

GIBSON DUNN

Accounting Firm Quarterly Update

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PCAOB Announces New Enforcement Director

On March 22, 2023, the PCAOB [announced](#) that Robert E. Rice would become Director of the Division of Enforcement and Investigations (DEI), effective March 31, 2023. He takes over from Mark Adler, who retired after holding the Director role in an Acting capacity since September 2022.

Rice has more than 30 years of white-collar litigation and investigations experience in both the public and private sectors. Most recently, he served as Special Counsel in the United States Attorney’s Office for the District of New Jersey from 2022 to 2023. He also served as Chief Counsel to SEC Chair Mary Jo White from 2013 to 2015, and as an Assistant U.S. Attorney in the Southern District of New York from 1991 to 2000.

ACCOUNTING FIRM QUARTERLY UPDATE

Practice Group Chairs



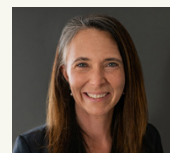
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In the private sector, Rice was a partner at Clifford Chance from 2015 to 2021 and at McDermott, Will & Emery from 2000 to 2004, focusing on criminal investigations and prosecutions, regulatory investigations and enforcement proceedings, and internal investigations. He also served as a Managing Director and the Head of Litigation and Regulatory Investigations at Deutsche Bank from 2004 to 2013.

PCAOB Advisory Group Meeting Suggests Topics of Regulatory Interest

On March 30, 2023, the PCAOB's Standards and Emerging Issues Advisory Group (SEIAG) convened a virtual [meeting](#) to discuss a range of topics of current regulatory interest, including Critical Audit Matters ("CAMs"), estimates and specialists, going concern determinations, and substantive analytical procedures.

As noted in our last [Update](#), the PCAOB's standards on [CAMs](#) and [estimates and specialists](#) were the subject of recent interim post-implementation reviews released in December 2022. Regarding CAMs, the SEIAG discussion noted that AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, requires audit reports to be comprehensive in their identification of CAMs while highlighting that the average number of CAMs per audit has declined over time. Regarding estimates and specialists, the SEIAG noted the variation in the amount of time that audit firms spent on implementation and training but noted that there were no reports of increased audit fees due to the new requirements.

With regard to the going concern standard, the SEIAG's discussion focused on whether AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*, and related standards should be revised in response to changes in financial reporting, the auditing environment, and stakeholder needs. Specifically, the SEIAG discussion indicated that the PCAOB is considering whether AS 2415 needs to be strengthened in light of (i) auditors' evaluations of issuers' ability to continue as a going concern potentially not being adequate, (ii) a lack of transparency regarding the procedures auditors perform as part of their going concern evaluation, and (iii) the fact that AS 2415 only requires disclosure when "substantial doubt" exists about the entity's ability to continue as a going concern, a standard which is not formally defined in AS 2415 and may be interpreted inconsistently among auditors.

It appears from the SEIAG discussion that PCAOB enforcement could include an increased focus going forward on failure to identify CAMs, failure to comply with the new estimates and standards requirements, and failure to conduct an adequate going concern analysis.

PCAOB Releases 2022 Annual Report

On April 5, the PCAOB issued its [2022 Annual Report](#), summarizing the PCAOB's key operations and financial results for the fiscal year ended December 31, 2022.

PCAOB Chair Erica Y. Williams, in her opening message to the Report, highlighted six areas of the PCAOB's most significant progress in 2022: (1) beginning "the most ambitious standard-setting agenda in PCAOB history"; (2) securing access for the first time in its history to

inspect and investigate firms in Mainland China and Hong Kong; (3) challenging auditors to reverse a “troubling trend” in audit quality; (4) imposing record-high enforcement penalties; (5) improving engagement with external stakeholders; and (6) investing in PCAOB staff.

The Report noted that, in 2022, the PCAOB began work on more than 30 audit standards; conducted 207 inspections involving 800 audit engagements; imposed over \$11 million in fines, the highest amount ever (including assessing fines on 100% of firms and 90% of individuals charged); and established two new advisory groups, launched one working group, and hired the first-ever Investor Advocate.

PCAOB and U.S. Senators Raise Questions About Crypto “Proof of Reserves” Reports

On January 25, 2023, Senators Elizabeth Warren (D-MA) and Ron Wyden (D-OR) sent a [letter](#) to PCAOB Chair Erica Williams urging the PCAOB “to act to ensure accountability” in light of “scandalous accounting practices in the crypto industry” in the wake of the FTX bankruptcy and other turmoil. In particular, the Senators highlighted the insufficiency of “proof of reserves” (“PoR”) reports and other limited scope engagements that do not require a full slate of PCAOB audit procedures. The Senators pressed the PCAOB with the view that its jurisdiction is “clearly not restricted to [audits of] public companies.”

Chair Williams responded with a [letter](#) on February 8, 2023 echoing the Senators’ concern regarding “sham audits” but noting that the FTX entities fell outside of the PCAOB’s jurisdiction. The Senators responded with another [letter](#) on March 21, 2023, after the collapse of Silicon Valley Bank, noting that they “continue to be disappointed by your unwillingness to use PCAOB’s existing authority to rein in these abusive practices by registered auditors.”

On March 8 2023, the PCAOB Office of the Investor Advocate published an Investor Advisory [bulletin](#) urging caution when relying on PoR reports and similar documentation when choosing to make investments in the crypto industry. In particular, the bulletin noted that PoR reports are not equivalent to an audit and are not conducted pursuant to PCAOB auditing standards, and provide no information regarding the effectiveness of internal controls or governance of the crypto entity.

PCAOB Sued as Unconstitutional by John Doe Plaintiff

A complaint was filed against the PCAOB in the U.S. District Court for the Northern District of Texas on January 19, 2023, by a plaintiff identified only as John Doe. The complaint states that Doe is the subject of ongoing PCAOB disciplinary proceedings, initiated in December 2022, stemming from an inspection of audit work performed by Doe’s firm of a Texas-based issuer’s financial statements for fiscal year 2015. At the time, Doe worked for a public accounting firm in Colombia, which is part of a “larger international network of accounting firms.” According to the complaint, the PCAOB alleges that Doe altered or instructed others to alter audit workpapers and interfered with the PCAOB’s inspection.

The complaint alleges violations of:

- The Appropriations, Taxing, and Spending Clauses of Article I of the Constitution resulting from the accounting support fees charged to issuers and broker-dealers that provide the PCAOB's largest source of funding;
- Article II of the Constitution resulting from the exercise of executive power by the Staff of the PCAOB;
- The Appointments Clause and the President's removal power under Article II of the Constitution as applied to the PCAOB's hearing officers;
- The Due Process Clause of the Fifth Amendment; and
- The Seventh Amendment right to a jury trial.

The complaint seeks both injunctive and declaratory relief, namely the discontinuance of disciplinary proceedings against Doe and a declaratory judgment that such proceedings are unlawful and unconstitutional. The PCAOB stated in its Annual Report that it "intends to defend this action vigorously."

On April 14, 2023, the PCAOB moved to dismiss Doe's complaint, arguing that the district court lacked personal and subject matter jurisdiction. One of the PCAOB's arguments was that the statutory review scheme divested the district court of jurisdiction to hear Doe's constitutional challenges. That argument was made the same day that the Supreme Court ruled, in *Axon Enterprise, Inc. v. FTC*, that the review scheme at the SEC and FTC did not remove the district court's jurisdiction to hear constitutional challenges. In *Axon*, the Court cited favorably to *Free Enterprise Fund*, 561 U.S. 477 (2010), in which the Court held that constitutional challenges to the PCAOB were collateral to the statutory review scheme and the federal district court retained jurisdiction over such challenges. Doe's opposition and the district court's ruling on the PCAOB's motion should occur later this year.

SEC Files Petition for Certiorari in SEC v. Jarkey

As reported in our [Q2 2022 Update](#), the Fifth Circuit [held](#) in May 2022 that (a) the SEC's ALJ hearing process violated the respondents' Seventh Amendment right to a jury trial because allegations of fraud are not "public rights" created by the securities laws; (b) Congress failed to provide an intelligible principle to the SEC concerning when to exercise its administrative proceeding authority; and (c) ALJs are inferior officers who are unconstitutionally protected from removal by a system that requires the Merits System Protection Board to find good cause. The SEC's subsequent petition for rehearing en banc was [denied](#).

On March 8, 2023, the SEC [filed](#) a Petition for Certiorari with the Supreme Court, seeking further review of the case. The response to the Petition is due in May 2023, and a decision on Certiorari could come later this year.

CPAB Brings Rare Enforcement Action Against U.S. Firm

On March 3, 2023, the Canadian Public Accountability Board (CPAB) [announced](#) it had imposed enforcement actions on Marcum LLP prohibiting the firm from accepting new "high risk Canadian reporting issuer" clients. Marcum was also required to pay the costs of increased regulatory oversight and monitoring, including a follow-up inspection by CPAB to ensure compliance with the enforcement action. CPAB's public censure of Marcum, a firm

headquartered in New York with no locations in Canada, is an unusual move both because it involves an American, rather than Canadian, accounting firm, and because the CPAB has annually averaged only one public censure in recent years.

CPAB's release did not offer detail regarding the purported violations, stating only that, upon inspection of two Marcum audit files in 2022, it identified breaches of nine Canadian Auditing Standards and Canadian Standard on Quality Control 1. CPAB did not identify the relevant issuers, but noted that Marcum had 21 Canadian issuer clients at the time of the inspection.

House Signals More SEC Oversight

Signaling an escalation of the House Financial Services Committee's oversight of the SEC, House Financial Services Chair Patrick McHenry (R-N.C.) and Oversight Subcommittee Chair Bill Huizenga (R-Mich.) sent a [letter](#) to SEC Chair Gary Gensler on February 10, 2023, stating that there are "serious questions about the SEC's process and cooperation with the Department of Justice" around the timing of the charges and arrest of former FTX CEO Sam Bankman-Fried, and requesting that the SEC produce all records and communications relating to the charges filed against Bankman-Fried.

On April 18, 2023, the Committee conducted a contentious [hearing](#) with Chair Gensler, in advance of which the Committee's 29 Republicans sent a [letter](#) accusing the SEC of failing to provide adequate opportunity for digital asset ecosystems to register with the Commission.

Ninth Circuit and Ohio Supreme Court Issue Rulings of Interest on Employment Arbitration Agreements and Ransomware Attack Insurance

On February 15, the Ninth Circuit Court of Appeals held in [*Chamber of Commerce v. Bonta*](#) that the Federal Arbitration Act preempts California's Assembly Bill 51. Assembly Bill 51 attempted to ban mandatory arbitration agreements in employment contracts, and was quickly challenged by the Chamber of Commerce before its original effective date of January 1, 2020. A federal district court granted a preliminary injunction against AB 51, which the Ninth Circuit Court originally reversed in part in September 2021. However, after a petition for rehearing was filed, the Ninth Circuit withdrew its opinion and has now issued a new opinion affirming the district court's preliminary injunction order and holding that AB 51 is preempted by the FAA. Gibson Dunn has issued a [client alert](#) concerning the ruling.

On December 27, the Ohio Supreme Court held in [*EMOI Services LLC v. Owners Insurance Co.*](#) that a business owner's insurance policy to cover any direct physical loss or damage to electronic equipment or media did not encompass ransom payments made to a hacker to recover illegally obtained computer systems and encrypted files needed for the business to use its software and database systems. The Court stated that "[c]omputer software cannot experience 'direct physical loss or physical damage' because it does not have a physical existence," and therefore the insurance company was not liable for the ransomware attack.

NLRB Issues Decision on Enforceability of Severance Agreement Provisions

On February 21, 2023, the National Labor Relations Board ruled in [McLaren Macomb](#) that an employer violates the National Labor Relations Act (NLRA) by offering a severance agreement to employees that includes confidentiality and non-disparagement terms restricting the exercise of the employees' rights under Section 7 of the NLRA. Section 7 gives employees the right to self-organize, join or form labor organizations, and bargain collectively. Subsequently, NLRB General Counsel Jennifer Abruzzo issued a non-binding [memorandum](#) expressing her position on the scope and application of the *McLaren Macomb* decision, including that it applies retroactively to severance agreements already in effect. Abruzzo's memorandum identifies other provisions that could draw NLRB scrutiny as well, including broad restrictive covenants, broad releases that extend beyond employment claims, and broad cooperation clauses.

The NLRB's holding may face court challenges in this or subsequent cases

SDNY Criminal Motion Alleges Conflict in Representing Both Company and Employee

On January 30, 2023, former Allianz employee Gregoire Tournant filed a motion to dismiss his securities fraud indictment in the Southern District of New York, alleging that a law firm's representation of both him and Allianz created a conflict of interest that ultimately led the law firm to disclose confidential discussions with Tournant to the government and advocate for his prosecution in lieu of a charge against Allianz. The motion asserts that the law firm's conduct is attributable to the Government because the coercive pressure created by its corporate cooperation policies "specifically induced [the law firm] to serve as the Government's 'back office' and build the case against" Tournant.

The U.S. Attorney's Office for the Southern District of New York filed its [opposition](#) on February 17, 2023, accusing Tournant of "making inflammatory claims about his former attorneys and the Government that are legally and factually baseless" and asserting that no wrongdoing occurred.

Other Recent SEC and PCAOB Regulatory Developments

Rulemaking

- On March 28, 2023, the PCAOB [issued](#) for public comment a proposed new standard, AS 1000, concerning the general responsibilities of the auditor in conducting an audit. If adopted, AS 1000 would reorganize and consolidate a group of standards that were adopted on an interim basis by the PCAOB in April 2003 and that address the core principles and responsibilities of the auditor, such as reasonable assurance, professional judgment, due professional care, and professional skepticism. Comments are due by May 30, 2023.
- In response to the PCAOB's proposed new [standard](#) concerning confirmations, the Institute of Internal Auditors submitted a [comment letter](#) on February 3, 2023 raising objections to the PCAOB's implication that internal auditors might intercept or alter confirmations before they reach the external auditor.

Inspections

- On April 17, 2023, the PCAOB Staff issued a [Spotlight report](#) detailing its inspection priorities for the coming year, including risk assessment and response, use of other auditors, digital assets, and quality control.
- The PCAOB is reportedly preparing to [conduct](#) another round of inspections in Hong Kong on Chinese companies' auditors, as part of the deal between the U.S. and China to prevent de-listings of Chinese firms from the U.S. stock exchanges. Meanwhile, Chinese authorities are reportedly urging state-owned enterprises to phase-out use of certain audit firms.

Other Regulatory Developments

- On February 14, 2023, Paul Munter, the SEC's Chief Accountant, released a [statement](#) stressing the importance of the Financial Accounting Standards Board promptly and efficiently developing improved and updated accounting standards. Additionally, on March 17, 2023, Munter released a [statement](#) emphasizing the need for lead auditors to plan, supervise, and evaluate the work performed by other auditors.
- On February 2, 2023, the PCAOB released a [Spotlight report](#) regarding the remediation process related to quality control deficiencies, including a description of the Staff's process to evaluate firms' remediation activities.

In addition to the Accounting Firm Advisory and Defense Practice Group Chairs listed above, this Update was prepared by David Ware, Timothy Zimmerman, Benjamin Belair, Monica Limeng Woolley, Stephanie Levin, and John Harrison.

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.