

# Memorandum

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## SEC Sanctions Chinese Affiliates of “Big Four” Auditing Firms

February 23, 2015

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On February 6, 2015, the Securities and Exchange Commission (“SEC”) announced a settlement with the Chinese affiliates of the “Big Four” auditing firms – Ernst & Young, KPMG, Deloitte, and Pricewaterhouse Coopers – resolving an administrative proceeding instituted against the firms in 2012 due to their refusal to produce requested audit work papers to the SEC.<sup>1</sup> An initial decision issued by an administrative law judge in January 2014 had found that the Chinese accounting firms willfully refused to provide the audit work papers in violation of Section 106 of the Sarbanes-Oxley Act of 2002 and the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and thus censured the firms and denied them the privilege of practicing or appearing before the SEC for six months.<sup>2</sup> Both the SEC’s Division of Enforcement and the respondents appealed the judge’s ruling to the SEC, ultimately leading to the current settlement.

The SEC’s order implementing the settlement includes a finding “that each Settling Respondent willfully refused to comply with the requests that were issued to it under Section 106, and each Settling Respondent willfully violated Section 106 of the Sarbanes-Oxley Act.” The order:

- censures each of the auditing firms “for its willful violations of the securities laws”;
- memorializes certain undertakings by each of the firms, including a payment by each of the firms in the

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<sup>1</sup> See *In the Matter of BDO China Dahua CPA Co., Ltd., et al.*, “[Order on the Basis of Offers of Settlement of Certain Respondents Implementing Settlement](#),” Securities Exchange Act Release No. 74217; File Nos. 3-14872, 3-15116 (Feb. 6, 2015).

<sup>2</sup> For a summary of the underlying facts and the administrative law judge’s initial decision, see Simpson Thacher & Bartlett LLP, “[Administrative Law Judge Temporarily Bars Chinese Affiliates of ‘Big Four’ Auditing Firms From Practice](#)” (Feb. 18, 2014).

- amount of \$500,000 to the United States Treasury;
- stays the proceeding against the firms for a period of four years, during which time the firms must “perform specified undertakings in response to any future requests for documents covered by Section 106 of Sarbanes-Oxley,” and indicates that if the proceeding is not restarted within four years, it will be deemed dismissed;
  - specifies procedures that the firms must follow “in response to any future requests for documents covered by Section 106 of Sarbanes-Oxley”; and
  - provides “at least three additional forms of relief in the event the Division [of Enforcement] is unsatisfied by the productions of documents that it receives in response to future requests.” Depending on the circumstances, the SEC may:
    - enter an order “that partially denies the Settling Respondent the privilege of practicing or appearing before the Commission, for a period of six (6) months”;
    - commence a new, expedited administrative proceeding against the non-compliant firm; or
    - terminate the stay and restate the current proceeding.

### Significance of the Settlement

The sanctions imposed on the Chinese accounting firms underscore that firms registered with the Public Company Accounting Oversight Board that perform audit work for U.S. issuers must, upon request, produce audit work papers to the SEC – regardless of any foreign laws that purportedly prevent them from doing so – and that refusal to comply with the SEC’s request for these documents can have severe consequences. As noted by the Associate Director of the SEC’s Enforcement Division, Antonia Chion, “[t]he settlement is an important milestone in the SEC’s ability to obtain documents from China,” which the SEC hopes to be “an enduring milestone.”<sup>3</sup>

The settlement lifts the uncertainty regarding the impact of the enforcement action on U.S. issuers with operations in China. Unlike the administrative law judge’s initial decision, which imposed a temporary practice bar on China’s “big four” accounting firms and thus would have required the Chinese branches of U.S.-traded companies to find substitutes for these firms to perform their audits, the terms of the settlement have no bearing on issuers, so long as the audit firms remain in compliance and the practice bar is not instated.

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<sup>3</sup> U.S. Securities and Exchange Commission, “[SEC Imposes Sanctions Against China-Based Members of Big Four Accounting Networks for refusing to Produce Documents](#)” (Feb. 6, 2015).

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If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** 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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**UNITED STATES**

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New York  
425 Lexington Avenue  
New York, NY 10017  
+1 212-455-2000

Houston  
2 Houston Center  
909 Fannin Street  
Houston, TX 77010  
+1 713-821-5650

Los Angeles  
1999 Avenue of the Stars  
Los Angeles, CA 90067  
+1 310-407-7500

Palo Alto  
2475 Hanover Street  
Palo Alto, CA 94304  
+1 650-251-5000

Washington, D.C.  
1155 F Street, N.W.  
Washington, D.C. 20004  
+1 202-636-5500

**EUROPE**

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London  
CityPoint  
One Ropemaker Street  
London EC2Y 9HU  
England  
+44 (0)20-7275-6500

**ASIA**

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Beijing  
3919 China World Tower  
1 Jian Guo Men Wai Avenue  
Beijing 100004  
China  
+86 10-5965-2999

Hong Kong  
ICBC Tower  
3 Garden Road, Central  
Hong Kong  
+852 2514-7600

Seoul  
West Tower, Mirae Asset Center 1  
26 Eulji-ro 5-gil, Jung-gu  
Seoul 100-210  
Korea  
+82 2-6030-3800

Tokyo  
Ark Hills Sengokuyama Mori  
Tower  
9-10, Roppongi 1-Chome  
Minato-Ku, Tokyo 106-0032  
Japan  
+81 3-5562-6200

**SOUTH AMERICA**

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São Paulo  
Av. Presidente Juscelino  
Kubitschek, 1455  
São Paulo, SP 04543-011  
Brazil  
+55 11-3546-1000