SEC Enforcement Chief Highlights Focus on Reporting and Disclosure, Gatekeepers

FEBRUARY 17, 2016

Speaking at the Directors Forum in San Diego recently, SEC Enforcement Director Andrew Ceresney reviewed the SEC's historical and current enforcement activity in the area of issuer reporting and disclosure, as well as the SEC's continuing focus on gatekeepers, particularly audit committee members and external auditors. Mr. Ceresney's January 2016 keynote address emphasized that failures in the financial reporting sphere "must always be a high priority" for the Enforcement Division, given the importance of financial reporting and audits to investor protection and market integrity.

Mr. Ceresney reported "good news" that the Enforcement Division has "succeeded in significantly increasing the quality and number of financial reporting cases." He noted that the SEC had more than doubled the number of cases in the issuer reporting and disclosure area from fiscal year 2013 to fiscal year 2015 and had similarly increased the number of parties charged with such violations. He also reported that the SEC had charged over 175 individuals in such matters during the past two years. Mr. Ceresney acknowledged that "there have been some signs of progress in the issuer reporting area more generally in recent years," particularly in the lower number of restatements. But he also warned that "we must continue to be very vigilant against misconduct because significant violations still occur, accounting frauds are still perpetrated, and gatekeepers still fail to comply with their legal and professional obligations."

As to gatekeepers, Mr. Ceresney noted that the SEC has not frequently brought cases against audit committee members because, in his experience, "audit committee members in most cases carry out their duties with appropriate rigor." However, he cited three cases against audit committee members who "approved public filings that they knew, were reckless in not knowing, or should have known were false because of other information available to them." He emphasized that "when an audit committee member learns of information suggesting that company filings are materially inaccurate, it is critical that he or she take concrete steps to learn all relevant facts and cease annual and quarterly filings until he or she is satisfied with the accuracy of future filings."

Mr. Ceresney also highlighted the role of external auditors, noting that in 2015 the SEC brought its first cases against national audit firms for audit failures since 2009. In September 2015, it sanctioned BDO USA for issuing false and misleading unqualified audit opinions, as well as five of the firm’s partners, including national office personnel, for their roles in the deficient audits. The SEC found that BDO failed to respond appropriately to indications of inaccuracies in the company’s filings, particularly by not insisting on an independent investigation of financial irregularities and potential fraud. In December 2015, the SEC charged that Grant Thornton and two of its partners ignored red flags and fraud risks while conducting deficient audits of two public companies. Among other things, the SEC criticized the firm’s assignment of an audit engagement partner for whom there were known quality issues with her work and failed to ensure the rest of the audit team compensated for her weaknesses and to ensure that its audit procedures were sufficiently rigorous to cover key risk areas. The lesson for board members from the GT case, Mr. Ceresney observed, is to “keep a close eye on the procedures that firms employ to monitor their partners’ work.”

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