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Accounting irregularities have moved to the front burner at the SEC again — can you feel the heat?

Accounting fraud and irregularities — Is your company vulnerable?

Potential issue: Many companies are hyperaware of the US government's continued push to fight corruption and enforce the US Foreign Corrupt Practices Act (FCPA). Less obvious to some, perhaps, is the resurgence of regulatory interest in accounting fraud and irregularities.

While fraud matters occurring at companies such as Enron and WorldCom may seem like turn-of-the-century relics, recent actions and statements from the US Securities and Exchange Commission suggest they are again interested in financial accounting reporting matters. For example, in FY 2014, the SEC increased antifraud enforcement actions by nearly 50 percent, the first year-over-year increase since 2007, and new investigations by nearly a third, opening more than 100[1]. Also, in the SEC's 2014 Agency Financial Report, chair Mary Jo White cited the commission's "redoubling efforts in traditional areas, like financial fraud…"[2]

Increased scrutiny is likely as the SEC Financial Reporting and Audit Task Force builds momentum. And, the action could accelerate as technologies such as the Accounting Quality Model (AQM) analytics tool, aka RoboCop, gain footing. These tools are making it easier for the regulators to proactively identify potential irregularities. Are you ready?

What do regulators frequently look for?

Revenue recognition: Long-term accounting contracts, gross vs. net, and rebate allowances are prime targets in this consistently active area of SEC enforcement.

Deferred expenses: Pushing expenses into later periods to increase net profits.

Improper capitalization of assets: Capitalizing expenses as assets to reduce current-period expenses to artificially inflate earnings.

Valuation issues: Faulty or biased assumptions may inflate or deflate asset valuation to help companies achieve a pre-determined income/loss.

Disclosures: Inadequate or missing disclosures can be easy factors for the SEC to identify.

Related-party transactions: Adequacy of disclosing related-party transactions.

Improper segment reporting: Improper aggregation of operating segments may also trigger inquiries.

Internal control reviews: Companies that file multiple restated financial statements should be prepared to explain variances in statements.

[1] "FY 2016 Budget Request by Program," US Securities and Exchange Commission, page 61, http://www.sec.gov/about/reports/sec-fy2016-budget-request-by-program.pdf.

[2] http://www.sec.gov/about/secpar/secafr2014.pdf

Are you prepared?
Here are some steps to consider:

Re-familiarize your accounting and audit staff to be aware of these issues and to potential identify fraudulent activity

Train your finance and internal audit department to identify potential red flags and fraudulent activity.

Conduct an antifraud review of internal controls surrounding the focus areas noted above.

Develop a plan for responding to allegations of fraudulent activity.

Put procedures in place to **preserve and protect data** potentially subject to investigation.

Establish protocols for when to engage internal and/or external counsel.

Speak to thought-leaders on trends in accounting frauds and enforcement matters.

For more information, please contact:

Anthony Campanelli
Partner
Deloitte Financial Advisory Services LLP
+1 212 436 5386
acampanelli@deloitte.com

Kevin Corbett
Partner
Deloitte Financial Advisory Services LLP
+1 212 436 6509
kcorbett@deloitte.com