



## SEC Charges Ernst & Young With Auditor Independence Violations

July 22, 2014

On July 14, 2014, the Securities of Exchange Commission (“SEC”) instituted settled administrative and cease-and-desist proceedings against Ernst & Young LLP (“E&Y”) for violating auditor independence rules, marking the second time this year that the SEC charged a major public accounting firm with auditor independence violations.<sup>1</sup> The SEC found that a subsidiary of E&Y, Washington Council EY (“WCEY”), performed various legislative advisory services on behalf of two SEC-registered audit clients of E&Y, impermissibly placing E&Y in a position of being an advocate for its audit clients. The lobbying actions undertaken by WCEY on behalf of E&Y’s audit clients included:

- sending a letter from a senior executive of an audit client to congressional staff, encouraging the passage of certain legislation;
- sending a letter signed by an audit client to Congress’s leadership, urging the passage of certain legislation and requesting that certain items be included therein;
- asking a congressional staff member to include into a pending bill a specific provision requested by an audit client;
- meeting with congressional staff members in an attempt to persuade them to withdraw support for a legislative proposal detrimental to an audit client’s business interests;
- urging third parties to contact a U.S. Senator to request an amendment sought by an audit client to a legislative proposal and providing these third parties with alternative draft amendments to submit to the Senator; and
- working closely with a congressional staffer to draft an alternative bill that was more favorable to E&Y’s audit client than the originally proposed legislation and providing the staffer with specific language drafted by the audit client to be inserted into the alternative bill.

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<sup>1</sup> See [In the Matter of Ernst & Young LLP](#), Release No. 72602, File No. 3-15970 (July 14, 2014); see also [In the Matter of KPMG, LLP](#), Release No. 71389, File No. 3-15687 (Jan. 24, 2014); Simpson Thacher & Bartlett LLP, [SEC Institutes Administrative Proceedings Against KPMG For Auditor Independence Violations](#) (Feb. 11, 2014).

The SEC found that E&Y incorrectly stated that its audits were conducted in accordance with the standards of the Public Company Accounting Oversight Board and SEC regulations, both of which require an auditor to be independent from its client. While, in discussing auditor independence, Regulation S-X does not explicitly refer to lobbying activities, Regulation S-X makes clear that among other things, an independence determination considers “all relationships between the accountant and the audit client, and not just those relating to reports filed with the Commission.”<sup>2</sup> The SEC has long indicated that an auditor is not independent, for example, when the auditor acts as an advocate for its audit client during the audit and professional engagement period.<sup>3</sup> The SEC found that WCEY impermissibly advocated for E&Y audit clients by providing them with legislative advisory services.

### IMPLICATIONS FOR PUBLIC COMPANIES

The SEC’s order reminds publicly traded companies of the importance of maintaining robust policies and procedures to ensure that the work performed by their outside auditors does not violate auditor independence rules. Because an auditor’s impartiality is critical to the integrity of an issuer’s financial statements, impaired auditor independence can result in the auditor’s withdrawal of its audit reports for the period in question and can trigger the issuer’s requirement to disclose non-reliance on previously issued financial statements under Form 8-K, Item 4.02. Ensuring auditor independence, however, is not necessarily a simple task; the rules pertaining to auditor independence are complex and can be a stumbling block for the unwary. It is essential, therefore, that to the extent any questions arise, issuers’ policies and procedures include a mechanism for those with decision-making authority to liaise with the outside auditors to obtain their views (and, in appropriate circumstances, to confirm those views with outside counsel) prior to making a recommendation to the company’s audit committee regarding whether a particular service should be approved.

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If you have any questions or would like additional information, please do not hesitate to contact [Yafit Cohn](mailto:yafit.cohn@stblaw.com) at (212) 455-3815 or [yafit.cohn@stblaw.com](mailto:yafit.cohn@stblaw.com), or any other member of the Firm’s Public Company Advisory Practice.

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<sup>2</sup> Rule 2-01(b) of Regulation S-X, 17 C.F.R. §210.2.01(b).

<sup>3</sup> See Preliminary Note to Rule 2-01 of Regulation S-X, 17 C.F.R. §210.2.01, ¶2; “Revision of the Commission’s Auditor Independence Requirements,” Exchange Act Release No. 42994, 45 Fed. Reg. 43148, 43149 (July 12, 2000) (Proposing Release).

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