

GIBSON DUNN

Accounting Firm Quarterly Update

JULY 2023

In this Issue:

- ALI CLE Holds Annual Accountants' Liability Conference
- PCAOB Proposes Expansive NOCLAR Auditing Standard
- Supreme Court Holds Section 11 Plaintiffs Must Show They Bought Registered Shares
- Supreme Court Holds States Can Require Corporate Consent to General Jurisdiction
- Australian Government Investigating Accounting Partnerships
- PCAOB Continues China Inspections
- PCAOB Issues Spotlight Report on Professional Skepticism
- Supreme Court Grants Certiorari in Challenge to SEC Administrative Proceedings
- Other Recent SEC and PCAOB Regulatory Developments

ALI CLE Holds Annual Accountants' Liability Conference

The annual ALI CLE Accountants' Liability Conference took place in Washington, DC, on May 4 and 5, 2023. The Conference featured panel discussions on a variety of topics, including trends in accounting litigation, emerging regulatory issues, PCAOB enforcement and inspections, and new and proposed standards, and featured speakers from across the industry, including the SEC and PCAOB, in-house counsel, outside counsel, and consultants. The Conference's keynote speaker was Natasha Guinan, Chief Counsel in the SEC's Office of the Chief Accountant. Guinan highlighted the "public responsibility" auditors assume when auditing the financial statements of public companies, and called for an increased focus by firms on compliance culture from the top down, auditor independence, and assurance practices. Guinan noted that significant change may be unavoidable should the audit profession fail to satisfy its professional obligations, welcoming future collaboration between the SEC and PCAOB on enforcement matters.

AFAD co-Chairs Ron Hauben and Jim Farrell each moderated a panel, on "Evolving Issues Affecting the U.S. Accounting Profession" and "International Issues," respectively.

Practice Group Chairs



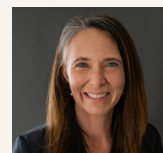
James J. Farrell

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

PCAOB Proposes Expansive NOCLAR Auditing Standard

On June 6, 2023, the PCAOB [introduced](#) a new proposed auditing standard, *A Company's Noncompliance with Laws and Regulations*, which is poised to dramatically expand the scope of audits and the role of auditors relating to non-compliance with laws and regulations (NOCLAR). Reflecting the unprecedented scope of the new standard, two of the PCAOB's five Board members, Duane DesParte and Christina Ho, dissented from the proposal, citing a range of concerns, including that compliance with the proposed standard would require auditors to operate outside the bounds of their core competencies and to rely extensively on legal specialists, which would significantly impact audit costs.

The proposed standard represents a significant revision of current AS 2405, *Illegal Acts by Clients*, and would require auditors to perform procedures to identify “the laws and regulations with which noncompliance could reasonably have a material effect on the financial statements” and “evaluate” whether any identified noncompliance likely occurred, “regardless of whether the effect of such noncompliance is perceived to be material to the financial statements.” The proposed standard would also impose new requirements that auditors communicate with management, the Audit Committee, and, in some cases, the full board of directors upon the identification of potential noncompliance.

Board Member Ho described the proposal as a “breathtaking expansion of the auditors’ responsibilities” while Board Member DesParte stated, “[t]he scope of the expanded auditor’s procedures cannot be underestimated.” Notably, the two dissenting Board members are also the two public accountants on the Board.

The PCAOB’s Office of the Investor Advocate issued a Bulletin on June 30, 2023 “strongly encourag[ing] all investors to carefully read the proposal and provide comments,” suggesting that the PCAOB is hoping to receive supportive comments from investors.

Gibson Dunn has issued a [client alert](#) discussing the proposal and its implications in further detail.

Supreme Court Holds Section 11 Plaintiffs Must Show They Bought Registered Shares

On June 1, 2023, the Supreme Court unanimously [held](#) in *Slack Technologies, LLC v. Pirani* that, in a direct listing, plaintiffs who claim that a company’s registration statement is misleading and who sue under Section 11 of the Securities Act of 1933 must plead and prove that they bought shares registered under that registration statement. In rejecting the plaintiff’s view of Section 11, the Court avoided an interpretation that could have unsettled the scope of liability under that section in cases beyond direct listings, including traditional IPOs and follow-on offerings. The Court did not resolve whether Section 12 of the ’33 Act likewise requires proof of purchase of registered shares, remanding that question to the lower courts to decide in the first instance. Gibson Dunn, which represented Slack Technologies at argument, has issued a [client alert](#) with additional insights.

Supreme Court Holds States Can Require Corporate Consent to General Jurisdiction

On June 27, 2023, the Supreme Court [held](#) in a 5-4 decision in *Mallory v. Norfolk Southern Railway Co.* that the Due Process Clause does not prohibit Pennsylvania from requiring Pennsylvania-registered businesses to consent to general jurisdiction in the state's courts. However, a majority of the Justices questioned whether other constitutional principles may limit states' powers to require such consent. The opinion was fractured, with Justice Gorsuch delivering the opinion of the Court, with Justice Alito and Justice Jackson authoring concurring opinions, and Justice Barrett dissenting, joined by Chief Justice Roberts and Justices Kagan and Kavanaugh. Please see Gibson Dunn's [client alert](#) for additional details.

Australian Government Investigating Accounting Partnerships

On June 22, 2023, Australia's Parliamentary Joint Committee on Corporations and Financial services opened an [inquiry](#) entitled "Ethics and Professional Accountability: Structural Challenges in the Audit, Assurance and Consultancy Industry," which will purport to examine the partnership models of large audit firms following recent allegations of wrongdoing. The inquiry's Terms of Reference cover, among other things, "global and national firm structures," including the basis for the partnership model and issues arising from cross-border operations; how governance may vary based on corporate structures; and regulators' ability to monitor audit quality and regulatory compliance.

PCAOB Continues China Inspections

The PCAOB has continued its inspection activity of firms registered in mainland China and Hong Kong. Following the Holding Foreign Companies Accountable Act, the PCAOB secured its first-ever inspection access in 2022, and recently issued inspection reports for the two firms inspected.

PCAOB Issues Spotlight Report on Professional Skepticism

In April 2023, the PCAOB released Spotlight report entitled [Professional Competence and Skepticism Are Essential to Quality Audits](#). The report reinforces the importance of professional skepticism and industry expertise in accepting new clients, maintaining existing client relationships, and audit planning. The PCAOB noted the importance of professional skepticism at all stages of the audit, especially in areas that involve significant management judgments, such as the assumptions that go into accounting estimates or transactions outside of the ordinary course of business. The report also emphasized that auditors have a responsibility to take into account all evidence gathered when evaluating the results of an audit. An audit firm's quality control system can help engagement teams improve the application of professional skepticism, including by creating employment and incentive practices for auditors that encourage and reward proper professional skepticism.

Supreme Court Grants Certiorari in Challenge to SEC Administrative Proceedings

On June 30, 2023, the Supreme Court granted the SEC's petition for certiorari in *SEC v. Jarkesy* (available [here](#)), in which the SEC is seeking reversal of a Fifth Circuit holding that SEC administrative enforcement proceedings unconstitutionally violate the right to a jury trial in civil matters and improperly infringe on executive and legislative power. In *Jarkesy*, the Court will determine whether: the federal statutes empowering the SEC to initiate and adjudicate administrative enforcement proceedings seeking civil penalties for common law claims violate the Seventh Amendment right to a jury trial in civil matters; the SEC's discretion to bring enforcement actions as either administrative proceedings or district court cases violates the nondelegation doctrine; and the multiple levels of for-cause removal protection afforded to SEC administrative judges violates Article II.

Other Recent SEC and PCAOB Regulatory Developments

Rulemaking

- As discussed in our [last update](#), 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. Comments on the proposal were due May 30, 2023. The PCAOB received 27 comment letters, including letters from numerous accounting firms, the U.S. Chamber of Commerce, and other associations, and individuals.
- On May 16, 2023, the PCAOB posted a revised standard setting agenda, including the addition of two standard-setting projects slated for action within the next 12 months. These projects include improvements to [Firm and Engagement Performance Metrics](#) and [Substantive Analytical Procedures in Auditor's Risk Assessment](#). The agenda also includes four new rulemakings, related to making enhancements in firm reporting and transparency, contributory liability, follow-on disciplinary proceedings, and registration.

Inspections

- On May 2, 2023, the PCAOB [announced](#) that it was adding a new Part I.C to its inspection reports that would identify instances of non-compliance with PCAOB independence rules (including the PCAOB's incorporation of SEC independence rules). The reports released so far have identified both non-compliance identified to the PCAOB by the firms themselves and non-compliance identified by the PCAOB.

Enforcement

- On June 21, 2023, the SEC [charged](#) Marcum LLP with quality control failures and violations of audit standards in connection with audit work performed for special purpose acquisition companies (SPACs) beginning in 2020.

Other Regulatory Developments

- On June 13, 2023, the PCAOB issued a [staff report](#) entitled *Spotlight: Inspection Observations Related to Public Company Audits Involving Crypto Assets* discussing the unique risks posed by the use of crypto assets when performing audits of public companies and broker-dealers, and reminding auditors of the importance of performing tests of controls and substantive responsive to the risks identified.

- The SEC Investor Advisory Committee held a [public meeting](#) on June 22, 2023, which included a panel discussion regarding audit committee workload and transparency. The panelists included four public company audit committee chairs, and discussed audit committee disclosures in the context of the expanding and varied role of audit committees.
- The PCAOB Investor Advisory Group [met](#) on June 7, 2023. The meeting included a briefing by the Subcommittee on Inspections & Data Transparency (SIDT), recommending ways to enhance PCAOB audit firm inspections for the benefit of investors. SIDT's recommendations included that audit firm-provided data and inspection information that is currently made public should be available in a searchable database.
- PCAOB Chair Erica Williams conducted a keynote Q&A session as part of the Baruch College Annual Financial Reporting Conference. Video of the session was posted [online](#).
- The PCAOB [announced](#) on July 14, 2023 that PCAOB General Counsel Kenneth Lench is leaving the PCAOB, and that Deputy General Counsel James Cappoli has been appointed Acting General Counsel. That same day, PCAOB [announced](#) that the Deputy Director of the Division of Enforcement and Investigations, Raymond J. Hamm, is leaving the PCAOB following nearly 20 years of service.

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, John Harrison, and Nicholas Whetstone.

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.