

Via Email

October 26, 2023

Ms. Phoebe W. Brown
Office of Secretary
Public Company Accounting Oversight Board
1616 K Street, NW
Washington, DC 20006-2803

PCAOB Rulemaking Docket Matter No. 053, Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability, PCAOB Release No. 2023-007.

Dear Secretary Brown:

The Council of Institutional Investors (CII) appreciates the opportunity to share our views and provide input on the Public Company Accounting Oversight Board’s (PCAOB or Board) *Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability* (Proposal).¹

CII is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately \$5 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true “Main Street” investors through their pension funds. Our associate members include non-U.S. asset owners with about \$4.8 trillion in assets, and a range of asset managers with more than \$55 trillion in assets under management.²

CII Policies

As the leading U.S. voice for effective corporate governance and strong shareholder rights, CII believes that accurate and reliable audited financial statements are critical to investors in making informed decisions, and vital to the overall well-being of our capital markets.³ That belief is

¹ PCAOB, Proposed Amendments to PCAOB Rule 3502 Governing Contributory Liability, PCAOB Release No. 2023-007 (Sept. 19, 2023), available at https://assets.pcaobus.org/pcaob-dev/docs/default-source/rulemaking/053/pcaob-release-no.-2023-007-rule-3502-proposal.pdf?sfvrsn=7d49cc51_9#:~:text=As%20discussed%20above%2C%20the%20Board,the%20registered%20firm%20that%20has.

² For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at <http://www.cii.org>.

³ CII, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (updated Mar. 1, 2017), http://www.cii.org/policies_other_issues#indep_acct_audit_standards.

reflected in the following CII membership-approved policy on the **Independence of Accounting and Auditing Standard Setters**:

Audited financial statements including related disclosures are a critical source of information to institutional investors making investment decisions. The efficiency of global markets—and the well-being of the investors who entrust their financial present and future to those markets—depends, in significant part, on the quality, comparability and reliability of the information provided by audited financial statements and disclosures. The quality, comparability and reliability of that information, in turn, depends directly on the quality of the . . . standards that . . . auditors use in providing assurance that the preparers’ recognition, measurement and disclosures are free of material misstatements or omissions.⁴

The policy on **Independence of Accounting and Auditing Standard Setters** also importantly establishes that the key attributes that underpin an effective auditing standard setter include: “A clear, rigorous and consistent mechanism for enforcement by regulators of the accounting and auditing standards.”⁵

CII also has a long-standing, membership-approved policy on **Financial Gatekeepers**.⁶ That policy explicitly identifies auditors as “financial gatekeepers.”⁷ The policy indicates that it is imperative that auditors be subject to “[r]obust oversight and [have] genuine accountability to investors. . . .”⁸ The policy also states that the “Sarbanes-Oxley Act of 2002 . . . bolstered the . . . oversight and accountability of accounting firms . . . [and that] [c]ontinued reforms are needed to ensure that the pillars of transparency, independence, oversight and accountability are solidly in place.”⁹

Finally, CII’s membership-approved policy on **Audit Committee Responsibilities Regarding Independent Auditors** states, in part, that:

The audit committee should fully exercise its authority to hire, compensate, oversee and, if necessary, terminate the company’s independent auditor. In doing so, the committee should take proactive steps to promote auditor independence and audit quality.¹⁰

⁴ *Id.*

⁵ *Id.*

⁶ CII, Policies on Other Issues, Financial Gatekeepers (adopted Apr. 13, 2010), https://www.cii.org/policies_other_issues#fin_gatekeepers.

⁷ *See id.* (“Auditors, financial analysts, credit rating agencies and other financial ‘gatekeepers’ play a vital role in ensuring the integrity and stability of the capital markets.”).

⁸ *Id.*

⁹ *Id.*

¹⁰ CII, Policies on Corporate Governance § 2.13a Audit Committee Responsibilities Regarding Independent Auditors (last updated on Mar. 6, 2023), https://www.cii.org/corp_gov_policies.

The Proposal

CII generally agrees with the observation of PCAOB Chair Erica Y. Williams that:

Like many of the standards this Board has voted to modernize, Rule 3502 is nearly 20 years old. Things have changed since it was first adopted in 2005.

The [Securities and Exchange Commission (SEC or Commission)] SEC now has the ability to seek civil money penalties in enforcement actions against associated persons when they negligently cause firm violations. The way that firms operate has changed. And the expert staff at the PCAOB who have seen how Rule 3502 plays out in the real world are recommending this update.¹¹

CII also generally agrees with the PCAOB that the proposed amendments would better align Rule 3502 with the scope of the Board’s enforcement authority under the Sarbanes-Oxley Act of 2002 (SOX) and address the regulatory gap within the existing framework, which can lead to anomalous results.¹² As Board Member Kara Stein explained:

¹¹ Erica Y. Williams, Chair, PCAOB Open Board Meeting, Chair Williams’ Statement on Proposed Changes to Board Rule on Contributory Liability for Firm Violations (Sept. 19, 2023), *available at* <https://pcaobus.org/news-events/speeches/speech-detail/chair-williams-statement-on-proposed-changes-to-board-rule-on-contributory-liability-for-firm-violations>.

¹² See Sarbanes-Oxley Act §105(c)(5)(A)-(B), 15 U.S.C. § 7201 (2002), *available at* https://pcaobus.org/About/History/Documents/PDFs/Sarbanes_Oxley_Act_of_2002.pdf (“The sanctions and penalties described in subparagraphs (A) through (C) and (D)(ii) of paragraph (4) shall only apply to— (A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or (B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.”); *see also* S. 2673, PUBLIC COMPANY ACCOUNTING REFORM AND INVESTOR PROTECTION ACT, S. Rep. No. 107-205, § 105(b) (2d Sess. 2002), *available at* <https://www.govinfo.gov/content/pkg/CRPT-107srpt205/html/CRPT-107srpt205.htm> (“Section 105(b) authorizes the Board to impose a full range of sanctions if it finds that a registered firm, or its partners or employees, have engaged in any act or practice that violates the Act, the Board’s rules, professional standards, or the portion of the securities laws (and SEC rules) relating to audits of public companies . . . [and] the Board’s ability to suspend or bar an associated person from the auditing of public companies, and the Board’s ability to impose civil money penalties above a certain amount, is limited to situations involving intentional, knowing, or reckless conduct, or repeated negligent conduct.”).

¹² Kara M. Stein, Board Member, PCAOB Open Board Meeting, Statement on Responsibility and Accountability for Persons Contributing to a Registered Audit Firm’s Violations of Law or Professional Standards, Proposed Amendments to PCAOB Rule 3502 (Sept. 19, 2023), *available at* <https://pcaobus.org/news-events/speeches/speech-detail/responsibility-and-accountability-for-persons-contributing-to-a-registered-audit-firm-s-violations-of-law-or-professional-standards-proposed-amendments-to-pcaob-rule-3502>; *see* Erica Y. Williams, Chair, PCAOB Open Board Meeting, Chair Williams’ Statement on Proposed Changes to Board Rule on Contributory Liability for Firm Violations (Noting that “firms don’t make the decisions or take the actions that lead to these violations [of quality control or independence standards] on their own [, p]eople participate in these decisions and actions.”); Anthony C. Thompson, Board Member, PCAOB Open Board Meeting, Board Member Thompson’s Statement on Proposed Changes to Board Rule on Contributory Liability for Firm Violations (Sept. 19, 2023), *available at* <https://pcaobus.org/news-events/speeches/speech-detail/statement-on-proposed-amendments-to-pcaob-rule-3502-governing-contributory-liability-thompson> (“The PCAOB can hold a firm accountable for negligently violating PCAOB rules and standards; however, an associated person who directly and substantially contributes to such violations is held to a recklessness standard, which is a higher threshold [and] [t]his discrepancy is inconsistent with our investor protection mission.”).

The PCAOB currently cannot bring an action against negligent auditors whose direct and substantial contributions furthered an audit firm’s violations. This creates an obvious gap in the Board’s ability to protect investors and public markets, as Table 1 in the economic analysis suggests. Today’s proposal would close this oversight gap, thus emphasizing the obligations under the auditing standards that auditors act with reasonable care and competence.¹³

More specifically, CII generally believes that the Proposal’s updating of Rule 3502’s liability threshold from recklessness to negligence will appropriately bring it in line with the existing requirement for auditors to exercise a standard of reasonable care during the performance of their professional responsibilities.¹⁴ And like the SEC has done historically, we believe the PCAOB will appropriately exercise its prosecutorial discretion when the underlying conduct is negligent.

Finally, CII notes that the Proposal includes two questions that appear to be directed at investors. Those questions and our specific responses follow:

5. Is it clear and understandable how the proposed amendments to Rule 3502 advance the Board’s statutory mandate to protect investors?¹⁵

CII generally believes it is clear and understandable how the proposed amendments to Rule 3502 advance the Board’s statutory mandate to protect investors. We note that our September 2022 letter in response to the PCAOB Draft Plan 2022-2026¹⁶ expressed support for the Board’s goal of strengthening enforcement.¹⁷ That letter stated:

¹³ Kara M. Stein, Board Member, PCAOB Open Board Meeting, Statement on Responsibility and Accountability for Persons Contributing to a Registered Audit Firm’s Violations of Law or Professional Standards, Proposed Amendments to PCAOB Rule 3502 (Sept. 19, 2023), available at <https://pcaobus.org/news-events/speeches/speech-detail/responsibility-and-accountability-for-persons-contributing-to-a-registered-audit-firm-s-violations-of-law-or-professional-standards-proposed-amendments-to-pcaob-rule-3502>; see Erica Y. Williams, Chair, PCAOB Open Board Meeting, Chair Williams’ Statement on Proposed Changes to Board Rule on Contributory Liability for Firm Violations (Noting that “firms don’t make the decisions or take the actions that lead to these violations [of quality control or independence standards] on their own [, p]eople participate in these decisions and actions.”); Anthony C. Thompson, Board Member, PCAOB Open Board Meeting, Board Member Thompson’s Statement on Proposed Changes to Board Rule on Contributory Liability for Firm Violations (Sept. 19, 2023), available at <https://pcaobus.org/news-events/speeches/speech-detail/statement-on-proposed-amendments-to-pcaob-rule-3502-governing-contributory-liability-thompson> (“The PCAOB can hold a firm accountable for negligently violating PCAOB rules and standards; however, an associated person who directly and substantially contributes to such violations is held to a recklessness standard, which is a higher threshold [and] [t]his discrepancy is inconsistent with our investor protection mission.”).

¹⁴ See PCAOB Release No. 2023-007 at 11 (Noting that the current “liability threshold serves a dual function: It incentivizes auditors to conduct their work knowing that reasonable care is the standard for assessing it . . .”).

¹⁵ *Id.* at 12 (emphasis added).

¹⁶ See Request for Public Comment, Draft 2022-2026 PCAOB Strategic Plan, PCAOB Release No. 2022-003 (Aug. 16, 2022), available at https://assets.pcaobus.org/pcaob-dev/docs/default-source/about/administration/documents/strategic_plans/2022-003-rfc-draftstrategicplan.pdf?sfvrsn=fdc9859a_4.

¹⁷ Letter from Jeffrey P. Mahoney, General Counsel, CII to Office of the Secretary, PCAOB 9-10 (Sept. 15, 2022), [https://www.cii.org/files/issues_and_advocacy/correspondence/2022/September%2015,%202022%20PCAOB%20letter%20\(final\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2022/September%2015,%202022%20PCAOB%20letter%20(final).pdf).

CII strongly supports the objective of rigorously enforcing PCAOB and other applicable standards, laws, and rules. We agree with the Board that “[r]igorous enforcement incentivizes the auditing profession to diligently follow all applicable requirements and, in so doing, promotes audit quality and investor protection.”

As indicated by our policy on Independence of Accounting and Auditing Standard Setters, our members view rigorous enforcement of PCAOB auditing standards as an important tool for the Board to successfully promote audit quality and investor protection. In furtherance of this objective, we respectfully request that, consistent with the recent statement of SEC Acting Chief Accountant Paul Munter, the PCAOB rigorously enforce those audit requirements that may be violated by “accounting firms looking to avoid the uncertainty about whether they will be in compliance with the Holding Foreign Companies Accountable Act (HFCA Act).” CII was an active proponent of the legislation that resulted in the HFCA Act and continues to support its effective implementation and enforcement.¹⁸

In addition, we agree with the Board that the Proposal is consistent with the investor protection provision of SOX which “plainly contemplates that disciplinary proceedings can be instituted for a violation based on a single negligent act.”¹⁹ And, as indicated in our policy on **Financial Gatekeepers**, we view as favorable those SOX provisions that were intended to enhance auditing firms’ accountability to investors with a recognition that additional requirements, like those provided by the Proposal, may be needed.

6. Beyond the dual purposes of deterrence and accountability, are there other ways that the proposed amendments would protect investors?²⁰

CII generally believes that beyond the dual purposes of deterrence and accountability, there are other ways that the proposed amendments would protect investors. For example, we believe that, generally consistent with the support for audit quality in our policies on **Independence of Accounting and Auditing Standard Setters** and **Audit Committee Responsibilities Regarding Independent Auditors**, the Proposal may improve “audit quality as auditors become more careful about their work”²¹ In addition, and generally consistent with the references to the markets in our policies on **Independence of Accounting and Auditing Standard Setters** and **Financial Gatekeepers**, we believe the proposed amendments may “have an incremental positive effect on capital market efficiency.”²²

¹⁸ *Id.* (footnotes omitted).

¹⁹ Rules on Investigations and Adjudications, PCAOB Release No. 2003-015, at A2-58 (Sept. 29, 2003), available at <https://pcaobus.org/Enforcement/Documents/Release2003-015.pdf> (“The Act plainly contemplates that disciplinary proceedings can be instituted for a violation based on a single negligent act.”).

²⁰ PCAOB Release No. 2023-007 at 12 (emphasis added).

²¹ *Id.* at 21.

²² *Id.* at 24.

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We appreciate the opportunity to provide CII's investor-focused perspective on the Proposal. Please let me know if you have any questions about the content of this letter.

Sincerely,

A handwritten signature in blue ink that reads "Jeff Mahoney". The signature is written in a cursive style with a long, sweeping underline.

Jeffrey P. Mahoney
General Counsel