SEC Charges Now Suspended Audit Firm BF Borgers with Massive Fraud Affecting More Than 1,500 SEC Filings

May 6, 2024

On May 3, 2024, the Securities and Exchange Commission (the "SEC") announced settled enforcement proceedings against audit firm BF Borgers CPA PC and its owner, Benjamin F. Borgers (together, "BF Borgers"), charging them with deliberate and systemic failures to comply with Public Company Accounting Oversight Board ("PCAOB") standards in its audits and reviews of hundreds of public companies, which were incorporated in more than 1,500 SEC filings from January 2021 through June 2023.

SEC Order Against BF Borgers Imposes Severe Penalty

The SEC imposed severe penalties on BF Borgers, including a $12 million civil penalty against the firm and a $2 million civil penalty against its owner, as well as permanent suspensions against both parties from appearing and practicing as accountants before the agency, effective immediately. Gurbir S. Grewal, Director of the SEC's Division of Enforcement noted that "thanks to the painstaking work of the SEC staff, Borgers and his sham audit mill have been permanently shut down."

The SEC found that BF Borgers failed to perform its audit and review engagements in accordance with PCAOB auditing standards, including by failing to adequately supervise the engagements, failing to obtain engagement quality reviews in connection with the engagements, failing to prepare and maintain sufficient audit documentation, and fabricating certain audit documentation, all while falsely representing to its clients and in its audit reports that the firm's work complied with PCAOB standards. Specifically, the SEC found that at Benjamin Borgers's direction, BF Borgers' staff simply "rolled forward" workpapers from previous engagements, changing only the relevant dates, and passed them off as workpapers for current period engagements. These workpapers documented engagement planning meetings that did not occur and falsely represented that Benjamin Borgers and a separate engagement quality reviewer had reviewed and approved the work. Additionally, the SEC found that electronic "sign offs" on the firm's engagement workpapers that were attributed to the engagement partner, engagement quality reviewer, and staff auditor were in fact all applied by a single staff person within seconds of one another.

The SEC's order focused only on the firm's public company audit and review engagements and did not address the firm's work for private companies.

The SEC's order can be found here.

Issuer Disclosure and Reporting Obligations in Light of SEC Order

The permanent suspension of BF Borgers no doubt throws its hundreds of audit clients into turmoil with respect to those clients' SEC filing obligations as they each search for a new firm. Acknowledging this, in a separate announcement, the SEC published guidance to assist impacted issuers in complying with their disclosure and reporting obligations.

Each impacted registrant will first need to file an Item 4.01 Form 8-K when BF Borgers resigns or is dismissed. The Form 8-K must be filed within four (4) business days of the resignation or dismissal and requires the inclusion of information called for by Item 304 of Regulation S-K. As BF Borgers is suspended from appearing before the agency and therefore unable to agree to the Item 304 disclosures, the SEC is permitting affected registrants to instead indicate that their prior auditor is not currently permitted to appear or practice before the SEC.

Issuers that had engaged BF Borgers to audit or review financial information to be included in any Exchange Act filings to be made on or after May 3, 2024 will need to engage a new qualified, independent, PCAOB-registered public accountant. Given the Form 10-Q filing deadline for calendar year companies is fast approaching and the need for a new audit firm to review the interim financial statements, it is unlikely that BF Borgers's public company clients will be able to timely file their Forms 10-Q. The SEC reminded issuers of the availability of Exchange Act Rule 12b-25, which provides for a limited extension of the deadline for filing certain Exchange Act reports (15 calendar days in the case of Forms 10-K and 20-F and 5 calendar days in the case of Form 10-Q). Issuers may file a Form 12b-25 no later than one business day after the original due date for the report and should include disclosure describing, in reasonable detail, the issuer's inability to file the report timely and the reasons therefore. Exchange Act reports that were filed before May 3, 2024 do not necessarily need to be amended solely because of the SEC's order, but issuers should consider whether their filings need to be amended to address any deficiencies that may exist as a result of their BF Borgers engagement, including as a result of any required restatement of previously filed financial statements.

Issuers that are currently in the registration process will need to file a pre-effective amendment with a new auditor before their registration statements can be declared effective. Similarly, issuers with a pending Regulation A offering statement will need to file a pre-qualification amendment with a new auditor. Any issuer who has submitted a

draft registration statement for nonpublic review that contains an audit opinion from BF Borgers must retain a new auditor before publicly filing the affected registration statement. Given the time required for a new audit firm to complete the required audit work, this is likely to delay any such capital raise by months, not weeks.

In addition, since any sales of securities in transactions registered under the Securities Act must be preceded or accompanied by a Securities Act Section 10(a)-compliant prospectus, issuers who relied on an audit opinion from BF Borgers with effective registration statements will no longer be able to use impacted registration statements.

Litigation Preparedness for Issuers

Notably, the SEC order states that as a result of BF Borgers' conduct, certain of the firm's issuer and broker-dealer clients violated the reporting provisions of the Exchange Act by filing financial statements that had not been audited or reviewed by an independent public accountant in accordance with PCAOB standards. These particular reporting violations are only actionable by the SEC, which has not yet announced any charges against BF Borgers' clients in connection with the matter.

In addition, we expect the Plaintiffs' bar to explore creative ways to pursue private litigation against issuers that were impacted by this fraud. For example, BF Borgers' audit clients may face private litigation alleging that the clients violated Section 10(b) of the Exchange Act or Section 11 or Section 12 of the Securities Act by misstating that their financial statements were audited by BF Borgers in accordance with PCAOB standards. Similar to any follow-on proceeding brought by the SEC, the likelihood of such private claims succeeding will depend in part on whether the plaintiff can successfully allege that the clients knew or recklessly disregarded that the audit work performed by BF Borgers was deficient and whether in fact the new audit firm discovers material misstatements or omissions in financial statements audited by BF Borgers.

The SEC order does not indicate that there were any red flags that would have put BF Borgers' audit clients on notice of the firm's misconduct. In fact, to the contrary, the order notes that BF Borgers misled audit clients in its engagement letters by stating that the audits and quarterly reviews would be conducted in accordance with PCAOB standards. The only evidence that the order references relates to internal engagement team meetings and workpapers which would not ordinarily be available to audit clients. For example, the order mentions BF Borgers teams' failures to hold planning meetings at the beginning of engagements, workpapers that appeared to be copied over from prior periods, and details concerning the timing and circumstances of electronic workpaper sign offs in the BF Borgers audit management software.

On the other hand, Grewal's statement accompanying the order does refer to BF Borgers as a "sham audit mill," which at least suggests that the firm's misconduct extended to the substantive audit procedures performed on the engagements in question. As a result, it is possible that the SEC or private plaintiffs could pursue claims based on theories that the audit clients knew or recklessly disregarded BF Borgers' failure to conduct an audit in accordance with PCAOB standards.

The Plaintiffs' bar may also pursue theories that do not require proof of an issuer's scienter. Under Section 11 of the Securities Act, issuers are effectively subject to strict liability for material misstatements in connection with public offerings. Private litigants generally need not demonstrate causation or reliance on misstatements or omissions and could bring a damages suit under Section 11. It remains to be seen how the courts will assess claims against a public company that has been defrauded by its auditor.

Any private litigation against issuers may test the boundaries of a recent Second Circuit determination that shareholders failed to show that an auditor's false certification was *material* to investors. A three-judge Second Circuit panel ruled last August[1] that shareholders failed to show that an auditor's allegedly false certification mattered to the issuer's investors, because the statements were so general that a reasonable investor would not depend on them. The same may be true concerning statements that BF Borgers conducted its audits in accordance with PCAOB standards, though the SEC would likely disagree: the agency submitted an amicus brief in support of a petition for rehearing in the Second Circuit, arguing that such auditor statements convey important information to investors, no matter their standardized form.

Other Considerations

The impact of this order may be felt beyond the above near-term considerations for affected public companies, including with respect to their contractual obligations with lenders.

Further, broker-dealers, investment advisers subject to the custody rule, and even private companies that engaged BF Borgers as their independent auditor will presumably need to find a replacement auditor and should give careful consideration when selecting a new firm.

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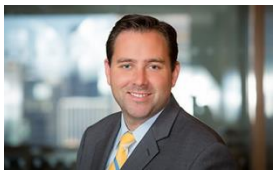
[1] *New Eng. Carpenters Guaranteed Annuity & Pension Funds v. DeCarlo*, 80 F. 4th 158 (2d Cir. 2023).

Please do not hesitate to contact us with any questions.

Elliot Greenfield
Partner, New York
+1 212 909 6772
egreenfield@debevoise.com



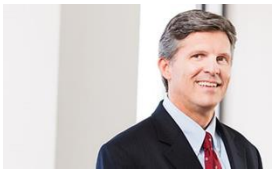
Morgan J. Hayes
Partner, New York
+1 212 909 6983
mjhayes@debevoise.com

Eric T. Juergens
Partner, New York
+1 212 909 6301
etjuergens@debevoise.com

Matthew E. Kaplan
Partner, New York
+1 212 909 7334
mekaplan@debevoise.com

Maeve O'Connor
Partner, New York
+1 212 909 6315
mloconnor@debevoise.com

Steven J. Slutzky
Partner, New York
+1 212 909 6036
sjslutzky@debevoise.com



Jonathan R. Tuttle
Partner, Washington, D.C.
+1 202 383 8124
jrtuttle@debevoise.com

Kelly Donoghue
Associate, New York
+1 212 909 6145
kgdonoghue@debevoise.com

Mark D. Flinn
Associate, Washington, D.C.
+1 202 383 8005
mflinn@debevoise.com

Matt Hirsch
Associate, Washington, D.C.
+1 202 383 8076
mjhirsch@debevoise.com

Andrew Lee
Associate, New York
+1 212 909 7405
alee1@debevoise.com