

Auditors Must Beware the Consequences of Settling SEC Enforcement Actions

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The Securities and Exchange Commission (SEC) launched “Operation Broken Gate” in October 2013 to hold accountable those auditors who have intentionally or negligently violated professional auditing or accounting standards. Since then, the SEC has increasingly prioritized enforcement actions against auditors, especially under SEC Rule of Practice 102(e), which was codified in the Sarbanes-Oxley Act and allows the SEC to seek sanctions against accountants. The SEC charged 22 individuals under Rule 102(e) in the last four months of 2015, a trend that is expected to continue in 2016.

Auditors often seek to settle these Rule 102(e) actions to minimize the sanctions imposed, which could include permanent or temporary bars from practicing before the SEC, censures, cease-and-desist orders, fines and remedial actions. Settlements of Rule 102(e) charges are far from risk-free, with the potential for severe, if not career-ending, harm.

In assessing the true impact of settling a Rule 102(e) proceeding, the reputational harm from these settlements is of critical concern to auditors. Such settlements are public and become common knowledge in the profession — they are posted on the SEC’s website and frequently are announced by a press release. The SEC order that documents the settlement not only contains the agreed-upon sanction(s) but also details the SEC’s view of the intentional or negligent violations of professional standards.

Reputational harm, additional investigations and the impact on an auditor’s license to practice are all relevant considerations in any settlement with the SEC.

One must consider the likely negative impact of any Rule 102(e) settlement on an audit committee’s acceptance of the auditor. Regardless of the auditor’s seniority, most audit firms and auditors would consider it a best practice (if not a duty) to bring the settlement to the attention of the audit committees of the sanctioned individual’s existing or potential clients. An audit committee’s duty to the company’s shareholders and the availability of other qualified auditors may mean that what may be perceived as the risk of hiring an auditor publicly sanctioned by the SEC

is unacceptable. Thus, even a “short” practice bar may effectively operate as a permanent bar on the auditor’s practice.

Another concern is the potential for additional investigations due to the overlap in enforcement responsibilities between the SEC and the Public Company Accounting Oversight Board (PCAOB). Although the PCAOB’s statutory mandate requires that it maintain a certain level of cooperation with the SEC, and regular coordination does occur between the two regulators, a settlement with the SEC does not preclude the PCAOB from commencing or continuing an investigation into the same activity and seeking its own penalties, which can include censures, fines and bars on public company accounting work. Thus, there is some uncertainty about whether a settlement with the SEC will bring finality to the matter for the auditor.

Finally, a significant consideration is the effect of a settlement on the auditor’s license to practice as a CPA. Most states require auditors to disclose any SEC disciplinary action to their state board of public accountancy, either as an affirmative duty or in connection with periodic license renewals. Once they learn of SEC settlements, state boards are able to open their own investigations and have the authority to revoke or suspend

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auditors' CPA licenses, even where the SEC sanctions did not involve practice bars. Examples abound of state boards revoking or suspending an auditor's CPA license for periods at least equal to the SEC's practice bar. To make matters worse, an auditor's loss of ability to practice as a CPA may effectively prolong the length of any practice bar because a current CPA license is a prerequisite to reinstatement to practice before the SEC. These possibilities entail great risk for an auditor seeking to settle with the SEC.

Understanding the true range of outcomes from seemingly favorable settlement terms of Rule 102(e) charges is essential. As Rule 102(e) enforcement actions continue in 2016, it is important to keep in mind that without proper assessment of the repercussions of a resolution with the SEC, an auditor may not understand the full exposure and career risks of settling, rather than litigating, these actions.