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November 3, 2023

Ms. Phoebe W. Brown
Secretary
Public Company Accounting Oversight Board
1666 K Street NW
Suite 300
Washington, DC 20006-2803

Re: Docket Matter No. 053: Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability, Rel. No. 2023-007 (Sept. 19, 2023)

Dear Ms. Brown:

Deloitte & Touche LLP is pleased to respond to the request for public comment from the Public Company Accounting Oversight Board on its proposed amendments to PCAOB Rule 3502, *Responsibility Not to Knowingly or Recklessly Contribute to Violations* (the “proposed amendments” or “proposing release”).

Our recommendation

We support the Board’s efforts to promote better compliance with PCAOB requirements and thereby promote audit quality. We also recognize that after-the-fact assessment of compliance with the PCAOB’s rules and standards through its inspection and enforcement programs is an important part of the PCAOB’s regulatory regime, and that the outputs of those programs can further contribute to audit quality. We strongly support the PCAOB’s enforcement program, which serves to deter wrongdoing and hold accountable those who put investors at risk by violating PCAOB rules and standards in a reckless manner.

We note, however, that the enforcement cases that the Board is likely to bring under the amendment to Rule 3502 would involve conduct less serious than that which the Board is currently empowered to sanction. We also believe that investors in our capital markets are best protected when noncompliance is avoided in the first place. We therefore believe that the Board’s attention and resources would be better focused on developing programs designed to support those who seek in good faith to comply with PCAOB rules and standards at the outset, such as more robust programs to provide interpretive guidance and to facilitate consultation with the PCAOB staff on audit quality and independence issues.

Supporting good faith compliance

When Rule 3502 was initially adopted by the PCAOB, the Board emphasized that it did not “seek to create through this rule a vehicle to pursue compliance personnel who act in an appropriate, reasonable manner that, in hindsight, turns out to have not been successful.”¹ At that time, the Board also noted that it chose to adopt a recklessness standard for Rule 3502, rather than the negligence standard it initially proposed, in part in recognition of the fact that “persons subject to [the Board’s] jurisdiction must comply with complex professional and regulatory requirements in performing their jobs.”² In the intervening two decades, our capital markets have become more complex and companies have become larger and more global (and audits therefore more complex and subject to increasingly difficult judgments), making the rationale of the Board in 2005 even more compelling.

We believe that the Board in 2005 was correct in choosing to adopt a recklessness rather than a negligence standard, and we see no compelling reason to change it now. While enforcement is an important component of the regulatory ecosystem, using a negligence threshold could result, as the current proposing release observes, in excessive self-protective behavior by firms and individuals who reasonably fear after-the-fact second-guessing of good faith judgments. Contrary to the goal of the Board, time spent on unproductive, excessively self-protective, activities detracts from other important obligations and thus negatively impacts audit quality.

We therefore encourage the Board to consider more effective ways to support audit quality in today’s complex environment, including by increasing the support the PCAOB makes available to firms and professionals to comply with its standards and rules at the outset. A regulatory approach that allocates resources to encouraging compliance would better support audit quality than would an approach that risks encouraging excessive self-protective behaviors and counterproductive second-guessing of good faith professional judgments.

The U.S. Securities and Exchange Commission has recognized the benefits of such support and therefore has a long history of providing guidance to the entities it regulates to encourage compliance at the outset. This takes the form of publicly available guidance, which can be general or targeted to certain categories of entities that the SEC regulates, including:

- **Staff Accounting Bulletins**, setting out the staff’s views on accounting-related disclosure practices³
- **FAQs**, which provide the staff’s views on frequently asked questions about compliance with SEC rules and regulations⁴
- **Letters** from the staff to certain groups, types of professionals, or industries⁵
- **Compliance & Disclosure Interpretations**, and other published guidance reflecting the views of the staff on certain interpretive issues related to the laws and rules it administers⁶
- A robust **Financial Reporting Manual**, which originally served as internal guidance to the SEC staff but was made public to increase transparency of informal staff interpretations⁷

¹ PCAOB Release No. 2005-014, *Ethics and Independence Rules Concerning Independence, Tax Services and Contingent Fees* (July 26, 2005) at https://cms-pcaob-staging.idevdesign.net/Rulemaking/Docket017/2005-07-26_Release_2005-014.pdf.

² *Id.*

³ See <https://www.sec.gov/regulation/staff-interpretations/accounting-bulletins>.

⁴ See, e.g., <https://www.sec.gov/page/oca-independence-guidance>.

⁵ See, e.g., <https://www.sec.gov/info/accountants/staffletters>.

⁶ See <https://www.sec.gov/divisions/corpfin/cfguidance> and <https://www.sec.gov/corpfin/cfdisclosure#cfguidancetopics>.

⁷ See <https://www.sec.gov/corpfin/cf-manual>.

- **Regulator meetings with the public accounting profession** to discuss emerging interpretive issues, summaries of which are released publicly⁸

We appreciate that over the last few years the PCAOB has increased the frequency of its publications and developed new publications (such as the Spotlight series), intended to help auditors and other stakeholders understand PCAOB views and thus encourage compliance. We have found the Spotlight series especially helpful to support our continuous improvement efforts, particularly when it provides timely PCAOB staff insights from across its inspection program about common audit deficiencies and good practices, which we can consider proactively during the audit process. As the Board continues its efforts to update its standards, guidance from the Board and its staff will become even more important for firms trying in good faith to implement multiple new standards. We therefore encourage the Board to continue not only to provide guidance through its current channels, but also to consider the various types of interpretive guidance provided by the SEC to determine if any of those forms of guidance may be equally effective to aid audit firms and their professionals in complying with PCAOB rules and standards.

We also encourage the Board to consider establishing processes that facilitates auditors seeking real time, fact specific, guidance from the PCAOB staff. Here too, the SEC provides a useful model. The SEC has well-established processes to consult with companies and auditors both for the application of accounting and other professional standards, as well as to address financial disclosure requirements in specific situations.⁹ The SEC process may vary based on the complexity of the issue and can range from informal oral inquiries to formal written requests and responses, including:

- Fact specific **consultations** on technical accounting matters—which can be oral or written, and in some cases anonymous¹⁰
- **No-action, interpretive, and exemptive letters**, which are granted to specific entities based on specific facts and circumstances but are made public as reference for those facing similar circumstances¹¹

In our experience, these consultations are invaluable to those who in good faith seek to comply with the SEC's requirements, even without insulating the consulting parties from all potential liability. This is because the SEC has established processes¹² that allow consulting parties to benefit from the SEC staff's significant experience and knowledge, as well as to understand better the staff's point of view on complex issues and consider any precedent that exists for the issue at hand. In fact, the SEC staff especially encourages companies and their auditors to consult on interpretations and questions that

⁸ For example, the Center for Audit Quality's (CAQ) International Practices Task Force and SEC Regulations Committee are composed of CAQ and audit firm representatives who meet periodically with staff of the SEC to discuss emerging technical accounting and reporting issues relating to SEC rules and regulations. Notes from those meeting are made public on the CAQ's website (see <https://www.thecaq.org/committees-and-task-forces>).

⁹ See <https://www.sec.gov/divisions/corpfin/cfreportingguidance>.

¹⁰ See, for example, the SEC Office of Chief Accountant's description of the accounting consultation process at <https://www.sec.gov/page/oca-consulting-oca-what-expect>.

¹¹ See, e.g., <https://www.sec.gov/corpfin/corpfin-no-action-letters>.

¹² For example, in the SEC's Office of the Chief Accountant, consultation requests are assigned to staff members who have experience and knowledge about the topic, and each issue has a designated team leader who serves as a point of contact, following timing guidelines established to encourage timely resolution of issues. Consultations often begin orally, but the staff may ask the consulting party to prepare written documentation of the issue. The SEC staff also has an established escalation process to more senior staff, especially in the case of novel or controversial issues. The SEC staff may gather opinions and interpretations from outside parties, such as the Financial Accounting Standards Board, the PCAOB, or even non-participating public accounting firms. The consulting parties may also seek review of the staff's conclusion by the SEC's Chief Accountant. (See description of the process at <https://www.sec.gov/page/communicating-oca>).

involve unusual, complex, or innovative transactions for which no clear authoritative guidance exists, as well as on issues regarding auditor independence.¹³

We encourage the Board to look to the SEC as a model, both in considering whether the PCAOB could increase the amount, timeliness, and specificity of the general-use interpretive guidance it provides, and—perhaps more importantly—establish formalized processes and devote adequate staff resources to encourage firms and professionals to consult with the PCAOB staff on specific issues related to the implementation and application of PCAOB rules and standards. The long history of success in the SEC’s efforts to guide the entities it regulates we believe is due in large part to the fact that it has dedicated significant expert resources to these efforts, as well as its transparent and formalized processes.

The need for the proposed amendments is unclear

The proposing release suggests that the principal benefit to investor protection of an amended Rule 3502 would be to increase compliance and audit quality. As noted, we believe that the PCAOB’s enforcement authority, including its current authority under Rule 3502, is an important part of its regulatory authority. We also believe that the PCAOB increasing resources dedicated to supporting firms’ good faith efforts to comply with PCAOB rules and standards at the outset is more in line with, and more likely to be successful in achieving, that goal than the proposed amendments to Rule 3502 would be.

The means by which the proposed amendments will achieve further investor protection benefits are unclear. Specifically, the Board already has the power to sanction negligent conduct in the context of a specific audit. All members of an audit engagement team are already bound by AS 1015, *Due Professional Care in the Performance of Work*, which requires the exercise of reasonable care, and failure to do so constitutes negligence. The Board also already possesses tools beyond Rule 3502 to sanction personnel who act negligently in other contexts. In the area of auditor independence, for example, the Board has sanctioned audit personnel as direct violators of applicable independence rules for engaging in activity that contributes to the impairment of the independence of the registered firm as a whole from its audit client.¹⁴ Similarly, in the non-cooperation context, the Board routinely sanctions a firm and an individual for non-cooperation, without alleging that the individual contributed to the firm’s violation under Rule 3502.¹⁵

The Board should also consider the necessity of the proposed amendments to Rule 3502 within the broader context of the PCAOB’s rulemaking and standard setting agenda. For example, the Board’s recent proposal to replace AS 2405, *Illegal Acts by Clients*, as well as its proposed updated standards on quality control and the general responsibilities of an auditor, would impose significant new responsibilities and obligations on firms and individuals. The potential for significant changes to firms’ and individual’s professional responsibilities if those proposals were adopted in some form underscores the benefit of developing robust processes for consultation on implementation and application of PCAOB rules and standards. It also separately reaffirms the need for further analysis of how the PCAOB’s other agenda items may intersect with the proposed amendments to Rule 3502—and whether, when

¹³ See <https://www.sec.gov/page/communicating-oca>.

¹⁴ See, e.g., *Susan E. Birkert*, PCAOB Rel. No. 105-2007-003 (Nov. 14, 2007). The *Birkert* order alleges that the respondent acted recklessly, but that finding was not necessary for the independence violation that the order alleged, merely for the heightened sanctions that the Board imposed, which would still be a necessary finding even if Rule 3502 were amended.

¹⁵ See, e.g., *Hay & Watson and Essop Mia, CPA*, PCAOB Rel. No. 105-2022-017 (Sept. 13, 2022).

viewed in that context the proposed amendments, are proportionate to the perceived problem that the Board is trying to address.

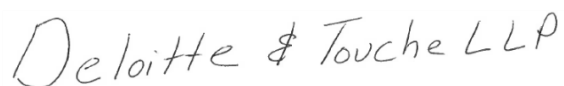
Finally, the Board has asserted that an expanded Rule 3502 is desirable to bring the PCAOB's enforcement regime into line with the SEC's power to bring actions for negligence. But the PCAOB's proposed amendments appear to contemplate broader enforcement power than the SEC has exercised. The SEC matters cited in the proposing release as evidence of the SEC's power to sanction negligent conduct all involve individuals who were alleged either to have acted recklessly or to have committed multiple acts of negligence.¹⁶ In contrast, under the proposed amendments to Rule 3502, the Board would be empowered when there is a firm violation to bring enforcement proceedings against individuals who committed only a single simple act of negligence.

Conclusion

By definition, the cases that the Board is likely to bring under the proposed amendments to Rule 3502 would involve conduct less serious than that which the Board is currently empowered to sanction. We encourage the Board to reconsider whether it should adopt the proposed amendments in light of the limited benefit and significant risk that they will cause excessive self-protective behavior that would negatively affect audit quality. We believe that the Board would better drive improvements in audit quality—and therefore benefit investors—if it did not adopt the proposed amendments and instead focused resources on developing more robust programs to provide interpretive guidance and encourage consultation with the PCAOB staff on audit quality and independence issues.

We appreciate the opportunity to provide our perspectives. If you have any questions or would like to discuss our views further, please contact John Treiber (312-486-1808) or Consuelo Hitchcock (202-220-2670).

Sincerely,

A handwritten signature in cursive script that reads "Deloitte & Touche LLP".

Deloitte & Touche LLP

¹⁶ See *David S. Hall, P.C.*, SEC Initial Decision Rel. No. 1114 (Mar. 7, 2017); *Gregory M. Dearlove, CPA*, SEC Rel. No. 34-57244 (Jan. 31, 2008); *Philip L. Pascale, CPA*, SEC Rel. No. 34-51393 (Mar. 18, 2005).