this reading of Rule 3502 when it adopted the rule, noting that "Rule 3502 applies only when an associated person causes a violation by the registered firm with which the person is associated."[61]

The "ordinary meaning" of the word "any," by contrast, "encompass[es] all varieties of" whatever noun follows it.[62] Thus, by proposing to prohibit associated persons from negligently contributing to a violation by "*any* registered public accounting firm," the Board intends for proposed Rule 3502 to apply to associated persons that contribute at least negligently (and directly and substantially) to a registered firm's primary violation, regardless of whether the person is an associated person of the registered firm. As discussed above, the Board believes that this proposed amendment would enhance investor protection by clarifying the application of Rule 3502, mindful of registered firms' contemporary organizational structures, operational

---

[60] *See In re Connors*, 497 F.3d 314, 319 (3d Cir. 2007) ("The word 'that' is a relative pronoun that restricts and, therefore, modifies, [a] preceding noun[.]"); *see also Carondelet Canal & Nav. Co. v. Louisiana*, 233 U.S. 362, 382 (1914) ("The natural and grammatical use of a relative pronoun is to put it in close relation with its antecedent, its purpose being to connect the antecedent with a descriptive phrase.").

[61] 2005 Adopting Release at 11 n.20.

[62] *Buffalo Marine Servs. Inc. v. United States*, 663 F.3d 750, 755 (5th Cir. 2011); *see New York v. EPA*, 443 F.3d 880, 889 (D.C. Cir. 2006) ("[T]he word 'any' indicates the intent to cover all of the ordinary meanings of the phrase" that follows it.); *see also Regions Bank v. Legal Outsource PA*, 936 F.3d 1184, 1194 (11th Cir. 2019) ("[T]he word 'any' without language limiting the breadth of that word, . . . means all." (citation and quotation marks omitted)); *e.g.*, *Ali v. Fed. Bureau of Prisons*, 552 U.S. 214, 220 (2008) ("Congress' use of 'any' to modify 'other law enforcement officer' is most naturally read to mean law enforcement officers of whatever kind.").

practices, and varied roles and assignments for certain personnel.[63] The Board also points out that Sarbanes-Oxley does not restrict the Board's authority to investigate and discipline individuals for violative conduct based on the particular registered firm or firms of which they are associated persons.[64]

The Board further notes that although it is proposing to change which *registered firms* can be the primary violator for purposes of Rule 3502, contributory liability under Rule 3502 remains distinct from liability for contributing to a primary violation by another *individual*, which the Board's rules currently do not contemplate and which the Board is not proposing at this time. Thus, under the proposal, an associated person would not violate Rule 3502 by negligently contributing to another associated person's violation of an applicable standard.[65]

However, consistent with the meaning of "directly and substantially," an associated person could be liable under proposed Rule 3502 for conduct that contributes to another person's act or omission that in turn also contributes to a violation by a registered firm if the Board were to find that the associated person's conduct nonetheless "directly and substantially" contributed to the firm's violation, notwithstanding the intervening actor's conduct (which may or may not be violative, including of Rule 3502).[66]

Questions:

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

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?

12. Are there scenarios where an associated person's conduct might contribute to another individual's primary violation but the conduct would be outside the

[63] *See supra* pages 9-10.

[64] *See, e.g.*, Sections 101(c)(4), 101(c)(6), 105(a), 105(b)(1), 105(b)(3)(A), 105(c)(1) & 105(c)(4) of Sarbanes-Oxley.

[65] However, two or more associated persons may be liable under the proposed rule for contributing to the same primary violation, including where one of them acts or fails to act in a manner that causes the other to directly and substantially contribute to the primary violation.

[66] *See* 2005 Adopting Release at 13 ("'Directly and substantially' does not mean that the associated person's conduct must be the *sole cause* of the violation, nor that it must be the *final step in a chain of actions* leading to the violation." (emphases added)); *id.* ("[T]he term 'directly' should not be misunderstood to excuse someone who knowingly or recklessly engages in conduct that substantially contributes to a violation, *just because others also contributed to the violation* . . . ." (emphasis added)).

scope of any Board standard or rule (current or proposed), including the current and proposed versions of Rule 3502? If so, what are the scenarios?

IV. ECONOMIC CONSIDERATIONS

The Board is mindful of the economic impacts of its rulemaking. This section discusses economic considerations related to the proposed amendments, including a description of the baseline, the need for rulemaking, the economic impacts and potential unintended consequences, and the alternatives considered. Because there are limited data and research findings available to quantify the economic impacts of the proposed amendments, the economic analysis is largely qualitative; however, where reasonable and feasible, the analysis incorporates quantitative information, including PCAOB enforcement data.

A. Baseline

Section II above describes important components of the baseline against which the proposed amendments' economic impacts are considered, including the current formulation of Rule 3502 and the Board's implementation experience. We discuss below additional data on the Board's enforcement activities.

Table 1 presents Board enforcement data on Rule 3502 charges for 2009-2022.[67] Column A shows the number of cases in which associated persons were found to have violated Rule 3502, column B shows the number of cases in which registered firms were sanctioned (for any violation), and column C is the ratio of the two, expressed as a percentage to reflect the proportion of times when a Rule 3502 charge could be considered by the Board because there was a sanction of the firm. As seen, there have been a total of 87 Rule 3502 cases in 14 years. At an average of six per year, the number of cases was highest in 2015 at 17 and lowest in 2010, when no Rule 3502 violations were found.[68] The 87 cases represent 36 percent of the total number of cases in which firms were charged by the Board with violations from 2009-2022. Although this data does not predict how many Rule 3502 violations the Board might find if Rule 3502 were amended as proposed, the data indicates that in nearly two-thirds of cases in which a firm was charged with a violation, no contributory actor was held accountable under Rule 3502.

[67] The Board brought the first Rule 3502 charge in 2009 for conduct committed after the effective date of Rule 3502 in April 2006.

[68] Column A reflects Rule 3502 cases involving sanctions of one or more respondents as one instance. Some firm violations were charged in different years than the Rule 3502 violations by the associated persons.

Table 1. Number and Incidence of Rule 3502 Charges, 2009-2022

	Cases with Rule 3502 Charges (A)	Firms Sanctioned (B)	Incidence of Rule 3502 Charges C = A / B
2009	2	5	40%
2010	0	2	0%
2011	2	6	33%
2012	3	4	75%
2013	5	10	50%
2014	2	20	10%
2015	17	37	46%
2016	14	30	47%
2017	15	42	36%
2018	8	13	62%
2019	8	19	42%
2020	2	13	15%
2021	3	14	21%
2022	6	30	20%
Total	**87**	**245**	**36%**

B. Need

This section discusses the problems the proposed amendments are intended to address and how they are expected to address them.

1. Problems to Be Addressed

In its current form, Rule 3502 creates two distinct misalignments between the Board's ability to hold accountable persons who contribute to registered firms' violations and the real-world ways in which individuals carry out their responsibilities vis-à-vis registered firms.

First, there is a mismatch between individuals' and firms' respective minimum culpability levels, which limits the Board's ability to hold accountable individuals who contribute to a firm's violation by failing to act reasonably. Specifically, 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. But a legal entity can act only through natural persons, which suggests that the standards for liability should be aligned. Individuals are also expected to act with due care with respect to their primary responsibilities under PCAOB standards and rules, which fails to align with the current recklessness standard of Rule 3502.

Second, although rare, there is the 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. The possibility that Rule 3502's current formulation could result in differing liabilities creates a risk of reduced individual auditor accountability, potentially diminishing investor protection and the public interest.

As discussed in Section III above, however, 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 or is not an associated person of the firm that commits the violation. Accordingly, the purpose is not to cause associated persons for the first time to feel as if they could be subject to liability (i.e., to impose liability for conduct that currently is not subject to enforcement). Rather, the purpose is narrower: to provide the PCAOB with jurisdiction over these matters so that individuals can be brought to account regardless of the resource allocation decisions that result in particular issuer or broker-dealer audit cases being brought by the Commission or by the PCAOB pursuant to the PCAOB's concurrent jurisdiction with the Commission.

2. How the Proposed Amendments Address the Need

The proposed amendments seek to promote investor protection and the public interest by changing Rule 3502 in two ways.

First, the proposed amendments would change the liability standard from recklessness to negligence. Doing so would allow the Board to hold individuals accountable when they contribute to a firm's violation if their contributory act or failure to act was negligent but not reckless.

Second, the proposed amendments would provide that the individual contributing to a violation need not be an associated person of the firm that commits the primary violation. Under this proposed amendment, so long as the person contributing to a registered firm's primary violation is an associated person of *any* registered firm, the person could be subject to liability under Rule 3502.

C. Economic Impacts

This section discusses the expected benefits and costs of the proposed amendments and potential unintended consequences. Overall, we expect that the economic impacts of the proposal will be modest, particularly given that the Commission's framework for imposing sanctions against persons who cause others' primary violations does not include either of the attributes of current Rule 3502 that are the subject of this proposal.

However, to the extent that individuals are not acting reasonably today because a gap between the Commission's and the PCAOB's respective frameworks creates a possibility that the

conduct would elude enforcement were the matter to be investigated by only the PCAOB, eliminating the inconsistencies would increase the probability of sanction. As firms act through individuals, an increase in the quality of individual performance should improve the firm's audit quality. The proposed amendments, by increasing the likelihood that individuals take more seriously their audit, quality control, and other compliance responsibilities, will make it more likely for registered firms to comply with PCAOB standards. Improved compliance with the standards promotes audit quality and protects the interests of investors.

The proposed amendments will impose certain additional costs on firms as potential misconduct is investigated and to defend against charges.[69] And they may impose certain unintended consequences to the extent that persons react inefficiently to the increase in the threat of sanction. We expect the proposed amendments' benefits will justify the costs and any unintended adverse effects.

1. Benefits

Enabling the PCAOB to enforce Rule 3502 in both situations identified in the Need section above will generate certain benefits.

Academic literature suggests that litigation risk and legal liability are important factors affecting audit quality. Studies provide empirical evidence that litigation risk against auditors improves audit quality as auditors become more careful about their work.[70] The studies do not, however, address whether the relationship is linear.[71] Imposing liability against individuals who contribute to a firm's violation provides additional deterrence against misconduct as compared with a regime where authorities are only able to sanction the firm and then rely on the firm potentially imposing private sanctions on culpable individuals; public authorities' sanctioning

---

[69] We do not separately account for any incremental costs that may be incurred by firms or associated persons to ensure, in light of the proposed amendments to Rule 3502, that associated persons do not act negligently in ways that contribute to firms' violations. Those costs are properly costs of complying with the primary rules, which generally assume full compliance at a reasonable level of care. However, we acknowledge their existence.

[70] *See, e.g.*, Clive Lennox & Bing Li, *Accounting Misstatements Following Lawsuits Against Auditors*, 57 J. ACCT. & ECON. 58-75 (2014); Baolei Qi, Liuchuang Li, Ashok Robin & Rong Yang, *Can Enforcement Actions on Engagement Auditors Improve Audit Quality?*, Accounting and Business Research (2015), SSRN 2549041; Ramgopal Venkataraman, Joseph Weber & Michael Willenborg, *Litigation Risk, Audit Quality, and Audit Fees: Evidence from Initial Public Offerings*, 83 ACCT. REV. 1315-1345 (2008); Jerry Sun, Steven Cahan & Jing Xu, *Individual Auditor Conservatism After CSRC Sanctions*, 136 J. BUS. ETHICS 133-46 (2016).

[71] Excessive litigation risk might bring declining returns or even harm audit quality. We discuss this potential effect in Section IV.C.3 below.

tools (e.g., public censure, fines, associational prohibitions) may more effectively deter future misconduct.[72]

Under the proposed rule, the increase in litigation and liability risk would be modest, but meaningful. Currently, individuals may act inappropriately if they discount the likelihood of public sanction because the PCAOB lacks the ability to bring charges for merely negligent contributory conduct or contributory conduct by someone who is not an associated person of the registered firm committing the primary violation (although they may not avoid private sanction by their firm or sanction by the SEC). The proposed amendments would provide enhanced incentives for individuals to perform important roles at a reasonable person level of care, as individuals could be subject to sanction regardless of whether the Commission or the PCAOB pursues their conduct.

To the extent that individuals may perceive greater litigation risk and therefore change their behavior and take their audit, quality control, or other compliance responsibilities more seriously by ensuring that their actions are objectively reasonable under the circumstances, registered firms in turn will be more likely to comply with their respective legal requirements (which will reduce firms' legal risks). These legal requirements—e.g., audit standards, quality control standards, and ethics and independence standards—were enacted to promote audit

---

[72] *See, e.g.*, John T. Scholz, *Enforcement Policy and Corporate Misconduct: The Changing Perspective of Deterrence Theory*, 60 L. & CONTEMP. PROBS. 253, 265 (1997). Scholz states:

> When corporations have the means of punishing subordinates for illegal behavior, punishing the corporation rather than individuals responsible for wrongdoing may serve to strengthen the corporation's private enforcement system. Criminal prosecution of individuals will be necessary, however, whenever the potential gains to the individual from illegal behavior far exceed the worst punishment the firm could impose.

Here, a firm may expel a partner, but such action is unlikely to be public (e.g., a private settlement may contain nondisclosure and antidisparagement clauses) and thereby is less likely to be an effective deterrent to associated persons of other firms as compared to a public sanction. Similarly, a firm may be able to inflict a private financial penalty (e.g., through a claw-back or forfeiture of paid-in capital or deferred compensation). Still, a firm may not have effective provisions in its partnership agreements or may view enforcing those clauses as uneconomical if forced to litigate them as a contractual dispute. These tools therefore may be less effective than an enforceable public civil penalty, which can be set in an amount appropriate to protect the public interest. Additionally, in the absence of a noncompete agreement, a firm cannot prevent that partner from associating with a different registered public accounting firm and performing issuer or broker-dealer audit work or becoming employed by an issuer or broker-dealer in a financial-management capacity; by contrast, a PCAOB sanction may do so. *See* Section 105(c)(7) of Sarbanes-Oxley. Lastly, a firm cannot suspend an individual's CPA license, but a PCAOB sanction can lead to collateral consequences with relevant state accountancy authorities. *See, e.g.*, N.Y. State Rules of the Board of Regents § 29.10(f); *see also* Section 105(d)(1) of Sarbanes-Oxley (requiring the Board to report disciplinary sanctions it imposes to, among others, "any appropriate State regulatory authority or any foreign accountancy licensing board with which [a sanctioned] firm or person is licensed or certified").

quality and the interests of investors. Better compliance with these requirements therefore will promote audit quality and protect the interests of investors.[73]

The proposed amendments also are expected to generate efficiencies in enforcement activities. The efficiencies are attained by enabling the PCAOB to bring negligence-based cases against firms and the relevant associated persons, rather than perpetuating the status quo in which only the Commission can bring such cases.

An additional benefit of the proposed amendments is that they address the potential absence of coordination among audit firms. Currently, individual firms may recognize the advantages of giving their personnel sufficient staffing and resources to exert greater effort (e.g., through staffing or otherwise resourcing quality control systems more robustly). However, they may hesitate because of the fear of a competitive disadvantage. This is because they might incur higher costs than rivals who operate with fewer resources, counting on the idea that their staff would not view the risk of detection and penalty as sufficiently high to either demand more resources or resign.

The proposed rule would apply across the board and level the playing field: To the extent that firms would prefer not to invest in sufficient staffing and resources are compelled by their associated persons' enhanced possibility of sanctions to make additional investments, firms that would prefer to make such investments absent competitive pressures would be freed to do so voluntarily, thereby promoting elevated standards among all firms. This collective uplift mitigates any single firm's competitive concerns and promotes broader societal benefits by fostering a more robust and reliable audit environment.

From a capital market perspective, improvements in audit quality would enhance investors' confidence in the information provided in companies' financial statements. This, in turn, can increase the efficiency of capital allocation decisions. As perceived risk in capital markets decreases due to enhanced audit quality, the supply of capital increases, leading to both an increase in capital formation and a reduction in the cost of capital to companies.[74] This increase in capital supply, coupled with reduced costs, can elevate the overall market valuation and create wealth for investors. Even when no additional capital is reallocated to companies, the reduced cost of capital inherently boosts the value of existing investments, thus benefiting companies and their shareholders. Finally, research has found a direct association between

[73] Quality control systems play a fundamental and widespread role in overall audit quality. These systems are essential in ensuring the audit process adheres to professional standards. A robust quality control system can help firms to detect and address factors that compromise audit quality.

[74] *See*, *e.g.*, Hanwen Chen, Jeff Zeyun Chen, Gerald J. Lobo & Yanyan Wang, *Effects of Audit Quality on Earnings Management and Cost of Equity Capital: Evidence from China*, 28 CONTEMP. ACCT. RES. 892, 921 (2011); Richard Lambert, Christian Leuz & Robert E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, 45 J. ACCT. RES. 385, 387 (2007); William Robert Scott & Patricia C. O'Brien, *Financial Accounting Theory* 412 (Prentice Hall 3d ed. 2003).

auditors' compliance with PCAOB standards and capital market efficiency,[75] indicating that the proposed amendments should have an incremental positive effect on capital market efficiency.

2. Costs

The proposed amendments are expected to result in increased costs.

In most cases, we expect that the costs of defending associated persons will be borne by the registered firm whose violation the associated person is alleged to have contributed to through indemnification agreements or otherwise. Direct costs include increased hours and resources (including attorneys, experts, and other personnel) to prepare for, respond to, and defend against investigations and charges—actual or anticipated. There may also be opportunity costs, as individuals are distracted from their normal responsibilities by the enforcement action.

The additional costs can be grouped into two categories based on the stage of the matter:

- First, during the investigative stage, Board staff works to determine whether a primary violation occurred and if so whether an individual contributed to that violation. Because that inquiry is conducted today (albeit with an objective of determining whether someone acted recklessly rather than negligently), we believe that the incremental cost of increased resources at the investigative stage would not be significant.

- Second, once Board staff were to preliminarily determine that an individual acted negligently and notify a potential respondent of that determination, the direct costs of the proposed amendments would increase more significantly. Staff lacks the data sufficient to form an estimate of the costs of each matter because the costs depend on numerous factors, including the duration of the matter,[76] the complexity of the matter (e.g., a complex audit case versus a simpler case of noncompliance with PCAOB filing requirements, the extent of expert testimony), the number and nature of counsel retained, and so forth.

While we could not estimate the per-case cost, we endeavored to estimate how many additional cases may result from the proposed amendments to give a sense of the magnitude of these costs. Board staff examined enforcement matters from the year 2022 to assess the

[75] *See, e.g.*, Nemit Shroff, *Real Effects of PCAOB International Inspections*, 95 ACCT. REV. 399-433 (2020).

[76] As set out in the PCAOB rules, a PCAOB enforcement case has numerous stages where the proceedings might halt. For example, a persuasive Rule 5109(d) submission may convince the staff not to recommend proceedings; the Board may determine not to institute proceedings under Rule 5200; the Hearing Officer might dismiss the matter; the matter might end with a Hearing Officer initial decision; or the initial decision might be appealed to the Board, the SEC, or beyond. The lengthier the litigation, the greater the costs (primarily lawyer or expert witness fees, but also opportunity costs).

potential increase in recommended cases had Rule 3502 included a negligence standard. Staff estimates two to three instances in 2022 where an amended Rule 3502 would have prompted staff to recommend a Rule 3502 charge.[77] Based on experience, staff also estimates that this number is likely a fair average representation across other years and provides an estimate of the additional cases that would result from the Board pursuing charges under the proposed amendment to the liability standard. However, 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.

While the relatively small number of incremental cases may limit the aggregate amount of the costs of the proposed amendments, these costs could nonetheless be substantial to the firms and individuals involved. We also acknowledge that the costs may have more impact on smaller firms where the direct costs and distractions are less absorbable by the firms' other activities or personnel. Relatedly, the proposed amendments could result in fee increases to cover probable future litigation losses to the extent that firms pass on some of the costs to their audit clients. Several academic studies find that higher litigation exposure for auditors is associated with higher audit fees,[78] and any such audit fee increases are ultimately borne by investors.

Indirect costs of the proposed amendments could result as individuals adjust their behavior and put forth additional effort to ensure that they are not contributing to any registered firm's violation through their negligence. However, to the extent that these costs are incurred to bring previously negligent conduct up to a level of due care, these costs are properly allocable to the underlying law, rule, or standard that the firm is alleged to have violated, as those provisions each assumes a level of costs necessary for the firm to comply. But because we acknowledge all the costs that may reasonably flow from the proposed amendment, we mention these costs here.

---

[77] The estimate reflects both aspects of the proposal and is an estimate of cases in which staff likely would have recommended charges against natural persons only. To be sure, because Rule 3502 charges can be brought against associated persons, which includes both natural persons and legal entities, it is possible that the estimate could be higher if it were to include potential additional cases against legal entities. Due to the complexity of the fact patterns that might be involved in such cases, however, Board staff was unable to estimate the number of additional cases that likely would have been brought against such entities.

[78] Fee increases are a transfer payment or distributional impact from audit clients to audit firms. Academic studies address the empirical relationship between audit fees and liability regime. *See, e.g.*, Venkataraman et al., *Litigation Risk, Audit Quality, and Audit Fees* 1315-1345; Ananth Seetharaman, Ferdinand Gul & Stephen Lynn, *Litigation Risk and Audit Fees: Evidence from UK Firms Cross-Listed on U.S. Markets*, 33 J. ACCT. & ECON. 91-115 (2002); Henock Louis, Thomas Pearson, Dahlia Robinson, Michael Robinson & Amy Sun, *The Effects of the Extant Clauses Limiting Auditor Liability on Audit Fees and Overall Reporting Quality*, 16 J. EMPIRICAL LEGAL STUDIES 381-410 (2019).

3. Potential Unintended Consequences

In addition to the benefits and costs, the proposed amendments could have unintended economic impacts. The following discussion describes potential unintended consequences we considered and, where applicable, factors that mitigate the adverse effects, such as steps we have taken or the existence of countervailing forces.

i. Self-Protective Behavior

While the threat of litigation can motivate individuals to act in a manner consistent with their legal obligations, it can also result in excessive monitoring and self-protective behavior, leading to an inefficient allocation of time and resources. The effect on audit quality may change as the degree of intervention increases. Individuals may spend more time on a task than is necessary to accomplish it at the appropriate level of due care. Similarly, individuals may excessively document the nature of their task performance to demonstrate compliance in a future proceeding. Time spent on unproductive, self-protective activities may detract from other important obligations and directly impact audit quality.

While we acknowledge the potential unintended consequences of these self-protective activities, compliance with documentation requirements in applicable professional standards should sufficiently demonstrate compliance if challenged, limiting additional unproductive documentation. In addition, the possibility of self-protective behavior is already largely present. As discussed in the Economic Impacts section above, the Commission currently can bring enforcement actions against individuals for negligent contributory conduct (and without regard to the formal relationship between the contributory actor and the primary violator), so the potential for litigation (and sanctions) already exists.

ii. Lack of Available Personnel or Compensation Enhancements

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. Alternatively, auditors may seek to offset the increased legal risk by demanding higher compensation for taking certain roles or responsibilities, which could have downstream effects on audit fees.

While we acknowledge these potential outcomes, we are not proposing a novel burden on individuals to refrain from acting negligently and thereby contributing to a firm's violation; instead, we are merely providing a mechanism for the PCAOB to discipline individuals who fail to reach that standard. The effect is, therefore, the incremental probability of PCAOB enforcement. However, this increase is not so novel and significant that it would be expected to impact noticeably the market for associated persons' services.

iii. Reduced Competition in the Audit Market

The proposed amendments to Rule 3502 could disproportionately impact small- and medium-sized firms if they are less able to bear the costs of defending their personnel. As discussed in Section IV.C.2, these costs include indemnification expenses (including attorney fees) to defend associated persons against charges and distracting personnel from generating income from the performance of services. In an extreme case, a firm might not be able to sustain its practice considering the negative impact, while more broadly, less profitable firms may perceive that the risk of such costs is too significant compared to their existing net profit from issuer and broker-dealer audit work and, therefore, decide to exit those markets. This result could further consolidate the market for issuer and broker-dealer audit services.

The likelihood that defense costs would cause substantial changes in the relevant markets is lowered by two factors. First, a firm already may be defending against an allegation of negligent primary conduct (brought using the PCAOB's current authority), such that, in any additional cases brought under the proposed rule, defending individuals facing contributory charges likely would involve common sets of facts and legal theories and could be done more efficiently (i.e., at lower additional cost) as compared to a wholly novel proceeding. Second, the Commission's existing authority to sanction associated persons for negligent contributory conduct means that firms' profitability calculations already should factor in the risk of defending personnel against such charges. Thus, the incremental cost of defending an individual, in addition to the firm's defense, might not be as significant as it appears at first glance.

Questions:

13. Are there other benefits and costs of the amendments that the Board should consider?

14. Are there any data sources that could provide a quantitative estimation of the expected benefits and costs? If so, please provide the names of such sources.

15. Are there other academic studies that would inform our analysis of the expected economic impacts of the proposed amendments? If so, please provide citations for the studies.

16. Are there additional unintended consequences that might result from the proposed amendments?

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?

D. Alternatives Considered

The Board considered two alternatives to the proposed amendments, discussed below. However, the Board believes that the proposed amendments strike a better balance of benefits and costs.

1. Alternative Articulations of the Standard of Liability

Rather than making the more modest amendments to the rule text that the Board is proposing, we considered rewriting Rule 3502 to mirror the language in the cease-and-desist provisions of the Exchange Act, 15 U.S.C. § 78u-3(a).

The primary benefit of such an approach would be to facilitate interpretive alignment with the scope of the Commission's causing-liability regime, which may provide associated persons with more clarity on the nature of the legal risk. However, for more than a dozen years, the Board has developed a distinguishable body of practice under Rule 3502 through its enforcement program—including via the rule-based requirement that any contribution to a primary violation be "direct[ ] and substantial[ ]"—and the proposed approach would maintain that familiar practice while narrowly adjusting only the standard of liability and the association requirement.

2. Removing Additional Barriers to Contributory Liability

We also considered an alternative to expand further the Board's ability to hold persons liable for contributing to firm violations by changing the "directly and substantially" modifier that describes the relationship of an associated person's contribution to a firm's primary violation, including by removing it altogether. This is currently an element of proof required for the Board to find a violation of Rule 3502.

Removing "directly and substantially" would enable the Board to use proposed Rule 3502 to hold accountable any individual who took part in any way in the chain of events leading to a firm's violation, even if only remotely. The relationship between the contributory conduct and the primary violation could be a discretionary factor to consider in bringing a proceeding in the first instance and when determining the appropriate sanction.

This alternative could improve audit quality by ensuring that all persons with relevant professional responsibilities are appropriately motivated to perform their responsibilities with due care. However, it could exacerbate the costs and unintended consequences discussed above in conjunction with the proposed amendments. Therefore, we are concerned that this alternative might tip the balance too far and lead to excessive motivation for auditors to increase defensive efforts that do not contribute to audit quality (e.g., excessive self-protective measures in anticipation of future litigation).

The proposal maintains the criteria of nexus and magnitude ("directly and substantially") for an associated person's contribution. We believe that these requirements appropriately specify the conduct that the Board considers to be actionable for purposes of "contributing" to a primary violation, as outlined above.[79] This approach tailors the incentives and potential unintended consequences to individuals with the most direct responsibility for firm compliance. In other words, the proposed amendments continue to focus on individuals most likely influenced by increased litigation risk, leading to improved firm compliance and audit quality. Conversely, individuals who are less involved would experience lower benefits in relation to costs and unintended consequences.

Questions:

18. Are there additional economic impacts or considerations associated with the two regulatory alternatives discussed above that should be considered? If so, what are those considerations?

19. Are there other regulatory alternatives the Board should consider? If so, what are they?

20. Are other regulatory alternatives preferable to the proposed amendments? If so, please explain the reasons.

V. SPECIAL CONSIDERATIONS FOR AUDITS OF EMERGING GROWTH COMPANIES

The proposed amendments do not impose any additional requirements on emerging growth company (EGC) audits. Accordingly, the Board believes that Section 103(a)(3)(C) of Sarbanes-Oxley does not apply. Nevertheless, we are including this analysis to inform the rulemaking. The discussion of benefits, costs, and unintended consequences in Section IV.C generally applies to audits of EGCs.

Under Section 104 of the Jumpstart Our Business Startups Act (JOBS Act), rules adopted by the Board subsequent to April 5, 2012, generally do not apply to the audits of EGCs, as defined in Section 3(a)(80) of the Exchange Act, unless the Commission "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation."[80] As a result of the JOBS Act, the rules and related

[79] *See supra* pages 14-15.

[80] *See* Pub. L. No. 112-106 (Apr. 5, 2012). Section 103(a)(3)(C) of Sarbanes-Oxley, as added by Section 104 of the JOBS Act, also provides that any rules of the Board requiring (1) mandatory audit firm rotation or (2) a supplement to the auditor's report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer (auditor discussion and

amendments to PCAOB standards that the Board adopts are generally subject to a separate determination by the Commission regarding their applicability to audits of EGCs.

To inform consideration of the application of auditing standards to audits of EGCs, Board staff prepares a white paper annually that provides general information about the characteristics of EGCs.[81] As of November 15, 2021, PCAOB staff identified 3,092 companies that self-identified with the Commission as EGCs and filed audited financial statements in the 18 months preceding that date.

EGCs are likely to be newer companies, which may increase the importance to investors of the external audit to enhance the credibility of management disclosures. All else equal, the benefits of the higher audit quality resulting from the proposed amendments may be more significant for EGCs than for non-EGCs, including improved efficiency of capital allocation, lower cost of capital, and enhanced capital formation. In particular, by increasing the likelihood that associated persons are held accountable for their roles in audit violations, proposed Rule 3502 aims to bolster investor confidence in the audit process. Because investors who lack confidence in a company's financial statements may require a larger risk premium that increases the cost of capital to companies, the improved audit quality resulting from applying the proposed amendments to EGC audits could reduce the cost of capital to those EGCs.[82] While the associated costs may also be higher for EGC audits than for non-EGC audits, they are unlikely to be disproportionate to the benefits because, as discussed in Section IV.C.2, the costs are expected to be relatively small.

The proposal could impact competition in an EGC product market if the costs of the proposed amendments disproportionately affect the EGCs relative to their competitors. However, as discussed above, the costs associated with the proposed amendments are expected to be relatively small, particularly given the Commission's existing authority to sanction associated persons. Therefore, the impact of the proposed amendments on competition, if any, is expected to be limited.

Overall, the proposed amendments are expected to enhance audit quality and contribute to an increase in the credibility of financial reporting by EGCs, thereby fostering efficiency. Accordingly, and for the reasons explained above, the Board believes that if it adopts the proposed amendments, it will request that the Commission determine, to the extent

analysis) do not apply to an audit of an EGC. The new proposed standard falls outside these two categories.

[81] For the most recent EGC report, see *White Paper on Characteristics of Emerging Growth Companies and Their Audit Firms at November 15, 2021* (Jan. 5, 2023), *available at* https://pcaobus.org/resources/other-research-projects.

[82] For a discussion of how increasing reliable public information about a company can reduce risk premiums, see David Easley & Maureen O'Hara, *Information and the Cost of Capital*, 59 J. FIN. 1553, 1578 (2004).

that Section 103(a)(3)(C) of the Act applies, that it is necessary or appropriate in the public interest after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, to apply the proposed amendments to audits of EGCs.

Questions:

21. What impact would the proposal have on EGCs, and how would this affect efficiency, competition, and capital formation?

22. Would the economic impacts be different for smaller firms or EGCs? If so, how?

23. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made to make the proposal appropriate for EGCs?

VI. EFFECTIVE DATE

If the proposed amendments to PCAOB Rule 3502 are adopted by the Board and approved by the Commission, the Board envisions that the proposed amendments would become effective sixty days from the date of Commission approval. In that regard, the Board anticipates that conduct occurring more than sixty days after Commission approval would be subject to Rule 3502, as amended, but that conduct occurring within sixty days after Commission approval would not be subject to the amendments to Rule 3502. The Board believes that the sixty-day delay in the amendments taking effect is appropriate to allow associated persons to ensure that their conduct conforms to the applicable legal standards and to increase their diligence as necessary and appropriate, which enhances audit quality and therefore serves the interests of the public and better protects investors.

Question:

24. Is the proposed effective date (sixty days after Commission approval) appropriate? If not, what would be an appropriate effective date for the proposed amendments?

VII. OPPORTUNITY FOR PUBLIC COMMENT

The Board is seeking comments on all aspects of its proposal, including in response to the specific questions presented above in Sections II through VI, which are reproduced below:

1. Are the regulatory concerns discussed above clear and understandable?

2. Are there other regulatory concerns related to the current formulation of Rule 3502? If so, what are they and how should the Board address them, if at all?

3. Would addressing the regulatory concerns discussed above incentivize associated persons to more fully comply with the applicable laws, rules, and standards that the Board is charged with enforcing against registered firms?

4. Are there common types of cases or fact patterns not discussed above in which a negligent standard of liability would be particularly useful to promote greater individual accountability under Rule 3502?

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

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

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

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?

9. Are there other phrases or terms that the Board should consider to modify "contribute," or other limitations that the Board should incorporate into the proposed rule? If so, what are they?

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

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?

12. Are there scenarios where an associated person's conduct might contribute to another individual's primary violation but the conduct would be outside the scope of any Board standard or rule (current or proposed), including the current and proposed versions of Rule 3502? If so, what are the scenarios?

13. Are there other benefits and costs of the amendments that the Board should consider?

14. Are there any data sources that could provide a quantitative estimation of the expected benefits and costs? If so, please provide the names of such sources.

15. Are there other academic studies that would inform our analysis of the expected economic impacts of the proposed amendments? If so, please provide citations for the studies.

16. Are there additional unintended consequences that might result from the proposed amendments?

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?

18. Are there additional economic impacts or considerations associated with the two regulatory alternatives discussed above that should be considered? If so, what are those considerations?

19. Are there other regulatory alternatives the Board should consider? If so, what are they?

20. Are other regulatory alternatives preferable to the proposed amendments? If so, please explain the reasons.

21. What impact would the proposal have on EGCs, and how would this affect efficiency, competition, and capital formation?

22. Would the economic impacts be different for smaller firms or EGCs? If so, how?

23. Are there reasons why the proposal should not apply to audits of EGCs? If so, what changes should be made to make the proposal appropriate for EGCs?

24. Is the proposed effective date (sixty days after Commission approval) appropriate? If not, what would be an appropriate effective date for the proposed amendments?

Comments may be submitted by e-mail to comments@pcaobus.org or through the Board's website at www.pcaobus.org. Comments also may be submitted to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. All comments should refer to PCAOB Rulemaking Docket Matter No. 053 in the subject or reference line and should be received by the Board by November 3, 2023.

The Board will consider all comments received. After the close of the comment period, the Board will determine whether to adopt final rules, with or without changes from the proposal. Any such final rules adopted will be submitted to the Commission for approval. Pursuant to Section 107 of Sarbanes-Oxley, proposed rules of the Board do not take effect unless approved by the Commission.

* * *

On the 19th day of September, in the year 2023, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

September 19, 2023

Appendix—Amendments to Board Rules

The proposed amendments to PCAOB Rule 3502 are set forth below. Language that would be deleted by the amendments is struck through; language that would be added is underlined.

RULES OF THE BOARD

SECTION 3. Auditing and Related Professional Practice Standards

* * * *

Rule 3502. Responsibility Not to ~~Knowingly or Recklessly~~ Contribute to Violations.

A person associated with a registered public accounting firm shall not ~~take or omit to take an action knowing, or recklessly not knowing, that the act or omission would~~ directly and substantially contribute to a violation by ~~that~~ any registered public accounting firm of the 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 the Act, or professional standards, by an act or omission that the person knew or should have known would contribute to such violation.

* * * *