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ENFORCEMENT

Fallout From the SEC's Move to Reverse 'No Admit or Deny' Policy



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In 2013, Securities and Exchange Commission (the “SEC”) Chairman Mary Jo White announced that the SEC will turn away from its “no admit or deny” policy for resolving enforcement actions and will seek admissions of wrongdoing from some defendants in settlements in the future.¹ Under the SEC’s previous approach, the SEC did not aggressively pursue admissions from defendants. However, coming off the heels of what many have claimed is one of the worst financial crises since the Great Depression, with the SEC under considerable pressure, White has expressed dissatisfaction with the prior policy and has sought to change course. Now, she is focusing on public accountability and making sure defendants accept responsibility for misconduct.

From a legal point of view, in addition to consequences flowing directly from the SEC’s case, collateral consequences could follow admissions of wrongdoing, causing defendants to be reluctant to cede to the SEC’s demands. An admission may surface in other litigation,

¹ Ronald D. Orol, *White: SEC Will Seek Admissions of Wrongdoing*, MARKETWATCH (June 18, 2013), <http://www.marketwatch.com/story/white-sec-will-seek-admissions-of-wrongdoing-2013-06-18>.

disadvantaging defendants in matters far beyond the original action with the SEC. An admission may also adversely affect current contracts and future transactions and business opportunities. Fallout could further extend to directors’ and officers’ liability insurance policies, as those who admit wrongdoing could find that policy exclusions apply because of their admission.

Because of the severity, many defendants will resist application of the new policy to their case and will advocate for a “no admit or deny” settlement consistent with past practice. Some will be successful, as the SEC itself has acknowledged it will continue to enter into “no admit or deny” settlements in the future. Although the SEC has set aggressive enforcement goals and priorities, the SEC has limited resources and can only afford to take a small fraction of its cases to trial. Nevertheless, given that the SEC has thus far required and obtained admissions in seven cases, it is clear that the SEC is in the middle of a transformation and is striking a different tone.²

Given the SEC’s policy shift, companies serve themselves well when they adopt and implement well-designed, carefully considered corporate compliance programs and internal controls customized for their or-

² *Government Officials Review Enforcement Priorities*, WOLTERS KLUWER SEC. REG. DAILY (Apr. 28, 2014).

ganization. Organizations are not perfect, and strong corporate compliance programs may serve as a mitigating factor in the event misconduct is uncovered.

Historical Overview: SEC Defends ‘No Admit or Deny’ Settlement Policy

Prior to White’s announcement, the SEC often settled matters on a “no admit or deny” basis.³ Under the “no admit or deny” policy, a defendant neither admitted that it had engaged in wrongdoing, nor denied the SEC’s allegations. Some defendants who entered into these settlements later issued press releases disclaiming wrongdoing, but the SEC demanded retractions or corrections.⁴

The SEC previously defended its “no admit or deny” settlement policy, asserting that settlements are beneficial because they serve the SEC’s enforcement goals of accountability, deterrence, investor protection and compensation to harmed investors.⁵ In testimony before the United States House of Representatives Committee on Financial Services in 2012, Robert Khuzami, the director of the Division of Enforcement for the SEC at the time, emphasized that defendants who settle suffer penalties and other sanctions.⁶ Khuzami stressed that a quick sanction may also prevent violators from continuing to engage in misconduct, especially because the terms of the settlement may bar defendants from participation in the securities industry and may preclude them from serving as an officer or director of a public company.⁷ Settlement provides certainty and ensures that the SEC is in a position to return funds to investors in a timely manner.⁸ Khuzami’s testimony took place not long before the policy change.

Before White’s announcement, members of Congress and the judiciary expressed concern about the lax nature of the “no admit or deny” approach. For example, in her first hearing as a senator, Elizabeth Warren advocated for stronger enforcement tools, claiming that “too-big-to-fail has become too-big-for-trial.”⁹ On the judicial front, Judge Jed S. Rakoff rejected a \$285 million settlement, stating that his decision was due in part to the fact that he could not determine whether the settlement amount was appropriate in light of the “no admit or deny” language.¹⁰ Similarly, United States District Judge Victor Marrero held off on final approval

³ Robert Khuzami, Dir., Div. of Enforcement, SEC, Statement on Examining the Settlement Practices of U.S. Financial Regulators Before the House Committee on Financial Services (May 17, 2012), <http://www.sec.gov/News/Testimony/Detail/Testimony/1365171489454>.

⁴ *Id.* Khuzami stated, “Indeed, the SEC . . . not only prohibits defendants from denying wrongdoing in a settlement, but has demanded a retraction or correction on those occasions when a defendant’s post-settlement statements are tantamount to a denial.”

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ Jake Zamansky, *Too Big to Fail Now Too Big to Stand Trial*, FORBES (Feb. 21, 2013), <http://www.forbes.com/sites/jakezamansky/2013/02/21/too-big-to-fail-now-too-big-to-stand-trial/>.

¹⁰ SEC v. Citigroup Global Markets Inc., 827 F. Supp. 2d 328 (S.D. N.Y. Nov. 28, 2011).

of a \$602 million insider trading settlement because of the “no admit or deny” language.¹¹

Though some believed the SEC’s policy was too lenient, navigating away from this settlement approach could prove risky for the SEC. Khuzami himself acknowledged that requiring admissions could cause defendants to choose to litigate.¹² Khuzami recognized that many defendants would refuse to enter into a settlement with the SEC if the settlement requires an admission because of the direct harm and the collateral damage that would flow from the admission.¹³

Chairman White Changes Course, Requires Admissions in Some Cases

White, the 31st SEC Chairman, began serving in this capacity in 2013 after President Barack Obama nominated her and the United States Senate confirmed her appointment.¹⁴ White previously served as both a law firm partner and as United States Attorney for the Southern District of New York.¹⁵ Many speculated that White would take action to transform the SEC into a more aggressive, litigious agency during her tenure.

Not long after taking her position at the helm, White announced the “no admit or deny” policy reversal and later acknowledged that her experience in the criminal arena influenced her thinking.¹⁶ In remarks before the Council of Institutional Investors in Chicago, Illinois last year, she explained that “[a]nyone who has witnessed a guilty plea understands the power of such admissions – it creates an unambiguous record of the conduct and demonstrates unequivocally the defendant’s responsibility for his or her acts.”¹⁷

The full scope of the SEC’s new policy is not yet clear, though White has indicated that the SEC may pursue an admission of wrongdoing in the following situations:

1. Instances in which the SEC believes a defendant engaged in egregious, intentional misconduct;
2. When a party obstructs an investigation;
3. When a party’s misconduct harms a large number of investors;
4. When an admission can send a particularly important message to the markets; or
5. When a wrongdoer poses a future threat to investors or the markets.¹⁸

¹¹ SEC v. CR Intrinsic Investors, LLC, 939 F. Supp. 2d 431 (S.D. N.Y. Apr. 16, 2013).

¹² *Id.*

¹³ *Id.*

¹⁴ SEC Biography: Chair Mary Jo White, <https://www.sec.gov/about/commissioner/white.htm> (last visited March 3, 2014).

¹⁵ *Id.*

¹⁶ Mary Jo White, Chairman, SEC, Deploying the Full Enforcement Arsenal at the Council of Institutional Investors Fall Conference in Chicago, IL (Sept. 26, 2013), <http://www.sec.gov/News/Speech/Detail/Speech/1370539841202>.

¹⁷ *Id.*

¹⁸ Mary Jo White, Chairman, SEC, Chairman’s Address at SEC Speaks 2014 in Washington, D.C. (Feb. 21, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370540822127#_ftnref17.

Despite the shift, the SEC's new policy may make settlement of cases more difficult, causing the SEC to be in a position in which it will be forced to take more cases to trial. In 2012, the SEC went to trial in only 22 out of 734 cases brought, settling the vast majority of cases.¹⁹ Some private parties with considerable financial resources will respond with a spirited defense, thus bringing risk to the SEC because litigation is expensive and there is no guarantee the SEC will prevail.

The SEC will have little choice but to balance its enforcement goals against its need to conserve agency resources and against the fact that protracted litigation delays compensation to harmed investors. Accordingly, the SEC will continue to follow the "no admit or deny" approach in many circumstances in the future. Nevertheless, parties to enforcement actions should expect that the SEC may follow the more aggressive admission approach in their case. SEC Enforcement Division Director Andrew Ceresney has indicated that he will be responsible for deciding whether to require an admission and that he will consult with other commissioners in some cases.²⁰ Once the SEC has decided to require an admission, it will not move off of this position in exchange for a higher monetary settlement.²¹ Instead, the SEC will litigate the case if the party refuses to comply with the SEC's demand.²²

Policy Shift Triggers Collateral Consequences

Legal Fallout. Defendants coming under pressure from the SEC to admit wrongdoing should weigh both the direct and indirect consequences of an admission. A party that considers admitting wrongdoing should not underestimate the magnitude of the collateral damage, as an admission of wrongdoing has the potential to impact adversely the defendant in many ways for years to come. The exact legal consequences will depend on the facts and circumstances of each particular case, but a few potential concerns are noted below.

Litigation. The legal fallout from admissions could extend to proceedings beyond the case brought by the SEC. For example, some lawyers will cite admissions as evidence against the defendant to bolster their cases in a whole host of actions such as criminal trials, parallel securities class actions, shareholder derivative cases and other civil litigation. In addition, parties may be more inclined to bring actions against defendants who have admitted wrongdoing knowing that they could have a strengthened case because of the admission.

The SEC itself has recognized the collateral litigation risk. While serving at the SEC, Khuzami acknowledged in congressional testimony that admissions could prohibit the defendant from challenging liability in private litigation.²³ An admission could also bolster a prosecutor's case in a criminal action, as "such an admission can help to establish elements of criminal liability, since many federal securities laws provide for both civil and

criminal liability for the same violation."²⁴ As a result, "at a minimum, the risks of increased civil and criminal liability that flow from an admission in an SEC action are sufficiently real that defendants are highly unlikely to settle, if at all, until those risks have passed or are quantified and deemed acceptable."²⁵

An admission of wrongdoing may also be used against a defendant in federal debarment proceedings and proceedings to bar an individual from serving as a director or officer of companies in certain regulated industries, thereby putting future income and professional opportunities at risk. Settlements may similarly include professional restrictions, though it is conceivable that an admission of wrongdoing could have a more severe impact on a defendant in this context.

Defendants who admit wrongdoing may negotiate with the SEC for the inclusion of language in their settlement agreement granting them the right to take different legal and factual positions in other proceedings. The SEC has agreed to include this language in past settlements, though the efficacy of this language remains uncertain at this time.

Business Transactions. An admission of wrongdoing could also impact current and future business transactions. For example, an admission might jeopardize the status of current contracts to which individuals and entities are parties. Contracts often contain representations and warranties that extend the length of the contract. Many contracts expressly include a "compliance with laws" representation whereby a party agrees to comply with all applicable laws during the term of the contract. A party admitting wrongdoing may breach this and other representations and warranties. These contracts may include financing agreements with financial institutions and lenders. An admission of wrongdoing may constitute a breach of a covenant and cause a default under these agreements, causing the loan to immediately come due.

Admissions may also adversely affect future transactions such as mergers and acquisitions. A party that settles an SEC investigation, but does not admit wrongdoing, may be a more attractive target for a prospective buyer. Admissions could lengthen and complicate the pre-closing transaction process, as sophisticated buyers will spend time and resources quantifying both future liability exposure and reputational impact.

Similarly, an admission of wrongdoing could result in a loss in upcoming business opportunities. Obviously, an admitting party will not be able to make an unqualified representation and warranty that the party has been in compliance with all applicable laws. Parties to future contracts may choose to conduct business with other companies not tarnished by an admission, particularly when their corporate compliance programs or other policies and procedures restrict their ability to conduct business with entities that have admitted violations of applicable laws.

Implications on Management Liability. White's requirement to admit wrongdoing to settle enforcement actions has also generated debate and discussion in the insurance industry. The conversation is primarily centered on certain common policy conditions that exist

¹⁹ Khuzami, *supra* note 3.

²⁰ *Government Officials Review Enforcement Priorities*, *supra* note 2.

²¹ *Id.*

²² *Id.*

²³ Khuzami, *supra* note 3.

²⁴ *Id.*

²⁵ *Id.*

across all management liability policies. The conduct exclusions such as the fraud and personal profit and personal gain exclusions are taking center stage. Additionally, severability, the language that allows the policy to continue to protect innocent parties while not protecting guilty parties, is another area warranting the careful attention of buyers. The shift in enforcement policy also impacts other provisions, such as non-rescindability and claims settlement. Lastly, broader industry perspectives, such as carrier behavior and public relations, possible tightening of policy language, claims paying reputation and a payback of defense dollars in the event of admission warrant close consideration. Accordingly, buyers of management liability policies should carefully oversee the insurance buying process after considering the potential long-term consequences that could flow from admissions of wrongdoing.

Conduct Exclusions. Most directors and officers liability insurance policies contain exclusions that apply when an insured has engaged in fraud or willfully violates the law. When considering these conduct exclusions, the most relevant question is whether the admissions required for settlement will be material enough to trigger the fraud and personal profit exclusions. Current policy language allows the policy to continue to defend up to final adjudication of the case. However, an insurance carrier may deny coverage and attempt to recover expenses advanced when conduct exclusions are found to apply.

Management liability policies historically contained much more restrictive policy language relative to conduct and covered admissions of wrongdoing, formal findings of fact and agreements to charges or allegations. Current language may include an amended form of final adjudication that makes it clear that the final adjudication applies to any underlying proceeding. Buyers will want to negotiate for a provision that limits an admission to the underlying action as opposed to other, related actions in which there has not been an admission or final adjudication. Whether the insurance industry will retreat to restrictive language on a selective or global basis remains open to debate.

Severability and Non-Rescindability. In a directors and officers insurance policy, interplay exists between the two clauses of severability and non-rescindability. Severability, the language that allows innocent parties to remain protected while coverage for guilty parties is denied, consists of two elements. The first relates to exclusions and in most cases is specific to the above-mentioned conduct exclusions. If one person is found guilty of fraud, then other innocent persons and sometimes an entity can still rely on the policy's protection. The second element of severability relates to the representations made in the application of insurance to the insurance carriers. If one party makes a misrepresentation in the application, the industry standard today allows innocent individuals, and in some instances the entity as well, to remain protected. Under both severability of the application and exclusions, current industry standard allows innocent parties to remain protected.

Non-rescindability is a related clause as it specifies that the insurance carrier may not rescind or void the policy with respect to any insured under any circumstance. If a misrepresentation is made in an application for insurance, a non-rescindability clause keeps the

coverage active and accessible. While both severability and non-rescindability language has evolved and is broad today, it is unclear whether the market will continue to support this language.

Repayment of Defense Costs. Once an admission is made, the insurance carrier may require repayment of relative defense costs. In some instances, insurance carriers have removed the requirement to repay defense costs for non-covered areas. However, given the SEC's shift in enforcement, insurance carriers may amend this wording to be more restrictive and require reimbursement of defense costs. Historically, carriers have been reluctant to recover defense dollars paid even in situations where the policy specifically allowed them to do so. Perhaps this is because ultimately recovery may not even be viable or worthwhile. Additionally, one can easily imagine the public relations or claims-paying reputational risk this repayment behavior presents.

Buyer's Concerns in Light of SEC Policy Shift. A buyer's primary concern is that the insurance policy will remain active and accessible. A buyer should also be concerned that the current policy limits purchased may become inadequate, as cases may drag on much longer than in the past, incurring significantly higher legal fees. Following admission, there may be interrelated cases, shareholder actions and follow on investigations across many policy periods. However, carriers are likely to look for a common nexus that may push all claims into one policy period – and one limit of liability.

In addition, many of these cases are likely to involve multiple defendants – individuals as well as the entity, insiders and outsiders. Getting all parties to agree on admission will likely be a laborious and contentious process. As a result, traditional limits of protection may be inadequate. Higher limits and additional products may earn a more prominent place at the buyer's table. "Side A Excess" is a product that provides additional protection dedicated solely to individuals. "Side A Excess Difference in Conditions" policy is another product similar to Side A Excess but broader in scope, has less exclusions and will apply when an underlying insurance company itself refuses to pay, becomes insolvent or attempts to rescind the policy. Lastly, "Individual, Personal or Independent Directors" policies function as Side A Excess coverage solely for the benefit of independent directors. This coverage is not shared with the entity or inside directors or officers.

Given Intensified Enforcement Environment, Focus on Prevention Is Critical

Because of the SEC's aggressive enforcement approach, companies should allocate resources to the adoption and implementation of an effective corporate compliance program and internal controls customized for the organization.²⁶ A focus on prevention is critical

²⁶ United States securities laws require publicly traded companies to disclose whether they have adopted a code of ethics. 17 C.F.R. § 229.406 (2014). In addition, New York Stock Exchange and NASDAQ rules both mandate the adoption and disclosure of a code of business conduct and ethics. New York Stock Exchange Listed Company Manual, Rule 303A.10 (2014) (stating that "listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and em-

due to the nature and severity of the possible penalties for non-compliance.

Corporate Compliance Programs. Properly designed compliance programs demonstrate an organization's commitment to ethical conduct and compliance with applicable laws. Such programs help companies to prevent and detect misconduct and can serve as a shield if a violation of law occurs. The Department of Justice and SEC "understand that 'no compliance program can ever prevent all criminal activity by a corporation's employees,' and they do not hold companies to a standard of perfection."²⁷ Nevertheless, adoption of a corporate compliance program can serve as a mitigating factor if wrongdoing is discovered.²⁸

Companies should tailor their corporate compliance programs to address the unique risks their business faces and should revisit and update their programs regularly as their business evolves and grows. While both the DOJ and SEC have acknowledged that there is no "one-size-fits-all program," a "check-the-box" approach runs the risk of being both inefficient and ineffective. When structuring their programs, companies should consider the United States Sentencing Commission Guidelines (the "Guidelines"), which set forth the following components of an effective compliance program:²⁹

1. Written standards and procedures to prevent and detect criminal conduct;
2. A knowledgeable governing authority charged with exercising reasonable oversight, a group of high-level personnel with responsibility for the program and a group of specific individuals with day-to-day operational responsibility;
3. Exclusion of individuals who have engaged in conduct prohibited by the program from being charged with compliance responsibilities;
4. A requirement to communicate the standards and procedures periodically and to conduct effective training programs;
5. A monitoring and auditing mechanism to detect criminal conduct and evaluate the efficacy of the program and a mechanism that allows for anonymous, confidential reporting of misconduct such as a hotline;
6. Promotion and enforcement of the program consistently through appropriate incentives and disciplinary measures; and
7. Appropriate response in the event the company discovers unlawful conduct coupled with steps the company will take to prevent similar misconduct from occurring in the future.

employees, and promptly disclose any waivers of the code for directors or executive officers"); NASDAQ Stock Market Rules 5610 (2014) (stating that "[e]ach company shall adopt a code of conduct applicable to all directors, officers and employees, which shall be publicly available").

²⁷ FCPA: A Resource Guide to the U.S. Foreign Corrupt Practices Act by the Criminal Division of the U.S. Department of Justice and the Enforcement Division of the U.S. Securities and Exchange Commission 56 (Nov. 14, 2012), <http://www.justice.gov/criminal/fraud/fcpa/guide.pdf>.

²⁸ *Id.*

²⁹ U.S. SENTENCING GUIDELINES MANUAL § 8B2.1 (2013).

Internal Controls and the Third Line of Defense. Internal control is broadly defined by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO")³⁰ in its executive summary to "Internal Control – Integrated Framework" as "a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in (1) effectiveness and efficiency of operations, (2) reliability of financial reporting, [and] (3) compliance with applicable laws and regulations."³¹ Internal controls cross all departments of an organization in order to protect from inherent risks associated with operating the business and allow the company to continue as a going concern.

In one of the SEC's test cases for the admission of wrongdoing settlement approach, ineffective internal controls were cited as a cause throughout the SEC's order and press release. Specifically, internal controls failed in that there was not adequate independence between the department in charge of valuation and reporting and the trading department.

An effective internal control environment is commonly referred to as the "Three Lines of Defense Model." Originally adapted by the Federation of European Risk Management Associations ("FERMA") and the European Confederation of Institutes of Internal Auditing ("ECIIA"),³² the Three Lines of Defense are paraphrased as the following:

1. First Line of Defense—Operational Management: Members of each department are responsible for mitigating risks of daily business operations and ensuring an effective internal control environment is upheld.

2. Second Line of Defense— Risk Management/ Compliance: These departments exist separately from business operating segments in part to aggregate all risks company-wide and determine appropriate training, risk assessment and reporting on internal and external (laws, regulations, etc.) risk factors.

3. Third Line of Defense— Internal Audit: A department that provides the board of directors with an independent assessment of how effectively the First and Second Lines of Defense are operating and an assessment of an organization's overall risk management program.

Once a strong Third Line of Defense is in place, below are several common ways that an internal audit department may protect an organization against transactions or business relationships that may pose a threat to

³⁰ The Committee of Sponsoring Organizations of the Treadway Commission ("COSO") is a joint initiative of the following five private sector organizations: American Accounting Association, American Institute of Certified Public Accountants ("AICPA"), Financial Executives International ("FEI"), The Association of Accountants and Financial Professionals in Business, and The Institute of Internal Auditors ("IIA"). COSO is "dedicated to providing thought leadership through the development of frameworks and guidance on enterprise risk management, internal control and fraud deterrence." The COSO online site is available at www.coso.org/.

³¹ COSO, EXECUTIVE SUMMARY TO INTERNAL CONTROL – INTEGRATED FRAMEWORK (May 2013), <http://www.coso.org/documents/Internal%20Control-Integrated%20Framework.pdf>.

³² ECIIA/FERMA, GUIDANCE ON THE 8TH EU COMPANY LAW DIRECTIVE, ARTICLE 41 (Sept. 21, 2010).

a company's risk environment. While these largely protect an organization against fraud, waste or abuse, performing an independent internal audit including periodic testing helps to ensure that the internal audit department is protecting the organization against inherent risks of doing business.

Whistleblower Hotline. In a survey conducted by the Association of Certified Fraud Examiners in its 2012 Report to the Nations,³³ over 40% of all fraud cases in 2012 were originally brought to management's attention via an anonymous tip. An organization may begin by empowering its employees, customers and vendors with an anonymous whistleblower hotline to identify issues regarding the organization's operations.

Best practices of a whistleblower hotline include the following:³⁴

1. Multilingual access to potential whistleblowers in all native languages that an organization may do business;
2. Claims regarding senior management should be routed directly to the Audit Committee without potential employee interference; and
3. Ticketing system or case management system that uniquely identifies each caller, potential claim and follow-up.

The internal audit department should have a clear understanding of each of the cases reported through a whistleblower hotline and ensure that each case is handled appropriately according to the risk that it poses to the organization.

Third Party Contract Compliance. As mentioned above, a "compliance with laws" clause may aid to prevent any retroactive recourse in the case of an SEC action against a third party customer. One example of a proactive contract provision is a "right to audit" clause, which allows both parties access to books and records in order to determine compliance with certain contractual terms.

Typically, "right to audit" clauses may include the following:

1. A clear definition of the records that may be made available to either party when exercising the right to audit clause (i.e., accounting records, invoices, bank statements, cancelled checks, etc.), including all additional items which may be specific to the nature of the contract between the two parties;
2. The time period for which all accounting records (referenced above) should be made available;
3. An extension of the clause to any subcontractors, agents, employees, etc.;
4. A description of which party or parties pay for the cost of a contract audit; and
5. The recourse available to either party in the event of fraud, misrepresentation, non-performance, etc.

³³ Ass'n of Certified Fraud Examiners, 2012 REPORT TO THE NATIONS (2012), <https://www.acfe.com/rtnn.aspx>.

³⁴ *Audit Committee Considerations for Whistleblower Hotlines*, J.A.C.T. (2010), <http://www.journalofaccountancy.com/Web/AuditCommitteeConsiderations.htm>.

By exercising the right to audit, an organization may ensure that it is paying the agreed cost for goods and/or services delivered and protecting itself from any other risks associated with doing business with a third party. In addition, an organization may potentially reap benefits from a financial review of contracts by identifying areas of fraud, waste or abuse.

Periodic Vendor Review. For larger vendors of an organization, testing for potentially false vendors on a periodic basis is a way to identify potentially fraudulent transactions. An internal audit department may consider performing data analytics to compare business volume for vendors on an annual basis. This can serve as a starting point from which the department may identify higher risk vendors for which to perform these periodic vendor reviews.

The review should address key qualitative questions such as ensuring the company has a valid address, phone number, taxpayer identification number and website. In reviewing this information for each vendor, the internal audit department should determine if the address or taxpayer identification numbers for the vendors tested match employee addresses and social security numbers. This tests whether employees have created fake vendors for their benefit. Through this initial review, the department can also assess if the vendor may pose a larger risk to the organization (for example, if the vendor is located in a foreign country with a higher propensity for corruption).

The department should also consider performing quantitative, transaction-level testing for those vendors that it has identified as higher risk and should challenge transactions that may require additional explanation and/or substantiation.

Conclusion

Under White's leadership, the SEC will refuse to enter into "no admit or deny" settlements in some cases in the future. However, defendants should carefully weigh the consequences of entering into a settlement that includes an admission of wrongdoing. In instances in which negotiations stall and the parties reach an impasse, the case may be tried in court.

In today's aggressive regulatory environment, avoidance of a violation is the best mode of protection. To guard against unauthorized wrongdoing and damages that flow from misconduct, companies should adopt and implement strong, intelligently designed corporate compliance programs and internal controls customized for their particular organizations.

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