GIBSON DUNN

Accounting Firm Quarterly Update

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PCAOB Signs Cooperative Agreement with China

On August 26, 2022, the PCAOB signed a cooperative agreement with the China Securities Regulatory Commission and the Ministry of Finance to provide PCAOB inspection access to China audit work. Although the agreement itself has not been made public, the PCAOB's press release and fact sheet state that the agreement is designed to provide the PCAOB with "complete access" to the work papers of China-based firms for audits selected solely by the PCAOB, as well as to audit personnel. The PCAOB has signaled that its assessment that it has been given complete access will be necessary to avoid a determination under the Holding Foreign Companies Accountable Act (HFCAA) that China-based firms are still subject to a "jurisdiction-wide" impediment to inspection access in 2022. A second jurisdiction-wide determination, coming after that made on December 16, 2021, would put China-based firms two years into the three-year period that would trigger delisting for their audit clients under the HFCAA.

In a speech on September 22, 2022, PCAOB Chair Erica Williams announced that PCAOB inspectors had landed in China the prior week to begin the inspection process, and both she and SEC Chair Gary Gensler have indicated that success depends on the willingness of the Chinese government to back up the agreement with complete cooperation in practice.

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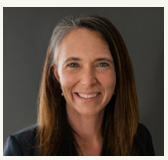

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Sens. Warren and Lujan Push for Increased Suspension/ Debarment

On August 11, 2022, Senators Elizabeth Warren and Ben Ray Lujan sent a letter to Attorney General Merrick Garland and Deputy Attorney General Lisa Monaco urging the Department of Justice to increase the use of its authority to suspend or debar corporate criminal defendants from the government contracting process.

Noting that the federal government spends over $600 billion annually on government contracts, the Senators argued that the government's suspension and debarment authority is an underused tool in protecting the public from harm. They cited certain instances in which they believed companies should have been, but were not, debarred.

The Senators proposed that the DOJ expand its use of debarment in four primary ways:

1. Using debarment authority for corporate entities, not just individuals;

2. Using debarment government-wide for entities that contract with any federal agency, not just DOJ itself;

3. Considering debarment for all corporate misconduct, including tax evasion, bribery, unsatisfactory performance, and health, safety, and environmental misconduct; and

4. Using suspension authority while an investigation is pending even when a final debarment action may not yet be justified.

The Senators recommended that DOJ view debarment as a tool to deter future unethical misconduct, consistent with Deputy Attorney General Monaco's October 2021 announcement that the DOJ intended to step up its corporate criminal enforcement measures.

Gibson Dunn has issued a client alert discussing the potential implications of the Senators' letter on pending and future False Claims Act investigations.

Ohio Supreme Court Leaves Verein Ruling in Place

On August 30, 2022, the Ohio Supreme Court refused to hear an appeal by the Dentons law firm of an Ohio Court of Appeals ruling affirming a $32 million malpractice judgment against Dentons. Dentons operates using a Swiss verein structure; the malpractice claim was based on the fact that Dentons U.S. took on representation of a client while Dentons Canada served as regular outside counsel to one of the parties that the client planned to sue for patent infringement.

Denton's argued that its U.S. and Canada firms are separate legal entities that are associated with the Denton's network, and that for conflicts purposes the actions of one of its network firms is not imputed to other such firms. The trial court found, however, and

the Ohio Court of Appeals affirmed, that a conflict existed between the two representations and had been foreseeable. In coming to that conclusion, the Court of Appeals noted that the Dentons U.S. and Canada firms, along with the other verein members, used the same website and email domain, and not only marketed themselves as a single firm but in fact operated as a single firm. As a result, the court ruled, Dentons U.S. was not permitted under Ohio Professional Conduct Rule 1.7(a) to represent the client without obtaining conflict waivers.

The ruling serves as a reminder that professional services networks using the verein structure or similar international structures need to remain aware of the potential for conflicts to arise across the network that could be imputed to individual firms.

SEC Adopts Whistleblower Program Enhancements

On August 26, 2022, the SEC adopted two amendments to the rules governing its whistleblower program, designed to further incent reporting of potential violations.

The first amendment concerns the Commission's Multiple-Recovery Rule, and permits the SEC to reward a whistleblower based not only on the monetary sanctions imposed by the Commission action but also the sanctions imposed in "related actions" brought by certain other agencies. Under the previous rule, other agency sanctions were only considered "related" if the SEC's whistleblower program had the "more direct or relevant connection" to the action. The new rule expands the concept of a "related action" and will likely increase SEC whistleblower awards in large and complex matters that cross regulatory and criminal boundaries.

The second amendment concerns the factors that guide the Commission's assessment of the appropriate whistleblower award under Exchange Act Rule 21F-6. The amendment expands the factors that the SEC can consider for the purpose of increasing an award, but not for the purpose of decreasing an award. The change is designed to reassure prospective whistleblowers regarding how the Commission will exercise discretion regarding the size of any award.

Although Chair Gensler issued a statement lauding the changes, Commissioner Hester Peirce continued her pattern of dissenting, arguing that the amendments added little to whistleblower incentives while making the program more complex.

PCAOB, SEC, and DOJ Signal Continued Aggressive Enforcement

The PCAOB, SEC, and DOJ all signaled during the third quarter of 2022 that they intend to continue their stepped-up enforcement efforts in the areas of securities and criminal law.

PCAOB: On August 16, 2022, the PCAOB published its draft five-year strategic plan for public comment, which includes a goal to "Strengthen Enforcement," by (i) taking a "more assertive approach" to enforcement, including enforcing rules and standards that have never before been subject to enforcement action; (ii) imposing more significant penalties and sanctions; (iii) more frequently naming the issuers and broker-dealers whose audits are implicated by

enforcement actions, and "increasing transparency around penalties"; and (iv) bringing enforcement actions concurrently with other regulators. In her statement supporting the draft plan, PCAOB Chair Williams noted that average enforcement penalties against registered firms had increased by 65% compared with the five previous years, and that the PCAOB was increasingly using sweeps to investigate potential violations across the profession. Chair Williams expanded on those remarks in a September 22, 2022 speech to the Council of Institutional Investors in which she also discussed working with other agencies to identify potential enforcement matters and the PCAOB's intention in certain matters to seek admissions from respondents.

SEC: Chair Gensler, Enforcement Director Gurbir Grewal, and Acting Chief Accountant Paul Munter each made multiple speeches and statements during the third quarter signaling continued aggressive oversight of audit firms and enforcement activity more broadly. Chair Gensler's statements included July 27, 2022 remarks on the twentieth anniversary of the Sarbames-Oxley Act arguing that both PCAOB auditing standards and SEC independence rules needed to be updated; and September 15, 2022 testimony to the Senate Banking Committee concerning (among other things) the need for additional enforcement resources. Director Grewal provided testimony on July 21, 2022 to a House Financial Services subcommittee in which he highlighted enforcement actions relating to cryptocurrency and cyber assets, as well as actions against gatekeepers, including accountants; and on September 9, 2022 made remarks at the SEC Speaks conference touting the need for a diverse workforce in the Enforcement Division to promote robust enforcement.

Acting Chief Accountant Munter issued two statements in the third quarter of 2022. The first, "Auditor Independence and Ethical Responsibilities: Critical Points to Consider When Contemplating an Audit Firm Restructuring" on August 29, 2022, addressed the need for audit firms to maintain independence when accepting investments from private-equity firms, divesting business lines, or engaging in other transactions. The second, "Audit Quality and Investor Protection under the Holding Foreign Companies Accountable Act" on September 6, 2022, addressed instances where issuers facing potential delisting under the HFCAA have changed their lead auditor to one sitting outside China or Hong Kong, and cautioned that lead audit firms continue to be required under PCAOB standards to assess whether it is appropriate for them to act as the signing firm in an engagement whose work will occur in multiple jurisdictions. Munter also released a statement on October 11, 2022, "The Auditor's Responsibility for Fraud Detection," which emphasized the role that auditors have regarding fraud under PCAOB standards and discussed how quality controls, risk assessment processes, and other audit steps can factor into the detection of fraud.

The SEC also released its own draft Strategic Plan on August 24, 2022, emphasizing its commitment to aggressive and consistent enforcement for the benefit of individual investors and using available data.

DOJ: On September 15, 2022, Deputy Attorney General Monaco issued a memorandum and delivered related remarks at NYU announcing further measures to promote corporate criminal enforcement, including requiring more timely disclosure of individual wrongdoing to receive cooperation credit, increased scrutiny of deferred prosecution agreements and non-prosecution agreements with repeat offenders, the expansion and standardization of voluntary disclosure programs across DOJ components (including not requiring a guilty plea or monitor in cases of self-disclosure), and consideration of how a company structures its compensation system as part of its corporate culture of compliance. Gibson Dunn's client alert provides more detail.

Supreme Court Grants Certiorari in Attorney-Client Privilege Case

On October 3, 2022, the Supreme Court granted certiorari in *In re Grand Jury,* a case out of the Ninth Circuit addressing the question of how so-called "dual purpose" communications that are made for both legal and non-legal purposes should be treated. The cert petition, filed on behalf of an unnamed tax law firm resisting a federal grand jury subpoena, argued that the Ninth Circuit ruling (which required privileged legal advice to be the primary purpose of the communication for it to enjoy privileged status) created a three-way circuit split on this point, with the D.C. Circuit permitting the assertion of privilege if legal advice was a "significant" factor in the communication, and the Seventh Circuit denying privileged status to any dual-purpose communication. The United States argued in its opposition to certiorari that the existence of a circuit split was overstated (due in part to the difference between tax and other contexts) and that, in any event, the arguments in this case for the application of privilege were weak.

This case, which has potentially significant implications for the assessment of privilege in the context of communications between a company's accountants and lawyers, will undoubtedly be watched closely given the current uncertainty in the law on such "dual purpose" communications.

New York Dept. of Financial Services Strengthens Corporate Cyber Requirements

On July 29, 2022, the New York Department of Financial Services (DFS) proposed amendments to its cybersecurity requirements for covered entities (meaning companies registered or licensed under the state's banking, insurance, or financial services laws). First promulgated in 2017, the DFS regulations have played a leading role in corporate efforts to develop programs to prevent, detect, and report cyber intrusions.

The proposed regulatory update would, among other things, expand the types of events that require notification to DFS within 72 hours (including ransomware attacks even prior to any data exfiltration); require notification within 24 hours of paying a ransom; and create special reporting and compliance obligations for larger companies ("Class A" companies). Class A companies, defined as having more than 2,000 employees or $1 billion in gross revenue, would have to adopt even more stringent cybersecurity processes, including weekly system scans and annual cybersecurity program audits. The draft amendments would also impose new requirements on covered boards of directors and Chief Information Security Officers.

Please refer to Gibson Dunn's client alert for more information.

Other Recent SEC and PCAOB Regulatory Developments

Rulemaking

- On September 26, 2022, the PCAOB issued a Request for Information and Comment concerning its Interim Attestation Standards. The standards, which were carried over from the AICPA when the PCAOB was established, cover examination, review, and other attest engagements outside the financial statement audit context. Comments are due by October 26, 2022.

Enforcement Actions

- On August 16, 2022, the PCAOB issued a settled order against KPMG Samjong Accounting Corp. (KPMG South Korea) for failing to establish and implement appropriate quality control policies and procedures to protect against improper alterations of work papers. The PCAOB also sanctioned a former KPMG South Korea partner and director for improperly altering work papers and violating auditing standards. The Board imposed a censure and a civil money penalty of $350,000 on the firm and required it to undertake quality control improvements.
- On August 29, 2022, the PCAOB issued a settled order against KPMG South Africa and two KPMG engagement partners for supervisory failures and violations of PCAOB rules and standards in connection with the use of an unregistered firm in a substantial role in three audits. The PCAOB imposed a $200,000 civil money penalty on KPMG South Africa and ordered the firm to improve its quality control procedures.
- On September 30, 2022, the SEC issued settled orders against accounting firm RSM and three of its personnel for failing to adhere to PCAOB auditing and quality control standards in an issuer audit. The SEC alleged that the issuer violated accounting principles by inflating revenue with bill and hold sales. RSM agreed to pay a $3.75 million penalty, to be censured, and to retain an independent consultant to review and evaluate its audit, review, and quality control policies and procedures.
- Other recent enforcement actions:
  - On August 24, 2022 and September 19, 2022, the SEC issued separate settled orders sanctioning accounting firms and personnel for professional standards violations arising from Custody Rule examinations.
  - On September 13, 2022, the PCAOB issued a settled order sanctioning a registered firm and its managing partner for altering work papers in connection with a PCAOB inspection.

Other Regulatory Developments

- On September 14, 2022, the PCAOB announced that Mark Adler would become the Acting Director of the PCAOB Division of Enforcement and Investigations upon the September 15 departure of Patrick Bryan.
- On September 22, 2022, four authors, including regular audit industry commentator Francine McKenna, published a paper, "Deconstructing the PCAOB: Using Organizational Economics to Assess the State of a Regulator," arguing that the PCAOB's culture and relationship with the SEC have promoted a revolving-door mindset and other weaknesses that hinder its accomplishment of its mission.

For further information about any of the topics discussed herein, please contact one of the Accounting Firm Advisory and Defense Practice Group Chairs, or the Gibson Dunn attorney with whom you regularly work.