SEC Division of Enforcement Focuses on Auditor Compliance

OCTOBER 20, 2016

Speaking at the American Law Institute's Conference on Accountants' Liability in September, Andrew Ceresney, Director of the Division of Enforcement of the Securities and Exchange Commission, reviewed in detail the SEC's historical and current enforcement activity in the area of auditing. Mr. Ceresney's September 2016 keynote address noted that the SEC holds auditors in high regard and considers them to be "key partners in [its] investor protection efforts." At the same time, he stressed that the SEC will continue to "closely scrutinize the conduct of auditors during the course of [its] investigations and [has] not hesitated to pursue auditors where such charges are warranted or their conduct may indicate that they are a threat to the Commission's processes."

As he has in prior speeches (see previous post), Mr. Ceresney reported that the SEC more than doubled the number of cases in the issuer reporting and disclosure context from fiscal year 2013 to fiscal year 2015 and similarly increased the number of parties charged with such violations. Mr. Ceresney also noted that the number of accountant proceedings under Rule 102(e) of the Commission's Rules of Practice has more than doubled over the same period, with the SEC bringing actions against 57 individual accountants and 19 firms in 2015, and he expects to see a similar trend in the number of such proceedings for the current fiscal year. Mr. Ceresney acknowledged that "there have been improvements in audit quality and processes," but cautioned that many of the SEC's recent audit failure cases continue to involve deficiencies in areas that are fundamental indicators of good auditing.

With respect to the audit failures giving rise to enforcement action, Mr. Ceresney highlighted notable failures in the areas of "properly planning the audit, adequately training or supervising staff, over-reliance on management representations without sufficient corroborating evidence, failures in auditing valuation estimates by management, and in understanding and appropriately auditing related party transactions." Recent SEC enforcement actions against audit firms are not limited to smaller firms. As Mr. Ceresney commented, in 2015, the SEC instituted audit-failure related cases against two major national audit firms, which were the first cases since 2009 against a major national audit firm for other than independence violations. (See previous post)

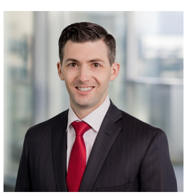
Mr. Ceresney also underscored the SEC's enforcement actions against auditors for independence violations, identifying this as "an area of significant importance to the Commission and to the audit profession." In recent years, independence-related cases have involved a host of violations, including

- providing bookkeeping and expert services to affiliates of audit clients;
- audit personnel owning stock in audit clients or affiliates of audit clients;
- lobbying on behalf of audit clients;
- audit firm employees or affiliates serving on boards of audit clients;
- preparing financial statements of brokerage firms who also were audit clients;
- circumventing the lead audit partner rotation requirement; and
- including indemnification provisions in engagement letters.

Two recent cases for the first time imposed sanctions on a registrant's management for violations of the independence rules. In both cases, senior finance and accounting personnel at the client got too close to audit professionals, leading to an impairment of the auditors' independence. Both cases involved relatively unusual circumstances of close personal relationships, and it is therefore not clear whether the SEC will continue to consider charging client management in more typical independence cases.

In sum, Mr. Ceresney emphasized that the SEC "will continue to be focused on financial reporting and the critical roles auditors and audit firms play in ensuring accurate and reliable financial reporting, which our markets depend on in ensuring investor confidence." As Mr. Ceresney cautioned, "those who fail to follow audit standards and perform unreasonable audits can expect scrutiny through [the SEC's] enforcement efforts."

Authors



Alan J. Wilson

PARTNER

alan.wilson@wilmerhale.com

+1 202 663 6474

Thomas W. White

RETIRED PARTNER

+1 202 663 6000