Hogan Lovells

Global Accountants' Liability Update

April 2022

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Our global team of securities and professional liability lawyers at Hogan Lovells is uniquely positioned to monitor legal developments across the globe that impact accountants' liability risk. We have experienced lawyers on five continents ready to meet the complex needs of today's largest accounting firms as they navigate the extensive rules, regulations, and case law that shape their profession. We recently identified developments of interest in Hong Kong, The Netherlands, and the United States, which are summarized in the pages that follow.

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Hong Kong

Recent Court Decisions

Hong Kong Court of Appeal upholds professional misconduct decision

The Hong Kong Court of Appeal has denied an accountant's appeal of a Disciplinary Committee of the Hong Kong Institute of Certified Public Accountants (HKICPA) order that cancelled her practicing certificate due to professional misconduct.

The accountant operated an accounting practice that had 26 audit clients, none of which was listed or regulated. The Practice Review Committee of the HKICPA submitted three disciplinary complaints against the accountant and the matter was referred to the Disciplinary Panel.

The accountant was accused of: (1) having issued inappropriate audit reports that contravened requirements of applicable auditing standards; (2) failing to maintain professional knowledge and skill at a level required to ensure her clients received competent professional services; and (3) failing to maintain an adequate quality control system.

In defense, the accountant argued that the applicable auditing standards did not apply to her practice because she had a small number of clients, all of which were small and privately held companies that needed financial statements merely for making a tax return. The accountant also argued that the non-compliance with the auditing standards had caused no consequences for her clients.

The Disciplinary Committee rejected the accountant's arguments and ordered that the accountant's practicing certificate should be cancelled, that no practicing certificate should be issued for 36 months and that the accountant should pay the Practice Review Committee HK$150,000 for costs of the disciplinary proceedings.

On appeal by the accountant, the Court of Appeal dismissed the appeal and upheld the Disciplinary Committee's decision finding that the operational size of the accounting practice and the nature of her clients were entirely irrelevant and did not justify the deviation from the auditing standards. The Practice Review Committee was awarded the costs of the appeal.

Hong Kong

Recent Regulatory and Enforcement Decisions

Financial Reporting Council (FRC) launches consultation regarding further reform of the accounting profession

The FRC will soon transform into the "Accounting and Financial Reporting Council" (AFRC), an independent regulator for the Hong Kong accounting profession, pursuant to the Financial Reporting Council (Amendment) Ordinance 2021 that was passed in October 2021.

In addition to exercising the FRC's existing regulatory powers, the AFRC's scope of oversight will expand to cover qualification and registration of CPAs, and the new body will also be vested with new functions of, among others, promoting and supporting the development of the local accounting profession. For more details, please refer to the September 2021 edition of our Global Accountants' Liability Update.

In light of the new regime, the FRC has launched a two-month consultation commencing in March 2022 to collect views from the 40,000 Hong Kong accountants and firms as well as other stakeholders on the proposed procedures and penalties.

One major proposal is to empower the AFRC to make administrative decisions on disciplinary matters (e.g. administering fines) without a hearing, but those subject to such disciplinary actions will have a chance to appeal the decision before an independent tribunal or the Court of Appeal. This change in the legal framework for administering disciplinary matters aims to facilitate their efficient resolution, and this framework is similar to those in place at other Hong Kong independent regulators such as the Securities and Futures Commission.

It is also proposed that the AFRC maintain the current maximum penalties for audit failures by listed companies (a fine of HK$10 million or three times the profits earned by the relevant accountant and firm) and private companies (a fine of HK$500,000). The tougher penalties for listed companies are said to be justified as their audits involve public interest and are therefore of greater importance.

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Hong Kong-listed companies' stocks halted for missing reporting deadline

At least 33 Hong Kong listed companies, including several prominent Chinese developers, failed to report annual results by 31 March 2022. As a result, trading in their shares was halted by the Hong Kong Exchanges and Clearing Limited, one of the regulators of Hong Kong listed issuers.

This is in stark contrast to the previous year where 384 Hong Kong listed companies failed to publish annual results by the same 31 March deadline yet were still allowed to continue to trade after publishing unaudited accounts or financial information because relevant rules were relaxed by regulators due to the COVID pandemic. There is no similar relaxation in force this year. Certain listed companies expressed concerns about publishing unaudited results which will "potentially be misleading to shareholders and potential investors."

At least HK$15 billion worth of shares were thought to have been impacted by the halt in trading.

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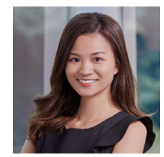

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The Netherlands

Recent Regulatory and Enforcement Decisions

Recent developments affecting the accounting sector in the Netherlands include adoption of the EU whistle-blowers directive, new rules relating to sustainability disclosures and continued audit reform efforts.

The Protection of Whistle-blowers Act expands protections

The House of Whistle-blowers Act (in force since 1 July 2016) will be replaced by the Protection of Whistle-blowers Act for the purpose of implementing the EU Whistleblower Protection Directive (2019/1937).

Some significant amendments as a result of the new Protection of Whistle-blowers Act include:

- The category of people enjoying protection and protection itself will be expanded; for example interns are now protected.
- There will be indemnification in legal proceedings for reporters.
- Direct external reporting will always be possible.
- Requirements for internal reporting policies will be more strict, for example in terms of confidentiality and registration.

The Accounting Bodies Regulation (*Verordening accountantsorganisaties* or VAO) already requires that accounting firms have an internal whistle-blowers policy. However, policies based on the current VAO rules will not be sufficient to meet the new requirements. Thus, accounting firms must update their policies before the Protection of Whistle-blowers Act enters into force. That date is unclear but is expected to be in 2022. Once the Protection of Whistle-blowers Act enters into force, all private employers must comply with the new rules immediately.

ESG updates

On 10 March 2021, the Sustainability Financial Disclosure Regulation EU 2019/2088 (the SFDR) entered into force and establishes new disclosure requirements for Undertakings for the Collective Investment in Transferable Securities and investment institutions. The Royal Netherlands Institute of Chartered Accountants (NBA) published a memorandum examining the impact of the SFDR on assurance engagements. In addition, Regulation (EU) 2020/852 on the establishment of a framework to promote sustainable investments and amending Regulation (EU) 2019/2088 (the "Taxonomy regulation") entered into force as of 1 January 2022. As a result of advancing insight into laws and regulations and suggestions from the Netherlands Authority for the Financial Markets (*Autoriteit Financiële Markten*) the abovementioned NBA memorandum was amended in February 2022. The amended memo explains:

- When assessing whether a prospectus contains the required disclosures, the accountant should also evaluate the extent to which such disclosures are accurate, fair, clear, not misleading, simple and concise.
- The SFDR and the Taxonomy regulation contain requirements – for the annual report on the basis of which the accountant will assess whether the environmental disclosure requirements have been met. In light of the foregoing, the accountant should perform – in particular in respect to funds with sustainable characteristics (under Article 8 SFDR) or funds with sustainable objectives (under Article 9 SFDR) – how the manager has fulfilled the disclosure requirements. The accountants should take into account the Final Report on draft Regulatory Technical Standards of the joint committee of the European supervisory authorities, which can be found here.

The European Commission has also adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD) as part of the efforts to achieve the goal of climate neutrality in the EU by 2050 (Green Deal). The CSRD will extend the scope and reporting requirements of the already existing Non-Financial Reporting Directive. The CSRD will provide for an obligation of sustainability reporting not only for large PIEs (*instellingen van openbaar belang* (OOB)), but also small and medium-sized listed companies and other large companies. The companies must disclose adequate information on sustainability risks, on opportunities to improve sustainability and on the impact of their business operations on people and the environment. The information must be included in the management report. The reported sustainability information must be externally audited. The requirements of the CSRD are expected to apply as of fiscal year 2023.

Also, on 23 February 2022, the European Commission adopted a proposal for a Directive on Corporate Sustainability Due Diligence. This directive goes beyond reporting duties and imposes requirements relating to due diligence that extends a company's accountability beyond its own operations into its supply chain. This will most likely also affect the accounting sector. Both proposals need to be approved by the European Parliament and the European Council.

Third report of the Dutch quartermasters on the future of the accountancy sector

We have previously updated you on the work of the Dutch quartermasters regarding the future of the accounting sector. On 29 December 2021, the third report of the Dutch quartermasters was published. In the report, the quartermasters provide an update on the status of various projects within their assignment:

- **Audit Quality Indicators** (hereafter: "AQI"): the AQI project has been finalized. A new AQI was added and several adjustments have been made. The new AQI deals with the amount of time spent on education in terms of non-financial information, with specific attention for ESG-information.
- **Structure regimes**
  - The investigation of the Joint audit model has been finished. The benefits of this model are limited. At the same time, the quartermasters indicate they are awaiting the results of the Audit only model and the Intermediary model before making an overarching statement about research on the structure regimes.
  - The research design for the experiment with the Intermediary model is in place. To do proper research, participants are now needed. The plan is to do the actual experiment in fiscal year 2022.
  - For the Audit only model, the investigation is in progress. The results of the research are expected to be presented in the fourth report of the Dutch quartermasters for the future of the accountancy sector (July 2022).
- **Fraud and (dis)continuity**
  - An in-depth research analysis was carried out by the NBA. The results provide insight into underlying structures and problems. The quartermasters believe the results of the NBA report provide room to come up with relevant measures that contribute to, among other things, improving the quality of the audit process and more transparency regarding continuity issues.

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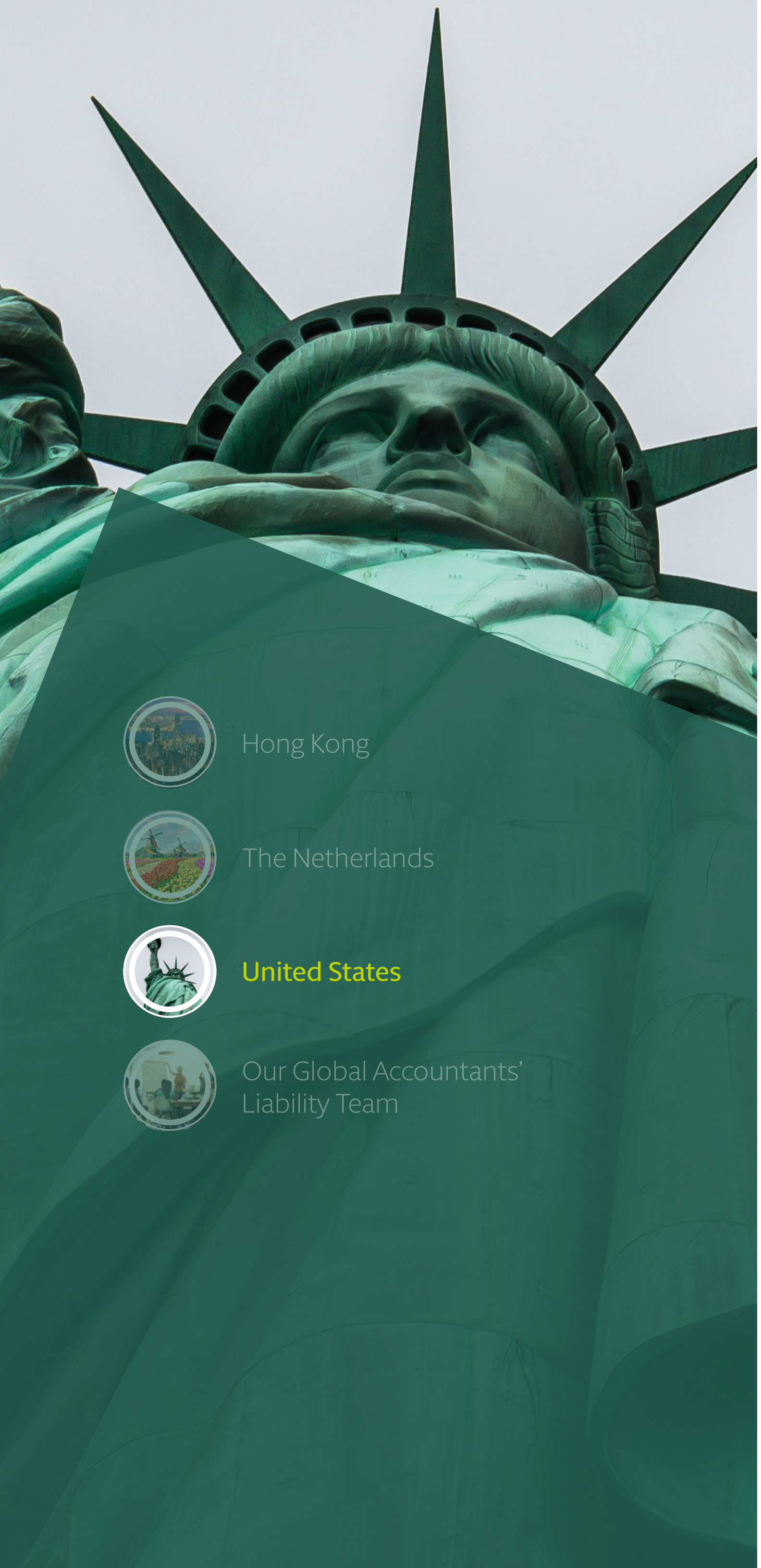

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Recent Regulatory and Enforcement Decisions

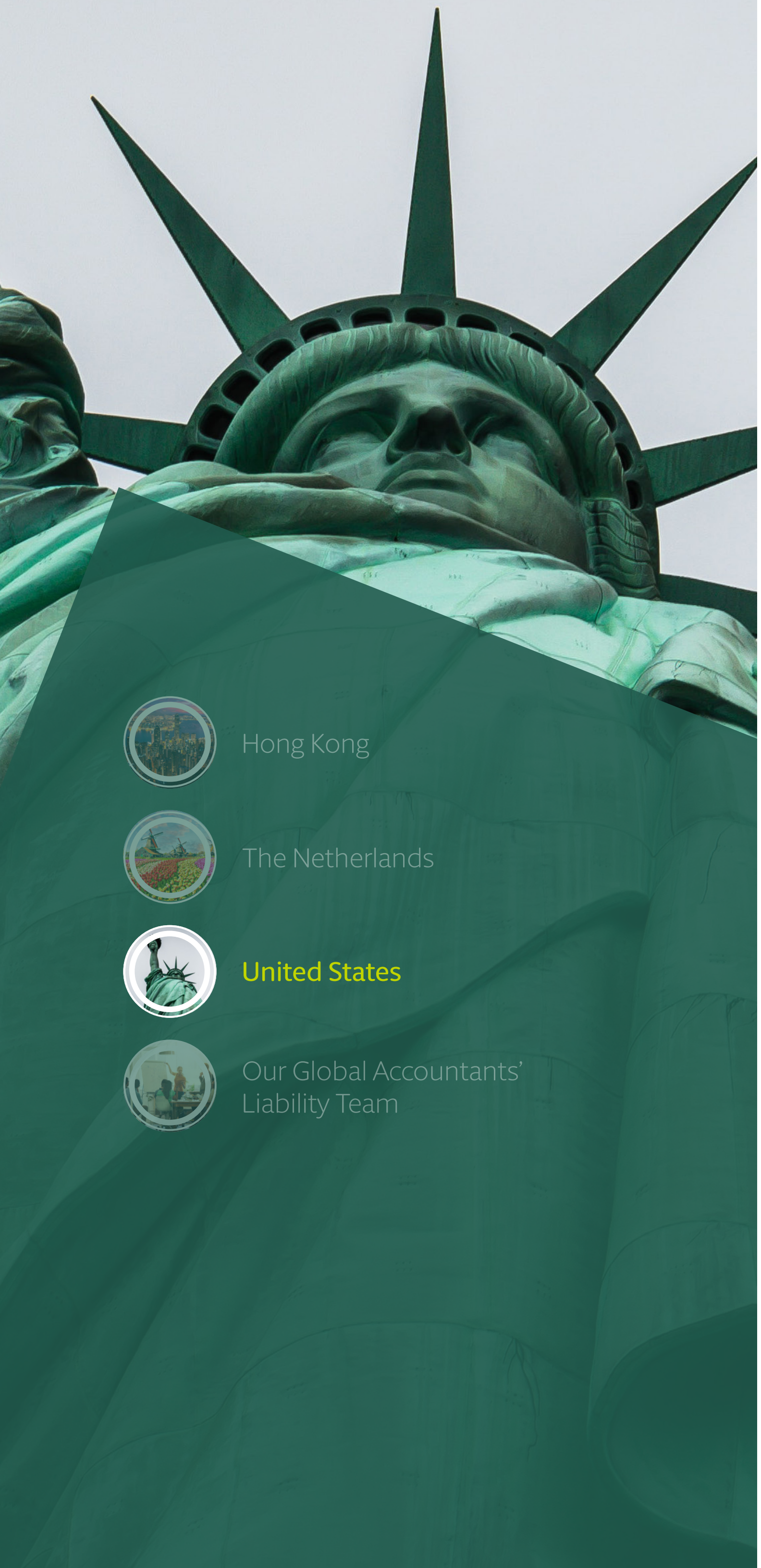
PCAOB and CPAB censure PwC Canada for cheating on internal training courses

The Public Company Accounting Oversight Board (PCAOB) and its Canadian equivalent, the Canadian Public Accountability Board (CPAB), have censured PricewaterhouseCoopers' Canadian firm (PwC Canada) and fined it a total of $950,000 after PwC Canada disclosed that over 1,200 of its employees had shared answers to mandatory internal exams from 2016 to 2020. The regulators have also required PwC Canada to establish new quality control policies and procedures and/or revise its existing policies and procedures to prevent future cheating on internal training courses.

In January 2020, PwC Canada's leadership discovered that employees were using shared drives, emails, hardcopies, and in person conversations to share answers to the exams that accompany the mandatory internal training courses on auditing, accounting, and professional independence. PwC Canada launched an internal investigation and self-reported the violations to the PCAOB and CPAB. The investigation revealed that most of the employees involved were junior level and were from the firm's assurance practice—the shared drives contained answers for at least 46 of the firm's approximately 55 mandatory assurance tests—though there were also answers to tests related to professional integrity and professional independence.

According to the regulators' orders, PwC Canada failed to uncover this cheating operation because its policies and procedures addressing integrity and personnel management were not designed to provide reasonable assurance that PwC Canada personnel acted with integrity when taking these internal training tests. The regulators specifically noted that, "on only one occasion between 2016 and early 2020 did the Firm formally advise its assurance personnel that they should perform training tests on their own," and that the Firm only monitored completion of the training. These failures violated PCAOB rules and CPAB rules requiring a system of quality control for a firm's accounting and auditing practice.

PwC Canada's CEO, Nicolas Marcoux, in announcing that PwC Canada had reached settlements with both regulators, acknowledged that PwC had failed to meet its own standards, and noted that PwC had taken remediation steps including retraining, additional ethics training, and imposing employee discipline ranging from written warnings to fines to terminations. He also said that PwC Canada is confident that the cheating had no impact on audit quality.



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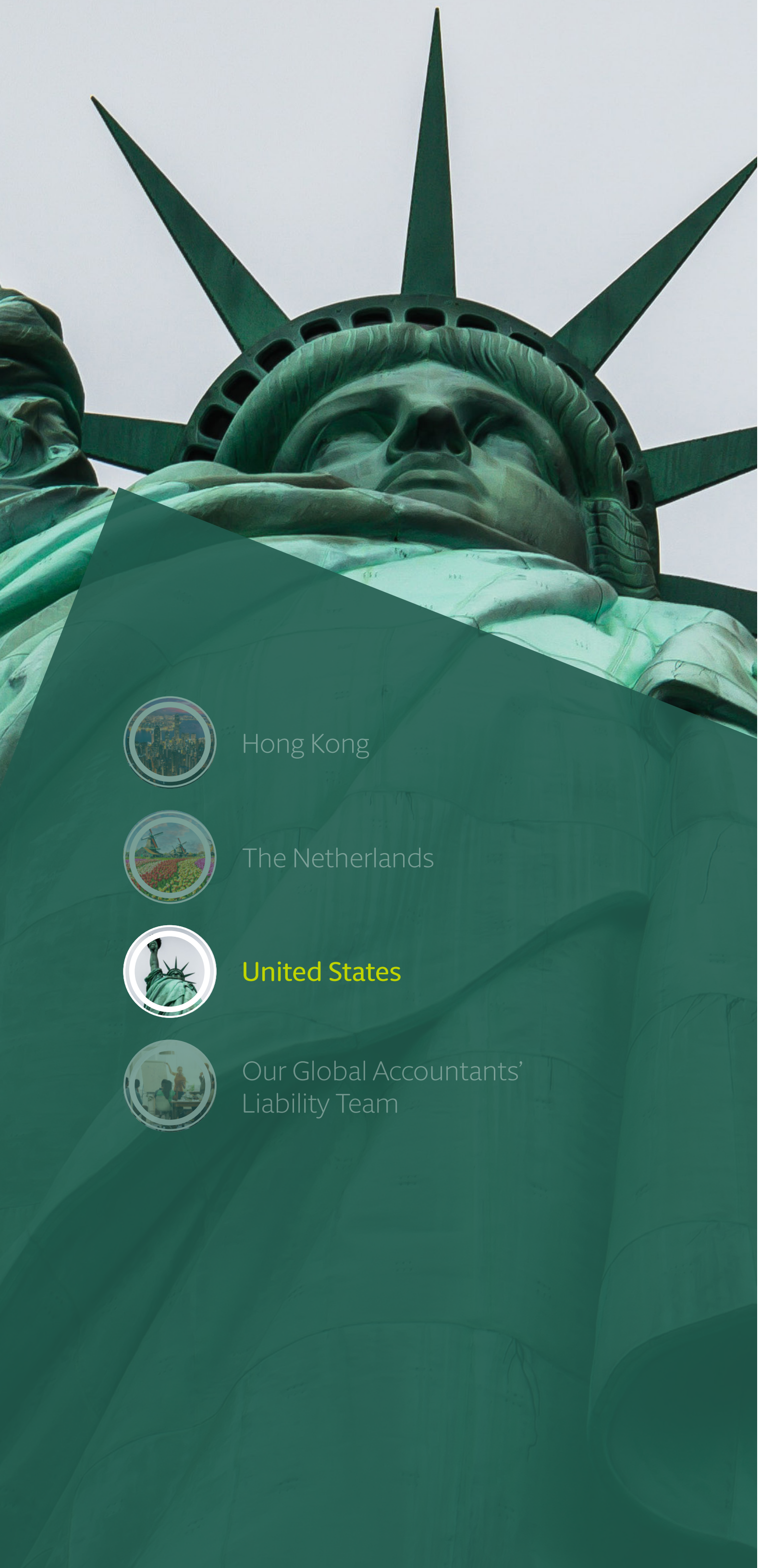
SEC institutes enforcement proceeding against auditor of private equity fund

On March 14, 2022, the U.S. Securities and Exchange Commission (SEC) announced that it was instituting public administrative proceedings against Halpern & Associates LLC and Barbara Halpern (Respondents) pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e)(1)(ii) of the SEC's Rules of Practice. The order alleges that Respondents engaged in improper professional conduct in their 2015 and 2016 audits of a private equity fund, ACP X, LLP (ACP). In 2019, the fund's principal, Laurence Allen was charged with defrauding investors by the New York Attorney General. The 2015 and 2016 audit reports, in the SEC's view, contained "strong indications that Allen's valuations of [certain] securities were speculative, based on inflated revenue projections, and used inconsistent inputs."

In the Order, the SEC identified two specific actions Respondents took that were problematic. *First* and foremost, Respondents expressed concern regarding the estimated revenue projections that Allen used to value NYPPEX Holdings, LLC (NYPPEX), a company in which ACP invested. Although Respondents expressed these concerns to Allen, Respondents approved the issuance of audit opinions without receiving additional information from Allen. *Second*, Halpern was aware of inconsistencies in the formula Allen used to calculate the value of NYPPEX, but nevertheless approved the issuance of audit opinions.

As a result of Respondents' actions, the SEC instituted charges pursuant to Section 4C of the '34 Act and Rule 102(e)(1)(ii). Rule 102(e) provides that the SEC can "censure a person or deny the privilege of appearing or practicing before it to any person if it finds that such person has engaged in 'improper professional conduct.'" Improper professional conduct can include two types of negligent conduct: (1) "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted," or (2) "[r]epeated instances of unreasonable conduct each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the [SEC]." The SEC alleges that Respondents failed to adhere to applicable ethical requirements, failed to exercise professional judgment, failed to maintain "an attitude of professional skepticism, which includes 'a questioning mind and a critical assessment of audit evidence,'" and failed to obtain sufficient audit evidence.

A public hearing is to be scheduled.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SEC proposes sweeping new rules to protect investors in SPACs

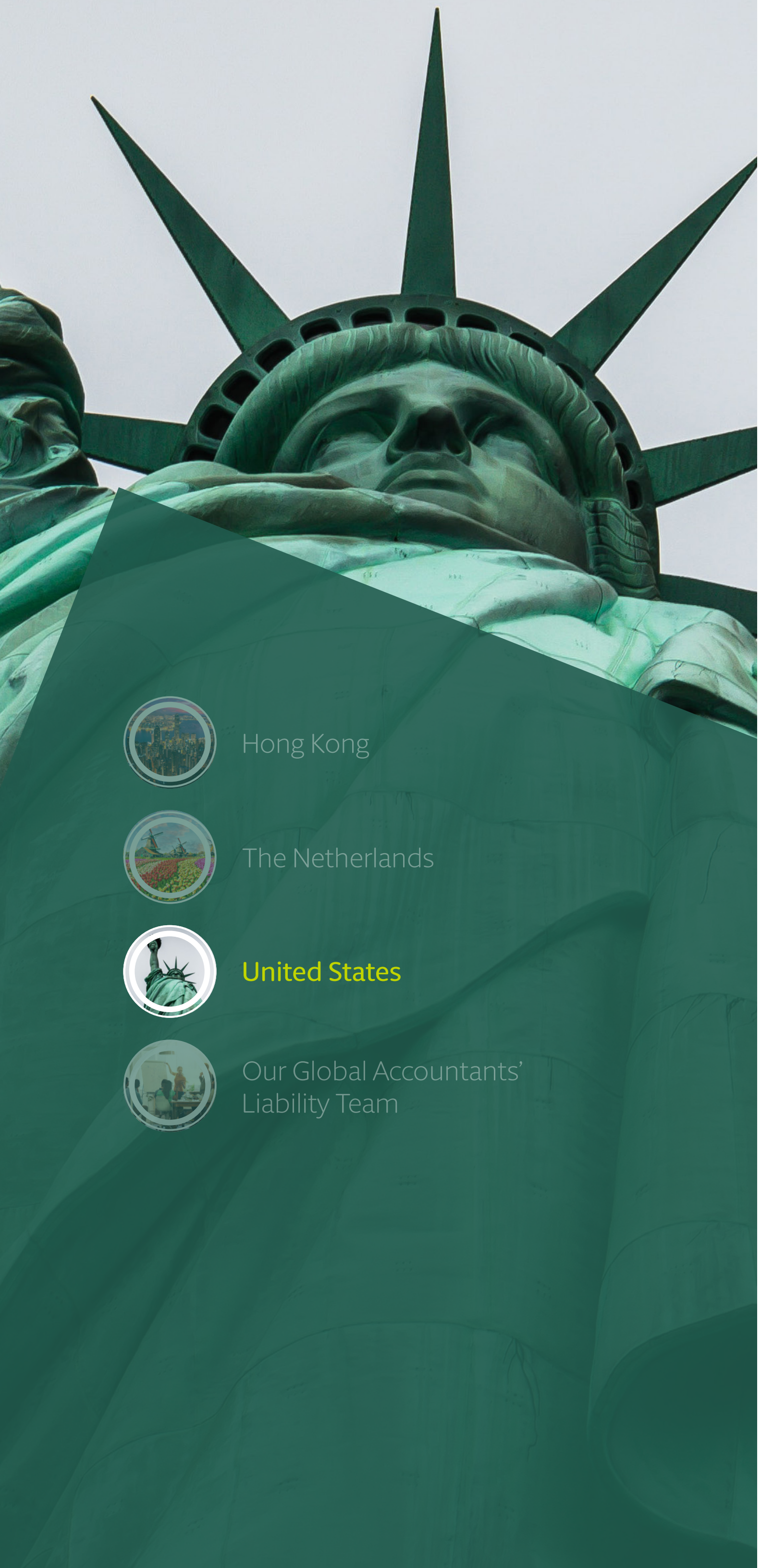
On March 30, 2022, the U.S. Securities and Exchange Commission (SEC) proposed new rules for transactions involving special purpose acquisition companies (SPACs). The stated goal of the proposed rules is to enhance investor protections in SPAC initial public offerings (IPOs) and in the subsequent business combination transactions between SPACs and target operating companies (de-SPAC transactions) to address concerns related to information asymmetries, fraud and misleading information, and conflicts of interest. They are designed to align the disclosure requirements and legal obligations of parties involved in SPAC IPOs and de-SPAC transactions with the disclosures requirements and legal obligations of parties involved in a traditional IPO. SEC Chair Gary Gensler stated "investors deserve the protections they receive from traditional IPOs, with respect to information asymmetries, fraud, and conflicts, and when it comes to disclosure, marketing practices, gatekeepers, and issuers." If adopted as proposed, the SEC's rules could have increased regulatory and litigation exposure for auditors involved in SPAC IPOs and de-SPAC transactions.

The proposed rules use four primary mechanisms to make wide-ranging changes to the regulatory regime that currently applies to SPACs.

First, they increase the disclosure requirements by requiring disclosure of (a) the compensation, interests, and rights of the SPAC sponsors, (b) the fairness to investors of the SPAC and de-SPAC transactions, (c) information regarding sources of dilution and other risks, and (d) additional information regarding financial projections including who prepared them, the purpose for which they were prepared, all material bases and all material assumptions underlying the projections, factors that may materially impact the assumptions, and whether the projections continue to reflect the views of the board and/or management on the date of filing.

Second, the proposed rules redefine certain key terms to increase the exposure to liability of various parties involved in SPAC transactions. In particular, they redefine "blank check company" to eliminate the Private Securities Litigation Act safe harbor for forward-looking statements in SPAC transactions; deem the underwriter in the SPAC's IPO to be an underwriter in the de-SPAC transaction under certain conditions; deem the de-SPAC transaction or any other business combination between a private operating company and reporting shell company to be a sale of securities to the shell company's shareholders subject to the requirements of the Securities Act; and deem the target operating company to be a co-registrant with the SPAC in signing the registration statement in the de-SPAC transaction.

Third, the proposed rules would codify much of the guidance that the SEC staff has issued regarding the financial statement requirements for de-SPAC transactions and further align those requirements with IPO requirements. These rules would require three years of financial statements, audited in accordance with PCAOB standards, from the private operating company unless it qualifies as an emerging growth company, smaller reporting company, or a certain foreign issuer, in which case two years would be permitted.



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These disclosure documents would have to be disseminated to investors at least 20 days prior to a shareholder meeting or the earliest date of action by consent. The proposed rules would also require companies, within four business days of the de-SPAC transaction, to redetermine whether they qualify as smaller reporting company.

Fourth, the proposed rules include a safe harbor for SPACs that meet certain qualifications to avoid being regulated as investment companies. The safe harbor applies to SPACs that (1) hold only cash, government securities and government money market funds as assets, (2) seek to complete a single de-SPAC transaction where the surviving company will be primarily engaged in the target company's business, and (3) enter into an agreement to engage in a de-SPAC transaction within 18 months of the SPAC IPO and complete the de-SPAC transaction within 24 months of the SPAC IPO.

The proposed rules are open for comment until May 31, 2022 or 30 days after publication in the Federal Register, whichever is later.

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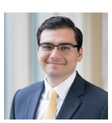

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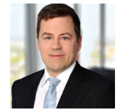

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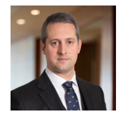

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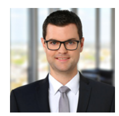

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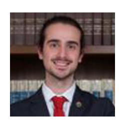

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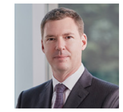

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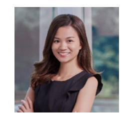

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