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Global Accountants'
Liability Update

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Hogan Lovells has a global team of securities and professional liability lawyers 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 German, Hong Kong, Spain, and the United States, which are summarized in the pages that follow.



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Recent court decisions

Germany

Cum/Ex-trades spark litigation

So called Cum/Ex-trades have become one of the hottest legal topics in Germany. A flood of claims dealing with those trades has reached German civil, financial and criminal courts, many of which are filed against financial institutions, investment banks and legal advisors. Accountants have also become a target of these claims.

Cum/Ex trades are stock trades designed to obtain double tax reclaims. The trades at issue took place between 2007 and 2012 and worked as follows: Shares in German stock companies were traded around the ex-dividend date of the respective stock entity i.e. they were sold cum-dividend (with entitlement to dividends) but delivered ex-dividend (without entitlement to dividends). Due to the legal framework and the usual practice that applied until 2011, these trades led to a situation where two withholding tax certificates were issued. In many cases, however, the respective withholding tax had only been paid once (i.e. by the original stockholder). As a consequence, two persons were in a position to file claims for tax refunds with the German financial authorities even though only the original stockholder had actually paid withholding taxes. This practice is estimated to have led to several billion euros of lost tax revenue.

Recently, a German criminal court handed down the first judgment that held that Cum/Ex-transactions are illegal. Further-

more, the German financial authorities have been issuing hundreds of tax reclaim orders seeking reimbursement for tax refunds granted in connection with Cum/Ex-trades. This has led to many damages claims against individuals and companies involved, as well as claims against former advisors and auditors. There are a variety of scenarios under which accounting firms could be held liable under civil law.

First, accounting firms may be held liable if they provided false legal advice in connection with such trades. Typically, Cum/Ex trades were accompanied by legal opinions that stated that these trades were compliant with German law. German courts tend to take the view that as far back as 2007 (when the number of Cum/Ex-trades picked up), it was apparent that Cum/Ex trades were illegal. Therefore, German courts consider legal opinions stating the contrary to be unreasonable. This has prompted companies that relied on such legal opinions to file claims against accounting firms.

Second, accounting firms may be held liable in connection with audits carried out for companies that executed Cum/Ex schemes. In many cases, auditors certified financial statements without warning the audited companies of the legal risk that Cum/Ex trades posed. As mentioned above, German courts tend to take the view that the illegality of such trades was ap-



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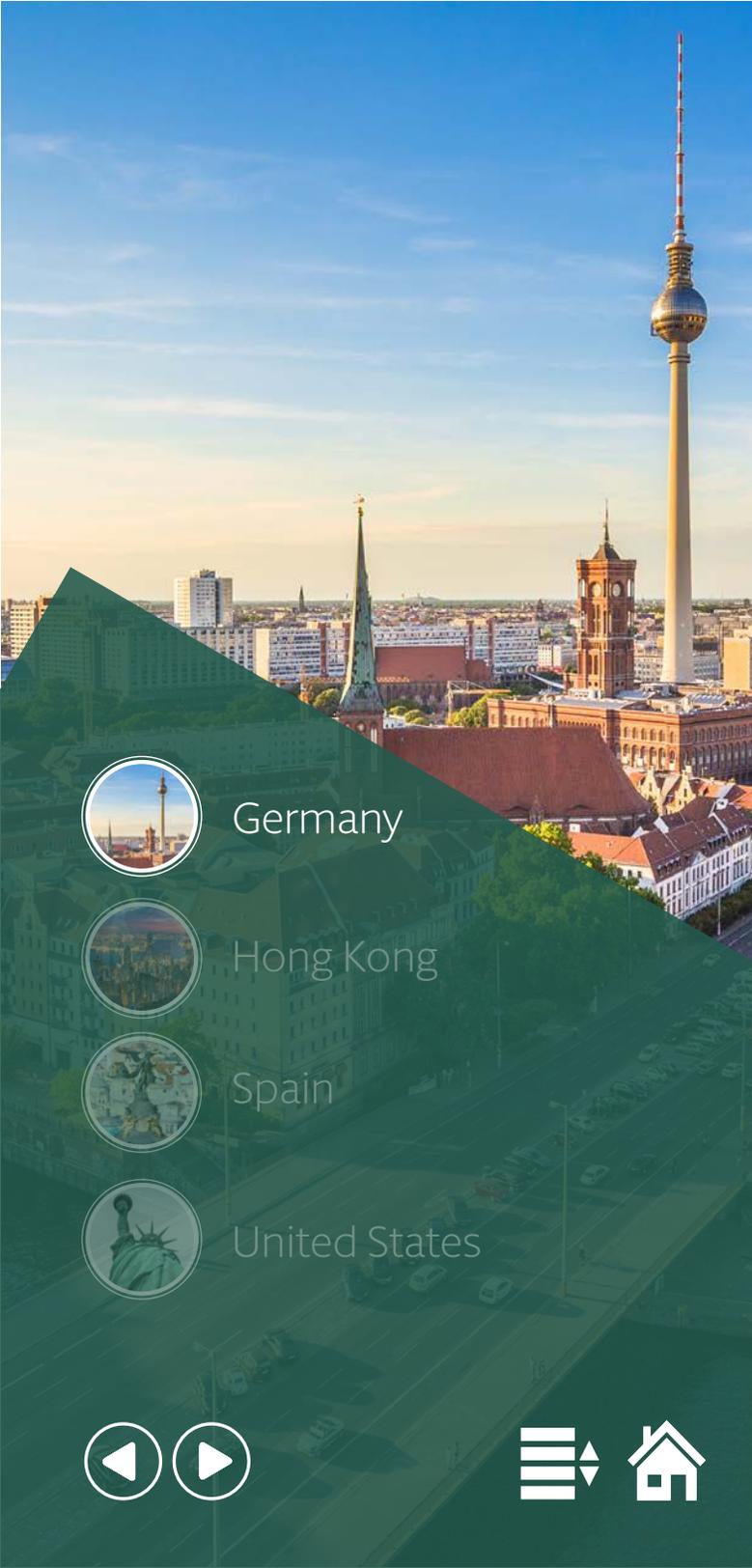


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parent. Therefore, audited companies (or their insolvency administrators) may seek compensation for damages that arose in connection with these trades.

Against this background, accounting firms should assess their legal position if they advised or audited companies who were involved in Cum/Ex trades and conduct a proper risk assessment.

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Recent regulatory and enforcement developments

Hong Kong

Efficient and effective – regulators issue new guidance on mitigating the impact of COVID-19

In April 2020, the Hong Kong Institute of Certified Public Accountants (the HKICPA) and the Securities and Futures Commission (the SFC) each released new guidance intended to assist businesses and individuals to mitigate the ongoing disruption and financial impact of COVID-19.

HKICPA Guidance

The [guide](#) produced by the Restructuring and Insolvency Faculty Executive Committee of the HKICPA, sets out options that businesses and their accountants may consider when they are unable to meet their short term financial obligations, even though their business is intrinsically viable. Those options include restructuring, engaging in discussions with lenders or landlords about adjustments to repayments and accessing government assistance available through an “Anti-epidemic Fund.” This fund provides financial assistance to hard-hit industries, including transport, retail and the convention and exhibition industry.

The guide also makes clear that companies need to be vigilant to ensure that they keep, and make available for inspection, company records including minutes, memoranda, and registers, as per sections 654, 655 and 657 of Companies Ordinance, Cap. 622 (Companies

Ordinance) and retain accounting records for the prescribed period of seven years, as prescribed by section 377, Companies Ordinance.

SFC Guidance

On 21 April 2020, the SFC published a new [Regulatory Response to COVID-19](#) and [associated Q&A](#) which CEO Ashley Alder described as having “*an overriding objective: to ensure that Hong Kong’s international financial markets will function efficiently, effectively and resiliently through this period of extreme stress.*”

Ensuring resilience

The SFC stated it will pursue a flexible approach to the market and market intermediaries supervised by the SFC aimed at ensuring the proper functioning of markets while safeguarding investor protection. The statement referred to joint guidance issued together with the Stock Exchange of Hong Kong Limited (the Exchange), which it said had enabled “*the vast majority*” of companies with 31 December year-ends to issue preliminary earnings in a timely manner.

The SFC said it was intensifying its supervisory efforts regarding



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vulnerabilities in the system, focusing on investment fund liquidity as well as the fair treatment of fund investors.

Looking forward, Mr. Alder added that *“The SFC will continue to liaise with all of our key stakeholders to ensure that markets operate efficiently and fairly amidst the extraordinary conditions we are now experiencing.”*

Notification requirement

The SFC reminded listed companies (LCs) that they must immediately notify the SFC of any confirmed case of COVID-19 infection that may affect their operations; closure of office premises as a result of infection or government lockdown; and of changes to organizational resources, such as split team arrangements or relocation. LCs must also inform the SFC if their business continuity plan is triggered.

Performing regulated activities from outside Hong Kong

The SFC confirmed it is acceptable for a licensed individual to perform certain regulated trading services from outside of Hong Kong, provided that the LC is able to exercise adequate oversight over the conduct of its staff.

Remote working

LCs may arrange for their staff to work from home, on a temporary basis, even if such premises are not premises approved for the keeping of records or documents

relating to the carrying on of the regulated business. LCs must still record the activities of staff in systems that they can access remotely. If the LC needs to store documents temporarily in unapproved premises, the documents should be returned at the earliest opportunity.

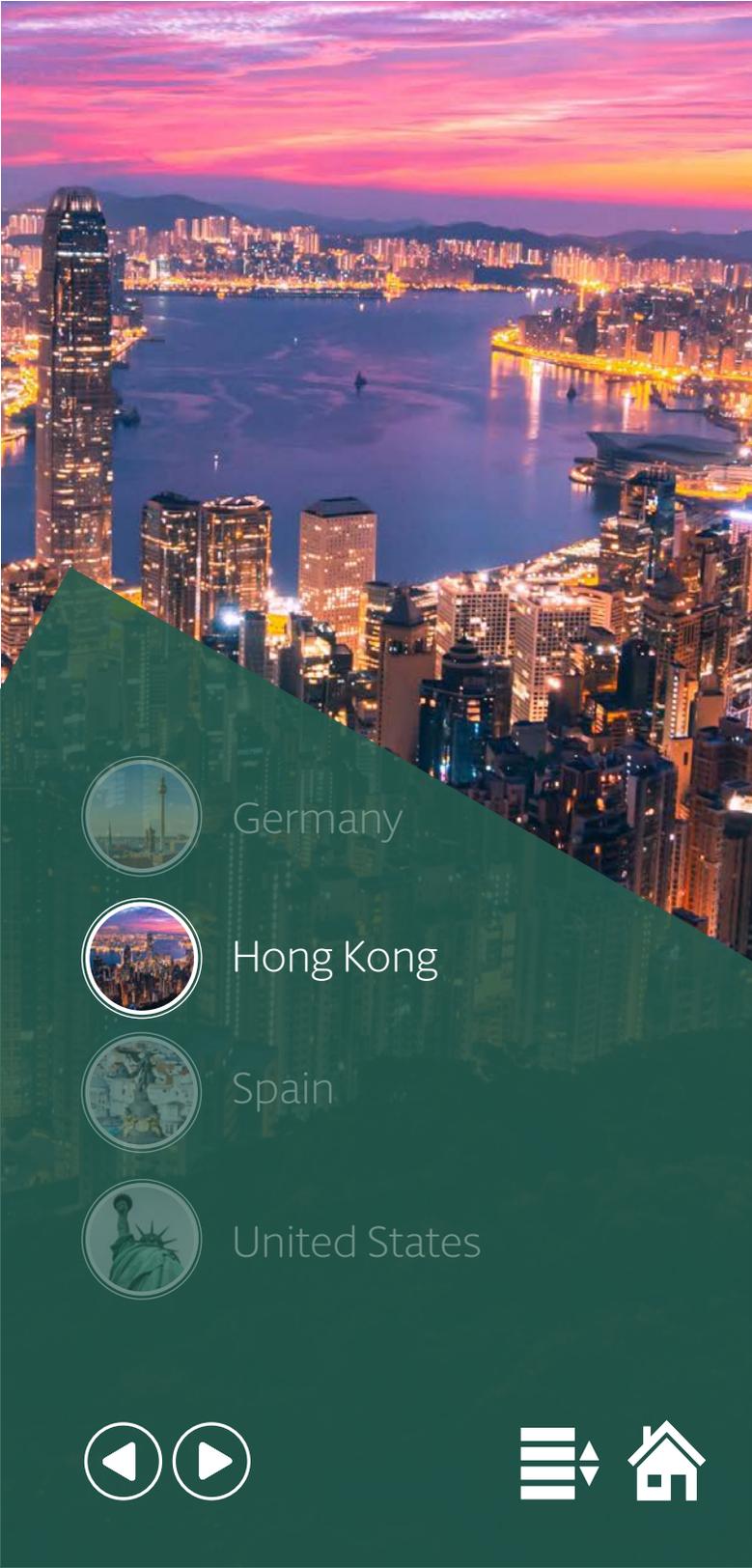
Temporary license applications

The SFC also said that – where postal services from overseas jurisdictions have been suspended or “stay-at-home” restrictions are in place – it is acceptable for an individual license applicant to submit an electronic copy of the signature pages of a temporary license application, stating the reasons why printed copies cannot be delivered. The individual is expected to post the “wet ink” original signed pages to the SFC *“once the situation returns to normal.”*

Extension for submitting audited accounts

The SFC reiterated that, if a LC or associated entities experience operational delays in submitting audited accounts within four months after the end of the financial year, it may apply for an extension of the submission period. The SFC would adopt a pragmatic attitude in considering such applications.

The renewed guidance from the regulators follows the guidance already provided to LCs on reporting requirements by the SFC and the Exchange regarding reporting requirements and disclosure of financial information in light of the disruption



caused by travel and other restrictions (see our previous publication titled [Understanding but no waiver – reporting requirements in the time of COVID-19](#), Global Accountants’ Liability Update, March 2020.)

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Spain

The impact of COVID-19 on companies' financial statements and audit services

Spain is among the countries most affected by the COVID-19 pandemic. This situation has led the Government to announce the declaration of the State of Alarm and to approve several Royal Decrees-Laws to manage the health crisis. Among those measures, is Royal Decree-Law 8/2020, of 17 March 2020 (amended by the First Final Provision of Royal Decree-Law 11/2020, of 31 March 2020), which extends deadlines for the administrative body of a legal entity to formulate, approve and verify its annual accounts.

The impact COVID-19 may have on the financial statements of companies, together with the measures adopted by the Spanish Government have a direct effect on auditor's work. For this reason, on 2 April 2020, the Spanish Institute of Accounting and Auditing (ICAC) published an information note, after a consultation, explaining the effect of the provisions of this Royal Decree-Law on the process of formulation, verification and approval of the annual accounts of companies. The information note explains:

- i. Regarding the drawing up of the accounts: from 14 March until the day on which the State of Alarm ends, the period for drawing up the annual accounts shall be suspended. This period will be extended for three

months, starting on the date on which the State of Alarm ends (which is still unknown);

- ii. Regarding the verification of the accounts: for those cases in which the annual accounts have been drawn up before or during the State of Alarm, the period for the accounting verification of those accounts, if the audit is compulsory, shall be understood to be extended by two months from the end of the State of Alarm. If the annual accounts have been drawn up after the State of Alarm, although there is not a specific time period established in any legal provision, it is understood that the verification of the accounts will have to be carried out between the period for drawing up the annual accounts and the period for approving the accounts (as the auditor's report is a necessary document to approve the annual accounts);
- iii. Regarding the approval of the accounts: the annual accounts must be approved within three months from the date on which the term to draw up the accounts ends.

Although it is not yet clear how this new regime will impact demands on auditors, the president of the ICAC has already made



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clear that the institute is aware this crisis affects all sectors, and thus will grant companies some degree of flexibility and try not to over-regulate processes.

Additionally, the Spanish Chartered Accountants Association (an organization that represents auditing professionals and companies, linked to the Ministry of Economic Affairs and Digital Transformation) (ICJCE), has gone one step further and has pointed out what issues auditors should pay special attention to when auditing a company during these times. It notes that audit companies will likely need to reassess their original audit plans and that it is very important for auditors to obtain sufficient and adequate evidence justifying the ways in which COVID-19 has impacted the financial statements of the companies.

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United States

PCAOB releases guidance for audits during COVID-19 pandemic

On April 2, 2020 the Public Company Accounting Oversight Board (PCAOB) released a staff Spotlight document, [COVID-19: Reminders for Audits Nearing Completion](#), to provide guidance to auditors of issuers and broker-dealers for audits nearing completion during the ongoing COVID-19 pandemic. The Spotlight recognizes that the scale of the COVID-19 pandemic – including governmental efforts to curb the spread of the virus – may present “challenges” to auditors in fulfilling their responsibilities to comply with PCAOB standards and rules and other applicable regulatory and professional requirements. For example, social distancing guidelines and state stay-at-home orders may complicate auditors’ ability to collect appropriate evidence to support the auditors’ opinions regarding a company’s financial statement, as by limiting the availability of – and auditors’ access to – company personnel. The PCAOB acknowledges that “completion of audits may require more effort or take longer” during the course of the pandemic due to such exigencies.

The PCAOB counsels that auditors should be mindful of how the COVID-19 pandemic might impact auditors’ analysis when identifying and responding to risks of material misstatement, noting that “[i]n light of the economic effects of the COVID-19 crisis ... new risks may emerge, or the

assessment of previously identified risks may need to be revisited because the expected magnitude and likelihood of misstatement has changed.” Similarly, the COVID-19 crisis may affect the auditor’s report in determining and communicating critical audit matters (CAMs) because, “[w]hile the COVID-19 crisis may not itself be a CAM, it may be a principal consideration in the auditor’s determination as to whether one or more CAM(s) exist, and may also affect how CAMs were addressed in the audit.” As such, “the significance of the impacts of COVID-19 may warrant including additional elements in the auditor’s report, such as explanatory language or an explanatory paragraph when there is substantial doubt about the ability of the company to continue as a going concern.”

The PCAOB recognizes that there are no concrete, one-size-fits-all solutions to these COVID-19 issues, and as such auditors’ appropriate responses to these issues “will depend on each audit’s unique facts and circumstances.” The Spotlight provides auditors with helpful guidance in navigating these novel and unexpected circumstances. The Spotlight also offers some assurance that the PCAOB will take a contextualized approach in reviewing audits conducted during the course of the pandemic, sensitive to the extraordinary difficulties we all face during this crisis.

Additional information about PCAOB’s response to COVID-19 is available [here](#).



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Treasury Secretary says COVID-19 relief loans over \$2 Million will be audited

On April 28, 2020, Treasury Secretary Steven Mnuchin [announced](#) that all loans of more than \$2 million provided under the Paycheck Protection Program (PPP) will be audited to ensure they were justified, following public outcry over revelations that large, high-value public companies and big chains had applied for and received these loans intended to help small businesses.

The Paycheck Protection Program is a component of the \$2 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act, an omnibus stimulus package signed into law on March 27, 2020 to address the economic fallout of the COVID-19 pandemic in the United States. PPP is implemented by the U.S. Small Business Administration (SBA) and provides up to \$10 million loans to help small businesses, self-employed workers, sole proprietors, and others similarly situated to keep paying their workers during the pandemic.

Numerous large public companies and big chains have taken multi-million dollar PPP loans since the program was launched, resulting in public backlash. The outcry has prompted several entities to start returning the money to the SBA, with over \$2 billion in awards from the first round of program funding being declined or returned thus far.

The Treasury Department and SBA issued guidance in late April reaffirming that companies seeking PPP relief must certify that they are affected by the pandemic and that large firms with other available

capital should not apply. Such firms that have already received PPP loans may return those funds by May 7, 2020 without penalty. Going forward, the SBA will audit borrowers receiving PPP loans in excess of \$2 million to ensure they properly certified their need for PPP funds because of the coronavirus pandemic.

For more information and guidance on the PPP, please visit the following resource pages from the [Small Business Administration](#) and the [Treasury Department](#).

Audit firm charged with back-dating audit work papers provided to SEC and PCAOB

On April 24, 2020 the Securities and Exchange Commission [instituted](#) administrative proceedings against California-based public account firm PLS, CPA, A Professional Corporation and its three individual auditors and co-owners – Chang G. Park, CPA, Joseph Yongyun Lee, CPA, and Ju-chi Lee, CPA – based on the SEC Enforcement Division’s allegations that the auditors engaged in improper professional conduct in connection with audit reports issued by PLS for at least four issuers.

According to the SEC’s Order Instituting Proceedings (OIP), the Commission issued an administrative subpoena to PLS in July 2016, including requests for audit work papers created or concerning specific client audits from September 30, 2014 to July 5, 2016. The PCAOB similarly scheduled an inspection of PLS in November 2016 and, before that inspection, informed PLS of the particular client audit work papers the



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PCAOB wished to review. PLS responded to the July 2016 subpoena, and prepared for its November inspection by reviewing the audit binders for the issuers PCAOB identified as the subject of its inspection.

The PCAOB’s inspection uncovered PLS’s alleged noncompliance with various PCAOB auditing standards, PCAOB and Commission rules, and provisions of the Securities and Exchange Act. Specifically, the Enforcement Division alleges in the OP that PLS’s individual auditors failed to prepare a complete set of audit documentation in connection with the reviewed audits, and added back-dated work papers after the corresponding audit reports were issued and after the time allowed under the PCAOB’s standard to complete or supplement the audit documentation had passed. The Division further alleges that: (i) the auditors back-dated those documents to make it appear as if they had been completed on or before the date of the corresponding PLS audit report; (ii) PLS and the individual auditors failed to obtain or perform adequate engagement quality reviews and to exercise due professional care; and (iii) PLS issued audit reports that falsely stated the audits had been performed in accordance with generally accepted auditing standards, and PLS and the auditors attempted to conceal their auditing deficiencies by, for example, back-dating documents that they provided to the SEC and the PCAOB. As such, the Division alleges that PLS and the individual auditors engaged in improper professional conduct under the Securities and Exchange Act and the corresponding SEC Rules of Practice and PCAOB Rules.

These actions reflect the PCAOB’s continued enforcement focus on sanctioning firms and individuals for the improper alteration of audit documentation. The PCAOB announced this enforcement focus – and provided a useful overview of the “requirements related to revising or supplementing documentation in compliance with PCAOB standards” – in its April 21, [2016 Staff Audit Practice Alert No. 14](#).

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