

**SECURITIES AND EXCHANGE COMMISSION**  
**[Release No. 34-100772; File No. PCAOB-2024-04]**

**August 20, 2024**

**Public Company Accounting Oversight Board; Order Granting Approval of Amendment to PCAOB Rule 3502 Governing Contributory Liability**

**I. Introduction**

On June 20, 2024, the Public Company Accounting Oversight Board (the “Board” or the “PCAOB”) filed with the Securities and Exchange Commission (the “Commission”), pursuant to section 107(b)<sup>1</sup> of the Sarbanes-Oxley Act of 2002 (“SOX”) and section 19(b)<sup>2</sup> of the Securities Exchange Act of 1934 (the “Exchange Act”), a proposal to adopt an amendment to PCAOB Rule 3502, *Responsibility Not to Knowingly or Recklessly Contribute to Violations*, the Board’s ethics rule governing the liability of associated persons who directly and substantially contribute to a registered public accounting firm’s primary violation (the “Amendment”). The Amendment was published for comment in the *Federal Register* on July 2, 2024.<sup>3</sup> The Commission received one comment letter in response to the Notice of Filing of Proposed Rules.<sup>4</sup> This order approves the Amendment, which we find to be consistent with the requirements of Title I of SOX and the rules and regulations thereunder and is necessary or appropriate in the public interest or for the protection of investors.

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<sup>1</sup> 15 U.S.C. 7217(b).

<sup>2</sup> 15 U.S.C. 78s(b).

<sup>3</sup> See *Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on Amendment to PCAOB Rule 3502 Governing Contributory Liability*, Release No. 34-100429 (June 26, 2024 [89 FR 54895 (July 2, 2024)]) (“Notice of Filing of Proposed Rules”), available at <https://www.sec.gov/files/rules/pcaob/2024/34-100429.pdf>.

<sup>4</sup> The Commission received a comment letter from the Pennsylvania Institute of Certified Public Accountants (July 22, 2024). This comment letter is available on the Commission’s website at <https://www.sec.gov/comments/pcaob-2024-04/pcaob202404.htm>.

## II. Description of the Amendment

Existing PCAOB Rule 3502 codifies associated persons' ethical obligation not to contribute to a registered firm's violations of the laws, rules, and standards that the Board is charged with enforcing.<sup>5</sup> The rule provides grounds for secondary liability when an associated person of a registered firm acts at least recklessly to directly and substantially contribute to such a violation. On June 12, 2024, the Board unanimously adopted the Amendment,<sup>6</sup> which changes from recklessness to negligence the liability standard for actionable contributory conduct by associated persons under Rule 3502. Whereas negligence is "the failure to exercise reasonable care or competence,"<sup>7</sup> recklessness requires "extreme departure from the standard of ordinary care" that "presents a danger to investors or to the markets that is either known to the (actor) or is so obvious that the actor must have been aware of it."<sup>8</sup>

Following notice and comment, and based on its experience with Rule 3502 since the Commission approved the ethics rule in 2006,<sup>9</sup> the PCAOB determined that the Amendment would better align Rule 3502 with the scope of the PCAOB's enforcement authority under SOX, thus further advancing the PCAOB's mission of investor protection.

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<sup>5</sup> Section 103(a) of SOX directs the Board, by rule, to establish "ethics standards . . . to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by [SOX] or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors."

<sup>6</sup> *See Amendment to PCAOB Rule 3502 Governing Contributory Liability*, PCAOB Release No. 2024-008 (June 12, 2024) ("Adopting Release"), available at [https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/053/2024-008-rule-3502-adoption.pdf?sfvrsn=9819bcd3\\_2](https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/053/2024-008-rule-3502-adoption.pdf?sfvrsn=9819bcd3_2).

<sup>7</sup> *In re S.W. Hatfield, C.P.A.*, SEC Release No. 34-69930, at 35 n.169 (July 3, 2013) (describing the standards for recklessness and negligence) (citation and quotation marks omitted).

<sup>8</sup> *Id.* at 29 (citation and quotation marks omitted).

<sup>9</sup> *See Public Company Accounting Oversight Board; Order Approving Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees and Notice of Filing and Order Granting Accelerated Approval of the Amendment Delaying Implementation of Certain of these Rules*, Release No. 34-53677 (Apr. 19, 2006), available at <https://www.sec.gov/files/rules/pcaob/2006/34-53677.pdf>.

The PCAOB determined that under the current formulation of Rule 3502, an incongruity exists 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. Specifically, a firm, which acts through its associated persons, 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. The PCAOB determined that this incongruity means that associated persons may have weaker incentives to exercise the appropriate level of care in their audit work, and that the modification to Rule 3502’s liability standard from recklessness to negligence would incentivize associated persons to be more deliberate and careful in their actions.

The PCAOB also determined that the current version of Rule 3502 prevents the Board from executing its investor-protection mandate to the fullest extent that Congress authorized in SOX. According to the PCAOB, in the instances in which the Board has instituted proceedings against firms for negligence-based violations, the Board has not been able to charge individuals who negligently, directly, and substantially contributed to the firms’ violations. The Amendment would allow the Board to do so.

### **III. Effective Date**

The Amendment will be effective 60 days from the date of this order.

### **IV. Comment Letters**

The comment period on the Amendment ended on July 23, 2024. The Commission received one comment letter.<sup>10</sup> That comment letter reiterated comments that had been submitted to the PCAOB on its proposing release and that were addressed by the Board in its Adopting Release.

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<sup>10</sup> See *supra* note 4.

The commenter questioned whether the PCAOB had legal authority for the Amendment, and was generally critical about the need for the Amendment and the economic and investor-protection rationales put forth by the Board. For example, the commenter argued that any benefit from additional enforcement actions does not justify the costs, potential negative effects on the talent pool, and anticompetitive outcomes, and urged the Commission to conduct a comprehensive impact assessment of the Amendment on the accounting and auditing sectors. The commenter also argued that the Amendment may cause some firms to exit the market for audit services and result in greater market concentration for auditors.

We have considered the concerns raised by the commenter, all of which were considered by the Board prior to finalizing the Amendment, and believe that the Amendment is consistent with the requirements of Title I of SOX and the rules and regulations thereunder and necessary or appropriate in the public interest or for the protection of investors.

With respect to the Board's authority, in its 2006 order approving Rule 3502, the Commission stated that "the rule is within the scope of the PCAOB's authority, particularly its authority to establish ethical standards."<sup>11</sup> The Amendment, which changes the standard for actionable contributory conduct but not the rule's basic ethical obligation, does not alter that conclusion. Section 103(a)(1) of SOX expressly authorizes the Board to establish or adopt ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports. As the Board observed when proposing the existing rule, an associated person has an ethical obligation not to cause any violations by the firm, and Rule 3502 codifies that

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<sup>11</sup> See *supra* note 9 at 9.

obligation.<sup>12</sup> We view that obligation as fundamental given that a firm can only act through its associated persons and believe that it is reasonable to conclude, as the Board did, that such an obligation should extend to situations in which an associated person fails to exercise sufficient care to avoid negligently causing a violation rather than being limited to reckless conduct. In this regard, we note that a contributory liability rule based on negligence is consistent with other longstanding ethical obligations that apply to associated persons when conducting audits.<sup>13</sup>

In addition, section 105 of SOX permits the Board to impose liability for single acts of negligence. Specifically, section 105(c)(4) authorizes the Board to impose an array of sanctions — listed in subparagraphs (A) through (G) — upon finding that a registered firm or associated person engaged in violative conduct, without reference to the level of culpability required but “subject to applicable limitations” in section 105(c)(5). Section 105(c)(5), in turn, provides that “[t]he sanctions and penalties described in subparagraphs (A) through (C) and (D)(ii) of [Section 105(c)(4)] shall only apply to [ ] intentional or knowing conduct, including reckless conduct,” or “repeated instances of negligent conduct each resulting in a violation of the applicable statutory, regulatory, or professional standard.” Section 105(c)(5) thus does not restrict the Board’s authority to impose for single acts of negligence certain sanctions — those in subparagraphs (D)(i) and (E) through (G) of section 105(c)(4).

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<sup>12</sup> See *Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees*, PCAOB Release 2004-015 (Dec. 14, 2004) at 18, available at [https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket017/2004-12-14\\_release\\_2004-015.pdf?sfvrsn=b15567fb\\_0](https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/docket017/2004-12-14_release_2004-015.pdf?sfvrsn=b15567fb_0).

<sup>13</sup> Indeed, the American Institute of Certified Public Accountants (“AICPA”) Code of Professional Conduct at the time that SOX was enacted (and still today) makes it an “act discreditable to the profession” — and therefore a violation of its ethics rules — for a member accountant to “permit[ ] or direct[ ] another to make[ ] materially false and misleading entries in the financial statements or records of an entity” “by virtue of his or her negligence.” AICPA Code of Professional Conduct, ET Section 501.05(a), *Negligence in the Preparation of Financial Statements or Records*, recodified at Section 1.400.040.01. That is also the case if a member were to “permit[ ] or direct[ ] another to sign[ ] a document containing materially false and misleading information” “by virtue of his or her negligence.” *Id.* Section 501.05(c).

With respect to the Amendment’s potential adverse effects, we acknowledge (as the PCAOB did) that the Amendment could result in some incremental legal costs and operational adjustments for firms, individuals, and issuers. However, for the reasons discussed below, we agree with the Board’s conclusion that any unintended consequences of the Amendments are likely to be limited and that, on balance, the Amendment will enhance audit quality, not diminish it, for the benefit of investors.<sup>14</sup>

As a threshold matter, the Amendment does not establish a novel burden on individuals to refrain from acting negligently and thereby contributing to a firm’s violation: the Commission already has the ability to bring cases against associated persons for negligently contributing to registered firms’ violations of numerous laws and rules governing the preparation and issuance of audit reports.<sup>15</sup> Rather, the Amendment merely provides a mechanism for the PCAOB to discipline individuals who fail to act reasonably. And while we appreciate that complex audit engagements can involve a wide range of judgments, we concur with the Board’s observation from the Adopting Release that the Amendment does not target mere errors in judgment, but rather *unreasonable* conduct.<sup>16</sup> With respect to market concentration, although the Amendment could lead some firms to exit the issuer audit market, it is unclear that this effect would necessarily detract from the provision of associated persons’ services. For example, such exit might involve low-quality auditors and lead to a higher concentration of more capable and compliant audit firms. At the same time, the Amendment is likely to result in significant benefits

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<sup>14</sup> See Adopting Release, *supra* note 6 at 57-63.

<sup>15</sup> Section 21C of 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,” and Section 21B further authorizes the Commission to “impose a civil penalty” upon finding that such person “is or was a cause of [such] violation.”

<sup>16</sup> See Adopting Release, *supra* note 6 at 10.

in the form of more efficient enforcement, while encouraging individuals to exercise the appropriate level of care, thereby raising audit quality.

SOX requires us to determine whether the Amendment is consistent with the requirements of Title I of SOX and the rules and regulations thereunder and is necessary or appropriate in the public interest or for the protection of investors. In making this determination, we have considered the comments received, as well as the feedback received and modifications made by the PCAOB throughout its rulemaking process.

## **V. Effect on Emerging Growth Companies**

Section 103(a)(3)(C) of SOX, as amended by section 104 of the Jumpstart Our Business Startups Act of 2012, requires that any rules of the Board requiring mandatory audit firm rotation or 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 analysis) shall not apply to an audit of an emerging growth company (“EGC”).<sup>17</sup> Section 103(a)(3)(C) further provides that “[a]ny additional rules” adopted by the PCAOB do not apply to audits of EGCs “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.”

The Board expressed its view that section 103(a)(3)(C) does not apply to the Amendment because the provisions of the Amendment do not fall into those categories and do not impose

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<sup>17</sup> The term “emerging growth company” is defined in Section 3(a)(80) of the Exchange Act (15 U.S.C. 78c(a)(80)). *See also Inflation Adjustments under Titles I and III of the JOBS Act*, Release No. 33-11098 (Sept. 9, 2022) [87 FR 57394 (Sept. 20, 2022)], available at <https://www.sec.gov/files/rules/final/2022/33-11098.pdf>.

additional requirements on the audits of EGCs.<sup>18</sup> To the extent that section 103(a)(3)(C) does apply, however, the Board recommended that the Commission determine that the Amendment apply to audits of EGCs.<sup>19</sup>

With respect to the Commission's determination of whether the Amendment will apply to audits of EGCs, the PCAOB provided information, including data and analysis of EGCs, that sets forth its views as to why it believes the Amendment should apply to audits of EGCs.<sup>20</sup> In addition, the Board sought public input on the application of the Amendment to the audits of EGCs. Some commenters agreed the Amendment should apply to the audits of EGCs, although one commenter suggested that the Amendment would have a greater impact on smaller firms with fewer resources to defend personnel and navigate an uncertain liability environment.<sup>21</sup>

We agree with the Board's assessment and believe that applying the Amendment to the audits of EGCs is necessary or appropriate in the public interest, after considering the protection of investors and whether the Amendment will promote efficiency, competition, and capital formation. Specifically, by applying the Amendment to all associated persons of registered public accounting firms engaged in the audits of issuers and registered broker-dealers, including audits of EGCs, investors will benefit from higher standards of audit quality and enhancements to investor protection brought about by the Amendment. Because EGCs are likely to be newer public companies, investors may place greater importance on external audits' adherence to applicable audit standards, in order to enhance and test the credibility of management disclosures, including whether financial statements are free from material misstatement due to

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<sup>18</sup> See Adopting Release, *supra* note 6 at 66–68.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> *Id.* at 67–68.



error or fraud. Therefore, all else equal, the benefits of the higher audit quality resulting from the Amendment may be more significant for EGCs than for non-EGCs, including improved efficiency of capital allocation, lower cost of capital, and enhanced capital formation. 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 Amendment to associated persons engaged in EGC audits could reduce the cost of capital to those EGCs.

Also, given the Commission's existing authority to sanction associated persons of accounting firms for single acts of contributory negligence, the costs to EGCs associated with the Amendment are expected to be small. Therefore, the Amendment's impact on competition, if any, is expected to be limited.

Accordingly, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation, we believe that the application of the Amendment to associated persons engaged in the audits of EGCs is necessary or appropriate in the public interest.<sup>22</sup>

## **VI. Conclusion**

The Commission has reviewed and considered the Amendment, the information submitted therewith by the PCAOB, the comment letter received, and the recommendation of the Commission's staff. The Commission concludes that the determinations made by the PCAOB as described in the Adopting Release are reasonable. In particular, the Amendment will make Rule

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<sup>22</sup> Although the Board expressed the view that Section 103(a)(3)(C) does not apply to the Amendment given that it does not impose any additional audit requirements, we note that Section 103(a)(3)(C) refers to "[a]ny additional rules" adopted by the PCAOB. Therefore, to avoid any ambiguity regarding the application of the Amendments within the context of EGC audits, we are making the finding required by Section 103(a)(3)(C).

3502 both a more effective deterrent against unethical contributory conduct by associated persons and a more effective enforcement tool. The Amendment also should prompt individuals to exercise the appropriate level of care in their audit work and lead firms to allocate resources more efficiently, which will raise audit quality. In doing so, the Amendment will advance the Board's investor protection mandate under SOX. Therefore, in connection with the PCAOB's filing and the Commission's review:

A. The Commission finds that the Amendment is consistent with the requirements of Title I of SOX and the rules and regulations thereunder and is necessary or appropriate in the public interest or for the protection of investors; and

B. Separately, the Commission finds that the application of the Amendment to associated persons engaged in the audits of EGCs 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.

IT IS THEREFORE ORDERED, pursuant to section 107 of SOX and section 19(b)(2) of the Exchange Act, that the Amendment (File No. PCAOB-2024-04) be and hereby is approved.

By the Commission.

**Vanessa A. Countryman,**

*Secretary.*