

# Due Diligence Defense for Section 11 Liability

## Forensic Accounting & Advisory Services

Section 11 of the Securities Act imposes liability for underwriters, directors and others involved with a public securities offering. The statute also provides a due diligence defense for everyone, except the issuer. FTI Consulting professionals are uniquely qualified to provide services prior to the deal closing to strengthen the due diligence defense of those involved with an offering.

Our consultants and testifying experts can also assist, after-the-fact, in determining whether adequate due diligence was performed prior to the offering. FTI Consulting's professionals include former officials with the Securities and Exchange Commission (SEC), The Financial Accounting Standards Board (FASB), the Public Company Accounting Oversight Board (PCAOB), and former partners and managers with audit firms including the Big Four and their predecessor firms.

### Due Diligence Defense Overview

Section 11 of the Securities Act imposes liability on parties involved in a securities offering if the registration statement contains a materially false statement or material omission. The potential defendants under a Section 11 claim include the issuer, its directors, underwriters, professionals that certified any part of the registration statement (*e.g.*, auditors) and anyone that signs the registration statement. Section 11, however, also gives defendants (other than the issuer) a due diligence defense.

To effectively use the due diligence defense, a Section 11 defendant carries the burden of proof to demonstrate that he or she, after reasonable investigation, had reason to believe, and did believe, that the statements in the registration statement were true and free of material omissions. Without a due diligence defense, Section 11 claims can be difficult to defend since plaintiffs are not required to show scienter or that the misstatement or omission caused the plaintiff's loss.

Because FTI Consulting has seasoned professionals with vast experience in accounting standards, auditing, disclosure requirements, internal control over financial reporting (ICFR), and forensic accounting, we are the go-to resource when performing due diligence and establishing a due diligence defense for underwriters and others subject to Section 11 liability.

### Assessing the Independent Auditors

We are retained, prior to a securities offering, by underwriters looking to bolster their due diligence with regard to the issuer's independent auditors. With our first-hand experience as auditors and former staff with the PCAOB and SEC, we are uniquely positioned to assess the outside auditor's compliance with professional standards and the issuer's compliance with GAAP or IFRS. In addition, we assist underwriters in identifying risk areas in the financial statements, related notes, and other disclosures. Subsequent to a securities offering, FTI Consulting is often retained, as consulting and expert witnesses, to assess and opine on the auditor's compliance with professional standards.

### — SERVICE HIGHLIGHTS

- Due diligence efforts can be strengthened through a review of audit workpapers. Prior SEC and PCAOB staff members review the auditor's workpapers for compliance with auditing standards.
- Former FASB staff and a deep bench of former Big Four audit partners, managers and staff provide a "second set of eyes" on complex accounting and disclosure areas.
- Former SEC and PCAOB staff members provide regulatory focus and assist the issuer with responses to regulatory questions, such as SEC comment letters.
- Former SEC staff members review issuer's registration statement for omissions of required disclosures.
- Forensic Accountants with CPA and CFE designations investigate and report findings in response to allegations of improper accounting, FCPA violations or inadequate internal controls.
- Accounting experts from various industries consult on the application of proper GAAP, IFRS and/or SEC guidance on accounting and disclosure.
- On numerous occasions retained by underwriters, prior to an offering, to review audit workpapers and assess (a) the firm's compliance with professional standards and (b) whether the issuer's financial statements complied with GAAP.



### Responding to Regulators

FTI Consulting professionals have the credentials and backgrounds to help issuers respond to regulators. Our senior professionals have regulatory experience as well as technical accounting and auditing skills gained from service at the SEC, PCAOB and Big Four accounting firms. These relationships, training and experiences allow FTI Consulting to quickly and effectively respond to accounting, disclosure and auditing issues raised by regulators. We are well suited to assist the issuer with SEC comments or PCAOB inspection findings.

### Experience Across Industries and Jurisdictions

Accounting and auditing practices can vary among industries and jurisdictions. As a result, industry expertise is often required to effectively and efficiently address unique areas material to the issuer's financial statements. FTI Consulting professionals have extensive experience across many industries and jurisdictions around the world, enabling us to provide the necessary expertise to bear on virtually any accounting and auditing matter.





### — SERVICE HIGHLIGHTS

- Retained on numerous occasions by registrants to assist with the resolution of accounting and disclosure issues by pre-clearing these issues with the SEC prior to the effectiveness of a registration statement.
- Performed analytical review and inquiry of information included in a pharmaceutical company's financial statements to assess compliance with IFRS; and assessed the remediation status of a previously identified material weakness in ICFR.
- Retained by counsel for an international accounting firm to assist in after-the-fact defense of Section 11 liability claims. Provided consulting and expert services related to the auditor liability and damages aspect of the case.
- Retained by underwriter's counsel to provide expert services in after-the-fact defense of alleged legal malpractice due to insufficient due diligence in connection with a public securities offering.

### Second Set of Eyes for High Risk Areas

Certain issuers are more susceptible to misstated financial statements due to complex or highly judgmental accounting areas, weak ICFR or increased risk of fraud. When an issuer's financial statements are at an elevated risk for misstatement, potential Section 11 defendants are well advised to intensify their due diligence. FTI Consulting will bring the appropriate resources to bear to review the specific areas of high risk to provide expert insight and strengthen the due diligence defense.

### Damage Assessment

In situations where a party is facing potential liability after the public offering, FTI Consulting can assess damages and provide related expert witness services. Our experienced damage professionals will determine if there were other factors attributable to the failure of the Company, e.g., mismanagement, significant economic losses, deteriorating industry conditions or other reasons for the company's failure. We can also evaluate the deepening insolvency theory and assess whether a wrongful prolongation of the businesses life occurred or whether damages are de minimis in the case. We also analyze misrepresentations to determine whether they were material.

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