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SEC Discusses New Task Force and Changes to Settlement Policy

By Elissa Preheim and Bret Finkelstein

Andrew Ceresney, co-director of the Division of Enforcement in the Securities and Exchange Commission (SEC) , recently proclaimed that “the SEC is back and better than ever” when it comes to accounting fraud. Both Ceresney and David Woodcock, director of the SEC’s Fort Worth Regional Office, discussed the SEC’s recently created Financial Reporting and Audit Task Force as well as changes to the commission’s settlement policy during the ALI Accountants’ Liability Conference, September 19–20, 2013.

New Financial Reporting and Audit Task Force

Ceresney acknowledged the sharp decrease in SEC enforcement actions related to accounting fraud in the wake of the financial crisis. He also noted a decrease in accounting restatements during this same time period, which he attributed, at least in part, to reforms implemented under the Sarbanes-Oxley Act. While oversight has improved, however, he posited that the SEC will not know whether accounting fraud has in fact decreased until it takes a look. The new Financial Reporting and Audit Task Force was formed to do just that.

Ceresney identified six specific areas on which the task force will focus: (1) accounting reserves and recognition of losses; (2) revenue recognition; (3) auditor independence (including audits of broker-dealers); (4) holding audit committees accountable; (5) cross-border issuers; and (6) the quality of financial-statement audits. Woodcock, chair of the task force, noted that six attorneys and six accountants have been detailed to the task force on a full-time basis from the SEC’s home office and nearly each regional office. Woodcock expects that the Task Force will include an industry focus, noting that certain industries face different problems at different times.

Woodcock explained that the Task Force will “detect and incubate” cases, and then hand them off to others in the SEC Enforcement Division. He underscored that the task force will not simply react to restatements and self-reports, but will be proactive in detecting potential accounting fraud. For that, it will use both internal and third-party analytical tools—such as tools used by short sellers and the Accounting Quality Model, an econometric regression model the SEC is developing—to identify outliers that may indicate accounting fraud. Woodcock does not expect to open investigations based on computer data alone. Rather, he said such data may prompt questions and will be considered among other information before an investigation is commenced.

Using all tools in its arsenal, the task force will continue to review restatements, closely monitor high-risk companies and class-action suits, analyze performance trends by industry, leverage the expertise of its Division of Corporation Finance and the Public Company Accounting Oversight Board, and rely on whistleblowers, which Woodcock noted have led to many of the SEC's investigations and enforcement actions.

"In some ways," Ceresney stated, the task force "is our Apollo 13 moment," with the SEC's mission being to protect investors and prevent accounting fraud. He noted that there are numerous cases in the pipeline relating to financial reporting, disclosure, and accounting issues, and he suggested that we may see such enforcement actions in the near future.

Changes to the SEC's Settlement Policy
Recent changes to the SEC's settlement policy were another significant topic of Ceresney's keynote address. The SEC has long allowed defendants to settle charges without admitting or denying the allegations, even where defendants had made admissions of wrongdoing in parallel criminal or civil proceedings. This "neither admit not deny" policy received substantial criticism in recent years, and the new SEC chairman Mary Jo White announced on June 18, 2013, that the SEC would modify its settlement policy.

Ceresney referred to the new policy as a "modified approach" under which the SEC will now require admissions in certain types of cases. He said such cases include those involving a large number of investors, unambiguous facts, a significant risk to the market, admissions in a related regulatory proceeding or criminal plea, or a situation in which an admission would safeguard the public or send a message to the market. If this new policy results in more litigation, Ceresney indicated that the SEC would shift its resources accordingly.

However, Ceresney emphasized that the "neither admit nor deny" settlement approach remained important and would be used regularly by the SEC. In his view, the no-admission settlement approach often secures settlements and relief for investors more quickly, helps conserve SEC resources, and eliminates litigation risk. He expects that these objectives normally will trump the need for securing an admission of wrongdoing, but he noted that the ability to seek admission "strengthens [the SEC's] hand" in enforcement cases.

Notably, on the very morning of Ceresney's keynote remarks, the SEC issued an order in which JPMorgan Chase settled charges and admitted to wrongdoing related to the $6 billion "London Whale" trading losses. Specifically, in the settled order, "JPMorgan Chase & Co. admits to the facts set forth [in the fifteen-page Annex A] and acknowledges that its conduct violated the federal securities laws." Those practicing before the SEC will monitor future settlement orders closely to see how the SEC applies its new settlement policy.

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