Securities Regulation Daily Wrap Up, ACCOUNTING AND AUDITING—SEC Chief Accountant warns auditors of hazards of taking on crypto assurance work, (Jul. 28, 2023)

Securities Regulation Daily Wrap Up

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By John Filar Atwood

In a public statement, Paul Munter said that accounting firms must ensure that their names and services are not being used to convey a false sense of legitimacy or to mislead investors.

SEC Chief Accountant Paul Munter, in response to the wave of scandals and insolvencies in the crypto space, issued a statement to accounting firms reminding them of the potential pitfalls of taking on non-audit services for crypto clients. In particular, he warned that any suggestion that a non-audit review of a crypto firm's work is at parity with or even more precise than a financial statement audit is false.

Munter noted that some crypto asset trading platforms have marketed to investors their retention of third parties, sometimes accounting firms, to perform a review of certain parts of their business, often presented as an "audit." Non-audit arrangements are neither as rigorous nor as comprehensive as a financial statement audit, he emphasized, and may not provide any reasonable assurance to investors.

Accounting firms that choose to perform work in the crypto space must keep several obligations and hazards in mind, according to Munter, especially the firm's potential liability for antifraud violations.

Misleading statements. Munter advised that an accounting firm should carefully consider the contents of any statements that it or its clients make about the scope of work performed because material misstatements regarding those subjects could result in legal liability for the firm. The statements could implicate the antifraud provisions of the federal securities laws, he continued, if there has been fraud "in the offer or sale" of a security or "in connection with" the purchase or sale of a security, and if certain other requirements for liability are met.

Munter added that any person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of the 1933 or 1934 Acts, or any rule or regulation thereunder, will be deemed to be in violation of that provision to the same extent as the person to whom such assistance is provided.

If an accounting firm becomes aware that a client has made misleading statements to the public about the nature of its non-audit work, the SEC's Office of the Chief Accountant believes that, as best practice, the accounting firm should consider making a noisy withdrawal, disassociating itself from the client, including by way of its own public statements, or possibly by informing the Commission.

His advice regarding non-audit clients who are new entrants to the crypto industry with no track record of misrepresentations is that accounting firms probably still should implement certain precautions. According to Munter, these could include contractual prohibitions on the ways in which the non-audit client can publicly describe a non-audit arrangement to ensure that investors are not misled into believing that the non-audit work provides assurance when it does not, or including in its client acceptance letters limitations on misleading references to "audit," "GAAS," "PCAOB standards," and "PCAOB inspections."

Independence considerations. A second potential pitfall arises with respect to auditor independence, Munter said. He noted that with newer market entrants without established operating histories which may pursue a public offering in the near term, accounting firms will consider performing only limited, non-audit consultation services in order to secure an audit engagement from those clients later on. In those cases, Munter advised, the accounting firm must assess whether it would meet applicable independence requirements if it accepted the audit engagement.

He advised that where an accounting firm engages in advocacy or lobbying efforts on behalf of an audit client in the course of an audit subject to Commission or PCAOB rules, a firm should consider its public statements to determine whether they could create a perception that there is a mutual interest between the audit firm, its client, and entities under common control or significant influence of the audit client. It also should consider whether the firm may be acting as an advocate for its audit client, such that a reasonable investor with knowledge of all relevant circumstances would conclude that the firm is not independent.

Rule 102(e) liability. The final area of concern, in Munter's opinion, is potential liability under Rule 102(e) of the Commission's rules of practice. Under Rule 102(e)(1), the SEC may censure or deny the privilege of appearing or practicing before it any person who is found to have engaged in unethical or improper professional conduct, or who willfully violates, or willfully aids and abets the violation of the federal securities laws.

Munter explained that for accounting firms, "improper professional conduct" includes not only knowing or reckless conduct that violates applicable professional standards, but also certain types of negligent conduct. These include 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 repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

An accountant's independence is so important to the integrity of the financial reporting system, Munter said, that the Commission has concluded that circumstances that raise questions about an accountant's independence always merit heightened scrutiny. Improper professional conduct by an accountant may create liability for the entire firm, and no firm is too big or too small to be suspended from appearing or practicing before the Commission, he concluded.

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