

2024 INTERNAL AUDIT WEBCAST SERIES

Course 2

Gatekeepers and the SEC: Are Internal Audit Leaders at Risk?

April 23, 2024



BDO and Our Internal Audit Webcast Series



Erin Sells, CPA

RISK ADVISORY SERVICES MANAGING DIRECTOR, BDO USA

Erin is a Managing Director in BDO's Risk Advisory Services practice in the Chicago office. She has deep accounting and financial reporting knowledge developed during 20 years of practice in public accounting working with mid-sized and large public and private corporations and organizations. Erin has extensive experience with internal controls, complex transactions, accounting standard implementations, compliance standards, and financial reporting.

Erin is a strategic thinker with the ability to navigate complex situations and devise services to achieve operational excellence. She has experience in directing business process transformation through simplification and automation.

Erin led the development of guidance for auditing internal controls related to compliance based on external regulations around management of state grants and funding policies. She has designed policies, procedures and an internal control partner framework for several financial statement and compliance areas. Erin has worked with her clients to institute tools for data visualization for in-depth and risk-based data analysis.

EDUCATION

- ▶ B.S., Northern Illinois University



312-616-4672
esells@bdo.com

Holly Carr

FORENSICS MANAGING DIRECTOR, BDO USA

Holly is a Managing Director within the Forensics and Investigation practice of BDO Advisory, a division of BDO USA, P.C.

She is a Certified Public Accountant with more than 20 years of experience that has achieved the accounting trifecta: Big Four auditor, Fortune 500 financial statement preparer and 10+ years as a financial regulator. Most recently, Holly served as Assistant Director in the Division of Enforcement at the U.S. Securities and Exchange Commission leading market intelligence operations. Holly led a team responsible for the review of all the whistleblower tips, investor complaints and referrals on accounting topics since the inception of the SEC's whistleblower program.

Holly has served on the SEC's Environmental, Social and Governance (ESG) Task Force, collaborated with numerous financial regulators and self-regulatory organizations such as the PCAOB and FINRA. Holly's experience has evolved in conjunction with major U.S. regulatory efforts, i.e., Sarbanes-Oxley, Dodd-Frank, and the JOBS Act. At BDO, Holly leverages her myriad of experience to assist with litigation risk mitigation efforts and investigations as organizations and their counsels navigate the complexity of new and evolving regulations.

EDUCATION

- ▶ B.A., Accounting, Hillsdale College



703-663-31179
hcarr@bdo.com

Learning Objectives



Identify the role of Internal Audit Directors as internal gatekeepers and their significance in ensuring compliance with regulations



Explain the SEC's actions and enforcement efforts related to gatekeepers, including case studies and real-world examples



Describe the SEC's expectations for internal audit directors, including best practices for maintaining effective internal controls and risk management systems

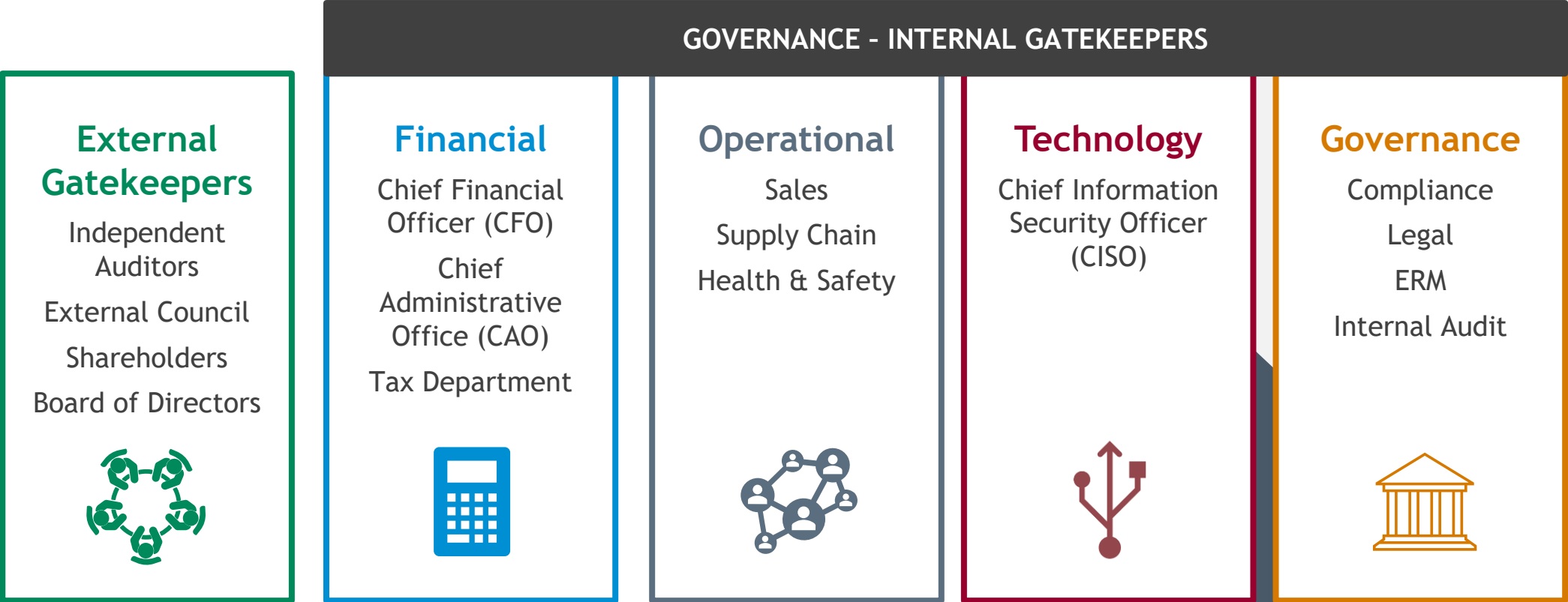
Who Are Viewed As Internal Gatekeepers?

Internal Gatekeepers

Review your company’s organizational structure to identify important functions and resources to support fraud risk management. The review should be able to identify those in critical "gatekeeper" roles

“Accountants and other gatekeepers are absolutely fundamental to the integrity of our capital markets.”

- **RYAN WOLFE**, ENFORCEMENT CHIEF ACCOUNTANT, U.S. SECURITIES AND EXCHANGE COMMISSION



SEC's Focus on Gatekeepers

“We also think about roles at public companies that could also be considered gatekeepers because of the function the individual is playing when it comes to accounting, when it comes to disclosure.”

CAROLYN WELSHHANS

Enforcement Associate Director

“We are very interested in individual liability and firm liability (audit firms).”

MELISSA HODGMAN

Enforcement Associate Director

“There has been an evolution over the years on... how we have become increasingly focused on things like gatekeepers as we get more interested in looking at beyond any given case and looking at the why something happened.”

LAURA JOSEPHS

Enforcement Assistant Director

Internal Audit Trends

Internal Audit Trends

FOCUS AREAS

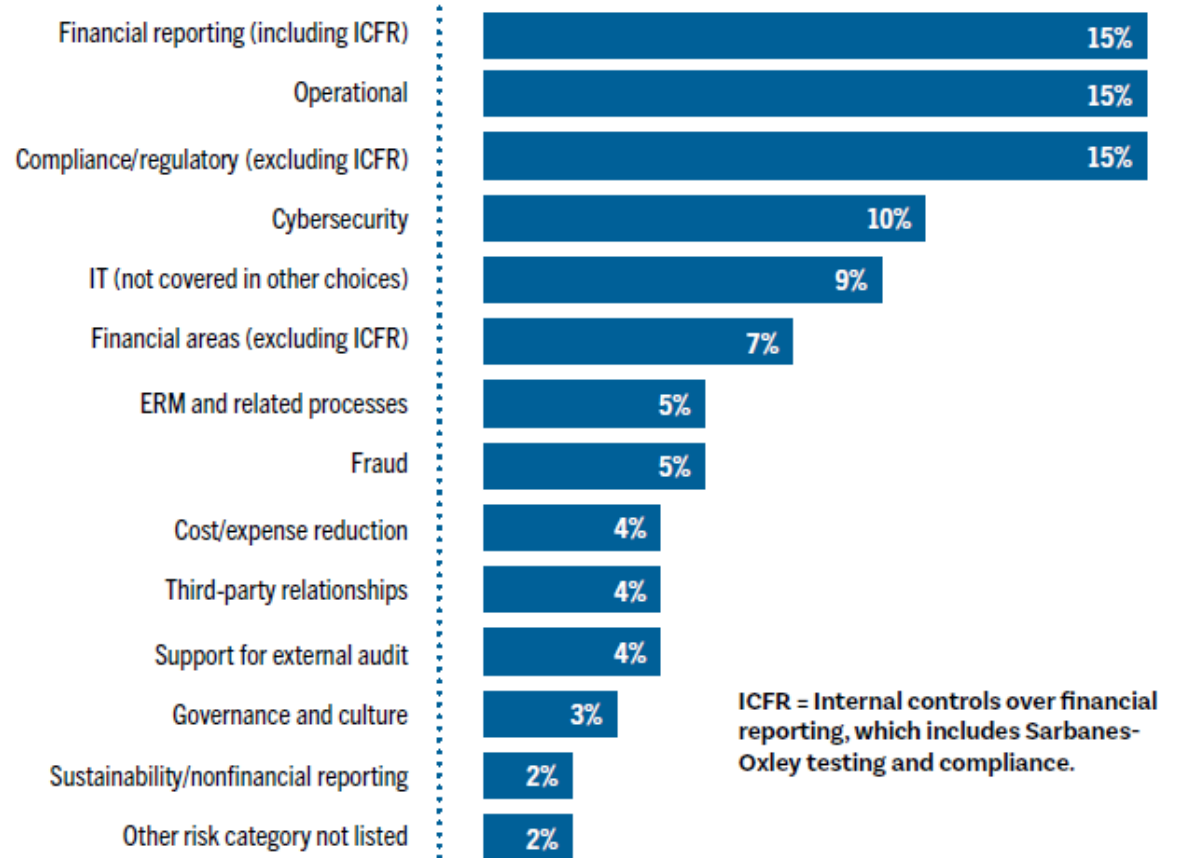
Top Focus Areas for Internal Audit

- ▶ Focus on Technology (19%)
 - Cybersecurity (10%)
 - IT (9%)
- ▶ Financial Reporting (15%)
- ▶ Operational (15%)

Does that Align with Regulatory Focus?

- ▶ Governance and culture. Tone at the Top (3%)
- ▶ Sustainability/ESG (2%)
- ▶ Cybersecurity & Data Privacy

Audit Plan for 2023 – All Respondents



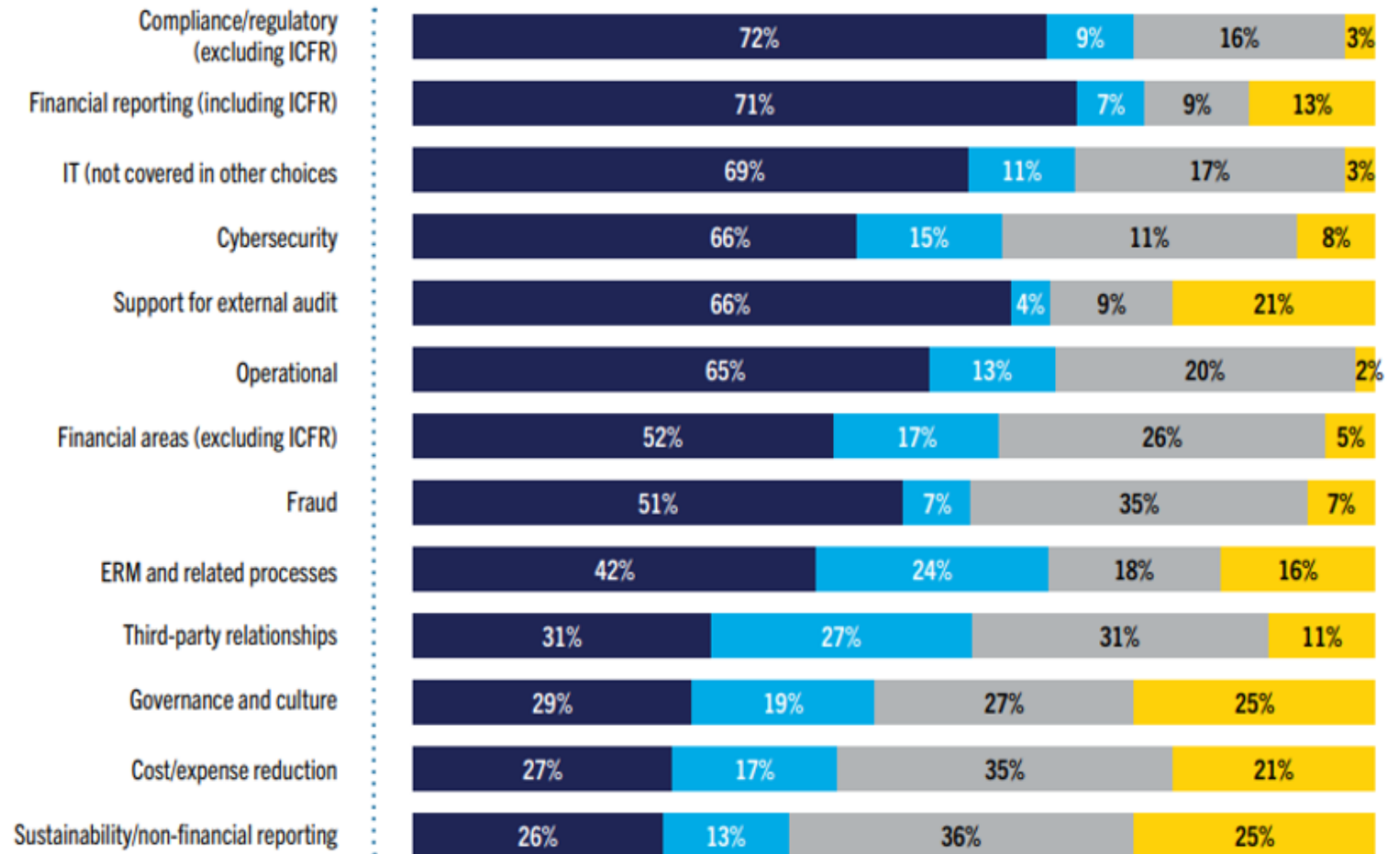
Note: The IIA's North American Pulse of Internal Audit Survey, Oct. 20 to Dec. 2, 2022. Q27: Looking ahead over the next 12 months, please indicate what percentage of your audit plan you anticipate will be allocated to each of the risk areas listed. *n* = 562.

Internal Audit Trends

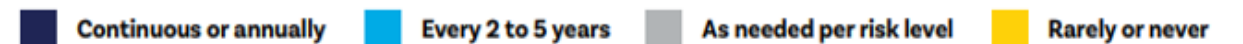
FREQUENCY OF AUDITS

Risk Areas

- ▶ Alignment with key regulatory focus
- ▶ Sustainability with ESG
- ▶ Board expectations with fraud internal audits
- ▶ Governance and culture focus



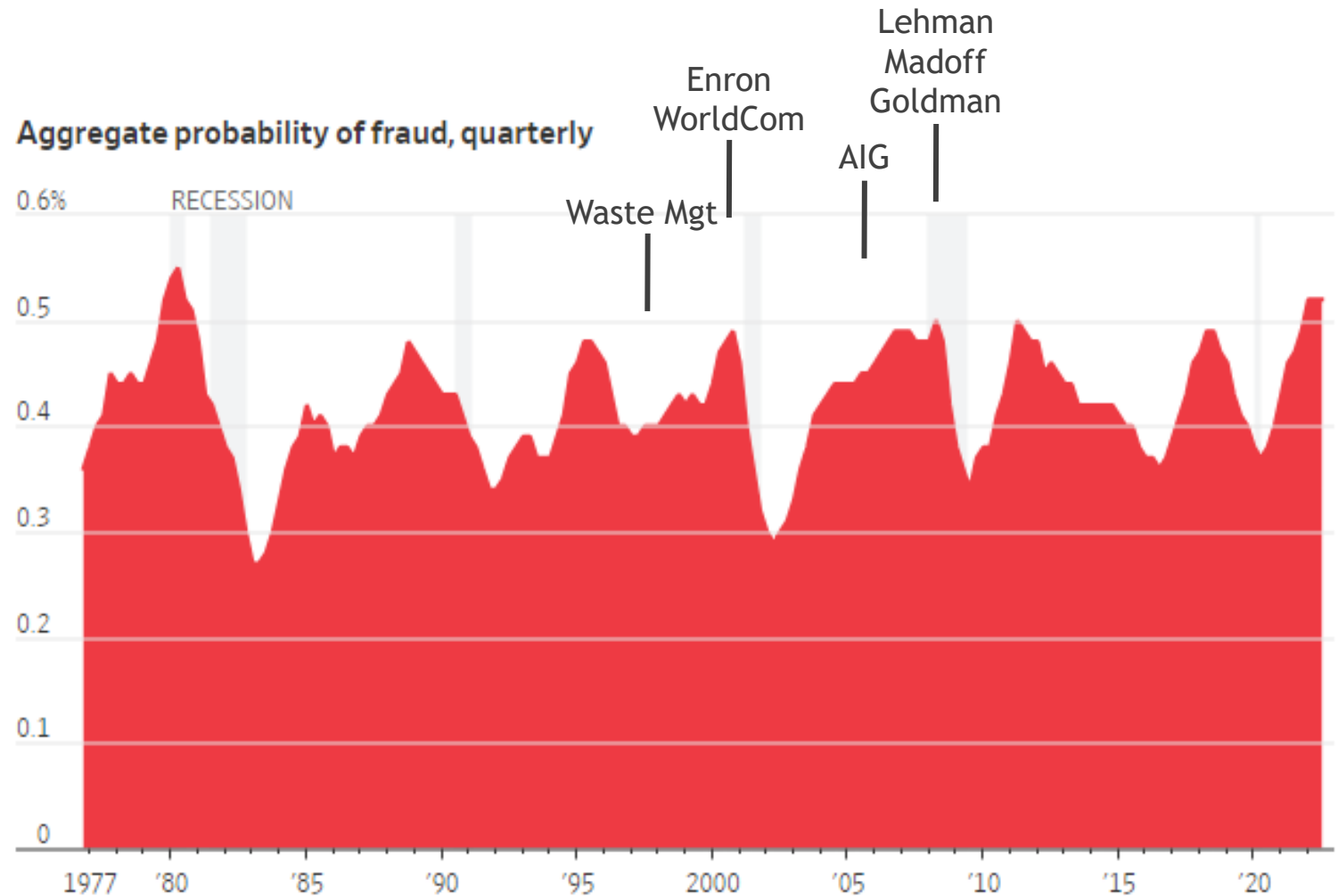
Source: The IIA's North American Pulse of Internal Audit Survey



Most Fraud Cases Never Reach Headlines... Until They Do

MACRO ENVIRONMENT

- ▶ The **M-Score** is a screening model that detects **fraud in corporate earnings reports**. It has recently reached a **40 Year High**.
- ▶ **One third** of frauds detected at public companies.
- ▶ **\$830 Billion** Estimated Annual Corporate Fraud and up to **5% of Revenue**
- ▶ **\$1,783,000** and **12-Months** Average Fraud Loss and Duration



Source: Messod D. Beneish, Indiana University

What Increases Fraud Risk?

FRAUD RISK FACTORS

Company Distress

Poor Tone

Change in Business Model

Material Acquisition(s)

Foreign Based Subsidiaries Fraud Risk Factors

Incentive Compensation

Dramatic/Crisis Conditions
(i.e., Economic Or Environmental Changes)

FRAUD RISK FACTORS

Pressure to Deliver Financial Results

Expense Reductions

Layoffs

Telework/Lack of In-person Interaction

Management Paying More Attention to Other Matters

Lack of Efficient Internal Controls and Compliance Systems

Real Cases with the SEC

Case Studies

Securities and Exchange v. SolarWinds Corporation and Timothy G. Brown (CISO)

- ▶ **Issue:** In 2023, SolarWinds Corporation and CISO, Timothy G. Brown were charged for internal control failures related to allegedly known cybersecurity risks and vulnerabilities. SolarWinds allegedly misled investors by disclosing only generic and hypothetical risks at a time when the company and Brown knew of specific deficiencies in SolarWinds' cybersecurity practices as well as increasingly elevated risks the faced at the same time. There were multiple communications among SolarWinds employees, including CISO, Timothy G. Brown, throughout 2019 and 2020 questioning the company's ability to protect its critical assets from cyberattacks. Brown is the first executive of a public company to face SEC charges related to cybersecurity.
- ▶ **Result:** SEC case is still ongoing. Class action lawsuit settled for tens of millions. Firms reputation severely impaired.

Securities and Exchange v. Fluor Corporation and Robin K. Chopra (CAO/Controller)

- ▶ **Issue:** In 2023, Fluor Corporation a global engineering and construction company, and five of its former and current officers were charged with failure to sufficiently maintain internal controls to account for projects under the percentage of completion method of accounting in accordance with U.S. GAAP. Allegedly, the accounting issues materially impacted multiple years. During the same period the company restated its financials and reported material weaknesses.
- ▶ **Result:** Fluor consented to cease and desist from committing or causing future violations and to pay a civil money penalty of \$14.5 million. Similarly, without admitting or denying the SEC's findings, the five employees consented to cease and desist from committing or causing the relevant violations and to pay penalties ranging from \$15,000 to \$25,000.

Case Studies

Securities and Exchange v. John Hughes (CCO)

- ▶ **Issue:** In 2023, John Hughes, President and Chief Compliance Officer of Prophecy Asset Management LP, was charged for his involvement in a multi-year fraud that concealed losses of hundreds of millions of dollars from investors. Hughes misrepresented the business model to investors and prospective investors, liquidity of investments, and failed to disclose massive trading losses.
- ▶ **Result:** SEC investigation is still ongoing. U.S. Attorney's Office for the District of New Jersey announced criminal charges against Hughes. In November 2023, Hughes pled guilty before the U.S. District Court and sentencing is scheduled for August 2024.

Department of Justice v. Joseph Sullivan (CSO)

- ▶ **Issue:** In 2022, Joseph Sullivan, the former Chief Security Officer (CSO) of Uber Technologies, Inc., was charged with obstructing a Federal Trade Commission (FTC) investigation of Uber's data security practices and failing to report a felony. Sullivan failed to disclose a 2016 data breach while Uber was already being investigated by FTC for a data breach in 2014. Sullivan paid the hackers \$100,000 in bitcoin and asked them to sign an NDA to further hide the facts from Uber executives, outside counsel and the FTC. In 2017, new management investigated the 2016 incident and Sullivan continued to misrepresent information.
- ▶ **Result:** In 2023, Sullivan was sentenced to three years probation, 200 hours of community service, and \$50,000 fine.

Best Practices

Best Practices

- ▶ Have a Communication Plan
- ▶ Establish Lines of Communication
 - Board of Directors
 - C-Suite
 - ERM
 - External Audit
- ▶ Leverage Data Assets to Identify Risk and Quantify Changes
 - Defining KPIs
 - Evolving with the business
- ▶ Have Sufficient Experience (NOCLAR Considerations)
 - Sustainability
 - Cybersecurity & Information Technology

“Not just about the gatekeepers, it’s about the gates, it’s about the systems, it’s about the internal accounting controls, internal control over financial reporting process, about disclosure controls and procedures. These systems serve investors by preventing and detecting misstatements before they make their way to the market.”

- RYAN WOLFE, ENFORCEMENT CHIEF ACCOUNTANT

Changes to NOCLAR

The PCAOB and AICPA have been reviewing and proposing to revise the auditing standards related to a Company's Noncompliance with Laws and Regulations (NOCLAR).



PCAOB - [AS 2405](#), A Company's Noncompliance with Laws and Regulations - Proposed June 3, 2023

- ▶ Requires auditors to plan/performance procedures, including hiring experts, to identify noncompliance with laws & regulations
 - Reporting obligation regardless of auditor perceives a material effect on the financial statements
 - Report as soon as practical; may be before auditor completes materiality evaluation or determines noncompliance has occurred
- ▶ Amendments are expected to proposal
- ▶ Revisions to audit fraud procedures need to be considered
- ▶ Current standard remains in effect



Both expand the definition of "illegal act" to include **any** noncompliance with laws and regulations that are applicable to the business under audit.

Both encourage coordination with specialists and experts.



AICPA - Responding to Noncompliance With Laws and Regulations - ([ET §1.180.010](#) and [ET §2.180.010](#)). Effective June 30, 2023

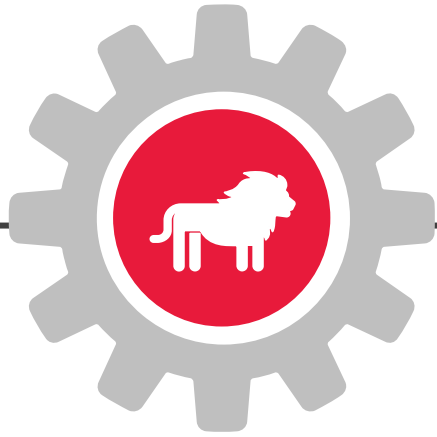
- ▶ Responsibilities of accountants, both internal and external, to take certain steps when encountering possible noncompliance with laws & regulations
- ▶ Gather information, report to supervisor, consider report to regulator, and document
- ▶ Obligations vary depending on your role and seniority
- ▶ FUN! [AICPA Video](#) and Interactive Q&A

Best Practices

Do What You Say and Say What You Mean

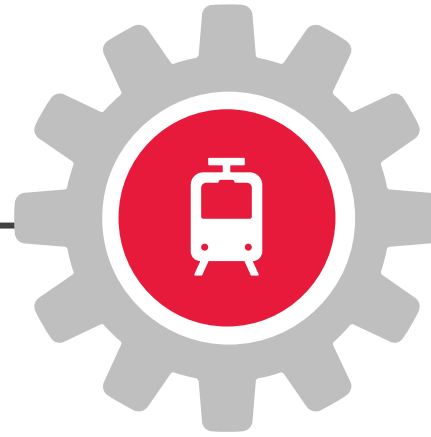
- ▶ Follow through
- ▶ Timeliness
- ▶ Communication & Documentation
- ▶ Align audit plan with regulatory focus areas and enterprise risks
- ▶ Keep a pulse on audit risk factors for your industry and organization plus the macro level

Final Thoughts & Takeaways



Be Courageous!

Have a voice and use it when necessary. Critical role in identifying risks and ensuring those risks are addressed in a timely manner.



Mind the Gap!

Continually assess differences between the audit plan for the year and actuality. Assess risk for items that might fall off and elevate those risks for discussion.



Be in the Know!

Understand the macro environment in which your organization operates. Be aware of regulator focus and overall operating environment.

Questions?



Thank You



ERIN SELLS

Risk Advisory Services
Managing Director

esells@bdo.com



HOLLY CARR

Forensics
Managing Director

hcarr@bdo.com

Join Us!

**From AI to IA:
How Internal Audit
Can Adopt and
Address the Risk of
Artificial Intelligence**

TUESDAY, JUNE 25, 2024

3:00 – 4:00 PM ET / 2:00 – 3:00 PM CST

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ESG Reporting: How to Navigate the Evolving ESG Regulatory Landscape and the Role of Internal Audit

TUESDAY, SEPTEMBER 24, 2023
3:00 – 4:00 PM ET / 2:00 – 3:00 PM CST

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Skills Development: Project Management for Internal Audit

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A modern office interior featuring a staircase with a glass railing, a reception desk with the BDO logo, and large windows overlooking a city skyline. The scene is dimly lit, suggesting an evening or night setting.

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