

CURRENT TOPICS IN SECTION 10A INVESTIGATIONS

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Agenda

1. Introductions and Overview

2. Considerations When Launching a Section 10A Investigation

3. Conducting and Reporting on a Section 10A Investigation

4. The Auditor's Perspective on Section 10A

5. Q&A

Introductions and Overview

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Overview

- **Section 10A landscape constantly shifting**
- **Evergreen need to keep current with recent developments**
- **Obligations and perspectives of each stakeholder are a significant focus**

Overview

What Is a Section 10A Investigation?

Section 10A in Statute

What is Section 10A?

- Arises out of Watergate-era AICPA Statement on Auditing Standards 17, now reflected for public companies in PCAOB Auditing Standard 2405, *Illegal Acts by Clients*.
- Requires the auditor to perform certain procedures relating to illegal acts and report up to the Audit Committee as necessary.
- Section 10A (15 U.S.C. § 78j-1) adopted in 1995 as part of the PSLRA, added a provision requiring reporting to the SEC in certain situations.

See Thomas L. Riesenber, Trying to Hear the Whistle Blowing: The Widely Misunderstood Illegal Act Reporting Requirements of Exchange Act Section 10A, 56 Bus. Law. 1417 (2001)

Overview

What Is a Section 10A Investigation?

Section 10A in Practice

What we talk about when we talk about Section 10A...

- *Notice pursuant to Section 10A is not required.*
- *Potential financial reporting effects make the auditor a key constituent for the investigation.*
- *Concurrent government investigations may or may not be occurring.*

Considerations When Launching a Section 10A Investigation

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Launching a Section 10A Investigation

Overview

- **Understanding the obligations and perspectives of stakeholders**
- **Key considerations when launching an investigation**
- **The auditor's Section 10A shadow team**

Launching a Section 10A Investigation

Key Stakeholders

- **Management**
- **Board and Audit Committee**
- **Auditor**
- **Regulators**



Launching a Section 10A Investigation

Key Stakeholders

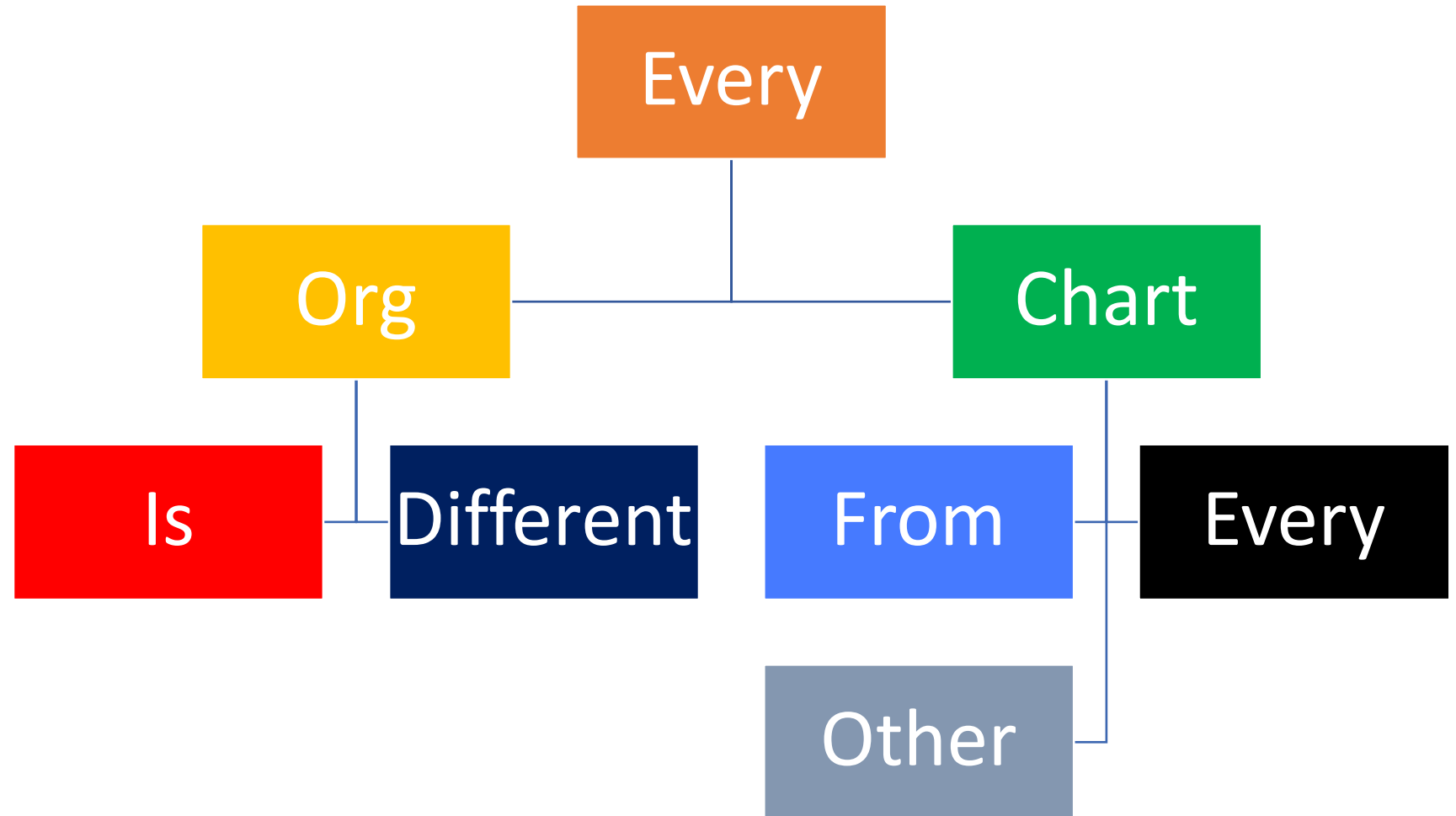
Management

- *What members of management are potentially implicated?*
- *What involvement will in-house OGC have?*
- *Is there a separate Compliance function that will be involved?*
- *What role will the Controllershship organization have in the process?*
- *Are there established HR processes to be followed for employee discipline?*
- *What other management functions will provide resources?*
- *What functions will be involved as fact witnesses?*

Launching a Section 10A Investigation

Key Stakeholders

Management



Launching a Section 10A Investigation

Key Stakeholders

Board and Audit Committee

- *Are there Board members or committees other than the Audit Committee that are relevant to the investigation?*
- *To what extent will the Audit Committee lead the oversight of the investigation?*
- *To what extent will other Audit Committee members look to the Chair to take a more active role?*

Launching a Section 10A Investigation

Key Stakeholders

Select Auditor Concepts

- *Sufficient appropriate audit evidence*
- *Management representations*
- *Competence and objectivity*
- *Engagement team vs. 10A team*

Launching a Section 10A Investigation

Key Stakeholders

NOCLAR



Proposing Release:
Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations
And Other Related Amendments

PCAOB Release No. 2023-003

June 6, 2023

PCAOB Rulemaking
Docket Matter No. 051

Summary: The Public Company Accounting Oversight Board ("PCAOB" or the "Board") is proposing amendments to its auditing standards related to an auditor's consideration of a company's noncompliance with laws and regulations in the performance of an audit. The proposal would:

- (1) Replace:
 - AS 2405, *Illegal Acts by Clients*, and retitle the standard *A Company's Noncompliance with Laws and Regulations*;
- (2) Amend:
 - AS 2110, *Identifying and Assessing Risks of Material Misstatement*; and
 - Other auditing and related professional practice standards; and
- (3) Rescind:
 - AS 6110, *Compliance Auditing Considerations in Audits of Recipients of Governmental Financial Assistance*;
 - AI 13, *Illegal Acts by Clients: Auditing Interpretations of AS 2405*; and
 - AI 21, *Management Representations: Auditing Interpretations of AS 2805*.

Public Comment: Interested persons may submit written comments to the Board. Comments should be sent by e-mail to comments@pcaobus.org or through the Board's website at pcaobus.org. Comments also may be sent to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. All

On June 6, 2023, the PCAOB proposed a new standard relating to a company's noncompliance with laws and regulations (NOCLAR). The new standard would significantly increase the auditor's obligations around laws and regulations whose violation could reasonably have a material effect on the financial statements.

Launching a Section 10A Investigation

Key Considerations

- **Financial reporting timeline.**
- **Existing investigations and other legal / compliance matters.**
- **Existing corporate / financial reporting / ICFR matters.**

Launching a Section 10A Investigation

Key Considerations

Financial Reporting Timeline



Launching a Section 10A Investigation

Key Considerations



Conducting and Reporting on a Section 10A Investigation

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Conducting and Reporting on a Section 10A Investigation

Conducting the Investigation

- **Planning is iterative, especially as the facts evolve.**
- **Lines of communication may shift, especially if the facts implicate additional members of management.**
- **Investigations are an EQ as well as an IQ exercise.**

Conducting and Reporting on a Section 10A Investigation

Conducting the Investigation

Developments with Potential Section 10A Implications

- **Fact developments regarding individual conduct.**
- **Financial reporting and ICFR developments, including:**
 - **Quantitative materiality.**
 - **Qualitative materiality.**
 - **Time period of relevant conduct.**
- **Employment / staffing developments.**
- **Regulatory developments.**

Conducting and Reporting on a Section 10A Investigation

Conducting the Investigation

Putting a Box Around the Conduct

How high did it go?

Who was involved?

How long did it last?

What financial reporting did it affect?

Conducting and Reporting on a Section 10A Investigation

Concluding the Investigation

When the Investigation Can Conclude

When is a Section 10A investigation complete?

- *Can the investigation cross reporting periods?*
- *When must the company take HR / disciplinary action?*
- *Must all correcting journal entries be made?*
- *What about fiscal periods that are no longer part of the current financial statements on file with the SEC?*
- *What if a regulator is still investigating?*

Conducting and Reporting on a Section 10A Investigation

Concluding the Investigation

Reporting to Management Functions

- **Reporting to HR on individual conduct and relevant policies.**
- **Reporting to the Controller on financial statement effects.**
- **Reporting to Compliance and Internal Audit on processes and controls.**

Conducting and Reporting on a Section 10A Investigation

Concluding the Investigation

Reporting to the Auditor

Answering the auditor's principal questions:

- **Financial reporting effect.**
- **ICFR effect.**
- **Management representation effect.**

Conducting and Reporting on a Section 10A Investigation

Concluding the Investigation

Reporting to the Regulator

If a regulator is not yet involved:

- **Whether a self-report is required.**
- **Whether to voluntarily self-report.**
- **To which regulator to report.**

If a regulator is already involved:

- **When and how often to report.**
- **To what extent the report can “wrap up” the matter.**

Conducting and Reporting on a Section 10A Investigation

Concluding the Investigation

Form of Reporting

What form should the reporting on the investigation take?

- **Sequencing.**
- **Oral versus written findings and conclusions.**
- **Support for conclusions – emails / interviews / accounting entries.**

The Auditor's Perspective on Section 10A

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The Auditor's Perspective on Section 10A

*Additional
Questions for
Deloitte &
Touche Chief
Risk Officer
John Treiber*

- *How is the Section 10A team staffed?*
- *How do the engagement team and Section 10A team reach consensus on their evaluation of the investigation?*
- *What input can the company or its counsel have into the manner in which the investigation is documented?*
- *How does the auditor react to assertions of privilege?*
- *What are some best practices for investigating counsel?*
- *What practices by investigating counsel are counter-productive?*

The Auditor's Perspective on Section 10A

Privilege

Do communications with the auditor waive investigation privilege? Does work product protection extend to internal investigations and is it waived when communicating with the auditor?

- ***SEC v. RPM International, Inc.*, Civ. A. No. 16-1803 (D.D.C.); *In re RPM International, Inc.*, No. 20-5052 (D.C. Cir. pet. for writ of mandamus denied May 1, 2020)**

When do communications with the SEC waive privilege?

- ***In re Cardinal Health, Inc., Sec. Litig.*, No. C2 04 575 (S.D.N.Y. Jan. 26, 2007)**
- ***SEC v. Herrera*, Case No. 17-20301-CIV (S.D. Fla. Dec. 5, 2017)**

Questions?

THANK YOU!

Please note that this presentation has been prepared for general informational purposes only and is not intended as legal advice.



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