

# SEC Audit Enforcement Trends Hint At 2020 Priorities

By Charles Smith and Andrew Fuchs (December 18, 2019)

U.S. Securities and Exchange Commission Rule of Practice 102(e), which was codified in Section 602 of the Sarbanes-Oxley Act, allows the SEC to seek sanctions against an individual auditor or audit firm that has intentionally or negligently violated professional auditing or accounting standards.

For such violations, the SEC typically seeks sanctions such as censures, cease and desist orders, fines, remedial actions and bars from practicing before the SEC for a specific number of years, after which the auditor or firm may apply for reinstatement.

For an auditor, the implications of a practice bar go beyond the ability to audit for the duration of the bar. Under the SEC's broad view, a bar generally prohibits any work relating to the preparation of financial statements of a public company or its affiliates, which can significantly limit the scope of nonaudit work an individual can undertake during a bar period.

In 2013, the SEC launched Operation Broken Gate to prioritize enforcement actions against auditors by holding accountable those auditors who intentionally or negligently violate professional auditing or accounting standards, and thus fail in their role as gatekeepers. This announcement marked the beginning of a period of increased use of Rule 102(e) to charge auditors that failed to adhere to professional standards.

Under Operation Broken Gate, the SEC charged or settled a wide range of Rule 102(e) cases, including some against auditors from prominent national firms, and the firms themselves.

However, the number of Rule 102(e) charges and settlements against auditors for violations of professional auditing or accounting standards has declined in recent years as compared to the period following the announcement of Operation Broken Gate.

The statistics show that in 2019 through Nov. 15, the SEC charged or settled with 13 individual auditors under Rule 102(e), as compared with nine in 2018, 18 in 2017, 29 in 2016 and 28 in 2015. Similarly, the total number of such actions, including both individual auditors and audit firms, is 23 to date in 2019, as compared to 17 in 2018, 22 in 2017, 42 in 2016, and 44 in 2015.

We expect this trend to continue in 2020 and probably 2021, with the total number of Rule 102(e) actions against auditors on par with the 2018 and 2019 levels. These actions take some time to work their way through the system, and thus the actions brought in any given year are a function of investigations the staff have commenced and pursued in the preceding few years. For that reason, even if there is a change in administration and/or enforcement priorities within the SEC, it may take some time for such a change to manifest itself in enforcement actions or settlements.

Qualitatively, the Rule 102(e) actions in 2019 reflect the SEC's continued focus on auditor



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independence issues. Settlements of alleged independence violations with two large audit firms were primarily related to the firms or their affiliates providing nonaudit services to audit clients or those clients' affiliates.

The SEC also settled alleged independence violations with a foreign affiliate of a large audit firm. In that instance, the alleged independence violations stemmed from personal financial relationships that the audit firm's partners had with an audit client. Through these settlements the SEC imposed cease and desist provisions and censures, and obtained monetary relief.

Importantly, the settlements with the two domestic firms also included significant undertakings designed to prevent future independence violations. In one of these settlements, the SEC required the firm to employ an independent consultant to complete a review of the firm's systems for ensuring compliance with independence requirements. In the other settlement, the SEC required the firm (without an independent consultant) to similarly assess and report to the SEC on its systems for complying with independence requirements.

The SEC imposed similar undertakings in other settlements involving audit firms in 2019. In settlements with a small, foreign firm and a small, domestic firm over alleged violations of the generally accepted auditing standards, or GAAS, the SEC imposed five-year practice bars against the firms and required independent consultants to report on the firms' quality systems as a condition of reinstatement.

In addition, although its circumstances were outside the typical violations of professional auditing or accounting standards, it is worth noting that the SEC settled with another large audit firm in 2019 over integrity violations, imposing undertakings that required an independent consultant to report on the firm's processes for ensuring compliance with ethics and integrity standards.

In 2020 and beyond, we expect to see the SEC continue to use undertakings that require firms to engage independent consultants to assure the remediation of violations that the SEC considers to have been caused by systemic issues.

In 2019, the SEC also continued to take action under Rule 102(e) against auditors and audit firms for violations of professional standards other than independence standards, including violations of GAAS or incorrect application of the generally accepted accounting principles, or GAAP.

In settlements related to these violations, the SEC imposed sanctions such as censures, cease and desist orders, fines and practice bars, including lengthy and permanent bars.

On the other end of the spectrum with respect to practice bars, we noticed that in 2019, as well as in 2018, the SEC agreed to several one-year practice bars for auditing violations. This is significant because in prior years the SEC generally maintained a two-year floor for practice bars. The rationale for this policy had been informally understood to be that if a violation was significant enough for the SEC to charge an auditor, a bar of at least two years was warranted.

In sum, our most important takeaway from SEC enforcement actions against auditors in 2019 is that the SEC continues to seek sanctions against individual auditors and audit firms that may have violated professional auditing or accounting standards, although fewer actions and settlements have materialized than in previous years.

With respect to remedies, 2019 has shown that the SEC believes that undertakings, including independent monitors, are effective measures to remedy violations at audit firms. We expect these trends to continue in 2020.

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