

GIBSON DUNN

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PCAOB Confirms China Access as Congress Shortens HFCAA Period

On December 15, 2022, the PCAOB [announced](#) that it had obtained, for the first time, complete access to registered firms in the People's Republic of China (PRC) (including Hong Kong) to exercise its inspection and investigation mandates. The access was obtained pursuant to the Statement of Protocol between the PCAOB and the Chinese Ministry of Finance discussed in last quarter's [Update](#). The PCAOB's [Determination Report](#) noted that in 2022 it both inspected two PRC-based firms and obtained documents and testimony in connection with investigations of PRC-based firms. Based on that complete access, the PCAOB rescinded its 2021 determination pursuant to the Holding Foreign Companies Accountable Act (HFCAA) that the PRC has impeded the PCAOB's access to local firms, meaning that the timeline for the SEC to force delisting of PRC-based issuers under the HFCAA has now been reset.

Practice Group Chairs



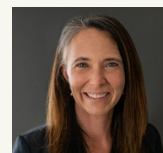
James J. Farrell

New York
+1 212.351.5326
jfarrell@gibsondunn.com



Ron Hauben

New York
+1 212.351.6293
rhauben@gibsondunn.com



Monica K. Loseman

Denver
+1 303.298.5784
mloseman@gibsondunn.com



Michael Scanlon

Washington, D.C.
+1 202.887.3668
mscanlon@gibsondunn.com

Eight days later, on December 23, 2022, Congress adopted the [Consolidated Appropriations Act, 2023](#), the omnibus bill to fund the U.S. government in fiscal year 2023, which President Biden signed on December 29, 2022. Among other things, the Act shortens the HFCAA's three-year non-inspection period before delisting to two years. The Act also tweaks the text of the HFCAA to provide that a registered audit firm can be subject to an HFCAA determination if the PCAOB's inspection or enforcement activity is blocked by a foreign authority in any jurisdiction, not only the jurisdiction in which the firm is located.

In light of these developments, the impending threat of delisting for PRC-based issuers has receded, but the PRC is now subject to a “two strikes and you’re out” policy on providing inspection and investigation access to the PCAOB.

PCAOB Proposes New Quality Control Standard

On November 18, 2022, the PCAOB [issued](#) for public comment a new proposed standard to govern quality control at registered firms. The proposed new standard would replace the existing interim quality control standards that have been in place since the PCAOB adopted them in 2003. Among other things, the new standard would: (i) impose new obligations on firms to structure their quality control systems in a risk-based fashion, (ii) require certain members of firm leadership to take on formal responsibility for overseeing the quality control system; (iii) revamp existing ethics standards; and (iv) require registered firms for the first time to file annual reports with the PCAOB on a new Form QC disclosing whether deficiencies exist in their quality control systems. The proposed standard purports to be designed to operate consistent with standards being implemented in other parts of the world such as the IAASB's International Standard on Quality Management 1 (ISQM 1), but goes beyond in several important respects. For example, the proposed standard would import a negligence standard as the lens through which quality control issues are evaluated. With this proposed negligence standard, the subjectivity inherent in developing and evaluating quality control systems, and the inevitable application of hindsight that will follow those assessments, the proposed standard presents real risk of expanding liability for firms and their personnel.

Comments on the PCAOB's proposed standard are due by February 1, 2023.

2023 SEC and PCAOB Budgets and Strategic Plans Finalized

The Consolidated Appropriations Act passed in December provides for an FY 2023 budget of almost \$2.15 billion for the SEC.

On December 23, 2022, the SEC [approved](#) a [2023 budget](#) for the PCAOB of \$349.5 million, a 12.6% increase over 2022. The increase includes an additional \$28 million for personnel expenses (12% above the prior year) and an additional \$7.5 million for “consulting and professional fees,” including investigation and litigation support. Commissioner Hester Peirce issued a [statement](#) criticizing the PCAOB's “ballooning budget” and recommended that the PCAOB be brought into the Congressional appropriations process.

The PCAOB and SEC also each approved a new Strategic Plan in November 2022. The objectives of the PCAOB's [Strategic Plan](#) include continuing its aggressive standard-setting agenda, improving the timeliness and relevance of the inspection information that it releases, and imposing more-significant enforcement penalties. As reported in our previous [Update](#) discussing the PCAOB's draft strategic plan, the PCAOB also signaled that it intends to more frequently name the issuers and broker-dealers whose audits are the subject of enforcement actions and collaborate with the SEC and foreign regulators to bring concurrent enforcement actions. The SEC's [Strategic Plan](#), consistent with the draft plan discussion in the previous Update, emphasizes protection of retail investors and the use of market data.

PCAOB Bars Indemnification in Certain Enforcement Orders

On October 18, 2022, the PCAOB issued settled disciplinary orders sanctioning the registered firm [Spielman, Koenigsberg & Parker, LLP](#) (SKP), and its partner, [Jonathan Taylor](#), for violations related to engagement quality reviews, documentation, and cooperation with the PCAOB. Each order stated that the respondent "shall not seek or accept, directly or indirectly, reimbursement or indemnification from any source including, but not limited to, any current or former affiliated firm or professional(s) or any payment made pursuant to any insurance policy," with respect to that respondent's penalty amount. We believe that these may be the first PCAOB orders containing such a provision, though the SEC has required settling respondents not to seek indemnification for their penalties.

From October 19 through the end of 2022, the PCAOB issued twenty additional settled enforcement orders. Of the eighteen orders that imposed a monetary penalty, twelve contained language similar to the SKP and Taylor orders prohibiting reimbursement or indemnification of the penalty amount. Further, certain of the orders contained additional provisions prohibiting the respondent from claiming a tax deduction or credit related to the penalty and from seeking to use the penalty to reduce a payment in any related private action. Based on that trend, registered firms and associated persons should be alert to the PCAOB enforcement staff pushing for the inclusion of such provisions in the foreseeable future.

New York State and City Employment Regulations Move Forward

New York State and New York City both took steps in the fourth quarter of 2022 related to regulation of employment matters.

On November 21, 2022, New York Governor Kathy Hochul signed into law [Assembly Bill A8092B](#), which allows New York State employees to bring retaliation claims against employers who penalize them for taking leaves of employment that are permitted by federal, state, or local law, including the Family and Medical Leave Act. Among other things, the bill prohibits employers from using a "no-fault" attendance system in which certain numbers of absences subject an employee to disciplinary action. Please refer to Gibson Dunn's [client alert](#) for additional details.

On December 9, 2022, the New York City Department of Consumer and Worker Protection (DCWP) announced that it was postponing enforcement of a new law regulating the use of

automated employment decision tools (AEDTs) in hiring and promotion until April 15, 2023. Notably, [Local Law 144](#) would require employers to conduct and publish the results of a bias audit in addition to imposing certain posting requirements. The law was scheduled to go into effect on January 1, 2023, but the high volume of public comments regarding ambiguities in the law's requirements prompted DCWP to further revise the proposed rules and announce a second hearing on the updated [proposed regulations](#) on January 23, 2023. Please refer to Gibson Dunn's [client alert](#) for additional details on the proposed rules.

FAR Council Proposes to Require GHG Emissions Reporting

On November 14, 2022, the FAR Council (acting through the Department of Defense, GSA, and NASA) [proposed](#) to amend the Federal Acquisition Regulation (FAR) to require federal contractors who did at least \$7.5 million in business with the U.S. government in the prior fiscal year to disclose their greenhouse gas (GHG) emissions, including Scope 1 emissions (direct emissions by the contractor) and Scope 2 emissions (emissions from energy use by the contractor). Additionally, "major" contractors—defined as those who did at least \$50 million of business with the U.S. government in the prior fiscal year—would be required to disclose their Scope 3 emissions (all other emissions traceable to their operations), disclose a climate risk assessment, and develop targets to reduce their GHG emissions that have been validated by the Science-Based Targets Initiative (SBTi) within the last five years. Notably, the proposed rule's reporting requirements are industry agnostic, and the rule does not distinguish between contractors delivering goods versus those providing services. The proposed rule implements the Biden Administration's [Executive Order 14030](#), which seeks to identify and mitigate climate risks across the federal government. Please refer to Gibson Dunn's [client alert](#) for additional details.

Supreme Court to Address '33 Act Standing in Direct Listings

On December 13, 2022, the Supreme Court granted certiorari in an investor lawsuit alleging that Slack Technologies, LLC, had made misstatements in violation of Section 11 of the Securities Act of 1933 in connection with a direct listing on the New York Stock Exchange in 2019. The case turns in part on whether an investor can bring a Section 11 claim without having to prove that he or she purchased registered shares, as opposed to the unregistered shares that were also available to be sold on the exchange in the immediate wake of Slack's direct listing. The filings by Slack (represented by Gibson Dunn) and the investor plaintiff are available [here](#).

Important Privilege Cases Heard in the European Court of Justice and Supreme Court

On December 8, 2022, the European Court of Justice (ECJ), acting on a request from the Belgian Constitutional Court, issued an interpretation of EU Directive 2011/16/EU, which requires among other things that intermediaries involved in potentially aggressive cross-border tax planning report relevant practices to tax authorities. The Directive permits EU member states to provide a waiver to intermediaries who are lawyers so that reporting does not breach any Legal Professional Privilege (LPP) recognized under national law, but requires that a lawyer nevertheless notify other intermediaries and the taxpayer of their reporting obligations.

Two legal organizations argued in Flemish court that even this notification violated the LPP because, among other things, it revealed the identity of the lawyer and the fact of the consultation. The ECJ: (1) reaffirmed the importance of LPP (which applies only to communications with outside, not in-house, counsel); and (2) expanded its definition such that all communications between outside lawyers and clients are presumed to benefit from LPP. Please refer to Gibson Dunn's [client alert](#) for additional details.

Additionally, on January 9, 2023, the Supreme Court heard [oral argument](#) in In re Grand Jury, the matter concerning the scope of attorney-client privilege discussed in our prior [Update](#). During oral argument, the Justices weighed the difference between the “primary purpose” test and the “significant purpose” test for communications that have a dual legal and business purpose, and focused in part on how the tests would be applied in practice.

Monica Loseman Named to Financial Accounting Standards Advisory Council

On December 5, 2022, the Financial Accounting Foundation [announced](#) that Gibson Dunn partner and Accounting Firm Advisory and Defense Practice Group Co-Chair Monica Loseman had been added as a member to its [Financial Accounting Standards Advisory Council](#) (FASAC). FASAC's function is to advise the Financial Accounting Standards Board (FASB) on standard setting and related projects on FASB's agenda. Ms. Loseman is one of two attorneys in private practice to sit on the FASAC.

Other Recent SEC and PCAOB Regulatory Developments

Rulemaking

- On December 20, 2022, the PCAOB [announced](#) the proposal of a revamped [auditing standard](#) to govern the confirmation process. The new standard would replace the interim standard originally adopted by the AICPA in 1992, and would be designed to better reflect both the increased use of electronic confirmations and the PCAOB's focus on a risk-based auditing approach.

Enforcement Actions

- On November 15, 2022, the SEC [released](#) its enforcement statistics for its fiscal year 2022, ended on September 30, 2022. For the year, the SEC brought 760 total enforcement actions (a 9% increase over the prior year), including 462 standalone actions (a 6.5% increase). The SEC's press release noted the record \$4.2 billion in civil money penalties, the focus on actions against individuals and gatekeepers, and the SEC's success in 12 of its 15 trials. The release also discussed the SEC's activity in hot-button areas such as crypto assets and ESG reporting.
- During the fourth quarter of 2022, the PCAOB was highly focused on bringing cases in groups to emphasize particular enforcement priorities or regulatory concerns. Of the 26 settled enforcement orders issued in the quarter, 20 were related to a sweep or were announced as part of a broader enforcement initiative:
 - Four orders issued on October 4, 2022 concerned the failure by certain firms to timely report their audits on Forms AP, and an additional three orders on October 19, 2022 concerned inaccurate Forms AP;

- Seven orders issued on December 6, 2022 concerned unrelated conduct at three different firms of the KPMG network, but were grouped together in a press release emphasizing the aggregated result; and
- Six orders issued on December 22, 2022 concerned the failure by certain firms to timely report information on Forms 3 as part of the PCAOB's continued enforcement sweep concerning Form 3 reporting
- On October 4, 2022, the PCAOB issued a [Notice of Finality of Initial Decision](#) imposing a permanent bar and a \$100,000 civil penalty against a Singapore-based audit senior associate who refused to respond to the PCAOB's Order Instituting Disciplinary Proceedings relating to work paper alteration. Notably, it was the first adjudicated disciplinary order issued by the PCAOB since 2017—after 12 were issued over the course of 2015 through 2017—underscoring the fact that litigation of PCAOB enforcement orders has become exceedingly rare.
- Other recent enforcement actions:
 - On November 17, 2022, the SEC [sanctioned](#) an audit engagement partner for violations related to risk assessment, confirmations, related parties, and other areas in connection with the audits of two issuers.

Other Regulatory Developments

- On December 7, 2022, the PCAOB released an [Interim Analysis Report](#) concerning its Critical Audit Matters (CAM) standard. The Report found that the number of CAMs per audit report have declined in the years since the CAM requirement took effect.
- On December 8, 2022, the PCAOB released another [Interim Analysis Report](#), reflecting an initial post-implementation review of its new standards on [the auditor's use of specialists](#) and [auditing accounting estimates](#), both of which were issued on December 20, 2018 and became effective for audits of financial statements ending on or after December 15, 2020. The Report found, based on stakeholder outreach and staff analysis, that the effects of the new standards have been limited but that implementation has not significantly increased audit fees or had other significant unintended consequences.
- Also on December 8, 2022, the PCAOB released a [Staff Update and Preview of 2021 Inspection Observations](#). The Update noted an uptick in the frequency of deficiencies identified, particularly Part I.B findings for triennially inspected firms concerning the identification of CAMs.
- On December 12, 2022, PCAOB Chair Erica Williams delivered one of the [keynote addresses](#) at the annual AICPA & CIMA Conference on Current SEC and PCAOB Developments. The address touted the PCAOB's standard-setting and enforcement activity in 2022, and previewed that in 2023 the PCAOB intends to address standards related to illegal acts, going concern, attestation standards, and due professional care. The remarks echoed similar [comments](#) that Chair Williams made at the Baruch College Annual Audit Conference on November 29, 2022.
- On November 30, 2022, the PCAOB [announced](#) the formation of a Technology Innovation Alliance Working Group, chaired by PCAOB Board Member Christina Ho and comprised of external leaders in financial reporting technology and data analytics, who will advise the PCAOB on the use of emerging technologies in the audit process.
- On November 15, 2022, SEC Enforcement Director Gurbir Grewal delivered [remarks](#) at the Securities Enforcement Forum in which he touted, among other things, the SEC's record

imposition of penalties in FY 2022, its issuance of numerous enforcement orders in which respondents had admitted to violations, and its use of SOX 304 clawbacks and disgorgement as enforcement remedies. Grewal also noted cases in which respondents had received reductions in their sanctions for cooperation.

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.