

Accounting Firm Quarterly Update

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PCAOB Undertakes Significant Standard-Setting and Rulemaking Projects

The PCAOB has been very active on the rulemaking and standard-setting front thus far in 2024, completing a number of initiatives and proposing several others. In the second quarter alone, the PCAOB:

- Adopted [QC 1000](#), in which it updated the quality control standards applicable to registered firms for the first time since the Board's founding;
- Adopted [AS 1000](#), in which it refashioned some of the fundamental obligations of the auditor, including due professional care;
- Adopted amendments to [AS 1105](#), *Audit Evidence*, and [AS 2301](#), *The Auditor's Responses to the Risks of Material Misstatement*, to address the use of technology and data analytics in audit procedures;

- Adopted an amendment to its rule on contributory liability, [Rule 3502](#);
- Proposed rules to require the reporting of [firm and engagement metrics](#) on a new annual form and an expanded Form AP;
- Proposed rules to expand the items subject to annual and special [firm reporting](#), and to reduce the timeframe in which special reports must be submitted; and
- Proposed to replace its auditing standard on [substantive analytical procedures](#), AS 2305.

As [set out](#) in its standard-setting, research, and rulemaking agenda, the PCAOB intends to remain active in 2024, including by adopting a final NOCLAR standard and proposing a revised standard on going concern analysis.

Supreme Court Issues Key Securities and Administrative Law Rulings

In the final months of its Term, the Supreme Court issued a number of rulings that could be of significant interest to the accounting profession, including:

- [Macquarie Infrastructure Corp. v. Moab Partners, L.P.](#) (April 12): Holding that a company's failure to disclose information required by Item 303 of SEC Regulation S-K does not give rise to a private action under Rule 10b-5(b) when such nondisclosure does not render any statements made misleading. The Court distinguished "half truths" that "omit[] critical qualifying information" from "pure omissions" that "occur[] when a speaker says nothing, in circumstances that do not give any particular meaning to that silence."
- [SEC v. Jarkesy](#) (June 27): Holding that—in SEC enforcement actions that allege violation of the anti-fraud provisions of the securities laws and seek legal, rather than equitable, relief—the defendant has a Seventh Amendment right to a jury trial, meaning that the SEC cannot bring such enforcement proceedings in its administrative forum.

- [Loper Bright Enterprises v. Raimondo](#) (June 28): Overruling the *Chevron* doctrine and holding that courts should not defer to agencies in resolving statutory ambiguities.
- [Corner Post, Inc. v. Board of Governors of the Federal Reserve System](#) (July 1): Holding that claims under the Administrative Procedure Act do not begin to accrue, and the six-year statute of limitations to challenge an agency action does not begin to run, until the plaintiff is injured by the action.

Additionally, the Supreme Court on June 10 and 17, 2024 granted certiorari in two securities litigation matters, [Facebook, Inc. v. Amalgamated Bank](#) and [NVIDIA Corp. v. E. Ohman J:or Fonder AB](#), respectively. Facebook will address a split among the federal circuits on the question of whether companies may be liable under Exchange Act Section 10(b) for failing to disclose a risk that has materialized in the past, even if that past event presents no known risk of ongoing or future business harm. Gibson Dunn represents Facebook parent Meta in the case. NVIDIA will address (1) the need to plead the contents of internal corporate documents with particularity; and (2) whether plaintiffs can rely on expert opinions to allege scienter with particularity.

President Biden Vetoes Resolution Overturning SEC Crypto Accounting Guidance

On May 31, President Joe Biden [vetoed](#) a Congressional resolution that would have overturned the SEC's cryptocurrency accounting guidance in Staff Accounting Bulletin 121, saying the measure would "inappropriately constrain" the agency's ability to "set forth appropriate guardrails" for the industry. SAB 121 directs institutions safeguarding cryptocurrency for customers to recognize both the asset and a safeguarding liability on their own balance sheets. Critics of SAB 121 say the guidance makes it difficult for financial institutions to work with crypto companies.



Major Ruling in SEC Cybersecurity Case as SEC Clarifies Cyber Disclosure Obligations

Two notable developments occurred in recent months in the rapidly evolving area of cybersecurity disclosures.

First, on July 18, 2024, Judge Paul A. Engelmayer of the Southern District of New York issued his order on defendants' motion to dismiss in *SEC v. SolarWinds Corp.* As noted in [last quarter's client alert](#), SolarWinds moved to dismiss the amended complaint, arguing that the SEC's claims that the company lacked proper internal controls and fraudulently failed to warn the public of known cyber security risks were "fundamentally flawed." In his order, Judge Engelmayer agreed with much of SolarWinds's argument, significantly paring back the SEC's misstatements case and dismissing entirely its claims under Section 13(b)(2)(B) (internal accounting controls) and Rule 13a-15 (disclosure controls). The court's analysis of Section 13(b)(2)(B) was congruent with the [criticisms](#) that SEC Commissioner Hester Peirce has lodged against the SEC's aggressive use of that provision in recent enforcement actions, [including](#) in connection with an [order](#) against R.R. Donnelley & Sons Co. in the second quarter for inadequate controls related to a ransomware attack.

Second, SEC Director of Corporation Finance Erik Gerding issued two statements during the quarter regarding cybersecurity disclosures. On May 21, 2024, Gerding [noted](#) that, while the SEC's 2023 cybersecurity rules mandated disclosure of material cybersecurity incidents on Form 8-K Item 1.05, companies were also encouraged to voluntarily disclose immaterial incidents in Item 8.01, with the distinction between the two items hopefully assisting investors in separating material from immaterial events. The statement made clear that an incident that is disclosed in Item 8.01 but it subsequently determined to be material must still be disclosed separately in Item 1.05. Gerding also reiterated the SEC's statements in its 2023 [adopting release](#) that the evaluation of materiality should include all relevant factors, both quantitative and qualitative. On June 20, 2024, Gerding issued a [second statement](#) clarifying that the SEC rules did not prevent companies from providing additional information about a cybersecurity incident to counterparties to assist with remediation, mitigation, or the counterparty's own disclosure obligations. The statement discussed the ways in which such communications could be exempt from reporting under Regulation FD.

SEC Permanently Suspends BF Borgers CPA PC and Grants Extension to Affected Registrants

On May 3, 2024, the SEC [charged](#) audit firm BF Borgers CPA PC and its owner, Benjamin F. Borgers, with “deliberate and systemic failures” to conduct audits in accordance with PCAOB standards—specifically failures to conduct engagement quality review and failures to adequately supervise, review, and document audit work. The SEC also charged the firm with making false representations to clients, fabrication of audit documentation, and false statements in the audit reports that the audits were conducted in accordance with PCAOB standards. The charges related to audits included in more than 1,500 SEC filings from January 2021 through June 2023, totaling at least 75% of BF Borgers’s public company audits during this period. SEC Director of Enforcement Gurbir Grewal described BF Borgers as “responsible for one of the largest wholesale failures by gatekeepers in our financial markets.” To settle the

SEC’s charges, BF Borgers agreed to pay a civil penalty of \$12 million and its owner agreed to pay a civil penalty of \$2 million. Both BF Borgers and its owner also agreed to permanent suspensions.

In order to provide registrants who had previously retained BF Borgers as their auditor with additional time to engage a new auditor, the SEC [announced](#) on May 20, 2024 that affected registrants would receive an extension of the deadline to file their Form 10-Q if they had previously notified the SEC of their inability to timely file their required report. The SEC’s exemptive order stated that the Form 10-Q for these registrants would be deemed to be filed on its prescribed due date so long as it was filed within 30 calendar days following the due date (as opposed to 5 calendar days).

Unanimous Fifth Circuit Panel Strikes Down SEC Private Funds Rule

On June 5, 2024, the Fifth Circuit vacated an SEC rule adopted under the Investment Advisers Act of 1940 to significantly enhance regulation of private fund advisers.

Gibson Dunn represented leading industry groups in the case. The Fifth Circuit agreed with Gibson Dunn’s argument that the

SEC exceeded its authority, returning stability to the regulation of private fund advisers lacking since the rule’s August 2023 adoption. A recent Gibson Dunn [client alert](#) provides more information about the Fifth Circuit’s reasoning and potential implications of the case’s outcome.

European Parliament Adopts Corporate Sustainability Due Diligence Directive

On April 24, 2024 the European Parliament passed the Corporate Sustainability Due Diligence Directive (“CSDDD”), which requires certain EU and non-EU companies to meet mandatory human rights and environmental obligations. Specifically, the CSDDD creates obligations for covered companies to: (1) identify any assess adverse human rights and environmental impacts; (2) prevent, mitigate, and work to end such impacts; and (3) adopt and implement a transition plan for climate mitigation that ensures the company’s business model is compatible with limiting warming to 1.5°C as provided for in the Paris Agreement. The CSDDD further requires member states to designate regulators to enforce the CSDDD and establish civil liability regimes for companies’ violations of its requirements. Covered

companies include both EU companies with more than 1,000 employees and net worldwide turnover of at least €450 million and non-EU companies that generate net turnover of at least €450 million within the EU. Covered companies will be required to comply with the CSDDD beginning between 2027 and 2029, depending on the size of the company. Please refer to Gibson Dunn’s [client alert](#) or [two part](#) podcast for more information.

PCAOB Staff Issues Spotlight Reports on Root Cause Analysis and Company Information

In April 2024, the PCAOB staff released a Spotlight report entitled [Root Cause Analysis – An Effective Practice to Drive Audit Quality](#). Drawing on its inspection findings, the staff encouraged audit firms to conduct root cause analysis (“RCA”) when they identify audit deficiencies, in addition to remediating those deficiencies, in order to prevent their recurrence. The report listed potential characteristics of a strong RCA process, including instituting dedicated teams to conduct RCA, providing guidance and training, implementing systems and tools to enable data gathering, analyzing both positive and negative quality events, looking beyond specific engagements to broader trends, prioritizing high-risk areas, cross-team engagement, and the creation of monitoring teams to identify frequent areas of remediation.

The PCAOB staff released a second Spotlight report in April 2024, entitled [Inspection Observations Related to Auditor Use of Data and Reports](#). This report focused on common deficiencies that the Board identified in comment forms issued to audit firms related to evaluating and testing information produced by the company (“IPC”) and other audit evidence. The staff identified deficiencies across several areas and standards, including testing accuracy and completeness of IPC, consideration of relevance and reliability of audit evidence, testing controls over IPC used in the operation of a control, the assessment of information used in expectations for substantive analytical procedures, the assessment of information produced by a service organization, the testing of supplemental information accompanying audited financial statements, and the use of data by auditor-engaged specialists.

SEC Leaders Issue Regulation and Enforcement Statements

The second quarter of 2024 saw numerous public statements by SEC leadership regarding topics of note. In addition to the Grewal and Gerding statements above, the SEC’s statements included:

- Director Grewal [touting](#) the SEC’s crypto enforcement efforts and its commitment not to compromise its credibility, and in a later speech [encouraging](#) parties to cooperate robustly with SEC investigations; and
- Chief Accountant Paul Munter [emphasizing](#) the importance of “tone at the top” at audit firms, including making ethics and integrity a key part of promotions and compensation.

Other Recent SEC and PCAOB Enforcement and Regulatory Developments

SEC Events

- On June 4, 2024, the SEC announced it will close its regional office in Salt Lake City later this year and move the office's enforcement jurisdiction to the Denver office.

Enforcement

- On June 4 and 6, 2024, the SEC brought settled enforcement charges against two food company executives and their employer, respectively. In a federal court [complaint](#) against Zhou Min Ni and Jiang Ming Ni, former executives of HF Foods Group, Inc., the SEC alleged a fraudulent scheme to hide millions of dollars in liabilities, misappropriate investor funds, and mislead HF Foods's auditors. The proposed settlement is pending in D.C. federal court. In its June 6 settled [administrative order](#) against HF Foods for the same conduct, the SEC imposed a civil penalty of \$3.9 million, which took into account remedial acts and cooperation by the company.
- PCAOB enforcement actions in the second quarter included an [action](#) for insufficient quality control policies related to reporting critical audit matters (CAM) and Form AP violations; an [action](#) for pervasive quality control violations that were flagged by the PCAOB in three previous inspections of the firm but were never remediated; and [actions](#) relating to alleged Form 2 and Form 3 violations.

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