

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of :
:
BDO CHINA DAHUA CPA CO., LTD., :
ERNST & YOUNG HUA MING LLP, :
KPMG HUAZHEN (SPECIAL GENERAL : INITIAL DECISION (PUBLIC)
PARTNERSHIP), : January 22, 2014
DELOITTE TOUCHE TOHMATSU CERTIFIED :
PUBLIC ACCOUNTANTS LTD., and :
PRICewaterHOUSECOOPERS ZHONG :
TIAN CPAs LIMITED :

APPEARANCES: David Mendel, Jan Folena, Amy Friedman, Douglas A. Gordimer, David J. Gottesman, and Marc E. Johnson, Esqs., representing the Division of Enforcement, Securities and Exchange Commission

Deborah R. Meshulam and Grayson D. Stratton, Esqs., representing Respondent BDO China Dahua CPA Co., Ltd.

Richard Martin, Justin P. Bagdady, Robert G. Cohen, and James A. Meyers, Esqs., representing Respondent Ernst & Young Hua Ming LLP

Neal E. Sullivan, Griffith L. Green, Timothy B. Nagy, and Giancarlo M. Pellegrini, Esqs., representing Respondent KPMG Huazhen (Special General Partnership)

Miles N. Ruthberg, Michael D. Warden, Gary F. Bendinger, Chanda M. Betourney, James J. Farrell, David A. Gordon, Elizabeth L. Howe, Brian E. Kowalski, and Jamie L. Wine, Esqs., representing Respondent Deloitte Touche Tohmatsu Certified Public Accountants Ltd.

Michael S. Flynn, Gina Caruso, and Lindsay Knapp, Esqs., representing Respondent PricewaterhouseCoopers Zhong Tian CPAs Limited

BEFORE: Cameron Elliot, Administrative Law Judge

SUMMARY

This Initial Decision finds that Respondents should be sanctioned pursuant to Securities and Exchange Commission (Commission or SEC) Rule of Practice (Rule) 102(e)(1)(iii) for willfully violating the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), Section 106 (Sarbanes-Oxley 106), as amended by Section 929J of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), and codified at 15 U.S.C. § 7216, and the Securities Exchange Act of 1934 (Exchange Act). This Initial Decision censures and denies the privilege of practicing or appearing before the Commission for a period of six months to Respondents Ernst & Young Hua Ming LLP (E&Y), KPMG Huazhen (Special General Partnership) (KPMG), Deloitte Touche Tohmatsu Certified Public Accountants Ltd. (DTTC), and PricewaterhouseCoopers Zhong Tian CPAs Limited (PwC), and censures Respondent BDO China Dahua CPA Co., Ltd. (Dahua).¹

I. INTRODUCTION

A. Procedural Background

The Commission issued a Second Corrected Order Instituting Administrative Proceedings (DTTC OIP) on May 9, 2012, against Respondent DTTC, pursuant to Rule 102(e)(1)(iii). The DTTC OIP alleges that DTTC willfully refused to furnish its audit work papers and other documents relating to its audit work to the Commission, pursuant to Sarbanes-Oxley 106, in connection with its audit work for an issuer, Client A (DTTC Client A). DTTC filed its Answer on June 5, 2012.

The Commission issued an Order Instituting Administrative Proceedings (Omnibus OIP) on December 3, 2012, against all Respondents, also pursuant to Rule 102(e)(1)(iii). The Omnibus OIP alleges that all Respondents willfully refused to furnish their audit work papers and other documents relating to their audit work to the Commission, pursuant to Sarbanes-Oxley 106, in connection with audit and interim review work for nine issuers, Clients A through I (Clients A through I). Respondents submitted their Answers on January 7, 2013.

The two proceedings were consolidated on December 20, 2012, pursuant to Commission Rule 201(a). I held a hearing on July 8-12, 22-25, and 29-31, 2013, at the Commission's headquarters in Washington, D.C. The Division of Enforcement (Division) and Respondents thereafter filed post-hearing briefs and post-hearing reply briefs.² The admitted exhibits are listed in the revised Record Index issued by the Office of the Secretary on January 22, 2014.

¹ As of January 2, 2013, DTTC is officially Deloitte Touche Tohmatsu Certified Public Accountants LLP. Tr. 1633-34, 1691; Resp. Ex. 267. As of April 30, 2013, Dahua is no longer affiliated with BDO International Limited, and its name is now Dahua CPA Co., Ltd. Tr. 2052.

² Citations to the transcript of the hearing are noted as "Tr. ____" and "July 31, 2013, Sealed Tr. ____." Citations to Respondents' various Answers to the Omnibus OIP are noted as "[Respondent] Omnibus OIP Answer ____" and to DTTC's Answer to the DTTC OIP as "DTTC

B. Summary of Allegations

The Omnibus OIP and DTTC OIP, read together, allege as follows. Respondents performed audit work for ten different U.S. issuers whose securities were registered with the Commission and whose operations are principally based in the People's Republic of China (China). Omnibus OIP at 3; DTTC OIP at 2. The ten issuers, Clients A through I and DTTC Client A, were or are the targets of fraud investigations by the Division. Omnibus OIP at 3; DTTC OIP at 2. Pursuant to Sarbanes-Oxley 106, the Division served requests for audit work papers and related documents pertaining to the ten issuers on all Respondents, through their designated U.S. agents, at various times between March 11, 2011, and April 26, 2012. Omnibus OIP at 3-4; DTTC OIP at 2. Each Respondent willfully refused to produce any audit work papers, which constitutes a violation of Sarbanes-Oxley 106 and of the Exchange Act. Omnibus OIP at 4-5; DTTC OIP at 3. The Division contends that each Respondent should accordingly be censured or denied the privilege of appearing or practicing before the Commission, pursuant to Rule 102(e)(1)(iii), which authorizes such sanctions on a respondent who has willfully violated any provision of the Federal securities laws. See Omnibus OIP at 5; DTTC OIP at 3; 17 C.F.R. § 201.102(e)(1)(iii).

In their Answers, Respondents denied most of the key allegations. They also asserted, as to Dahua, twenty-two defenses, as to E&Y, twenty-four defenses, as to KPMG, twenty-six defenses, as to PwC, twenty-one defenses, and as to Deloitte, seventeen defenses to the Omnibus OIP and seventeen defenses to the DTTC OIP. Dahua Omnibus OIP Answer at 12; E&Y Omnibus OIP Answer at 14; KPMG Omnibus OIP Answer at 13; PwC Omnibus OIP Answer at 18; DTTC OIP Answer at 11; DTTC Omnibus OIP Answer at 18. Not all defenses actually constitute affirmative defenses, and not all defenses are addressed in Respondents' post-hearing briefs.

C. Confidentiality

A large amount of material in this case has been filed under seal in order to maintain its confidentiality. In some cases, the confidentiality of a particular document or testimony is not readily apparent, and in some cases, it is. Although the vast bulk of the testimony and exhibits were presented publicly, in open court, I have determined that certain sections of this Initial Decision, including sections discussing testimony presented in open court, should be sealed. I have accordingly issued two Initial Decisions, an Initial Decision (Public) and an Initial Decision (Sealed), which are identical except that the public version contains redactions of sections I have determined should not be publicly disclosed, and the sealed version has a "SUBJECT TO PROTECTIVE ORDER – OUTSIDE COUNSEL'S EYES ONLY" designation at the top of each page.

OIP Answer ____." Citations to exhibits offered by the Division and Respondents are noted as "Div. Ex. ____." and "Resp. Ex. ____.", respectively. The Division's and Respondents' post-hearing briefs are noted as "Div. Br. ____." and "Resp. Br. ____.", respectively. The Division's and Respondents' post-hearing reply briefs are noted as "Div. Reply ____" and "Resp. Reply ____", respectively. The Division's and Respondents' prehearing briefs are noted as "Div. Prehearing Br. ____." and "Resp. Prehearing Br. ____.", respectively.

As a general proposition, the redacted sections fall into two categories. First, I have redacted much of the discussion of the testimony and opinions of the expert witnesses offered on the subject of sanctions. Two of those experts testified entirely non-publicly, and their expert reports were filed under seal. Because their opinions rely on non-public information, including proprietary information, there is a substantial risk that disclosing their testimony and opinions will reveal confidential information. At the same time, I have determined that the probative value of the opinions of all the sanctions-related expert witnesses is extremely low, as explained infra. Thus, the potential cost of disclosing their testimony and opinions greatly outweighs the benefits of disclosure. 17 C.F.R. § 201.322(b).

Second, I have redacted large portions of the factual findings and legal discussion pertaining to Chinese law and interactions between the Commission and the China Securities Regulatory Commission (CSRC). I am hopeful that the Commission and the CSRC will continue to constructively engage each other. However, some passages of this Initial Decision discuss the Commission, the CSRC, and their interaction more candidly than is customary in diplomatic circles. I am therefore concerned that some of my factual findings and legal discussion may interfere with any ongoing discussions between the Commission and the CSRC, and this consideration is of paramount importance. Accordingly, although the expert testimony regarding Chinese law, and the testimony pertaining to interactions between the Commission and the CSRC, were entirely in open court, I find that the potential cost of disclosing some of my factual findings and legal discussion on these issues outweighs the benefits of disclosure, so much so that they should be issued under seal. 17 C.F.R. § 201.322(b).

Because some of the redacted material contains or discloses commercially sensitive or proprietary information, the Initial Decision (Sealed) is subject to the Stipulated Protective Order entered May 9, 2013, as modified by the Joint Stipulation and Amendment to Stipulated Protective Order entered July 29, 2013. However, because the Initial Decision (Sealed) contains or discloses commercially sensitive or proprietary information as to all Respondents, no partner, principal, employee, in-house counsel, or witness of Respondents or Respondents' global network should have access to it. Accordingly, the Initial Decision (Sealed) should be treated generally as "CONFIDENTIAL – SUBJECT TO PROTECTIVE ORDER – FILE UNDER SEAL – OUTSIDE COUNSEL'S EYES ONLY," except that no partner, principal, employee, in-house counsel, or witness of Respondents or Respondents' global network shall review it.

II. FINDINGS OF FACT

The findings and conclusions herein are based on the entire record. I applied preponderance of the evidence as the standard of proof. See Steadman v. SEC, 450 U.S. 91, 102 (1981). I have considered and rejected all arguments, proposed findings, and conclusions that are inconsistent with this Initial Decision.

A. Dahua

Dahua is an accounting firm headquartered in Beijing, China. Tr. 2048-49. It has twenty offices in China and no offices outside of China, and approximately 3,500 employees. Tr. 2049.

Ji Feng (Ji), Dahua's only lay witness, has been employed by Dahua for twelve years and was Dahua's executive partner in charge of quality control in 2011 and 2012. Tr. 2049-50. He is currently in charge of one of Dahua's six headquarters business divisions and its headquarters management and consulting division. Tr. 2050.

Dahua "ranks number 10" among accounting firms in China. Tr. 2051. Dahua provides auditing, management, and consulting services to Chinese listed companies, initial public offerings, large state owned companies, and other companies. Tr. 2051. Dahua formerly provided services to Chinese companies with securities listed in the U.S., but in response to this proceeding, it exited that market and terminated its relationships with such clients. Tr. 2051. To develop its ability to provide services to China-based U.S. issuers, Dahua provided specialized training to its employees and recruited professionals with English proficiency and appropriate work experience. Tr. 2051-52. Dahua has or had a division that focused on work for China-based U.S. issuers, with offices in Beijing, Shenzhen, and Wuhan. Tr. 2052. Dahua was a member firm of the BDO international network until April 30, 2013. Tr. 2052. It left the BDO international network for reasons unrelated to this proceeding. Tr. 2053.

Dahua is regulated in China by the Chinese Ministry of Finance (MOF) and the CSRC. Tr. 2053. Dahua registered with the Public Company Accounting Oversight Board (Board or PCAOB) in 2006. Tr. 2053-54. Its registration with the Board was its first registration with a foreign regulator. Tr. 2054. It registered with the Board because China-based U.S. issuers wanted to hire Dahua as their auditor. Tr. 2054.

Dahua stated in its application to the Board that it could not provide work papers or related documents directly to the Board. Tr. 2054-55. This statement was based at least in part upon a June 15, 2005, letter from the Century-Link & Xin Ji Yuan (Century-Link) law firm, which opined that Chinese law prevented Dahua from giving work papers directly to U.S. regulators. Tr. 2101-02; Div. Ex. 148, Exhibit 5. The Board accepted Dahua's application, but told Dahua that it was obligated to follow U.S. law. Tr. 2055, 2057, 2104. In its annual reports to the Board, Dahua stated that because of Chinese law, Dahua could not provide work papers and related documents directly to the Board. Tr. 2057. The Board did not respond to any of these statements in Dahua's annual reports, which led Dahua to believe that the Board accepted the statements. Tr. 2058, 2105-06.

Pursuant to Chinese law, Dahua has a file management policy and a file management office staffed by file management personnel. Tr. 2058. When work papers are filed and sorted, they are delivered to the file management office and preserved for the required period. Tr. 2058. Dahua considers its work papers to be archives. Tr. 2058-59.

1. Client A Investigation

Client A,³ a former client of Dahua, is located in Fujian Province, China, and is incorporated in Nevada. Tr. 607, 2059-60, 2084, 2096; Div. Ex. 30 at 3. Client A markets and

³ The parties have agreed to refer to the ten clients under investigation by letter designation, in order to minimize their public exposure. E.g., Tr. 605-06. Because the actual identities of the

distributes fresh seafood products and dried seafood products, and has an algae-based drink business. Tr. 607. Its securities are registered with the Commission and trade on the New York Stock Exchange (NYSE). Tr. 607. Dahua was engaged to prepare an audit report for Client A, and performed its audit work on site, in China. Tr. 2060. Dahua's Client A work papers are located in Shenzhen, China. Tr. 2060. Client A's current auditor is Li Xin, another Chinese accounting firm. Tr. 2053, 2121.

Daniel Weinstein (Weinstein) has been employed by the Commission since September 1997 as a senior counsel with the Division. Tr. 603-04. He testified for the Division regarding Client A. The Commission opened an investigation into Client A in 2011, based on a transaction reported in a form 8-K/A filed March 16, 2010. Tr. 606, 608, 648; Div. Ex. 36. The transaction was an acquisition of a company by Client A for \$27 million, even though the primary asset of the acquired company, which the form 8-K/A characterizes as "Algae-based drink know-how," had been obtained five months before for \$8600. Tr. 608; Div. Ex. 36 at F-14.

As part of the investigation, Weinstein sought documents directly from Client A, including acquisition valuations, and received all of them except for those identified in a privilege log. Tr. 610, 644. The privilege log did not cite impediments under Chinese law to producing documents. Tr. 610. Also, certain Client A executives testified during the investigation. Tr. 644.

Also as part of the investigation, Weinstein sought Dahua's audit work papers in connection with their audit of Client A. Tr. 616. Dahua was engaged as Client A's auditor in October 2010, a fact reflected in a form 8-K filed November 2, 2010. Tr. 611-12; Div. Ex. 32 at 3. Client A filed a form 10-K on March 2, 2011, for the fiscal year ended December 31, 2010, which included an unqualified audit opinion by Dahua. Tr. 615, 2099; Div. Ex. 31 at F-2. Dahua's audit work papers were requested because the investigators had reason to doubt the valuation of the acquired company's principal asset. Tr. 616-17. The work papers would reveal facts about the algae-based drink business, and would disclose whether Dahua had performed an "impairment analysis" and their procedure for doing so. Tr. 617.

Weinstein sent a subpoena on May 19, 2011, to BDO USA, LLP (BDO USA), seeking BDO USA's audit work papers for Client A, among other things. Tr. 624; Div. Ex. 281. Although BDO USA eventually produced certain documents, they did not produce any audit work papers for Client A. Tr. 624-25. Weinstein also sent a voluntary request for Dahua's audit work papers on May 19, 2011, to BDO USA's general counsel, who had agreed to forward the request to Dahua. Tr. 617-18; Div. Ex. 280. Weinstein did not consider it appropriate to communicate directly with Dahua or with individuals in China. Tr. 684-85. He understood that the Commission and the CSRC, but not the MOF, are signatories to a Multilateral Memorandum of Understanding (MMOU). Tr. 657-58, 687.

clients are of minimal relevance, this Initial Decision follows the same practice. I note, however, that the identities of the clients are readily ascertainable because they have generally not been redacted from the exhibits admitted at the hearing.

In response to the voluntary request, Ji telephoned Director Lim Qiyang of the regulation and examination bureau of the MOF. Tr. 2062-63. Ji was told that according to Chinese law, Dahua could not provide work papers directly to the Commission. Tr. 2064.

BDO USA responded on May 25, 2011, by forwarding an email from Joan Chen (Chen) at Dahua, in which Dahua stated it “would like to provide documents” but “has decided to withhold” them because under Chinese law “any domestic accounting firm should not voluntarily submit any audit information as well as working papers of a client to any foreign government investigation agency.” Tr. 619-20; Div. Ex. 282. Dahua cited to a request made on May 24, 2011, to the MOF, which directed Dahua not to produce the requested documents, and referred the Commission to the MOF. Div. Ex. 282.

Weinstein considered this response to be unduly vague, and so sent another letter to BDO USA on August 3, 2011, requesting clarification. Tr. 621-22; Div. Ex. 283. BDO USA responded on October 17, 2011, by email to Weinstein, forwarding another email from Chen. Tr. 622; Div. Ex. 284. Chen’s second email again stated that Dahua “would like to provide documents” but “decided to withhold” them, cited to its May 24, 2011, request to the MOF, and referred the Commission to the MOF. Div. Ex. 284. It also cited to Article 21 of the Law on Guarding State Secrets of China (State Secrets Law) and to Article 22 of the Measures for Implementation of the State Secrets Law. Div. Ex. 284.

Weinstein considered Dahua’s second response to be insufficiently specific, and so he discussed the matter with the Commission’s Office of International Affairs (OIA). Tr. 623. Weinstein had previously sought and obtained documents from foreign regulators by working with OIA, although in one instance it took “a number of months” to obtain the documents. Tr. 644-46, 650. As a result of discussions with OIA, which revealed that requests made to the CSRC in other investigations had not been fruitful, the investigators determined in approximately October 2011 not to submit such a request to the Chinese government as to Client A. Tr. 623, 643, 659.

On October 10, 2011, Ji attended a meeting with representatives of the MOF, the CSRC, and five other Chinese accounting firms, namely, the other Respondents and GT International. Tr. 2064, 2116. The MOF and CSRC officials “explicitly” stated three opinions. Tr. 2064. First, they said that Chinese accounting firms must abide by Chinese laws and they cannot provide work papers and related documents to overseas regulators directly. Tr. 2064-65. Second, they said that legal penalties would be imposed on firms that provide work papers without authorization. Tr. 2065. Third, they said that if any overseas regulatory agencies request access to work papers, they should discuss the matter with Chinese regulatory authorities. Tr. 2065.

These three points were documented in a letter dated October 26, 2011 (Letter 437), which the CSRC faxed to Dahua. Tr. 2065-66; Resp. Ex. 20. For unknown reasons, Dahua did not receive Letter 437 until June 2012. Tr. 2088-89, 2115-17; Resp. Exs. 20-A, 651. Dahua did not rely on Letter 437 in its initial response to the Sarbanes-Oxley 106 request because Dahua was already “very aware” of the MOF’s position. Tr. 2119. Dahua knew of the MOF’s position, and the CSRC’s similar position, as early as 2005, before registering with the Board. Tr. 2120.

Ji understood that Letter 437 was disseminated privately, not publicly, to the six accounting firms in attendance at the October 10, 2011, meeting. Tr. 2116. During his testimony, Ji underlined in red the portion of Letter 437 that stated, in Mandarin, “cannot provide work papers.” Tr. 2110-12; Div. Ex. 350 at 3.

2. Client A Sarbanes-Oxley 106 Request

Weinstein sent a request to Dahua, via BDO USA, on February 1, 2012, pursuant to Sarbanes-Oxley 106, seeking “[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client A] for the fiscal year ending December 31, 2010.” Tr. 625; Div. Ex. 34. Dahua designated BDO USA as its U.S. agent for service under Sarbanes-Oxley 106 no later than August 2011. Div. Ex. 165A at 25-28.

Dahua received the Sarbanes-Oxley 106 request on or about February 1, 2012. Tr. 2108. In response, Ji contacted the CSRC. Tr. 2089. The CSRC, like the MOF in May 2011, told Ji that Dahua could not provide audit work papers and related documents directly to overseas agencies, and if it did so without prior authorization, Dahua would be held legally responsible. Tr. 2090. Although Dahua was “very willing” to provide the work papers, they did not do so, in compliance with Chinese law and the CSRC’s opinion. Tr. 2090. According to Ji, Dahua had “no choices” in the matter. Tr. 2125, 2131.

Dahua responded to the Sarbanes-Oxley 106 request by letter dated April 2, 2012, with Chen’s two previous emails attached, but without any audit work papers. Tr. 627; Div. Ex. 35. The letter stated, among other things, that Dahua “cannot produce documents responsive to the Investigation directly to the [Commission] because such production will violate [Chinese] law and expose [Dahua] and its employees to serious civil and criminal liability.” Div. Ex. 35 at 1. The letter also stated that Dahua “would welcome the cooperation of the [Commission] and the CSRC in [Dahua’s] production of documents.” Div. Ex. 35 at 1. After a summary of Dahua’s understanding of Chinese state secrets law, the letter explained that Dahua had sought consent to produce the requested documents from the CSRC, the MOF, the State Secrets Bureau, and the State Archives Bureau, without success, and that absent such consent, it would be “impossible . . . for [Dahua] to produce its documents.” Div. Ex. 35 at 2. In closing, the letter stated that Dahua “cannot responsibly take steps that could expose itself and its employees to draconian sanctions – including prison time.” Div. Ex. 35 at 3. Dahua did not identify any particular documents that had been designated as state secrets, nor did the Chinese government state that the requested documents were designated as state secrets. Tr. 631-32, 634.

Weinstein made no further inquiries to determine whether Dahua accurately characterized its assertions, nor have they issued a subpoena to Dahua, requested the documents from any Chinese regulatory agency, or attempted to enforce the Sarbanes-Oxley 106 request in court. Tr. 674, 680-83. The lack of audit work papers hindered the Division’s investigation because it prevented review of how the auditors examined Client A’s corporate acquisition and the viability of the acquired company, and how they tested the “validity of the business.” Tr. 634-35. The investigation remains open but has resulted in no enforcement action, and the investigators are trying to determine their next step. Tr. 635, 655.

On May 3, 2012, after a “Wells call” with the general counsel of BDO USA, Weinstein sent a Wells notice to Dahua via BDO USA, notifying Dahua that the Division intended to recommend initiation of the present action. Tr. 635-36; Div. Ex. 140. In response, Dahua provided a written report for the MOF and the CSRC, notifying those agencies that it had received the Wells notice. Tr. 2091-92; Resp. Ex. 52. The report warned that Dahua might “face fines and be [stripped] of the status of a qualified auditor in the U.S. securities market,” noted that DTTC had already been the subject of an administrative proceeding, and requested both guidance on how to proceed and permission to produce the requested audit work papers. Tr. 2091-92; Resp. Ex. 52 at 17-18. The CSRC responded in a private communication, essentially repeating its previous position. Tr. 2091-92. Neither the MOF nor the CSRC gave permission to produce the requested work papers. Tr. 2092. Dahua, through counsel, made a Wells submission by letter dated June 4, 2012, which included a copy of a letter from the CSRC to DTTC, dated October 11, 2011 (Letter 413), that is very similar to Letter 437. Tr. 2127; Div. Ex. 148, Exhibit 1.

In December 2012, after the OIP was issued and received by Dahua, Dahua once again provided a written report for the MOF and the CSRC, notifying those agencies of the situation. Tr. 2093; Resp. Ex. 56. Dahua once again had a private conversation with the CSRC, on approximately December 5, 2012, in which the CSRC once again repeated its previous position and declined to permit production of the requested work papers, and also stated that Dahua had discretion in how to respond to the present proceeding. Tr. 2093-95. Dahua also published a notice of the pending proceeding on its website. Tr. 2093; Resp. Ex. 56 at 8.

On December 10, 2012, Ji attended a meeting with representatives of the MOF, the CSRC, and the other Respondents, at which Respondents reported on the present proceeding. Tr. 2095. The MOF and the CSRC reiterated their previous positions, and again said that the accounting firms had discretion in how to respond to the present proceeding. Tr. 2096. There was no discussion at this meeting about a state secrets review by any of the firms in attendance. Tr. 2124.

Ji opined that if Dahua lost its registration with the Board, Dahua would lose all its business in the U.S. market, its reputation would be hurt because clients might mistakenly think that Dahua was sanctioned for poor audit quality, and its investment in specialized staff, training, and technical support directed to the U.S. market would have been wasted. Tr. 2096-97. Dahua has stopped taking on any new China-based U.S. issuers as clients and terminated its existing contracts with such clients. Tr. 2097-98. It retains its Board registration, however, and plans to keep its registration current. Tr. 2102-03.

B. E&Y

E&Y is an accounting firm established in Beijing, China in 1992. Tr. 1398-99. It performs services in mainland China and has no offices or employees outside of China. Tr. 1401. Two persons testified for E&Y, Alden Leung (Leung) and Randall Leali (Leali). Tr. 1397, 1728. Leung, who has a degree in economics from the University of Manchester in the U.K. and is a qualified accountant in China and the U.K., has worked at Ernst & Young since 1994. Tr. 1397, 1490-91. He has been a partner since 2000, and since 2007 he has been quality

and risk management leader for China, Hong Kong, and Taiwan. Tr. 1397-98. He helps engagement teams, including those at E&Y, provide quality service, handles regulatory matters, and manages risk in areas such as investigations, inspections, and litigation. Tr. 1398. Leali, who has been licensed as a certified public accountant (CPA) since 1986, has worked at Ernst & Young or an affiliated or predecessor firm since 1984, mainly in northeast Ohio. Tr. 1728. He transferred to Hong Kong in 2006 as professional practice director for the Far East area, where he worked with E&Y. Tr. 1728-30. He was the head tactical accounting and auditing partner, with four areas of supervision: capital markets, inspections, audit methodology, and consultation regarding U.S. and international financial reporting standards. Tr. 1729-30. The capital markets group exercised a quality control function over U.S. regulatory filings. Tr. 1486, 1750-51. Leali moved to Ernst & Young's Chicago office in June 2013. Tr. 1728, 1750.

E&Y provides primarily auditing and assurance services. Tr. 1399. It prepares audit reports for U.S. issuers, although it did not in 1992. Tr. 1399. In 1992, it had one office with about 100 employees, in 2004 it had five offices with 1,288 employees, including 1,046 accountants and 229 CPAs, in 2012 it had eight offices with 4,275 employees, including 3,746 accountants and 998 CPAs, and as of the hearing it had about 1,100 CPAs. Tr. 1482-84; Resp. Ex. 605. E&Y developed expertise in the auditing of U.S.-related engagements, which included special training and the establishment of the capital markets group. Tr. 1486-87. The capital markets group had ten employees in Hong Kong in 2006, and by 2013 it had forty employees in Hong Kong, Beijing, and Shanghai. Tr. 1751. The growth in the practice group was the result of market demand centered on initial public offerings, presumably in the U.S., and involved recruiting bilingual professionals. Tr. 1751-52. E&Y audited three foreign private issuers in 2006, and over twenty in 2013. Tr. 1752. E&Y is a member of the EY Global Network of Ernst & Young firms. Tr. 1402.

E&Y is licensed and regulated in China by the MOF and the CSRC. Tr. 1399-1400. The MOF and the CSRC report to the State Council of China, which is headed by the Chinese premier. Tr. 1400. Both agencies have the power to license, supervise, inspect, and sanction Chinese accounting firms. Tr. 1400. Sanctions may include reprimands, suspensions, and license revocations. Tr. 1401. E&Y maintains its work papers in mainland China. Tr. 1401. This is pursuant to Chinese law, namely, CSRC announcement 29 of 2009 (Reg 29), which prohibits work papers from leaving China without approval of the regulatory authorities. Tr. 1402.

E&Y registered with the Board in 2004. Tr. 1402-03; Resp. Ex. 1. It files annual reports with the Board, and since 2010, Leung has signed them. Tr. 1403. E&Y stated in its application to the Board that it "might not be able to comply" with Board requests for documents or testimony, because of Chinese law. Tr. 1498-99; Resp. Ex. 1 at 33. This statement was based at least in part upon an April 29, 2004 letter from Century-Link, which opined that Chinese law prevented E&Y from complying with such requests. Tr. 1499-1500; Resp. Ex. 1 at 22, 33. According to the letter, possible penalties for legal violations include an order to cease the illegal conduct and a fine. Tr. 1499-1501. The letter also concludes that both the sender (i.e., the accounting firm) and the recipient (e.g., the Board) of requested documents could be held legally liable for violating Chinese law. Tr. 1595-96; Resp. Ex. 1 at 36. E&Y expected a resolution between the U.S. and China on any rules conflicts. Tr. 1503, 1506. The Board accepted E&Y's

application, but told E&Y that it was obligated to follow U.S. law. Tr. 1505-06; Div. Ex. 8. In its 2010, 2011, and 2012 annual reports to the Board, E&Y declined to affirm that it consented to cooperate with Board investigations, but also disclosed that it had completed audits of eleven, twenty-three, and twenty-one U.S. issuers, respectively, for all of which E&Y had been paid. Tr. 1507-12; Div. Ex. 18 at 6-7, 19; Div. Ex. 19 at 6-9, 20; Div. Ex. 20 at 6-9, 20.

1. Client B Investigation

Client B, a former client of E&Y, is based in China, where it manufactures and distributes organic fertilizer, and was incorporated in Delaware as of March 2011. Tr. 471, 1730; Div. Ex. 42 at 2. Its securities traded on NASDAQ beginning in 2009, NASDAQ delisted its securities in April 2012, and its registration was revoked as a result of an enforcement proceeding in October 2012. Tr. 471-72, 517-19; Resp. Exs. 9, 36. Crowe Horwath LLP (Crowe Horwath) (or its predecessor in interest) was Client B's auditor for fiscal years 2008 and 2009, and audited its 2008 and 2009 financial statements. Tr. 472-73, 475; Div. Ex. 40 at 59; Div. Ex. 41 at 3.

E&Y was engaged on November 13, 2010, by Client B to perform an integrated audit for the year ended December 31, 2010. Tr. 473, 1403, 1730-31; Div. Ex. 41 at 3. It never conducted a review or completed an audit before being terminated on March 14, 2011, although it did do some audit work. Tr. 496, 1547; Resp. Ex. 8 at 2. In December 2010, the engagement team approached Leali about certain findings, mostly related to internal controls, and which included a refusal of access to Client B's facility in Harbin, China. Tr. 1731. Leali advised the engagement team to put their findings in writing and give the letter to the audit committee, which they did. Tr. 1731-32. That E&Y might give such a letter to the audit committee was actually written into their engagement letter. Tr. 501; Resp. Ex. 566 at 1. Leali had an additional meeting about new findings regarding Client B in Beijing in January 2011. Tr. 1732.

In February 2011, while E&Y was continuing its normal audit procedures, a short seller report came out, which E&Y treated as a whistleblower disclosure. Tr. 1732. The short seller report claimed that Client B was a scam, and that the size of its operations was considerably smaller than what was publicly reported. Tr. 1732-33. Client B's audit committee engaged E&Y to expand its procedures to be responsive to the short seller report's allegations. Tr. 1733.

E&Y's resulting findings were "considerable," involving potentially illegal acts, and were summarized in a Powerpoint presentation made to the audit committee on March 8, 2011, in Beijing. Tr. 1733-34, 1755; Div. Ex. 49. E&Y recommended that the audit committee begin an independent investigation, and the audit committee said they wanted to discuss the matter with management. Tr. 1734-35. E&Y also "ceased [its] audit work" on that date. Resp. Ex. 6 at 2. E&Y met with the audit committee again on March 10, 2011, at which time the audit committee agreed to an independent investigation and to issue a form 8-K about the investigation. Tr. 1735. Leali reviewed drafts of the form 8-K before it was issued, which included a statement that certain issues were identified in the course of E&Y's audit. Tr. 1735-36. The final form 8-K, which was issued on March 13, 2011, did not contain that statement. Tr. 1736; Div. Ex. 43 at 6. This omission was significant to E&Y because the short seller report was public but E&Y's audit findings were not, so E&Y contacted Client B's external legal

counsel and informed them that if Client B did not issue a corrective form 8-K, then E&Y would resign. Tr. 1737.

Client B did not issue a “corrective” form 8-K, and instead terminated E&Y on March 14, 2011, before it issued any audit report, and issued another form 8-K on March 18, 2011, which reported the termination. Tr. 1404-05, 1738, 1742; Resp. Ex. 8. The reason given for the termination was incorrect, in E&Y’s view, so E&Y issued a letter pursuant to Section 10A(b) of the Exchange Act (10A Letter) to the board of Client B, informing the board of illegal acts. Tr. 1406, 1739-40; Div. Ex. 45. Because it had no evidence that Client B had timely forwarded the 10A Letter to the Commission, E&Y sent the 10A Letter to the Commission itself. Tr. 1741-42; Resp. Ex. 570. In fact, Client B did provide the 10A Letter to the Commission. Tr. 514. Leali had a role in issuing the 10A Letter, but Leung did not. Tr. 1405-06. This was Leali’s first involvement in drafting a 10A Letter to a client. Tr. 1747, 1758.

Client B’s audit work papers were preserved in Beijing, pursuant to document preservation notices. Tr. 1407-08; Resp. Ex. 568. Specifically, they were provided to in-house legal counsel, segregated, indexed, and prepared for production. Tr. 1742. E&Y would produce the audit work papers for Client B if it were allowed to do so under Chinese law and by Chinese regulators. Tr. 1407.

Eric Hubbs (Hubbs) has been employed by the Commission since June 2000 and is an assistant chief accountant. Tr. 469. He primarily investigates financial fraud and auditor misconduct. Tr. 469. He investigated Client B and testified for the Division on that subject. Tr. 470. The time frame investigated was 2008-2010, and dealt with many aspects of Client B’s activities, including production capacity, revenue recognition, undisclosed related party transactions, internal control deficiencies, and the existence of customers, suppliers, and facilities. Tr. 472-73. In Hubbs’ experience, a 10A Letter is “not common,” and in his time at the Commission he has seen “under five” such letters. Tr. 502.

Hubbs received documents from various entities in response to document requests and subpoenas. Tr. 474. A “substantial” number of documents were produced by Client B directly, including general business records, emails, and board minutes. Tr. 474-75. Client B did not assert that any produced documents held state secrets, nor did it indicate that it withheld any documents on that basis. Tr. 475. Crowe Horwath also produced documents, pursuant to a subpoena, including audit work papers, and did not withhold any documents based on any Chinese law restrictions. Tr. 479-80. Crowe Horwath is based in Sherman Oaks, California, and the field work for Crowe Horwath’s audits was conducted by a Crowe Horwath affiliate in Hong Kong. Tr. 480, 544-45, 549; Div. Ex. 40 at F-1. It is unknown whether the Hong Kong affiliate is licensed to practice accounting in mainland China. Tr. 580. It is unknown whether Crowe Horwath is licensed to practice accounting in mainland China, although Leung knows of no U.S. firms so licensed. Tr. 1592.

Hubbs also sought E&Y’s audit work papers. Tr. 483. Hubbs considered them potentially “very useful” to the investigation. Tr. 482. He would have expected to see in the audit work papers documentation regarding E&Y’s concerns, representations from Client B’s management, documentation regarding cash confirmations, and documentation regarding the

expanded procedures as to which Client B's audit committee engaged E&Y. Tr. 482-83. In particular, he would have expected to see presentations from the auditor to the audit committee, such as E&Y's March 8, 2011, Powerpoint presentation. Tr. 509; Div. Ex. 49. Hubbs is not sure how the Division came into possession of that presentation, although it has no E&Y Bates number on it and Hubbs testified that it "may have" been obtained directly from Client B. Tr. 508. Leali testified that he understood Client B sent it to the U.S. Tr. 1757.

Accordingly, Division investigators sent E&Y a voluntary request for production on June 30, 2011, after sending a "substantively identical" request to Ernst & Young LLP on May 3, 2011. Tr. 483-84; Div. Ex. 306. E&Y designated Ernst & Young LLP as its U.S. agent for service under Sarbanes-Oxley 106 no later than March 1, 2011. Tr. 1517, 1520; Div. Ex. 165-A at 11-12. Leung became aware of the voluntary request in late June 2011. Tr. 1409; Resp. Ex. 11. This was the first time, to Leung's knowledge, that E&Y had received a request for work papers from any U.S. regulatory authority. Tr. 1409. Leung discussed the request with E&Y's general counsel, who discussed it with Chinese counsel. Tr. 1410. Based on Reg 29 and advice of counsel, and because they are E&Y's regulators, Leung called and reported the matter to the MOF and the CSRC. Tr. 1410-11. He then met with them separately. Tr. 1411. Prior to the meetings, his position was that E&Y was "very willing" to provide working papers to the Commission so long as Chinese law allowed it. Tr. 1411.

Leung met with three officials of the CSRC, including its chief accountant, in mid-July 2011. Tr. 1411-12. He had met these officials previously as part of his job, although this was his first meeting with them regarding requests from a foreign regulator. Tr. 1412-13. When he met with them, he brought a copy of the voluntary request, explained the request, asked for advice, and was told that foreign regulators should contact the CSRC directly and accounting firms should not provide work papers directly to foreign regulators. Tr. 1413-14. He was also told that any further requests or communications should be brought to the CSRC's attention. Tr. 1414. There was no discussion of the State Secrets Law, or laws pertaining to archives or certified public accountants, and because he was told not to provide work papers to foreign regulators, he made no effort to contact the Chinese State Secrets Bureau or Archives Bureau. Tr. 1415-16. Leung had known since 2004 that this was likely to be the guidance he would receive. Tr. 1531, 1539-40.

Leung met with the director of the MOF's Supervision and Investigations Bureau on the same day he met with CSRC officials. Tr. 1416-17. He had met the director previously as part of his job. Tr. 1417. As with the CSRC meeting, Leung brought a copy of the voluntary request, explained the request, asked for advice, and was told that foreign regulators should contact Chinese regulators directly and accounting firms should not provide work papers directly to foreign regulators. Tr. 1417-18. He was also told that Chinese regulators were in discussions with U.S. regulators about work papers, and that there was an understanding that U.S. regulators would not punish any Chinese accounting firm for not providing work papers. Tr. 1418-19.

Leung then reported to legal counsel, and counsel from Linklaters responded to the Commission's voluntary request by letter dated July 29, 2011. Tr. 1419; Div. Ex. 307; Resp. Ex. 12. The response included less than about thirty documents, totaled seventy-seven pages, and included a legal memorandum from external counsel (Linklaters LLP and Century-Link),

explaining the basis for withholding other documents. Tr. 484, 1420; Resp. Ex. 12 at 3. The documents produced included engagement letters, invoices, and the 10A Letter. Tr. 484. Division investigators then sent a subpoena to Ernst & Young LLP on February 15, 2012, seeking documents in that organization's possession pertaining to Client B's audit. Tr. 487-88; Div. Ex. 308. Although Ernst & Young LLP produced some documents in response, they did not include work papers from E&Y. Tr. 488; Div. Ex. 309.

2. Client C Investigation

Client C, a former client of E&Y, operates in and around China, where it works in the oil field business, specifically in enhanced oil recovery, and it was incorporated in the Cayman Islands as of March 2011. Tr. 266, 1743; Div. Ex. 50 at 3; Resp. Ex. 14. E&Y was engaged in February 2011 to audit Client C's financial statements for the year ended September 30, 2010, an audit it completed on March 31, 2011. Tr. 270, 1743; Div. Ex. 50; Resp. Ex. 14. Client C's securities were registered with the Commission and traded on NASDAQ beginning in November 2010, but trading was suspended in August 2011, when a short seller report was issued. Tr. 266, 1744; Div. Ex. 53. Thereafter, Client C's shares traded for a time on the pink sheets before their registration was revoked on May 30, 2012. Tr. 266; Div. Ex. 51.

The short seller report alleged that Client C was a shell corporation not capable of importing the volume of product it claimed, that the price for its product was considerably lower than claimed, and that its five largest customers were also shell corporations. Tr. 1744. When Client C asked NASDAQ to resume trading, NASDAQ requested verification of Client C's bank accounts by an independent accountant, and management engaged E&Y to do that. Tr. 1744.

When E&Y attempted to verify the primary bank account, it was prevented from doing so. Tr. 1745. E&Y went back to management, and on September 6, 2011, after multiple discussions, Client C's chairman confessed that there had been an unauthorized transfer of about \$40 million out of that account in July 2011. Tr. 1745-46. Although the transfer occurred outside the reporting period for which E&Y was engaged, E&Y asked for authorization to verify bank accounts dating to the beginning of the reporting period, and asked the audit committee and the board to take appropriate action against Client C's chairman. Tr. 1746-47; Resp. Ex. 14 at 1. E&Y was not allowed to verify bank accounts, and was told that the chairman would be retained. Tr. 1747.

On September 22, 2011, E&Y submitted a 10A Letter and a resignation letter to Client C's audit committee. Tr. 1747-48; Div. Ex. 54; Resp. Ex. 14. The resignation letter also withdrew E&Y's previously issued opinion. Tr. 1748; Resp. Ex. 14 at 2. A much briefer letter, dated September 22, 2011, was sent to the Commission and to the audit committee, simply announcing E&Y's resignation. Tr. 1748-49; Resp. Ex. 15. As of September 2011, E&Y's audit work papers for Client C had been provided to internal legal counsel, indexed, and prepared for production. Tr. 1749.

David Peavler (Peavler) joined the Commission in April 2000 as an enforcement staff attorney, left after about a year and a half to enter private practice, and then returned in November 2002, again as an enforcement staff attorney. Tr. 263. He was promoted multiple

times and in November 2011 he was appointed associate regional director for enforcement in the Commission's Fort Worth Regional Office, where he supervises all enforcement activity in that Regional Office. Tr. 262-63. He has spent a "great deal of time" working on financial misstatement cases at the Commission and in private practice. Tr. 264. Peavler supervised the investigation of Client C and testified about it for the Division. Tr. 264-65.

The investigation of Client C began as a result of the short seller report and E&Y's 10A Letter. Tr. 268-69; Div. Exs. 53, 54. Peavler has not "seen very many [10A Letters] at all" in his years of experience. Tr. 346. There were two subjects of investigation: a possible overstatement of the number and value of Client C's principal assets (lateral hydraulic drilling units), and the chairman's embezzlement. Tr. 267. Division investigators requested information directly from Client C, and served subpoenas on, and interviewed witnesses at, a U.S.-based supplier of Client C's lateral hydraulic drilling units. Tr. 269-70.

After first submitting to E&Y a request to preserve documents, which E&Y did, on October 5, 2011, Division investigators submitted a voluntary request for "workpapers" and other documents pertaining generally to Client C's bank account verification and the embezzlement by its chairman, as opposed to the year-end September 30, 2010, audit. Tr. 272-74, 296-97, 317-18, 1420-21; Div. Ex. 59; Resp. Exs. 17, 573. Division investigators also sent a virtually identical request to Ernst & Young Hong Kong. Tr. 274. At approximately this time, the Board opened its own investigation into E&Y's audit of Client C. Tr. 1421; Resp. Ex. 574. The Board submitted to Leung at E&Y an accounting board demand (ABD) dated October 7, 2011, which requested "[a]ll work papers and other documents concerning all audits and reviews" of Client C. Tr. 1421-22; Resp. Ex. 574 at 8.

Leung consulted with counsel and then contacted the MOF and the CSRC, in particular, one of the directors in the CSRC's accounting department. Tr. 1423-24. The CSRC official stated that other accounting firms had received similar requests, and that he wanted Leung to organize a meeting of the accounting firms with the CSRC. Tr. 1424-25. These accounting firms included the other Respondents and Grant Thornton, and they confirmed to Leung that they had received similar requests. Tr. 1425-26. The meeting took place on October 10, 2011, on short notice, so that Leung could not arrive in time to attend. Tr. 1426-27. Leung arranged for two other E&Y employees to attend, Li Di and Sabrina Uang (Uang). Tr. 1429.

According to Uang, as told to Leung, at the meeting the accounting firms reported on the demands received from U.S. regulators, and in response the CSRC said that firms are not allowed to provide work papers directly to foreign regulators and that the foreign regulators should contact the CSRC. Tr. 1430. The CSRC also said that it would issue a written response to DTTC, that DTTC was allowed to show that response to foreign regulators, and that the CSRC would issue a written response to accounting firms that provide a written report to it. Tr. 1430-31. The firms were warned that providing work papers to foreign regulators without authorization could result in cancellation of a firm's license. Tr. 1432.

Leung then consulted with counsel and wrote a report for the CSRC. Tr. 1433-36. He also wrote a similar report for the MOF, dated October 12, 2011. Tr. 1436-37; Resp. Exs. 19, 19A. In response, the CSRC sent E&Y a copy of Letter 437, which Leung understood to be a

“directive” from the CSRC and consultation with the MOF. Tr. 1437-41; Resp. Ex. 20. Leung understood Letter 437 to say, in summary, Chinese accounting firms must abide by Chinese laws, foreign regulators seeking work papers must contact Chinese regulators, Chinese accounting firms cannot provide work papers and related documents to overseas regulators without authorization, and if Chinese accounting firms do, they will be held legally liable. Tr. 1440-41; Resp. Ex. 20. Although Leung identified no substantive differences between Letter 437 and the CSRC’s instructions in July 2011, he viewed Letter 437 as “formal and official.” Tr. 1441-42.

E&Y and Ernst & Young Hong Kong responded to the Commission’s October 5, 2011, voluntary request, through counsel, by letter dated November 11, 2011. Tr. 274-76; 1444-45; Div. Ex. 60. The letter stated that both firms “wish to cooperate in this matter” but that Chinese law precluded them from doing so, and cited to Letter 437. Div. Ex. 60 at 2. A similar letter, also dated November 11, 2011, was provided to the Board. Tr. 1443-44; Resp. Ex. 21.

In November 2011, the Board sent E&Y a letter regarding legal impediments on production of work papers. Tr. 1445-46. Leung consulted with counsel, asked to meet with the CSRC, and wrote a letter to the CSRC. Tr. 1446-47; Resp. Ex. 22. In the letter, dated December 7, 2011, Leung offered to provide the CSRC with its Client C-related work papers, which were ready to be produced and which E&Y was willing to produce to the Board. Tr. 1447-48, 1453; Resp. Ex. 22. He met with the CSRC’s chief accountant and one of her deputies on December 8, 2011. Tr. 1449, 1455. They told Leung that Chinese accounting firms were not allowed to produce work papers directly to foreign regulators without permission, regardless of Chinese law, so he made no inquiries regarding the State Secrets Law or laws regarding archives. Tr. 1448, 1450-51, 1455, 1528. They did not respond to Leung’s offer to provide the CSRC with its Client C-related work papers. Tr. 1451.

At about this time, Leung had conversations with the other firms represented at the October 10, 2011, meeting. Tr. 1453. KPMG advised him that it had inquired with the Chinese State Secrets Bureau and Archives Bureau, but were told that they would not consider inquiries from private entities. Tr. 1453-54. He also met with the MOF, which provided guidance similar to that provided by the CSRC. Tr. 1454.

3. Client C Sarbanes-Oxley 106 Request

Division investigators consulted with OIA, principally with Alberto Arevalo (Arevalo) of that office, and concluded that a request for assistance to Chinese regulators would not be fruitful, and that the best course would be to serve a Sarbanes-Oxley 106 request. Tr. 276, 321. Accordingly, they submitted such a request, via Ernst & Young LLP, on February 2, 2012, pursuant to Sarbanes-Oxley 106, seeking “[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client C] for the fiscal year ending September 30, 2010 and subsequent periods.” Tr. 276-77; Div. Ex. 55; Resp. Ex. 23.

Leung reviewed the request on or about February 2, 2012, and confirmed with other accounting firms that they had received similar letters. Tr. 1454-57. He also compared the request to the Board’s ABD, and determined that the ABD was more comprehensive, that is,

everything requested in the Sarbanes-Oxley 106 request is also requested in the Board's ABD. Tr. 1457. On February 22, 2012, the Board sent a letter to E&Y's external counsel, granting E&Y an extension on the due date for production of the documents requested in the ABD, on the basis that E&Y "may need the assistance of the relevant Chinese authorities to facilitate production." Tr. 1457-58; Resp. Ex. 24 at 1. The letter stated that the Board had reached out to the CSRC on the issue already. Tr. 1459; Resp. Ex. 24 at 1. It also stated that the Board has "unequivocal legal authority under Section 105(b)(3) of [Sarbanes-Oxley], to suspend or revoke the Firm's registration status" for noncompliance with the Board's ABD, and that failure to timely produce documents would result in a recommendation that the Board "institute disciplinary proceedings against [E&Y] for its failure to cooperate with our investigation." Resp. Ex. 24.

Leung consulted with counsel and requested a meeting with the CSRC and other accounting firms. Tr. 1459. When he met with the CSRC's chief accountant and her deputy, he brought with him the Sarbanes-Oxley 106 request, and a letter dated February 23, 2012, which he had prepared to summarize the situation and to once again offer to produce Client C's work papers to the CSRC. Tr. 1459-61; Resp. Exs. 25, 25A. Except for Dahua, representatives of the other Respondents also attended. Tr. 1461. Leung and the other firm representatives reported receiving the various demands from U.S. regulators, and Leung noted that he sensed an "escalation" of U.S. regulators' actions against the firms. Tr. 1463. The CSRC again stated that Chinese firms are not allowed to provide work papers directly to foreign regulators and that the foreign regulators should contact the CSRC, and again gave no response when Leung offered to provide audit work papers to the CSRC. Tr. 1463-64. The four accounting firms also met with the MOF on the same day, and the meeting was very similar to the one with the CSRC. Tr. 1464.

On March 2, 2012, the Board sent E&Y a letter which stated, in substance, that in view of the CSRC's "apparent willingness" to assist in production of the materials requested in the ABD, the Board intended to disclose to the CSRC the fact that the Board was investigating E&Y and a detailed description of the materials sought in the ABD. Tr. 1464-65; Resp. Ex. 575 at 1. The letter also stated, again, that E&Y still had an "obligation to provide requested documents in the event any such documents are not provided through the CSRC." Resp. Ex. 575 at 2. Leung consulted with counsel and wrote a letter to the CSRC reporting the receipt of the Board's letter and requesting a meeting with the CSRC. Tr. 1465. No such meeting occurred. Tr. 1465.

E&Y informed Division investigators by telephone on March 19, 2012, that the Board had issued the ABD. Tr. 339-40; Div. Ex. 56 at 2 n.3. E&Y, through external counsel, responded to the February 2, 2012, Sarbanes-Oxley 106 request on April 4, 2012. Tr. 277-78, 1465-66; Div. Ex. 56; Resp. Ex. 27. The letter stated that E&Y "wishes to cooperate with the [Commission] in this matter and to provide the [Commission] with the documents it is seeking." Div. Ex. 56 at 1. It also asserted that E&Y would be "held responsible for any production in violation of [the CSRC's and the MOF's] instructions and subject to potentially severe sanctions." Div. Ex. 56 at 2. The letter did not forward any audit work papers, identify any documents containing state secrets, disclose any determination by the Chinese government regarding state secrets or archives, or describe any efforts by E&Y to obtain approval from the Chinese government to provide the requested documents. Tr. 277-80.

Although the Commission ultimately brought a civil enforcement action against Client C, its chairman, its CEO, and its former CFO, Division investigators were hampered by the lack of audit work papers in identifying other possible enforcement targets. Tr. 280, 283; Div. Ex. 57. Additionally, investigators wanted to find out how E&Y missed certain things in its audit, which may have resulted in an investigation for improper professional conduct. Tr. 281-82. For example, Client C's initial public offering filings indicated that it had obtained all of its drilling units from a company in Louisiana, but investigators were able to quickly confirm that Client C had not purchased the number or the value of equipment it claimed. Tr. 281. The fact that Client C's auditor missed that fact in its audits struck Peavler as "very unusual." Tr. 281. The audit work papers would have shed light on this issue. Tr. 282-83. Also, the lack of audit work papers prevented the Commission from charging the civil defendants with a violation of Exchange Act Rule 13b2-2. Tr. 283-84.

The Division submitted a Wells notice to E&Y, through external counsel, on April 27, 2012. Tr. 284; Div. Ex. 142. E&Y sent a Wells submission to the Commission on May 29, 2012. Div. Ex. 150.

4. Client B Sarbanes-Oxley 106 Request

Division investigators sent a request to E&Y, via Ernst & Young LLP, on April 26, 2012, pursuant to Sarbanes-Oxley 106, seeking "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client B] for the fiscal year ending December 31, 2010." Tr. 489; Div. Ex. 46; Resp. Ex. 29. Leung discussed the Sarbanes-Oxley 106 request with counsel and met again with the CSRC's chief accountant and her deputy in May 2012, to discuss both the Client B Sarbanes-Oxley 106 request and the Client C Wells notice. Tr. 1466-67. The CSRC again stated that Chinese accounting firms should refer foreign regulators to Chinese regulators, and not provide work papers directly to foreign regulators. Tr. 1468. Leung again offered to provide work papers to the CSRC, for both Client B and Client C, but the CSRC did not respond. Tr. 1468-69.

E&Y responded to the Sarbanes-Oxley 106 request, through counsel, by letter dated May 25, 2012. Tr. 490; Div. Ex. 47. The response stated that E&Y "wishes to cooperate in this matter" and "would comply with the Commission's Section 106 Request . . . if it could do so without violating [Chinese] law." Tr. 562-63; Div. Ex. 47 at 1-2. It also summarized its version of the investigation's proceedings up to that date, and provided a brief explanation of the impediments to production under Chinese law. Tr. 563-64; Div. Ex. 47 at 2-7. The response did not identify any documents containing state secrets or protected archives, describe any consultations with Client B about state secrets or protected archives, or state that the Chinese government had determined any documents to be state secrets. Tr. 491-92.

Division investigators sent a Wells notice to E&Y, via external counsel, on June 15, 2012. Tr. 493; Div. Ex. 141. E&Y submitted a Wells response on June 25, 2012, but again did not produce audit work papers. Tr. 493; Div. Ex. 149. Hubbs has always had full access to audit work papers in his other investigations. Tr. 493. He opined that the failure to produce E&Y's work papers for Client B prevented investigators from unearthing "a good amount of evidence"

pertaining to the allegations E&Y made regarding Client B. Tr. 492. In particular, it prevented investigators from testing any of the issues raised in E&Y's 10A Letter. Tr. 573.

5. Recent Events

In December 2012, after the OIP was issued and received by E&Y, E&Y contacted the other Respondents, and after consulting with legal counsel, a meeting was arranged with the CSRC. Tr. 1469. As Leung remembers it, sometime in December 2012 E&Y attended a meeting with representatives of the MOF, the CSRC, and the other Respondents, at which the Respondents reported on the present proceeding, including its potential consequences. Tr. 1469-71. The CSRC reiterated its previous position, but also said that it needed to deliberate on the matter. Tr. 1470. Leung thereafter consulted with counsel. Tr. 1471. He intended at that time to provide work papers to the Commission if permitted to do so by Chinese regulators. Tr. 1471.

On May 10, 2013, the Board, the MOF, and the CSRC executed a "Memorandum of Understanding on Enforcement Cooperation" (MOUEC), which sets forth the parties' "intent with regard to mutual assistance and the exchange of information for the purpose of enforcing and securing compliance with" the parties' respective laws. Tr. 1472; Resp. Ex. 274 at 1. Leung read the MOUEC at approximately the time it became public, and discussed it with the other Respondents. Tr. 1472-73. In early June 2013, the five Respondents met with representatives of the MOF and the CSRC, and urged the CSRC to respond as soon as possible in the event the Board made any request under the MOUEC. Tr. 1473-74. The CSRC informed Respondents that it had received requests already from both the Board and the Commission. Tr. 1474. Specifically, the CSRC told Leung that it had received a Board request regarding Client C. Tr. 1474. Leung urged the CSRC to issue a "notice" to E&Y as soon as possible, so that E&Y could produce the work papers, and the CSRC agreed to do so. Tr. 1474.

About two weeks after the early June meeting, the CSRC arranged another meeting with Respondents, except for DTTC, as well as a representative of the MOF's Supervision and Investigation Bureau. Tr. 1475. The CSRC spelled out a new procedure for screening the firm's work papers for state secrets and other sensitive information, which included the hiring of an external law firm to assist in the screening process. Tr. 1476. This procedure was to be used to produce work papers to the CSRC. Tr. 1476. Leung was told that the new procedure had been approved by the State Council of China. Tr. 1476-77.

Leung discussed the new procedure with counsel, and instructed E&Y staff to follow up every few days with the CSRC so that they could get any CSRC notice as soon as possible. Tr. 1477. On July 3, 2013, E&Y received a notice from the CSRC to produce Client C's work papers, pursuant to a request from the Board dated May 22, 2013. Tr. 1477-78; Resp. Exs. 632, 632A. The Board's May 22, 2013, request is substantively identical to its October 7, 2011, ABD. Tr. 1478; Resp. Exs. 574, 632. E&Y then retained external counsel and started work on the screening process, and delivered the required documents to the CSRC, consisting of four boxes, on July 22, 2013, the day Leung testified. Tr. 1479-81, 1589; Resp. Exs. 649, 649A. Documents identified by the external law firm as containing state secrets were redacted, although that did not have a major impact on the audit work papers. Tr. 1481-82. Leung told Leali that Client B's work papers are also with the CSRC. Tr. 1762-63.

Leung opined that a revocation of the privilege of practicing before the Commission would deprive E&Y of the opportunity to serve a market that it has put resources into. Tr. 1488. It would also bar the EY Global Network from serving the Chinese market. Tr. 1488. Although he stated that E&Y “did not have the choice” to provide work papers directly to the Commission, and that “there wasn’t a decision,” he also agreed that E&Y “decided that it would not send those documents directly” to the U.S. Tr. 1522-23, 1557-58. The decision not to provide work papers was made between Leung and senior management, in consultation with counsel. Tr. 1523.

C. KPMG

KPMG is an accounting firm established in 1992 as a joint venture between KPMG Hong Kong and Huazhen, a Chinese firm. Tr. 1904-05. The joint venture agreement lapsed in August 2012, and KPMG is now a special general partnership, which is an arrangement similar to a limited liability partnership under U.S. law. Tr. 1905. KPMG has no offices or employees outside of China. Tr. 1905-06. Two persons testified for KPMG, Isaac Yan (Yan) and Jacqueline Wong (J. Wong). Tr. 1903, 2133. Yan has been a chartered accountant in England and Wales since 1988 and a fellow member of the Hong Kong Institute of Certified Public Accountants for over ten years. Tr. 1904, 1930. He started at KPMG Hong Kong in 1988 and moved to KPMG in 2000. Tr. 1931. Yan is currently KPMG’s quality and risk management partner for China. Tr. 1903. He works in Beijing and his job mainly involves protecting KPMG from risk, and there are five units within his department: regulatory and public affairs, regulatory filing, practice protection, contracting, and central policy. Tr. 1903-04, 1930. J. Wong has a bachelor of commerce degree from the University of British Columbia and a graduate diploma from McGill University. Tr. 2133. She is a chartered accountant under the Canadian Institute of Chartered Accountants, and the equivalent under the Hong Kong Institute of Certified Public Accountants. Tr. 2133. She started at KPMG Hong Kong in 1997 as an assistant manager in auditing, transferred to advisory in 1999, and transferred to quality and risk management in 2003. Tr. 2133-34. J. Wong is now a partner at KPMG Hong Kong and reports to the country risk management partner. Tr. 2133-34. She also reports to KPMG personnel on a project-by-project basis, including to Yan. Tr. 2197-98. KPMG Hong Kong’s quality and risk management department ensures that quality controls are in place and complied with, and it is responsible for regulatory compliance, reporting, and registration. Tr. 2135. This includes responding to regulatory requests. Tr. 2142-43.

KPMG performs primarily auditing and some advisory services. Tr. 1905. Its clients include public companies listed on stock exchanges in Hong Kong, China, Canada, Singapore, Korea, and the U.S. Tr. 1906. It mainly performs substantial role audits, that is, auditing of the Chinese operations of companies that may be headquartered elsewhere, where the Chinese operations equate to twenty percent or more of overall revenues or assets. Tr. 1907, 2138; Resp. Ex. 517 at 6-13. In 2004, KPMG had 1,002 employees. Tr. 2142. As of 2012, it had between 20 and 25 clients, 3,425 total employees, 3,071 accountants, and 587 CPAs or CPA-equivalents, and had offices in Beijing, Shanghai, Guangzhou, and Shenzhen. Tr. 2141-42; Resp. Ex. 517 at 14-18. KPMG’s growth was the result of investment in business, infrastructure, and people. Tr. 2142. KPMG and KPMG Hong Kong are member firms of KPMG International. Tr. 2136.

KPMG is regulated in China by the MOF, CSRC, and Chinese Institute of Certified Public Accountants (CICPA). Tr. 1904, 1908. The MOF and CSRC grant licenses to firms wishing to perform audit work in China. Tr. 1908. The CSRC is “something like” the Chinese equivalent of the Commission. Tr. 1908. KPMG is licensed by both the MOF and the CSRC. Tr. 1908. The CICPA licenses and qualifies individuals to be CPAs. Tr. 1908. The MOF, CSRC, and CICPA inspect KPMG yearly on a rotating basis and review license renewal applications. Tr. 1908-09. KPMG, mainly represented by Yan, meets with its regulators as needed. Tr. 1909. KPMG considers instructions from its regulators to be “very important.” Tr. 1910. The possible consequences of disobeying its regulators include license suspension, license revocation, public and private reprimands, monitoring, and penalties. Tr. 1910-11. Audit work papers generated in mainland China must now be maintained in mainland China, even when the auditor is based somewhere else; for example, when KPMG Hong Kong audits a client in mainland China without using a component auditor, its work papers stay in mainland China. Tr. 2203-05. KPMG Hong Kong is authorized to audit clients in mainland China, including U.S. issuers, by virtue of a temporary license granted by the MOF for five years. Tr. 2200-01.

KPMG registered with the Board in 2004. Tr. 1402-03. KPMG and KPMG Hong Kong are organized separately under their respective country’s laws, although KPMG Hong Kong is responsible for registering both KPMG and KPMG Hong Kong and filing KPMG’s annual PCAOB reports. Tr. 2136-37, 2141. KPMG did not sign the “Consent to Cooperate With the Board and Statement of Acceptance of Registration Condition” in its PCAOB Form 1. Tr. 2139; Resp. Ex. 513 at 16. KPMG’s lack of consent was based upon an April 16, 2004, letter from Century-Link, which opined that Chinese law prevented KPMG from complying with PCAOB testimony and document requests. Tr. 2139; Resp. Ex. 513 at 213. KPMG was aware at the time it registered that production of documents to U.S. regulators could result in civil and criminal penalties. Tr. 2236-37; Resp. Ex. 513 at 215-16. The Board accepted KPMG’s application, acknowledged that it had withheld consent to cooperate, and told KPMG that it was obligated to follow U.S. law. Tr. 2140; Resp. Ex. 544, Attachment 1. In its 2010, 2011, and 2012 annual reports to the Board, KPMG declined to affirm that it consented to cooperate with Board investigations, but also disclosed that it had performed substantial role audit work for twenty-four, twenty-three, and twenty-five U.S. issuers, respectively, for all of which KPMG was paid. Tr. 2243-44; Resp. Ex. 514 at 7-12, 22; Resp. Ex. 516 at 7-12, 22; Resp. Ex. 517 at 7-13, 23. In February 2011, KPMG was a “foreign public accounting firm” as that term is defined in Sarbanes-Oxley. Tr. 2247. On February 25, 2011, KPMG designated KPMG LLP, the U.S. KPMG affiliate, as its agent for service of Sarbanes-Oxley 106 requests. Tr. 2250; Div. Ex. 165-A at 16.

1. Client D Investigation

Client D, a former client of KPMG, is a biodiesel producer located predominantly in mainland China and incorporated in Delaware. Tr. 2145; Div. Ex. 62 at 2. It also distributes fuel and has an interest in gas stations in China. Tr. 738. It engaged KPMG in December 2010 as a component auditor on its consolidated audit for the year ending December 31, 2010, with KPMG Hong Kong as the principal auditor. Tr. 2145. KPMG was responsible for more than ninety percent of the audit work. Tr. 2145-46. KPMG played a substantial role in this audit. Tr. 1934, 2226-27. The work papers generated in connection with the engagement are maintained in

mainland China. Tr. 2146. Client D's shares are registered with the Commission and were traded on NASDAQ until Client D was delisted in April or May 2011. Tr. 738.

Shortly after Client D's audit opinion issued in mid-March 2011, short seller reports appeared. Tr. 2146. Either KPMG or KPMG Hong Kong reported this fact to the audit committee chairman and requested a special investigation. Tr. 2146-47. The special investigation did not proceed as expected, the investigating law firm and the audit chairman resigned, and KPMG resigned in April or May 2011. Tr. 742, 2146-47.

Leslie Kazon (Kazon) began working for the Commission in 1990, and since 1999 she has been an assistant director of the Division in the Commission's New York regional office. Tr. 735-36. She conducts and supervises investigations into federal securities laws violations, and to a lesser extent, litigation arising out of investigations. Tr. 736. She supervised the investigation of Client D from its onset until the initiation of the present proceeding. Tr. 736-37.

The investigation of Client D was prompted by two short seller reports which came out in March 2011. Tr. 739-40; Div. Exs. 64, 65. The specific allegations were that Client D had reported cash on its balance sheet that it did not possess, and that it had acquired a biodiesel plant in a related party transaction which had not been reported as such, and in which the plant's revenues had been overstated. Tr. 739. The investigators subpoenaed and received documents from Client D, received presentations from its counsel, and interviewed the head of its audit committee. Tr. 740. Kazon does not remember which documents investigators received from Client D, or the number of such documents. Tr. 740-41. J. Wong is not aware of any person at Client D who was sanctioned for providing documents to SEC investigators. Tr. 2270-71.

KPMG Hong Kong signed Client D's audit opinion, but KPMG conducted all or substantially all of the audit. Tr. 741. The audit report was filed with Client D's form 10-K. Tr. 741-42. Work papers are traditionally requested in financial fraud investigations because they provide a roadmap of the client's business and internal controls, and identify relevant witnesses, customers, and third parties who can confirm transactions. Tr. 743. The investigators therefore issued a broad voluntary request for documents, including work papers and engagement documents, to KPMG Hong Kong. Tr. 743-44. They sent the request to KPMG Hong Kong's U.S. counsel on March 30, 2011. Tr. 744-45; Div. Ex. 297.

KPMG Hong Kong, by letter dated April 6, 2011, informed investigators that it would not comply with the voluntary request based on Chinese law and the fact that the requested documents were located in mainland China. Tr. 746-47; Div. Ex. 299. The investigators did not consider KPMG Hong Kong's letter sufficiently specific regarding the barriers to production posed by Chinese law, and sent a follow-up letter to KPMG Hong Kong dated May 4, 2011. Tr. 747-48; Div. Ex. 301. KPMG Hong Kong responded by letter dated May 11, 2011, in which it reiterated the contents of its April 6, 2011, letter, referred investigators to a Memorandum of Understanding (MOU) between the SEC and the CSRC, and indicated that it would respond to any request from its local regulator "as appropriate." Tr. 749-50; Div. Ex. 303.

In the meantime, investigators issued a subpoena on May 4, 2011, to KPMG LLP, seeking, among other items, "[a]ll working papers" relating to the audit of Client D's 2010

financial statements in the possession of any KPMG affiliate. Tr. 751-52; Div. Ex. 302 at 4, 7. Although investigators received some documents in response, they did not receive any work papers of KPMG or KPMG Hong Kong. Tr. 753. Investigators also requested assistance from the Hong Kong securities commission in the production of audit work papers and related materials. Tr. 753. Investigators received a response, which was apparently a communication from a KPMG affiliate to the Hong Kong securities commission, reiterating KPMG Hong Kong's previously articulated position, that responsive documents were in mainland China and could not be produced because of Chinese law. Tr. 753. Investigators considered making a request for assistance to the CSRC, but after consulting with OIA determined that it would likely not be successful. Tr. 757-58. KPMG is prepared to produce audit work papers for Client D to a local regulator. Tr. 2157.

2. Client E Investigation

Client E, a former client of KPMG, is a petrochemical producer located in Ningbo, China, and incorporated in Nevada as of April 2012. Tr. 167, 2147-48; Div. Ex. 70 at 3. It engaged KPMG in January 2011 as a component auditor of its consolidated audit for the year ending December 31, 2010, with KPMG Hong Kong as the principal auditor. Tr. 175-76, 2147-48; Resp. Ex. 516 at 9. Client E's previous auditor, Patrizio & Zhao, LLC (Patrizio & Zhao), a firm located in Parsippany, New Jersey, issued unqualified audit opinions for 2008 and 2009.⁴ Tr. 176, 204; Resp. Ex. 521 at 2-3. KPMG was responsible for more than ninety percent of the audit work. Tr. 2148. KPMG played a substantial role in this audit. Tr. 1934, 2227. The work papers generated in connection with the engagement are maintained in mainland China. Tr. 2148. Client E's shares are registered with the Commission, were traded on NASDAQ between 2010 and 2011, and are currently traded over the counter. Tr. 167.

During the audit of Client E, the audit team identified seven "issues and discrepancies." Tr. 172-73, 2147-48; Div. Ex. 77. The audit team reported its concerns to the audit committee chairman and requested an investigation. Tr. 2148; Div. Ex. 77 at 18-19. The investigation did not proceed as expected, and KPMG resigned on May 24, 2011, without completing the audit. Tr. 2147-48; Div. Ex. 293.

⁴ On September 18, 2013, I issued an order closing the record in this proceeding. BDO China Dahua CPA Co., Ltd., Admin. Proc. Rulings Release No. 882 (Sept. 18, 2013). Shortly thereafter, the Commission issued an OIP in a settled case against Patrizio & Zhao. Patrizio & Zhao LLC, Exchange Act Release No. 70562 (Sept. 30, 2013). I have taken official notice of Patrizio & Zhao. The OIP found that, in auditing Client E's 2008 and 2009 financial statements and reviewing Client E's financial statements for the first three quarters of 2010, Patrizio & Zhao had failed to comply with PCAOB standards, engaged in improper professional conduct, and caused Client E to commit disclosure and reporting violations. Id. at 2-3. Patrizio & Zhao consented to revocation of the privilege of practicing before the Commission with the right to reapply after three years, and a \$30,000 civil penalty, among other sanctions. Id. at 13-14. Patrizio & Zhao consented to entry of the OIP against it, without admitting or denying the OIP's findings. Id. at 2.

Fuad Rana (Rana) began working for the Commission in January 2011 and is now a senior counsel with the Division. Tr. 165. He conducts investigations into possible violations of federal securities laws. Tr. 165-66. Before coming to the Commission he spent six years in private practice, specializing in litigation and white collar work, and served as a federal law clerk. Tr. 166. He was the Commission's principal investigator of Client E. Tr. 166.

The Commission opened its investigation of Client E in April 2011 when Client E filed a form 8-K indicating that it would not be able to file its annual form 10-K on time. Tr. 168, 206. The stated reason was that its auditors, KPMG and KPMG Hong Kong, had identified "unexplained issues regarding certain cash transactions and recorded sales." Tr. 168; Div. Ex. 71 at 3. The investigation focused on fiscal years 2008, 2009, and 2010, because investigators had reason to believe that Client E had failed to make certain disclosures during those years. Tr. 170. This belief was apparently based on a draft of a March 28, 2011, letter from KPMG to Client E's audit committee chairman, which outlined KPMG's concerns, and a memorandum from certain corporate officers to Client E's audit committee, responding to KPMG. Tr. 171-73; Div. Exs. 77, 78. Investigators issued subpoenas to various persons and entities, including Client E and its auditors. Tr. 174. Client E produced internal emails, financial records, its general ledger, and other documents relating to the issues raised in KPMG's draft letter to Client E's audit committee chairman. Tr. 174.

Rana considered it "extremely important" that investigators review KPMG's audit work papers, because it was KPMG that initially identified the issues leading to the termination of its engagement. Tr. 180, 192-93. KPMG's U.S. counsel would not accept a subpoena but was willing to accept a voluntary production request. Tr. 178. Rana accordingly sent a voluntary request for documents, including work papers, to KPMG's U.S. counsel on April 28, 2011, pertaining to both KPMG and KPMG Hong Kong. Tr. 178-79; Div. Ex. 287. J. Wong saw the voluntary request at about the time it was sent. Tr. 2151. KPMG and KPMG Hong Kong, by letters dated April 29, 2011, the following day, informed investigators that they would not comply with the voluntary request based on Chinese law and the fact that the requested documents were located in mainland China. Tr. 179-80; Div. Ex. 289. The letters are substantively identical to the one KPMG Hong Kong sent twenty-three days earlier regarding Client D. Div. Exs. 289, 299. Rana was not satisfied with this response and sent two follow-up letters dated May 6, 2011, one which requested clarification of KPMG's refusal to voluntarily produce documents, and one which requested that KPMG and KPMG Hong Kong preserve all relevant documents. Tr. 180-81; Div. Exs. 290, 291. J. Wong saw the first follow-up letter at about the time it was sent. Tr. 2153-54. KPMG and KPMG Hong Kong responded by letter dated May 17, 2011, in which they reiterated the contents of their April 29, 2011, letters, referred investigators to the MOU, and indicated that they would respond to any request from their local regulators "as appropriate." Tr. 181-82; Div. Ex. 292. KPMG is prepared to produce audit work papers for Client E to a local regulator. Tr. 2157.

On May 10, 2011, Rana issued a subpoena to KPMG LLP, seeking, among other things, "all working papers relating to any audit or review" of Client E in the possession of KPMG LLP and its non-U.S. affiliates. Tr. 183-84; Div. Ex. 288 at 5, 8. KPMG LLP produced approximately 724 pages of documents in response, related to a U.S. tax law issue, but it did not produce any of KPMG's audit work papers. Tr. 185-86; Div. Exs. 294, 295. In parallel with the

subpoena activity, investigators consulted with OIA and determined that a request for assistance directed to the CSRC was “not likely to yield any success.” Tr. 182-83, 186-87, 222. Rana is unaware of any request for assistance directed to the PCAOB, it is not his practice to seek such assistance, and he would consider such a practice “highly unusual.” Tr. 224, 228-29.

Investigators issued a subpoena to Patrizio & Zhao, which produced at least 3,000 pages of work papers and other documents between July 21, 2011, and August 24, 2012. Tr. 189-90; Div. Exs. 321-23. Based on his review of documents and testimony, Rana understood that Patrizio & Zhao conducted their audits with the assistance of individuals located in China. Tr. 190. Patrizio & Zhao raised no concerns about state secrets or archival material. Tr. 190-91. Investigators also issued a subpoena to GHP Horwath, P.C. (GHP Horwath), an accounting firm based in Denver, Colorado, which completed Client E’s audit for 2010, and on November 17, 2011, GHP Horwath produced a laptop containing its complete audit binder for 2010 and review binders for two quarters of 2011. Tr. 191, 206; Div. Ex. 320. Rana does not recall GHP Horwath raising concerns about state secrets or archival material. Tr. 192. Rana understood that GHP Horwath’s work papers were prepared in China and transmitted electronically to the U.S. Tr. 206.

3. PCAOB Investigation

On June 15, 2011, KPMG received an ABD from the PCAOB related to Clients D and F, seeking “[a]ll work papers.” Tr. 2157; Resp. Ex. 535 at 7. J. Wong saw the ABD at about the time it was sent, and it was the first ABD KPMG had received from the PCAOB. Tr. 2158. KPMG responded through outside counsel by letter dated June 28, 2011. Tr. 2158; Resp. Ex. 536. The June 28, 2011, letter did not explicitly decline to respond to the ABD; instead, it referred the PCAOB to the Commission staff investigating Client D, and suggested that the PCAOB deal directly with the CSRC regarding Client F-related documents. Resp. Ex. 536. The PCAOB sought clarification of KPMG’s position by letter dated June 30, 2011. Resp. Ex. 537. On July 26, 2011, KPMG sent the PCAOB a “lengthy” letter, in which it explained that it was unable but not unwilling to produce the documents requested by the ABD. Tr. 2162-63; Resp. Ex. 542. The July 26, 2011, letter included several attachments and a disc containing approximately 11,000 pages of documents responsive to two items of the ABD, neither of which pertained to audit work papers. Tr. 2166; Resp. Ex. 542. The PCAOB responded on October 3, 2011, with its equivalent of a Wells notice, that is, a letter notifying KPMG that the PCAOB’s Division of Enforcement and Investigations intended to recommend initiation of a disciplinary proceeding against KPMG. Tr. 1912, 2165-66; Resp. Ex. 544.

KPMG sought guidance regarding the ABD from the CSRC and the MOF, by letters dated July 20, 2011.⁵ Tr. 2158, 2160; Resp. Ex. 539 at 7-12. After receiving the PCAOB’s October 3, 2011, letter, KPMG again sought guidance from the CSRC by email dated October 4, 2011. Tr. 1913-14, 2166; Div. Exs. 333, 333-A. It also sought consent from Clients D and F, by letters dated July 21, 2011, to produce the requested documents. Tr. 2163-64; Resp. Exs. 540,

⁵ J. Wong viewed this request for guidance as a request for permission to produce the documents. Tr. 2208, 2212. However, there is nothing in the July 20, 2011, letters explicitly seeking such permission. Resp. Ex. 539.

541. Client D responded that KPMG should consult with its own counsel, and Client F did not respond. Tr. 2164-65; Resp. Ex. 543.

KPMG provided the PCAOB a statement of position, by letter dated October 24, 2011, in response to the PCAOB's October 3, 2011, letter. Resp. Ex. 550. By letter dated February 22, 2012, the PCAOB provided KPMG an April 23, 2012, deadline by which to make arrangements with Chinese regulators to produce the requested documents. Tr. 2183; Resp. Ex. 550. The PCAOB also requested the CSRC's assistance, and provided certain information to the CSRC, which would otherwise presumably have been confidential, to facilitate that assistance. Resp. Exs. 550, 552. In May 2013, the PCAOB and the CSRC signed the MOUEC. Tr. 2191.

4. Client F Investigation

Client F, a former client of KPMG, is a chemical manufacturer located in mainland China and incorporated in Nevada as of March 2011. Tr. 785-86, 2150; Div. Ex. 81. It engaged KPMG in October or November 2008 as a component auditor of its consolidated audit for the year ending December 31, 2008, with KPMG Hong Kong as the principal auditor. Tr. 788, 2149-50. KPMG was responsible for more than ninety percent of the audit work. Tr. 2283. The engagement continued until 2011, and KPMG Hong Kong issued unqualified opinions for fiscal years 2008 and 2009. Tr. 790-91. KPMG played a substantial role in the fiscal year 2009 audit. Tr. 1934. The work papers generated in connection with the engagement are maintained in mainland China. Tr. 2150. Client F's shares were registered with the Commission until the fall of 2012, when Client F voluntarily deregistered them; they were traded on NASDAQ between 2007 and 2011, were quoted for a time thereafter on the OTC Bulletin Board, and they are currently not traded. Tr. 786-87.

During the 2010 audit of Client F, the audit team identified certain issues. Tr. 2149-50. The audit team reported its concerns to the audit committee chairman and requested an investigation. Tr. 2150. The investigation did not proceed as expected, and KPMG resigned in April or May 2011, without completing the audit. Tr. 791, 2150.

Roger Boudreau (Boudreau) began working for the Commission in 1986 and is currently a senior accountant in the Los Angeles regional office. Tr. 783-84. He investigates public companies and performs other work as needed, including analyzing Ponzi schemes. Tr. 784. He has worked on "many cases" of accounting fraud since 1986. Tr. 784. He was the Commission's primary investigator of Client F. Tr. 785.

Boudreau first received documents from Client F's audit committee, including a copy of KPMG's letter outlining the issues it had identified during its audit of Client F's 2010 financial statements. Tr. 788-89. These issues included difficulty confirming cash, vendor issues, and an issue with revenue relating to Client F's second largest customer. Tr. 788. Boudreau then sent a production request to Client F, which produced "many thousands of pages" from two of Client F's directors, who were in the U.S. and who produced documents possibly located or created in the U.S. Tr. 789, 804, 818. Client F did not withhold any documents on the ground that their production violated Chinese law, nor did Client F assert that any documents contained state secrets, to Boudreau's recollection. Tr. 789-90.

As part of the investigation, Boudreau sought audit work papers because they may contain memoranda documenting problems at the client, document testing performed, and record interviews of and representations from management. Tr. 792. On August 23, 2011, Boudreau sent a voluntary request for documents, including audit work papers for fiscal years 2008 through 2010, to KPMG Hong Kong's counsel. Tr. 793; Div. Ex. 86. He did not know at the time that KPMG had any role in Client F's audits. Tr. 793. KPMG Hong Kong, by letter dated September 6, 2011, informed him that it would not comply with the voluntary request based on Chinese law and the fact that the requested documents were located in mainland China. Tr. 794; Div. Ex. 87. The letter is more detailed than the ones KPMG Hong Kong sent investigators regarding Clients D and E. Div. Exs. 87, 289, 299. In particular, it referred Boudreau to the MOU and to the investigators of Client D, and stated that KPMG Hong Kong was preserving relevant documents. Div. Ex. 87. Boudreau does not know if investigators responded to KPMG Hong Kong's September 6, 2011, letter; Boudreau did not personally respond, although he participated in a telephone call with KPMG Hong Kong's counsel. Tr. 814, 816. Boudreau had "several discussions" with OIA, but eventually did not make a request through Chinese regulators because other Commission investigators had been unable to obtain work papers through that route. Tr. 795-96.

5. KPMG's Consultation With Chinese Regulators

CSRC and MOF officials agreed to meet with KPMG after receiving KPMG's October 4, 2011, email concerning the PCAOB's intent to initiate disciplinary proceedings. Tr. 2166-67. The first meeting took place at the CSRC's offices on Sunday, October 9, 2011, and was attended by CSRC officials, Yan, Len Jui (Jui), who heads KPMG's regulatory and public affairs unit, and Belinda Tian (Tian), another KPMG partner. Tr. 1913-14, 2167-68. Jui reports to Yan. Tr. 2017. Jui explained his understanding of the PCAOB's October 3, 2011, letter, requested guidance from the CSRC, and did most of the talking; the CSRC officials did not answer KPMG's questions directly. Tr. 1914-15, 2167-68. The meeting lasted twenty to thirty minutes. Tr. 1914.

Another meeting took place the next day, October 10, 2011, at CSRC headquarters. Tr. 1915. A request went out in the morning for a meeting in the afternoon. Tr. 1915, 2168. Attendees included at least one official from the CSRC and MOF, and representatives of Dahua, E&Y, DTTC, PwC, Grant Thornton, and KPMG, with KPMG represented by Yan and Tian. Tr. 1915, 1945, 2168-69. The accounting firms briefed the CSRC and MOF regarding the requests they had received and their responses, which included whether each accounting firm had produced any work papers to overseas regulators. Tr. 1915-16. The CSRC and MOF stated that any work papers production would be in accordance with Chinese law, any overseas regulator seeking work papers should go through Chinese regulators, and any firm violating those two directives "may face severe consequences," including license revocation. Tr. 1916. The accounting firms requested permission to produce documents, and the CSRC and MOF told them to put their requests in writing. Tr. 1916-17.

On October 12, 2011, KPMG hand delivered a letter to the CSRC seeking "directions" from the CSRC regarding whether KPMG was "allowed to produce the audit work papers" of Clients D and F to the PCAOB. Tr. 1917, 2172; Resp. Ex. 545. Later that day, Jui sent an email

to Li Haijun (Haijun), who is “someone senior at the CSRC,” forwarding a marked-up version of Letter 413. Tr. 2026-27, 2172-73; Div. Exs. 335, 335-A. The attendees at the October 10, 2011, meeting received copies of Letter 413, most likely by email from DTTC; the CSRC would not give such a letter to a third party, and indeed, normally gives only oral guidance. Tr. 2037, 2215-17, 2282. Jui sent the marked-up version of Letter 413 (apparently without informing his supervisor, Yan, beforehand), because Jui believed his proposed edit would make Letter 413 more consistent with his understanding of the directives provided at the October 10, 2011, meeting. Tr. 1919, 1979, 2029-30, 2032-33, 2176, 2216. Yan did not specifically recall, but believed that he briefed Jui on the CSRC’s directives at the October 10, 2011, meeting. Tr. 2046. Jui’s proposed edit was to add a clause to the second paragraph of Letter 413 to the effect that audit work papers produced by accounting firms “should be approved by the corresponding legal procedures as well as the relevant authorities.” Tr. 2028-29; Div. Exs. 335, 335-A. The CSRC sometimes, but not not frequently, accepts such proposed edits from regulated firms. Tr. 1982.

The CSRC responded to KPMG’s October 12, 2011, letter by its own letter dated October 17, 2011 (Letter 422), which did not include Jui’s proposed edit. Tr. 1919-20, 2177-78; Resp. Exs. 546, 546-A. Yan viewed Letter 422 as consistent with the oral directives provided at the October 10, 2011, meeting, but less bluntly worded; in particular, Letter 422 did not mention that a serious case may result in license revocation. Tr. 1919-20, 1954, 1956. That is, Jui’s proposed edit was not related to what Yan considered to be the portion of Letter 422 that was less bluntly worded than the CSRC’s oral directives. Yan’s understanding of the CSRC’s directives was that KPMG was not allowed to produce documents to U.S. regulators. Tr. 1920. He considered the instruction “not to produce documents directly to the overseas regulator” to be “quite clear” even in Letter 422. Tr. 1955-56. He understood the final paragraph of Letter 422 as stating that KPMG needed “appropriate permission” from its regulator to produce audit work papers, and it did not have such permission. Tr. 1963.

Sometime in late 2011, KPMG sought guidance regarding its Client E and F work papers from the Chinese State Secrets Bureau and Archives Bureau, which both informed KPMG that it could not deal with those Bureaus directly. Tr. 2178-79, 2221. KPMG so informed the CSRC by letter dated February 24, 2012, and the CSRC confirmed that KPMG could not deal directly with the State Secrets Bureau and Archives Bureau. Tr. 2179-80; Resp. Ex. 551. J. Wong understands that only the State Secrets Bureau or another Chinese government authority can make the decision that a particular document contains state secrets. Tr. 2259.

6. Sarbanes-Oxley 106 Requests

In early February 2012, the three Division investigative teams submitted requests pursuant to Sarbanes-Oxley 106, via KPMG LLP, seeking “[a]ll audit work papers and all other documents related to any audit work or interim reviews.” Tr. 194 (Client E), 754 (Client D), 797 (Client F); Div. Exs. 66, 73; see also Div. Ex. 84 (“All audit work papers and all other documents related to any audit reports issued, audit work performed, or interim reviews conducted.”). As to Client D, the request was dated February 6, 2012, and sought documents for the fiscal year ending December 31, 2010. Div. Ex. 66. As to Client E, the request was dated February 9, 2012, sought documents for the fiscal year ending December 31, 2010, and was

addressed to both KPMG and KPMG Hong Kong. Div. Ex. 73. As to Client F, the request was dated February 3, 2012, sought documents from January 1, 2008, to the present, and was addressed to “KPMG LLP as designated agent.” Div. Ex. 84. The Commission authorized the Sarbanes-Oxley 106 request as to Client D.⁶ Tr. 763-64.

In response, Jui had “various exchanges” with Chinese regulators, including a February 24, 2012, meeting with the CSRC and MOF. Tr. 1920-21, 2182-83, 2185; Resp. Exs. 553, 556 at 7. Jui reported to Yan that the CSRC’s guidance was unchanged. Tr. 1920-21, 1985-86. KPMG sent a consolidated response to all three Sarbanes-Oxley 106 requests by letter dated March 27, 2012. Tr. 2185; Div. Ex. 74; Resp. Ex. 556. The letter stated KPMG’s position that it was unable but not unwilling to produce the requested documents, recited the various actions KPMG had taken to attempt to comply with the Commission’s requests, and suggested that production via the MOU would be an acceptable alternative means of production within the meaning of Sarbanes-Oxley 106(f). Tr. 2186-91; Div. Ex. 74; Resp. Ex. 556. The letter also quoted from an April 27, 2011, letter from the Commission’s Chairman at the time, Mary Schapiro (Chairman Schapiro), to Congress. Div. Ex. 74 at 18. The letter stated that, with respect to China, the Commission “generally work[s] with the jurisdiction’s home regulator to pursue [its] enforcement aims.” Div. Ex. 74 at 18 (quoting Ltr. from SEC Chairman Mary L. Schapiro to Hon. Patrick T. McHenry, Chairman of the Subcomm. on TARP, Fin. Servs., & Bailouts of Pub. and Private Programs, Comm. on Oversight and Gov’t Reform, at 6-7 (Apr. 27, 2011) (Schapiro Letter)).

No audit work papers have been produced pertaining to Client D, which stymied the investigation. Tr. 755, 759. In particular, investigators were unable to adequately investigate the allegations regarding cash and biodiesel plant revenue. Tr. 759. The investigation is currently “on hold.” Tr. 759.

No audit work papers have been produced pertaining to Client E, which frustrated the investigation. Tr. 199. The Commission filed a settled action against Client E and its chief financial officer in federal district court in February 2013, but other potential violations could have been investigated had the audit work papers been produced. Tr. 200-01; Div. Ex. 76.

No audit work papers have been produced pertaining to Client F, which frustrated the investigation. Tr. 797, 799. The investigation is still “technically open,” but inactive. Tr. 799-800.

The Division issued a consolidated Wells notice to KPMG, as to all three Clients, on May 2, 2012. Tr. 201; Div. Ex. 143.

7. Recent Events

Sometime between December 2012, when the OIP issued, and June 2013, possibly on December 31, 2012, representatives of all Respondents met with the CSRC and MOF to discuss

⁶ This is likely true of all Sarbanes-Oxley 106 requests in this proceeding, but there is no record evidence of Commission authorization except as to Client D and DTTC Client A (see infra).

the present proceeding. Tr. 1922, 1965. The position of the CSRC and MOF was unchanged. Tr. 1922-23.

On June 4, 2013, representatives of all Respondents, including Yan for KPMG, met with the CSRC and MOF to discuss the present proceeding, in particular, to discuss it in light of the announced hearing date and to find out if the recent MOUEC changed anything. Tr. 1923, 2191-92. The CSRC and MOF told the accounting firms that they “just have to wait for instruction” from the CSRC and MOF. Tr. 1924. Approximately two weeks later, Tian attended a meeting with the CSRC, where the CSRC stated that a protocol had been developed for producing audit work papers to the CSRC, which would forward them to overseas regulators. Tr. 1925. The protocol has three elements: (1) the accounting firm must redact all documents itself, to remove state secrets or other sensitive information; (2) the accounting firm must hire a Chinese attorney to certify that the accounting firm followed protocol; and (3) the accounting firm must ask its client to certify that the accounting firm’s work is proper. Tr. 1925-26; Resp. Exs. 650, 650-A. J. Wong attended one of the two June 2013 meetings and learned for the first time that the Commission had not sought assistance from the CSRC in the production of KPMG’s audit work papers. Tr. 2191-92.

In accordance with the new protocol, the CSRC informed KPMG by letter dated July 19, 2013 (five days before Yan testified), that it was sending two individuals to KPMG to start the document screening process for Clients D and F.⁷ Tr. 1926; Resp. Ex. 650, 650-A. Yan understands that this was in response to the PCAOB ABDs. Tr. 1926. KPMG is currently conducting the screening process in accordance with the CSRC’s protocol. Tr. 1927, 2192.

Yan testified, when asked if KPMG “elected not to produce documents to the SEC in response to the Section 106 requests,” that he did not “think there is an election as such” and “I think we simply have no choice.” Tr. 2001. He also testified: “I don’t think I have a choice. I just have to comply with Chinese law.” Tr. 2002. However, when asked whether he “could live with” a bar on practicing before the Commission, he stated: “No, the consequence we couldn’t live with, but I have to comply with Chinese law. I – well, basically there is a conflict between the two laws. I have to be forced to make a decision.” Tr. 2002-03. He also testified that he believed “the decision” regarding how to respond to the Sarbanes-Oxley 106 requests was made by KPMG’s chairman in consultation with its management committee. Tr. 2004-05.

J. Wong testified, when asked if KPMG “chose not to produce the work papers directly to the SEC,” that she “wouldn’t say it’s a choice.” Tr. 2266. However, she also testified, when asked if KPMG “decided to follow those oral and written directives” from the CSRC, “[y]es, we are complying with the CSRC.” Tr. 2269.

D. DTTC

DTTC is headquartered in Shanghai, China. Tr. 1625. As of June 2012, it had seven offices in China and no offices outside of China, and approximately 5,857 employees, including

⁷ Yan testified that the screening pertained to Clients E and F, but Resp. Ex. 650-A clearly shows that it is for Clients D and F, as J. Wong testified. Tr. 1926, 1993, 2192.

4431 accountants and 974 CPAs. Div. Ex. 17. Richard George (George) has been a CPA in Hong Kong for about eighteen years. Tr. 1639. He is currently the reputation and risk leader for Deloitte China, which includes DTTC and the Deloitte affiliates in Hong Kong and Macau. Tr. 1597. He is responsible for firm-wide risk management, regulatory affairs, independence conflicts, ethics, legal, and security. Tr. 1598. His group considers requests from regulators and formulates recommendations about them to firm leadership. Tr. 1598. He sits on DTTC's management executive body, and five partners and thirty-two staff report to him. Tr. 1598. Chiu Chi Man (Chiu) works in Beijing as DTTC's professional practice director for northern China, covering DTTC's Beijing, Tianjin, and Dalian offices. Tr. 1768-69. He is responsible for ensuring that DTTC employees comply with the law, although another professional practice director handles that responsibility with respect to U.S. issuers. Tr. 1769. Chiu began his career as an accountant in 1987 with KPMG Hong Kong and moved to DTTC in 1990. Tr. 1769-70. He was seconded to the Hong Kong Securities and Futures Commission in 1997, and to the CSRC for two years beginning in 2002, one year full time and one year part time. Tr. 1770. He returned to DTTC full time in 2004, although he is now at DTTC part time. Tr. 1770-71.

DTTC is regulated in China by the CSRC, which has the authority to revoke DTTC's registration. Tr. 1608-09, 1714-15. DTTC registered with the Board in June 2004. Tr. 1624, 1664; Div. Ex. 7; Resp. Ex. 205. Its registration with the Board was its first registration with a foreign regulator. Tr. 1630-31. DTTC did not sign the "Consent to Cooperate With the Board and Statement of Acceptance of Registration Condition" in its PCAOB Form 1. Tr. 1625; Resp. Ex. 205 at 16. DTTC's lack of consent was based upon an April 16, 2004, letter from Century-Link, which opined that Chinese law prevented KPMG from complying with PCAOB testimony and document requests. Tr. 1625; Resp. Ex. 205 at 201. DTTC also provided a letter with its application stating that it would take reasonable steps to cooperate with requests for testimony and for production of documents made by the Board. Tr. 1626; Resp. Ex. 205 at 227.

By letter dated June 2, 2004, the Board accepted DTTC's application, acknowledged that it had withheld consent to cooperate, and told DTTC that it was obligated to follow U.S. law. Tr. 1629, 1667-68; Div. Ex. 7. In its 2010, 2011, and 2012 annual reports to the Board, DTTC declined to affirm that it consented to cooperate with Board investigations, but also disclosed that it had issued audit reports for thirty-two, forty-five, and forty-five U.S. issuers, respectively, for all of which DTTC had been paid. Tr. 1668-75; Div. Ex. 15 at 6-10, 22; Div. Ex. 16 at 6-12, 23; Div. Ex. 17 at 6-12, 23. DTTC is a "foreign public accounting firm" as that term is defined in Sarbanes-Oxley. Tr. 1677. On June 9, 2011, DTTC designated Deloitte & Touche LLP, located in the U.S., as its agent for service of Sarbanes-Oxley 106 requests. Tr. 1680-81; Div. Ex. 165-A at 5-6.

1. DTTC Client A Investigation

DTTC Client A is based in China, manufactures and distributes solar panels, and is incorporated in Ontario, Canada. Tr. 53; Div. Ex. 124 at 4. Its securities are registered with the Commission and trade on NASDAQ. Tr. 54. DTTC audited DTTC Client A's financial statements for the fiscal years ended December 31, 2008, through December 31, 2012. Tr. 1645. As of April 26, 2013, it remained a client of DTTC. Div. Ex. 124 at 143.

Laura Josephs (Josephs) is an assistant director in the Division, where she oversees and supervises the investigation of potential securities violations. Tr. 51-52. She joined the Division in 1990 as a staff attorney, was later promoted to branch chief and deputy assistant director, and was named an assistant director in 2004. Tr. 52. She supervised the investigation of DTTC Client A and testified for the Division on that subject. Tr. 52-53.

The subject matter of the DTTC Client A investigation was financial fraud, focusing on revenue recognition issues, for the period 2008 to 2010. Tr. 54. Investigators obtained several thousand documents directly from DTTC Client A, including documents relating to financial statements, and DTTC Client A did not withhold anything based upon Chinese law, to Josephs' knowledge. Tr. 57-58.

Investigators issued a subpoena on April 9, 2010, to DTTC's U.S. affiliate, Deloitte LLP, asking for "[a]ll documents" relating to audits and reviews of DTTC Client A by any Deloitte LLP affiliate, including all "manual and electronic workpapers." Tr. 61-62; Div. Ex. 129 at 8. Josephs testified that audit work papers are useful to investigators because the audit firm has already examined a company's financial information and because they help to assess liability, in that they may reveal whether a company has been honest with its auditors, whether the auditors opined that the company's conduct was proper, or whether the auditors were complicit in the company's misconduct. Tr. 59-61. Investigators received an oral response from Deloitte LLP and a Deloitte network liaison, Cary Miller (Miller), stating that Deloitte LLP had not performed any audit work for DTTC Client A, that DTTC was a separate entity, and that DTTC could not produce any documents voluntarily because of various legal impediments. Tr. 62-63.

DTTC Client A filed a form 6-K on June 3, 2010, which attached a press release announcing the receipt of a subpoena from the Commission requesting documents related to certain sales transactions in 2009, and the resulting initiation of an internal investigation by DTTC Client A's audit committee. Tr. 54-55; Div. Ex. 125. DTTC Client A also filed a form 20-F on August 19, 2010, which attached DTTC's audit opinion for the fiscal years ended December 31, 2008, and December 31, 2009, which opinion referenced findings of material weaknesses in internal controls, but was otherwise unqualified. Tr. 56; Div. Ex. 121 at F-2.

After contacting Deloitte LLP, and before contacting DTTC directly, investigators sent a request for DTTC's "work papers" to the CSRC through OIA, based on the MMOU, on June 7, 2010. Tr. 64-65, 100; Div. Ex. 192. Investigators were "hopeful" at the time that the CSRC would gather and produce the requested documents. Tr. 65. The CSRC sent DTTC a request on July 6, 2010, for its "audit working papers" of DTTC Client A for 2008 and 2009. Tr. 103-04, 1599; Resp. Exs. 72, 72-A. DTTC produced nineteen boxes of documents, including 2008 and 2009 "working paper," on July 23, 2010. Tr. 104-05, 1600-01; Resp. Exs. 74, 75, 75-A. These included the documents received by DTTC pertaining to the investigation ordered by DTTC Client A's audit committee. Tr. 1648-50. The CSRC did not produce the documents, and investigators still do not have the requested audit work papers. Tr. 65. The CSRC responded to OIA with a "variety" of explanations for not producing the requested documents. Tr. 66-67.

After learning that Deloitte LLP had performed "some sort of ministerial formatting type work" for DTTC Client A, investigators sent a second subpoena to Deloitte LLP on June 8,

2010, asking for “[a]ll documents” relating to any work done by any Deloitte affiliate for DTTC Client A. Tr. 68; Div. Ex. 130 at 7. Deloitte LLP responded by letter dated June 29, 2010, enclosing approximately 1,749 pages of responsive documents, but otherwise stating that Deloitte LLP did not possess responsive documents or information, and referring investigators to DTTC. Tr. 69; Div. Ex. 131.

2. Client G Investigation

Client G, a former client of DTTC, is based in China, designs, manufactures, and sells offset printing equipment, and was incorporated in Wyoming as of September 2010. Tr. 693-94; Div. Ex. 92. Its securities are registered with the Commission and were traded on the NYSE until April 2011, when they began trading over the counter. Tr. 694. Moore Stephens Wurth Frazer and Torbet, LLP, an accounting firm based in California, which later became Frazer Frost LLP (Frazer Frost), issued audit reports as to Client G’s financial statements for the fiscal years ended June 30, 2008, and June 30, 2009. Tr. 694, 731-32; Div. Exs. 91, 92. Client G dismissed Frazer Frost on March 1, 2010. Div. Ex. 91.

DTTC was engaged on March 2, 2010, to audit the financial statements of Client G for the fiscal year ended December 31, 2010. Tr. 694-95, 1652; Div. Ex. 91. It never completed the audit before being terminated on September 6, 2010, although it did commence audit work.⁸ Tr. 697, 700-01, 1652; Div. Ex. 92. Frazer Frost then returned as Client G’s auditor. Tr. 715.

Rhoda Chang (Chang) is a staff accountant in the Division, based in the Los Angeles regional office, and has been with the Commission since 2003. Tr. 691-92. She assists in Division investigations by analyzing and reviewing financial records and audit work papers. Tr. 692. She has worked on various financial fraud cases, including ones involving financial statement misstatements and inadequate or falsified disclosures, and she has reviewed auditor conduct. Tr. 692. She participated in the investigation of Client G and testified for the Division on that subject. Tr. 692-93.

The Client G investigation began in September or October 2010 and covered the period July 1, 2009, to the present. Tr. 694, 702; Div. Ex. 211 at 2. The trigger for the investigation was a form 8-K filed on September 13, 2010, which disclosed the dismissal of DTTC as Client G’s auditor, effective September 6, 2010, and the resignation of three members of Client G’s audit committee. Tr. 694-95, 713, 719, 1652; Div. Ex. 92 at 5-6; Div. Ex. 211 at 2. The investigation’s subject matter is described in the form 8-K: Client G’s denial of access to DTTC to review original bank statements, DTTC’s inability to verify the authenticity of advertising and

⁸ Additionally, Chang testified that DTTC “would have” reviewed Client G’s form 10-Q financial statement for the quarter ended March 31, 2010; i.e., it would have conducted an interim review. Tr. 725; see 17 C.F.R. § 210.10-01(d) (auditors must review interim financial statements included in forms 10-Q). I have taken official notice of Client G’s form 10-Q for the quarter ended March 31, 2010, pursuant to Rule 323. 17 C.F.R. § 201.323. There is no indication in the form 10-Q that DTTC reviewed it, nor is there a requirement that the form so indicate. 17 C.F.R. § 210.10-01(d).

tradeshow costs, and inconsistencies in information about certain distributors and vendors of Client G. Div. Ex. 92 at 5.

Investigators initially reviewed Client G's public filings, and then sent a subpoena to Client G. Tr. 696. They also sent a subpoena to Frazer Frost for Client G's audit work papers. Tr. 696. They sought audit work papers because they expected them to aid in understanding Client G's internal controls and bank account information and Frazer Frost's review procedures. Tr. 699-701. Investigators received "a couple hundred thousand pages" from Client G, including financial records, general ledgers, invoices, and purchase orders. Tr. 696-97. Frazer Frost produced its audit work papers generated between January 1, 2008, and March 2010, when they were dismissed, as well as review work papers, email communications, and the audit staff's desk files. Tr. 699. To Chang's knowledge, neither Client G nor Frazer Frost withheld any documents based on Chinese law. Tr. 697, 700.

Investigators also sought DTTC's Client G audit work papers, because they believed they would shed light on the issues and allegations disclosed in Client G's September 13, 2010, form 8-K. Tr. 701. As Chang's first step in requesting DTTC's audit work papers, she contacted Miller shortly after the investigation opened. Tr. 702. Eventually, Miller told Chang that DTTC needed Client G's consent to produce audit work papers, but after obtaining that consent, DTTC did not produce the audit work papers. Tr. 702-04; Div. Ex. 94; Resp. Ex. 95.

Chang sent a voluntary request for production to DTTC on May 5, 2011, seeking audit work papers and other documents. Tr. 704; Div. Ex. 96. DTTC responded orally in May 2011, and in writing on September 27, 2011, declining to produce its audit work papers on the basis of Chinese law. Tr. 704-05; Div. Ex. 97. The written response cited various Chinese laws, including Reg 29, the State Secrets Law, and laws pertaining to archives and public accountants, and attached a letter dated April 16, 2004, from Century-Link, opining that various provisions of Chinese law prohibited production of the requested documents. Div. Ex. 97 at 1-3, 24-48. After receiving DTTC's oral response to the voluntary request, on June 30, 2011, investigators made a request to the CSRC, through OIA, for assistance in obtaining the Client G audit work papers. Tr. 705; Div. Ex. 211. The request to the CSRC was unsuccessful. Tr. 706.

3. DTTC Client A Sarbanes-Oxley 106 Request

After Dodd-Frank took effect, investigators decided to send DTTC a Sarbanes-Oxley 106 request regarding DTTC Client A because a response would be mandatory, rather than voluntary. Tr. 69-70. The DTTC Client A Sarbanes-Oxley 106 request was issued on March 11, 2011, seeking "[a]ll audit work papers and all other documents related to any audit work or interim reviews" for the fiscal year ending December 31, 2009. Tr. 70, 108; Div. Ex. 127. DTTC informed the CSRC of the request, and the CSRC told DTTC not to produce the audit work papers directly to the Commission, and that the appropriate channel for production was through the CSRC. Tr. 1601-02. George viewed this direction as "very clear," and understood that there were "potentially very serious consequences" for both DTTC and its employees if they disobeyed their Chinese regulator. Tr. 1603, 1608, 1616. DTTC viewed any effort to obtain guidance from the State Secrets Bureau and the State Archives Bureau, in addition to the CSRC, and any effort to obtain client consent to production, as superfluous. Tr. 1608-10.

DTTC, through counsel, informed investigators in March 2011 (possibly during a conference call on March 29, 2011) that the CSRC had approached DTTC about the requested documents, and that DTTC had produced them to the CSRC in July 2010. Tr. 66-67, 70, 101, 157-58. DTTC also stated that it could not comply with the Sarbanes-Oxley 106 request “because of various legal impediments,” although Josephs opined that DTTC’s counsel “didn’t seem to have a firm grasp on what those legal impediments were.” Tr. 70-71. The legal impediments were provided to investigators in “laundry list” fashion by email dated April 11, 2011. Tr. 158-59; Div. Ex. 132.

DTTC made a written inquiry of the CSRC on April 8, 2011, seeking “direction on how we may respond to SEC.” Tr. 122-23; Resp. Ex. 92, 92-A. Chairman Schapiro issued the Schapiro Letter on April 27, 2011. Tr. 109-12.

DTTC, through counsel, later sent a written response, dated April 29, 2011, to the DTTC Client A Sarbanes-Oxley 106 response. Tr. 72; Div. Ex. 128; Resp. Ex. 97. The written response stated that DTTC produced responsive documents to the CSRC on July 23, 2010, and that Haijun, an “officer” of the CSRC, told DTTC on April 19, 2011, that direct production to the Commission was not permitted and that the CSRC could not provide a written confirmation of its position. Div. Ex. 128. The written response also stated that DTTC “wishes to cooperate with the SEC” and would be happy to provide the requested documents if permitted to do so. Div. Ex. 128. It was otherwise relatively terse and discussed the legal impediments to production in very general terms, although it did cite specifically to Reg 29. Tr. 72-73, 125; Div. Ex. 128.

Josephs opined that the lack of audit work papers delayed the investigation of DTTC Client A, and that a “significant chunk” of the investigation was missing. Tr. 74. The investigation remains ongoing. Tr. 74. Josephs did not seek DTTC Client A’s audit work papers through the Board, she does not recall reading the MOUEC to determine if it could be used to obtain them, and she does not know whether the Board can share information it receives with the Commission. Tr. 83, 89-91. She did not think the MOUEC would “necessarily” be better than the avenues investigators had already pursued. Tr. 161-62.

Investigators issued a Wells notice regarding DTTC Client A to DTTC on July 6, 2011. Tr. 76; Div. Ex. 147. On August 10, 2011, DTTC filed a Wells submission. Div. Ex. 162. On the same day, it wrote to Haijun at the CSRC, requesting he “reconsider” his earlier decision to prohibit direct production of audit work papers to the Commission. Tr. 132-33; Resp. Exs. 115, 116. The CSRC did not change its position. Tr. 1613.

Two partners at DTTC, its national audit leader and a regulatory partner reporting to George, attended a meeting with the CSRC on October 10, 2011. Tr. 1614. The CSRC told DTTC⁹ that any approach from a foreign regulator should be referred to the CSRC, DTTC could not unilaterally produce audit work papers to the foreign regulator, and the appropriate channel for production was through the CSRC. Tr. 1614-15. George testified that DTTC did not think there was any “ambiguity” in these instructions. Tr. 1615. The CSRC issued Letter 413 to

⁹ George testified that the CSRC gave this direction to “the firms,” rather than solely to DTTC. Tr. 1613-15.

DTTC the next day, October 11, 2011, confirming these instructions. Tr. 1613; Resp. Ex. 245, 245-A.

On January 27, 2012, DTTC, through counsel, wrote to Josephs to report the results of the October 10, 2011, meeting between the CSRC, the MOF, and Respondents. Tr. 134-36; Resp. Ex. 137. At some time in January 2012, CSRC representatives met with the Commission in Washington, D.C. Tr. 137. On January 31, 2012, DTTC, including George, met with the Division in Washington, D.C., to discuss the Division's proposed enforcement action (i.e., the DTTC OIP) and efforts DTTC could make to facilitate production of documents to the CSRC. Tr. 139-41. George considered this meeting to be part of the Wells process. Tr. 1616. At the meeting, DTTC conveyed its understanding of the CSRC's instructions, and the Division stated its intention, nonetheless, to recommend issuance of the DTTC OIP, but the Division also stated that it might be possible to defer formal initiation of the enforcement proceeding to give DTTC more time to work with the CSRC. Tr. 1616-17.

Josephs informed DTTC's outside U.S. counsel by voicemail on February 3, 2012, that the Commission, with Mary Schapiro as Chairman, had authorized the DTTC OIP. Tr. 146, 157. Later that day, Josephs and DTTC's outside U.S. counsel spoke, and Josephs told DTTC's outside counsel that there would be a delay between authorization and issuance. Tr. 146-47. The purpose of the delay was to allow DTTC to work with the CSRC to facilitate production of DTTC Client A's audit work papers, and this purpose was later memorialized in an attachment to a letter from DTTC's outside U.S. counsel to Josephs dated February 8, 2012. Tr. 148-49; Resp. Ex. 140. Thereafter, Josephs and DTTC's outside U.S. counsel spoke at least weekly about DTTC's progress and related matters. Tr. 147.

4. Client G Sarbanes-Oxley 106 Request

Investigators decided to send DTTC a Sarbanes-Oxley 106 request regarding Client G because a failure to respond to such a request, in contrast to a failure to respond to a voluntary request, would have "repercussion[s]." Tr. 706-07. The Client G Sarbanes-Oxley 106 request was issued on February 14, 2012, seeking "[a]ll audit work papers and all other documents related to any audit work or interim reviews" for the fiscal year ending June 30, 2010. Tr. 707; Div. Ex. 93. DTTC responded by letter dated April 17, 2012, citing Chinese law and Letter 413. Tr. 707-08; Div. Ex. 94. It also attached four documents from the Commission's action seeking enforcement of an administrative subpoena pertaining to work papers generated during DTTC's audit of Longtop Financial Technologies Limited (Longtop). SEC v. Deloitte Touche Tohmatsu CPA Ltd., No. 1:11-mc-00512 (D.D.C.).

Investigators still do not have DTTC's Client G audit work papers. Tr. 708. Chang opined that this has hampered the investigation because investigators do not know the facts surrounding the issues mentioned in Client G's September 13, 2009, form 8-K. Tr. 708-09.

The Division issued a Wells notice on April 30, 2012. Tr. 709; Div. Ex. 144. DTTC filed a Wells submission on May 29, 2012. Div. Ex. 152.

5. Recent Events

Chiu, on behalf of DTTC, attended a meeting with the CSRC at the CSRC's Beijing office sometime in February 2012. Tr. 1771-72. DTTC's managing partner for northern China and a partner in its risk and reputation group also attended. Tr. 1772-73. Tong Zi (Tong) attended on behalf of the CSRC. Tr. 1772-73. At the meeting, the CSRC said that it understood DTTC was in a difficult situation with regard to DTTC Client A and that it wanted to facilitate production of audit work papers to the Commission. Tr. 1772-73. Chiu understood that DTTC could not produce audit work papers directly to the Commission and instead had to go through the CSRC. Tr. 1795-96.

Tong asked DTTC to screen the DTTC Client A audit work papers for, and redact any, state secrets. Tr. 1774-75. The CSRC explained what constituted state secrets, using examples from the DTTC Client A audit work papers. Tr. 1774. In general terms, Chiu understood information to be a state secret if its disclosure would "affect the interest of the state." Tr. 1797. Chiu was "quite optimistic" after the February 2012 meeting. Tr. 1775.

DTTC thereafter formed a review team, overseen by Chiu, which involved three other DTTC partners and a Chinese law firm. Tr. 1776-77. The team spent about two weeks reviewing the audit work papers page by page, and determined that a relatively small portion of the audit work papers contained state secrets. Tr. 1777-78. The portion containing state secrets was cataloged in a spreadsheet that was between three and six pages long and contained about five to ten entries per spreadsheet page. Tr. 1806, 1808-09. Chiu could not remember the precise number of pages of audit work papers which DTTC had determined contained state secrets. Tr. 1809. The state secrets were "scattered throughout the working papers," and included "technology know-how" and non-public Chinese "governance policy." Tr. 1800-01, 1804. State secrets were not, "in general," found in bank confirmations, supplier confirmations, customer confirmations, bank statements, financial books and records, or DTTC's findings. Tr. 1804-05. DTTC reported the results to the CSRC at interim and final meetings. Tr. 1778. The CSRC then reviewed the results, discussed them with other government agencies, determined that it agreed with most but not all of DTTC's findings, and directed DTTC to redact the papers accordingly using a marker, which was done at the CSRC's office. Tr. 1778-79, 1807.

The CSRC then made an offer to the Commission to produce the DTTC Client A audit work papers, subject to two conditions. Tr. 1780. DTTC did not participate in setting those conditions. Tr. 1780. Chiu understood that the Commission rejected the offer, apparently based on a May 8, 2012, email from OIA to the CSRC stating that the conditions the CSRC had imposed on production of the DTTC Client A audit work papers were "inconsistent with the assistance [OIA] need[s]." Tr. 1024, 1780; Div. Ex. 223. Chiu felt helpless, because he felt DTTC could do nothing to resolve the disagreement between the regulators. Tr. 1780-81.

The Commission then issued the DTTC OIP on May 9, 2012, shortly after the end of the 2012 Strategic and Economic Dialogue between the U.S. and China, although Josephs testified that she did not recall that the issuance of the DTTC OIP was tied to the timing of the Strategic and Economic Dialogue. Tr. 150-51. On July 19, 2012, I issued an order postponing proceedings under the DTTC OIP. Deloitte Touche Tohmatsu Certified Public Accountants Ltd.

(July 19, 2012) (unpublished) (Postponement Order). The Postponement Order noted that the Division sought a six-month stay because in July 2012, the Chairman of the Commission discussed with the Chairman of the CSRC and other Chinese government officials the need to develop a mechanism for the Commission to obtain documents from audit firms in China. It also noted that the Division represented that if Commission staff satisfactorily obtained the documents it sought from the CSRC through these negotiations, the Division would likely seek to dismiss the DTTC OIP. On December 10, 2012, I issued an order in which I noted the Division's representation that negotiations between the Commission and the CSRC had been unsuccessful. Deloitte Touche Tohmatsu Certified Public Accountants Ltd. (Dec. 10, 2012) (unpublished).

The CSRC contacted DTTC about the audit work papers for Longtop in July 2012, because it wanted to "resolve the deadlock with the SEC." Tr. 1782. Chiu then met with the CSRC, which informed him that it wanted DTTC to review the Longtop audit work papers, in a manner similar to the DTTC Client A review. Tr. 1783. Because the Longtop review involved more documents, it also involved more personnel and a computerized key word search. Tr. 1783-84. In total, about 9,000 man-hours were expended by DTTC during the review. Tr. 1784. DTTC reported back its results to the CSRC in approximately November 2012, although DTTC did not produce the audit work papers to the CSRC at that time. Tr. 1784-85.

Chiu and two other DTTC partners met with the CSRC and MOF in February 2013. Tr. 1785-86. The Chinese regulators explained that they had consulted with different government agencies, including the State Council, which is a "very high level of government," and had formulated procedures for handling requests for audit work papers from overseas regulators. Tr. 1787-88. The procedure, in summary, was: the regulators determine whether a request is appropriate to process; the regulators ask accounting firms to search for state secrets in the audit work papers and submit them to the CSRC within a specified period; and the regulators further process the papers and coordinate with the overseas regulators. Tr. 1787-88. The regulators emphasized that in screening audit work papers, accounting firms should use "sound judgment" and redact matter only because it contains state secrets, and not because it contains matter that would cast the accounting firm in a bad light. Tr. 1788-91.

The regulators also told DTTC that it should consider the meeting to be an informal notice of a request for the DTTC Client A and Longtop audit work papers, and that DTTC would receive a formal notice later. Tr. 1791. DTTC received a formal notice pertaining to Longtop on April 8, 2013, and a formal notice pertaining to DTTC Client A on April 16, 2013. Tr. 1791-92; Resp. Exs. 636, 644. In May 2013, DTTC produced to the CSRC the reviewed DTTC Client A audit work papers, including audit work papers generated after the July 23, 2010, demand. Tr. 1695-96. According to Chiu, the CSRC has produced the Longtop papers to the Commission, and is still working on producing the DTTC Client A papers. Tr. 1792-93. DTTC thereafter produced Client G's audit work papers to the CSRC in July 2013. Tr. 1637, 1793.

George opined that DTTC had "no choice at all" as to whether it could produce audit work papers directly to the Commission. Tr. 1715-16. He denied that "[s]omebody at DTTC made the decision to follow [the CSRC's] direction," because "there was no decision to make." Tr. 1718. However, he also testified that DTTC "decided not to act contrary to" the CSRC's

direction. Tr. 1723. He explained that the “position” that DTTC could not produce audit work papers directly was “pre-existing” since 2004, when DTTC registered with the Board. Tr. 1719-21. His group formulates such positions in consultation with counsel and “take[s] them to our firm leadership in order to have a final decision made.” Tr. 1719-22.

E. PwC

PwC is an accounting firm headquartered in Shanghai, China. Tr. 1285; Div. Ex. 26 at 1. It is the “largest firm in China.” Tr. 1390. It performs services primarily in mainland China and Hong Kong and has no offices or employees outside of China. Tr. 1285. Two persons testified for PwC, Raymond Chao (Chao) and Debra Wong (D. Wong). Tr. 1284, 1830. Chao, who is a chartered accountant in Canada and a licensed CPA in Hong Kong, worked at Arthur Andersen until 2002 or 2003, when Arthur Andersen merged with PwC. Tr. 1288, 1323-24. He moved to Beijing from Hong Kong in 2003, but travels on business about fifty percent of the time. Tr. 1288, 1324. In late 2005, he became PwC’s assurance leader for China, and in 2011, he became PwC’s assurance leader for Hong Kong, China, and the Asia-Pacific region. Tr. 1288-89. As assurance leader, he heads PwC’s assurance practice, which largely involves auditing. Tr. 1284, 1286. He is ultimately responsible for the 6,000 to 7,000 PwC employees working in that area of PwC’s business. Tr. 1284-85. D. Wong graduated from college in 1978 and has been licensed as an accountant in Canada since 1981, and in Hong Kong since 1991. Tr. 1882. She worked as an accountant in Canada between 1978 and 1988, and moved to Hong Kong in 1988. Tr. 1882. Beginning in 1988 she worked on audit engagements in China, and has traveled back and forth between Hong Kong and China. Tr. 1894. She was PwC’s overall risk management leader from 2005 until 2010, when she became a regional risk management leader, although she retained her risk management position in connection with Commission matters even after 2010. Tr. 1830-31. She has retired from, and is currently a contract employee of, PwC, serving as risk management leader “for SEC matters for FPI clients.” Tr. 1883. She routinely interacts with PwC’s audit engagement teams, for example, when audit adjustments may be required or client fraud is suspected. Tr. 1831. She is generally familiar with PwC’s engagements of Clients H and I. Tr. 1832.

PwC primarily provides assurance services, which largely involves auditing. Tr. 1285-86. In 2004 it had eleven offices with 2,060 employees, including 1,780 accountants and 470 CPAs, and in 2012 it had ten offices with 8,578 employees, including 7,354 accountants and 2,428 CPAs. Div. Exs. 5, 26; Resp. Exs. 1, 605. PwC’s clients include private companies, public companies listed both in China and elsewhere, including the U.S., and state-owned enterprises, which may be listed in China, Hong Kong, and, in some cases, the U.S. Tr. 1286-87. Since at least 2002, PwC has made a substantial investment in servicing U.S. issuers; it trains its personnel and sends them overseas for development, and has organized them in a practice group specializing in U.S. reporting work. Tr. 1287-88. Chao considers its U.S. issuer business to be “very significant,” and PwC invested in the business because it expected it to be a very important market in the future. Tr. 1288, 1319. With respect to U.S. multinational companies, PwC is generally engaged as a component auditor, and “in some cases” as a principal auditor. Tr. 1315-16. With respect to Chinese companies listed in the U.S., PwC acts as the principal auditor, and this makes up ten to fifteen percent of PwC’s overall business. Tr. 1316.

PwC is regulated in China by the MOF, the CSRC, and the Administration of Industry and Commerce. Tr. 1286. Chao agreed that a 2009 Chinese government directive (presumably Reg 29) prohibits work papers from leaving China without approval of the regulatory authorities. Tr. 1352-53. Chao testified that the CSRC and MOF do not have jurisdiction over Client H, and that the 2009 directive applies to accounting firms but not to their clients.¹⁰ Tr. 1372. The CSRC has the authority to stop PwC from auditing listed companies, and the MOF has the authority to revoke PwC's license to practice in China. Tr. 1314.

PwC registered with the Board in 2004. Tr. 1327-28; Div. Ex. 5 at 17. PwC did not sign the "Consent to Cooperate With the Board and Statement of Acceptance of Registration Condition" in its PCAOB Form 1. Tr. 1329; Div. Ex. 5 at 16. PwC's lack of consent was based upon an April 16, 2004, letter from Century-Link, which opined that Chinese law prevented PwC from complying with PCAOB testimony and document requests. Tr. 1330-33; Div. Ex. 5 at 31. PwC was aware at the time it registered that production of documents to U.S. regulators could result in very severe sanctions. Tr. 1333-34, 1352; Div. Ex. 5 at 34. By letter dated July 13, 2004, the Board accepted PwC's application, acknowledged that it had withheld consent to cooperate, and told PwC that it was obligated to follow U.S. law. Tr. 1334-36; Div. Ex. 10. PwC did not respond to the Board's July 13, 2004, letter because, in Chao's view, it did not need to. Tr. 1337. Although PwC has declined many engagements, it has "not necessarily" done so because of the Board's position. Tr. 1338-39. In its 2010, 2011, and 2012 annual reports to the Board, PwC declined to affirm that it consented to cooperate with Board investigations, but also disclosed that it had issued audit reports for seventeen, twenty-seven, and thirty-one U.S. issuers, respectively, for all of which PwC had been paid. Tr. 1339-42; Div. Ex. 24 at 6-8, 20; Div. Ex. 25 at 6-9, 22; Div. Ex. 26 at 6-10, 22. In March 2011, PwC was a "foreign public accounting firm" as that term is defined in Sarbanes-Oxley. Tr. 1344. On June 9, 2011, PwC designated PricewaterhouseCoopers LLP, the U.S. PwC affiliate, as its agent for service of Sarbanes-Oxley 106 requests. Tr. 1346-47, 1350; Div. Ex. 165-A at 22.

1. Client H Investigation

Client H, a former client of PwC, is based in China, engages in commercial vehicle leasing, and was incorporated in the Cayman Islands as of December 2011. Tr. 852-53; Div. Ex. 99. Its securities traded on multiple exchanges, including NASDAQ, and were quoted on the OTC Bulletin Board as of November 30, 2011. Tr. 853, 1369; Resp. Ex. 380 at 104. Crowe Horwath was engaged as Client H's auditor between January 12, 2009, and April 5, 2010, conducted the audits of Client H's 2008 and 2009 financial statements, and provided unqualified audit opinions for those fiscal years, including an updated opinion on Client H's restatement for 2009. Resp. Ex. 380 at 102, F-3. Crowe Horwath is located in Sherman Oaks, California. Resp. Ex. 380 at F-3. Marcum Bernstein & Pinchuk LLP (Marcum) was engaged as Client H's auditor in approximately September 2011, conducted the audit of Client H's 2010 financial statement, and provided an opinion on November 30, 2011, which noted that it issued a separate report finding a material weakness in Client H's internal control over financial reporting. Resp. Ex. 380 at 103, F-2. Marcum is located in New York, New York. Resp. Ex. 380 at F-2.

¹⁰ This is not consistent with the language of Reg 29, which clearly applies to issuers (i.e., "overseas listed company[ies]") as well as accounting firms. Resp. Ex. 296 at 1.

PwC was engaged on April 13, 2010, to audit the consolidated financial statements of Client H for the fiscal year ended December 31, 2010.¹¹ Tr. 859-60, 1832-33; Div. Ex. 100. It never completed the audit before being terminated, although it did commence audit work. Tr. 861, 892, 1833; Resp. Ex. 377. PwC was terminated because of disagreements with Client H over PwC's desire for certain additional audit work and an independent investigation into certain matters. Tr. 1833-34, 1888. PwC's audit work was conducted in China and all of its audit work papers are in China. Tr. 1834.

David London (London) had been employed by the Division for almost thirteen years at the time he testified, first as a staff attorney and later as a senior counsel in the Boston regional office. Tr. 850-51. He has investigated and litigated a variety of cases, including accounting fraud. Tr. 850-51. In approximately early 2011, he joined the Division's Market Abuse Unit, which focuses on large scale market abuse, such as insider trading and market manipulation. Tr. 851. He did not investigate Client H personally, but reviewed Client H-related documents, spoke with the Client H investigative team, and testified for the Division on that subject. Tr. 852.

The trigger for the Client H investigation was a February 1, 2011, blog post which alleged accounting fraud. Tr. 854-55; Div. Ex. 104. Another aspect of the investigation focused on market manipulation, which led to an ongoing federal lawsuit against Client H. Tr. 854. Investigators initially requested information from Client H related both to the alleged market manipulation and the alleged accounting fraud. Tr. 857-58. They received "some information" directly from Client H. Tr. 858. Client H's U.S. outside counsel emailed the investigative team on June 6, 2011, and informed them that PwC would "very much welcome the opportunity to speak" with the investigative team, but warned them that Chinese "privacy laws" might hinder PwC's ability to answer questions. Tr. 884-85; Resp. Ex. 371.

Investigators also reached out to PwC directly for information related to the alleged accounting fraud, including its audit work papers. Tr. 858-59, 861. London testified that audit work papers are "always" sought in accounting fraud investigations, because, for instance, issuers are not necessarily forthcoming about their financial operations, investigators do not know the identities of an issuer's customers, but auditors do, and auditors will have verified or confirmed the issuer's claims about its business. Tr. 861-64. An issuer may also provide its auditors false information, which is a potential charge the Commission can bring, or the auditor may itself participate in the issuer's misconduct, and in both such cases audit work papers are potentially useful. Tr. 864-65.

Initially, investigators contacted PwC by telephone, including a conference call on June 28, 2011, with PwC's outside counsel and internal general counsel, PwC's engagement partner for Client H, and D. Wong, but the information conveyed in the conference call was not specific to Client H and not responsive to investigators' specific questions. Tr. 866-67, 882, 885-86, 1840-42; Resp. Ex. 375. PwC wanted to answer investigators' questions, but had an outside counsel with expertise on Chinese law present to provide "real-time advice" on whether certain answers should not be provided in light of Chinese law. Tr. 1841. On the conference call,

¹¹ Chao testified that PwC was engaged on March 31, 2010. Tr. 1369. In fact, PwC was not formally engaged until April 13, 2010. Div. Ex. 100 at 3.

investigators indicated that they intended to send PwC a request for additional information, but they never did so. Tr. 888-90, 1843. Client H announced the Division's investigation, as well as a planned restatement of its fiscal year 2009 financial statement, in a form 6-K dated June 30, 2011. Tr. 855-56; Div. Ex. 101.

Client H terminated PwC on September 16, 2011. Div. Ex. 98 at 1. On September 19, 2011, PwC sent Client H's audit committee chairman a letter (9-19 Letter) detailing PwC's disagreements with Client H and its audit committee. Tr. 903-04; Div. Ex. 98. Among other issues, PwC listed possible insider trading, artificial inflation of trading volume, and improper disclosure of related-party transactions. Div. Ex. 98 at 3-5. On September 28, 2011, the investigative team emailed PwC's counsel regarding the team's desire to speak with PwC about its termination as Client H's auditor. Tr. 894-95; Resp. Ex. 378. D. Wong participated in a conference call with investigators, probably in September 2011.¹² Tr. 1843. During that call, PwC explained the circumstances of its dismissal, including PwC's disagreements with Client H, and referred investigators to the 9-19 Letter. Tr. 1843-44. D. Wong believed that investigators were not aware of the 9-19 Letter prior to the September 2011 call. Tr. 1844. How the 9-19 Letter came into the Division's possession is not clear from the record.

Client H filed a form 20-F for the period ended December 31, 2010, dated November 30, 2011. Tr. 904-08; Resp. Exs. 380, 380-B. The form 20-F identifies three investigations Client H's audit committee undertook, at PwC's recommendation, and which PwC considered to be insufficient. Tr. 914; Resp. Ex. 380 at 103-04. It also states that PwC's concerns were based at least in part on "SEC deposition transcripts" provided by Client H to PwC after Client H filed its June 30, 2011, form 6-K. Tr. 910; Resp. Ex. 380 at 104. Another call between PwC's counsel and investigators took place in December 2011. Tr. 1849.

London did not know if investigators sought the audit work papers of Crowe Horwath, Client H's auditor before PwC, or if investigators sought the PCAOB's assistance in obtaining audit work papers regarding Client H. Tr. 877, 923. London testified that the investigative team did not contact the CSRC for assistance in obtaining audit work papers regarding Client H. Tr. 868, 923-24. Based on other investigations of which they were aware, the investigative team did not think a request to the CSRC would have resulted in anything. Tr. 869.

2. Client I Investigation

Client I, a former client of PwC, is based in China, manufactures automobile parts, and was incorporated in Nevada as of December 2011. Tr. 364, 1835; Div. Ex. 112. Its securities traded on NASDAQ between 2007 and 2012, and were also traded over the counter, although their registration was revoked on November 16, 2012. Tr. 364; Div. Ex. 108. PKF Certified Public Accountants (PKF) in Hong Kong conducted the audits of Client I's financial statements

¹² D. Wong initially testified that the call took place in December 2011. Tr. 1843. However, she later testified that it took place in September 2011, and that prior to that call, Client H had not made any public disclosure of the substance of the 9-19 Letter. Tr. 1845, 1849. London has no recollection of such a call. Tr. 915. I conclude that the call took place in late September 2011, likely in response to investigators' September 28, 2011, email.

for the fiscal years ended December 31, 2008, and December 31, 2009, and was dismissed on December 6, 2010. Tr. 369; Div. Ex. 109 at 2.

PwC was engaged on December 6, 2010, to audit the financial statements of Client I for the fiscal year ended December 31, 2010. Tr. 1835; Resp. Ex. 407 at 2. It never completed the audit before it resigned as Client I's auditor, although it did commence audit work. Tr. 1835; Resp. Ex. 407 at 2. PwC resigned on December 6, 2011, because of disagreements over how Client I remedied certain problems identified in an internal investigation. Tr. 1835-36; Resp. Ex. 407 at 2. PwC issued two letters to Client I's audit committee chairman in connection with its resignation, on December 6, 2011, and December 10, 2011, both of which D. Wong helped draft and which PwC provided voluntarily to the Commission. Tr. 1838-39; Resp. Ex. 405. PwC's audit work was conducted in China and all of its audit work papers are in China. Tr. 1839.

Stephen Kaiser (Kaiser) has been an attorney with the Division since September 2010. Tr. 361. He previously worked in private practice, beginning in approximately 2003. Tr. 361. While with the Division he has been involved with six or seven financial fraud investigations. Tr. 371. He was a member of the team investigating Client I, and testified for the Division on that subject. Tr. 362.

The Client I investigation focused on potential undisclosed related party transactions, misappropriation of company assets by company employees, accounting irregularities, and securities manipulation, all between about 2007 and 2011. Tr. 365. Investigators requested documents on both a voluntary and non-voluntary basis from a number of entities, spoke to third parties, dealt with the law firm representing Client I's audit committee, and sent requests to Client I. Tr. 368. For example, during PwC's engagement, Client I filed two forms 8-K, one reporting an intent to restate its financial results for 2008 and 2009, and one reporting the resignation of Client I's chairman and the initiation of an investigation into related party transactions and other accounting issues, and Kaiser reviewed these forms during the investigation. Tr. 366-68; Div. Ex. 110 at 2; Div. Ex. 111 at 2.

Kaiser generally requests production of audit work papers during financial fraud investigations, and made such a request of PwC in connection with Client I. Tr. 369-71. Audit work papers are useful in a financial fraud investigation because auditors would be expected to look, during their audits, at some of the same issues investigators were looking into. Tr. 370. PKF produced audit work papers in response to a voluntary request in early 2011, apparently without objection. Tr. 374. Client I, through counsel, produced a "limited" amount of documents at some point in the investigation. Tr. 392-93.

PwC learned of investigators' interest in Client I in about July 2011. Tr. 1850. Around July 7, 2011, D. Wong had a telephone call with Division personnel, in which she informed investigators that Chinese law presented certain impediments to discussing the specifics of audit work for a particular client. Tr. 1850-51. D. Wong arranged for a second call on July 21, 2011, on which was D. Wong, PwC's engagement team leader, PwC's general counsel, and PwC's outside counsel. Tr. 1851-52; Resp. Ex. 388. The call was long, with many questions from investigators, and PwC suggested that investigators obtain a copy of an opinion letter, presumably from Century-Link or Linklaters, from other Division personnel. Tr. 1852-53. A

third call occurred on August 11, 2011, on which was D. Wong, PwC's general counsel, PwC's outside Chinese legal counsel from Linklaters, and PwC's outside counsel. Tr. 1853; Resp. Ex. 390. At the end of the call, the Linklaters attorney suggested that investigators contact the CSRC for assistance, and investigators said they would get back to PwC in written form if they had additional questions. Tr. 1853-55.

Investigators sent a voluntary request to PwC on September 23, 2011, which asked for certain specific information and supporting documentation for that information, as well as chronologies, which PwC would have to draft. Tr. 376-77, 1855-56; Div. Ex. 113. Although audit work papers were not specifically requested, the requested supporting documentation fell within the definition of audit work papers. Tr. 377. In response, PwC went through their audit work papers and drafted a response in the format requested by investigators, which took three or four weeks. Tr. 1856.

On October 10, 2011, while PwC was preparing its response, the CSRC scheduled a meeting with Respondents and Grant Thornton for that same day. Tr. 1292, 1857-58. The meeting was attended by Chao and one other PwC employee, the CSRC's chief accountant and her staff, and the MOF's inspection and supervisory bureau chief and his staff. Tr. 1293-94, 1858. Chao knew the meeting was "very important," because a joint meeting of the CSRC and MOF had never happened before. Tr. 1294. The CSRC informed the firms that they could not supply information directly to foreign regulators, that foreign regulators should work through the CSRC, and that production of audit work papers to a foreign regulator directly without authorization would result in legal consequences, including "personal" consequences. Tr. 1294-96, 1859.

PwC personnel, including Chao and D. Wong, met privately with the CSRC on October 17, 2011, where PwC presented the CSRC chief accountant and her staff with a letter reporting the Division's September 23, 2011, voluntary request. Tr. 1298, 1860-61; Resp. Exs. 393, 393-A. The CSRC reiterated its guidance from the October 10, 2011, meeting, and stated that it was considering issuing a letter to all six firms that attended the October 10, 2011, meeting. Tr. 1299, 1862-64. The CSRC issued such a letter (Letter 437) on October 26, 2011. Tr. 1300-01, 1864, 1867-68; Resp. Ex. 246, 246-A. That same day, PwC transmitted to the CSRC the response PwC had prepared to the Division's September 23, 2011, voluntary request. Tr. 1863; Resp. Exs. 394, 394-A.

PwC responded to the Division's voluntary request, through counsel, by letter dated November 2, 2011. Tr. 378-79; Div. Ex. 114; Resp. Ex. 396. The letter recited at length the various interactions between investigators, PwC, and PwC's counsel, over the course of the preceding several months, concerning production of various items, and attached approximately forty-nine pages of responsive documents. Div. Ex. 114. The letter also attached a letter dated November 2, 2011, from Linklaters, a law firm in Hong Kong affiliated with Linklaters LLP, which opined that Chinese law prevented PwC from giving work papers directly to U.S. regulators. Tr. 379; Div. Ex. 114. The following day, November 3, 2011, the CSRC sent PwC a letter reiterating its previous advice contained in Letter 437. Tr. 1867-68; Resp. Exs. 398, 398-A.

Investigators were not satisfied with PwC's response, and sent a second voluntary request dated November 15, 2011. Tr. 380-81; Div. Ex. 115. The scope of the documents sought in the second request was different than the scope sought in the first request, and specifically included a request for "[a]ll work papers related to revenue, restated items and related party testing" for Client I. Tr. 381-82; Div. Ex. 115. As with the September 23, 2011, voluntary request, PwC went through their audit work papers and drafted a response. Tr. 1868-69. PwC then sent the CSRC a letter dated December 1, 2011, which stated that PwC had "assembled the requested documents (approximately total 1,600 to 2,200 pages)." Tr. 1870; Div. Ex. 116; Resp. Exs. 400, 400-A. PwC then sent to Division investigators, via counsel, a letter dated December 2, 2011. Tr. 382-83; Div. Ex. 116. No new responsive documents were attached to the letter, but it did attach PwC's letter to the CSRC dated December 1, 2011. Tr. 1871; Div. Ex. 116. The letter also attached a letter dated December 1, 2011, from Linklaters, which supplemented the Linklaters opinion letter dated November 2, 2011. Tr. 383; Div. Ex. 116. PwC resigned as Client I's auditor four days later, and its outside counsel forwarded the resignation letters to investigators on December 13, 2011. Tr. 1872; Resp. Ex. 405.

Investigators were again not satisfied with PwC's response, and considered submitting a compulsory request to PwC. Tr. 384-85. They did not consider any other avenues; in particular, they did not consider making a request to Chinese regulators because, as Kaiser understood it, Chinese regulators had not been responsive to requests from other Division investigators. Tr. 384-85. They also did not seek assistance from the Board, because they did not expect the Board to be successful in obtaining audit work papers. Tr. 462-63.

3. Sarbanes-Oxley 106 Requests

Investigators submitted a request pursuant to Sarbanes-Oxley 106 on February 8, 2012, via PricewaterhouseCoopers LLP, seeking "[a]ll audit work papers and all other documents related to any audit work or interim reviews" performed for Client H. Tr. 869-70; Div. Ex. 106. Investigators submitted requests pursuant to Sarbanes-Oxley 106 on February 16, 2012, through PwC's U.S. outside counsel, and on March 22, 2012, through PricewaterhouseCoopers LLP, seeking "[a]ll audit work papers and all other documents related to any audit work" performed for Client I. Tr. 386, 453; Div. Ex. 117; Resp. Ex. 408.

When PwC became aware that other firms had received similar requests, it asked for a meeting with the CSRC and MOF. Tr. 1873. PwC met with regulators on February 24, 2012; the MOF held a meeting in the morning and the CSRC held one in the afternoon.¹³ Tr. 1873. Both agencies reiterated their previous guidance, that production requests from foreign regulators should be directed to the CSRC. Tr. 1876. On April 12, 2012, PwC, through counsel, responded to both the Client H and Client I Sarbanes-Oxley 106 requests. Tr. 386-87, 871; Div. Exs. 107, 118. In substance, the responses are very similar, although the Client I response attaches a copy of correspondence provided by PwC to the CSRC regarding the Client H Sarbanes-Oxley 106

¹³ It is unclear whether both Sarbanes-Oxley 106 requests had been transmitted to the Chinese regulators as of February 24, 2012; D. Wong's testimony on this point is unclear. Tr. 1873-76. However, the CSRC had received both requests as of March 22, 2012. Tr. 1874; Resp. Exs. 409, 409-A.

request. Tr. 390; Div. Ex. 118 at 5 n.4. Both responses assert that PwC had “segregated the materials requested,” and could “promptly deliver them to the CSRC” upon reasonable notice. Div. Ex. 107 at 5; Div. Ex. 118 at 5. Neither response attached documents responsive to the Sarbanes-Oxley 106 requests. Div. Exs. 107, 118.

Client H audit work papers have never been produced by PwC. Tr. 870. As a result, investigators were unable to develop sufficient evidence of accounting violations to bring an enforcement action on that basis. Tr. 875. Investigators were, however, able to bring an enforcement action for market manipulation, which was filed in federal district court in April 2012. Tr. 875-76; Div. Ex. 105.

Client I audit work papers have never been produced by PwC. Tr. 387. As a result, investigators were not able to look into all the various issues they had identified, and although the investigation remains open, Kaiser does not expect any further progress to be made in the near future. Tr. 396. However, the Division filed a settled administrative action against Client I, which revoked Client I’s securities’ registration. Tr. 396.

The Division issued Wells notices as to both Client H and Client I on April 26, 2012. Tr. 397, 876-77; Div. Exs. 145, 146. PwC submitted a consolidated Wells response on May 24, 2012. Div. Ex. 153.

4. Recent Events

In December 2012, after issuance of the OIP, PwC and the other Respondents (except Dahua) attended a meeting with the CSRC and MOF. Tr. 1876-78. The Chinese regulators again reiterated their previous guidance. Tr. 1877-78. On June 4, 2013, PwC attended a meeting with the CSRC and MOF, at which the execution of the MOU was announced. Tr. 1878-79. The Chinese regulators again reiterated that audit work papers could not be produced directly to foreign regulators, but also stated that the CSRC would send Respondents requests for their audit work papers, and that Respondents should prepare such papers for delivery to the CSRC. Tr. 1878-79. On June 19, 2013, PwC and the other Respondents (except DTTC) attended a meeting with the CSRC and MOF, where the Chinese regulators explained the process for preparing and producing audit work papers to the regulators, if a request was received pursuant to the MOU. Tr. 1879-80. DTTC did not attend because it had already undergone the process. Tr. 1880. PwC has not yet received a request from the CSRC for its audit work papers. Tr. 1880.

Chao wanted to be able to produce its Client H and Client I audit work papers, and told his team to be “fully ready.” Tr. 1320-21. Nonetheless, Chao considered the directives from the CSRC and MOF to be “very clear.” Tr. 1315. D. Wong testified that PwC “wanted to cooperate as much as possible with the SEC.” Tr. 1898-99. Both Chao and D. Wong were concerned that regulatory sanctions might include sanctions, including criminal penalties, against individual PwC employees. Tr. 1315, 1898. In Chao’s view, only Respondents and Grant Thornton have the training and “capabilities” to audit U.S. issuers, and barring PwC from practicing before the Commission would adversely affect audit quality and the business of other PwC network firms. Tr. 1318-19.

Chao opined that the decision not to produce documents directly to the Commission “was made by the MOF and the CSRC in terms of their directive” to PwC. Tr. 1358. However, he also testified that, as assurance leader for PwC, he personally “made the decision to follow the directions of the CSRC and MOF.” Tr. 1359. D. Wong testified that PwC was “directed not to produce” audit work papers to the Commission “directly by the Chinese authorities,” and that PwC did not “view it as a choice.” Tr. 1890-91, 1893, 1900. But she also testified that PwC “made the decision to abide by Chinese laws and the admonition from the regulators.” Tr. 1890-91, 1893.

F. OIA and the Chinese Regulators

Arevalo has been the chief of international cooperation and technical assistance with OIA since 2012. Tr. 933. Between 2007 and 2012, he was the assistant director of OIA for international enforcement matters, in which position he was primarily responsible for sending requests for assistance on behalf of the Division to foreign regulators, and responding to reciprocal requests. Tr. 934. He has worked at the Commission since 2004, and before that was employed in private practice and as an Assistant U.S. Attorney. Tr. 934-35. As assistant director, he reported to OIA Director Ethiopis Tafara (Tafara), and currently he reports to Acting Director Robert Fisher. Tr. 933-34. He interacts with the CSRC, and testified for the Division regarding OIA and its dealings with the CSRC. Tr. 935.

Arevalo’s interactions with the CSRC involve making requests of the CSRC for assistance with Division matters. Tr. 935. The CSRC and the Commission are signatories to the MMOU, which is sponsored by the International Organization of Securities Commissions (IOSCO). Tr. 935-36; Div. Ex. 325, Exhibit 1. Under the MMOU, members seeking assistance must submit written requests, and the receiving member must provide the fullest assistance permissible under its laws. Tr. 937. The Commission has been a member of the MMOU since 2002, and the CSRC since 2007. Tr. 936. Membership in the MMOU means that a securities regulator becomes a signatory to the MMOU. Tr. 937. Membership requires an application process, during which an application is first verified and then screened. Tr. 937-38. A securities regulator has to make certain representations to IOSCO during the application process. Tr. 938. The CSRC and Commission are also signatories to the MOU, which was executed in 1994, and the Terms of Reference, which was executed in 2006.¹⁴ Tr. 938, 1105-06; Div. Ex. 325, Exhibits 2 and 3. Also, the PCAOB, CSRC, and MOF are signatories to the MOUEC, which explicitly

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authorizes production of “audit working papers” and their forwarding to the Commission. Tr. 1110-12; Resp. Ex. 274 at 3, 6. However, the MOUEC does not explicitly permit the Commission to make a request for assistance to the Board or to the CSRC. Tr. 1219; Div. Ex. 274.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

¹⁵ According to Chiu, the head of the CSRC's international cooperation department is Tong Zi, whom Chiu called "Mr. Tong." Tr. 1772-73. According to Div. Ex. 207, the Director General of the CSRC's Department of International Affairs is Tong Daochi, whom Arevalo called "Dr. Tong." Tr. 980; Div. Ex. 207. Respondents apparently take the position that they are the same person, and some CSRC documents were issued under the authority of "Hu Daiocha TongZi." Tr. 1773; Resp. Exs. 636, 644. I conclude that Tong Zi, Tong Daochi, and Hu Daiocha TongZi are the same person, and refer to him as Tong.

[REDACTED]

On September 18, 2013, I closed the record. BDO China Dahua CPA Co., Ltd., Admin. Proc. Rulings Release No. 882, 2013 SEC Lexis 2769 (Sept. 18, 2013). On November 20, 2013, Respondents filed their Motion to Supplement the Record (Supp. Motion), which I discuss infra.

G. Expert Testimony

1. Donald Clarke

The Division offered Donald Clarke (Clarke) as an expert witness to present his opinions as to: 1) obligations of accounting firms under Chinese state secrets laws, archives laws, and certain other laws referenced by Respondents; and 2) the approvals and reports required under Chinese law for an accounting firm to respond to a request for documents from an overseas

regulator.¹⁶ Expert Report of Donald Clarke (Clarke Rep.) at 3. Specifically, he was asked to examine various assertions made in Respondents' correspondence and Wells submissions prior to the institution of these proceedings that various rules of Chinese law prohibited Respondents from producing documents requested by the Commission under Sarbanes-Oxley 106. Id. Clarke did not offer any opinion with respect to the oral instructions Respondents received from the CSRC not to produce documents directly to U.S. regulators in response to information requests. Id. at 16-17; Tr. 2359-60, 2365.



¹⁶ Clarke received a bachelor's degree from Princeton University, where his major area of study was international affairs, and a master's degree in the government and politics of China from the School of Oriental and African Studies at the University of London. Clarke Rep., Ex. 1 at 1-2. Clarke participated in a non-degree academic exchange program at Beijing University and Nanjing University in the People's Republic of China from 1977 until 1979. Id. at 2. He received a J.D. from Harvard Law School in 1987. Id. at 1. Clarke is currently the David Weaver Research Professor of Law at George Washington University Law School where he teaches courses in Chinese law, Chinese business law, business organizations, and law and development. Id. at 1. He also maintains an independent consulting practice. Clarke Rep. at 5. Clarke's academic specialization is the law of the People's Republic of China and specifically the legal regime of Chinese economic reform. Id. at 4. He speaks and reads Chinese fluently. Id.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

¹⁷ Clarke testified he would have pointed out that fact in his expert report if he had recalled it, but he did not believe this fact made the statement in his expert report incorrect because he was referring to criminal cases in his expert report. Tr. 2401-02.

[REDACTED]

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[REDACTED]

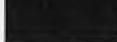
[REDACTED]

[REDACTED]

[REDACTED]

¹⁹ Clarke noted that he quoted Tang’s translation verbatim other than shifting a misplaced comma, which he believed did not change the meaning. Clarke Rebuttal Rep. at 10 n.11.





2. Xin Tang

Respondents offered Xin Tang, Associate Professor of the Law School of Tsinghua University in Beijing, China, as an expert witness to present his opinions as to: 1) what Chinese laws, if any, a Respondent may violate if it provides audit work papers to the U.S. regulator without going through the Chinese regulators; 2) what sanctions and liabilities, if any, a Respondent will encounter if it violates these Chinese laws; and 3) the means that may be used for the U.S. regulator to obtain the audit work papers under Chinese law.²⁰ Expert Report of Professor Tang (Tang Rep.) at 1-2.



²⁰ Tang received a bachelor's degree in economic law in 1992; a L.L.M. degree in civil and commercial law in 1995; and a Ph.D. in civil and commercial law in 1998 from Renmin University of China, School of Law, in Beijing, China. Tang Rep., Ex. 4. Since 2000, he has been teaching at the School of Law of Tsinghua University where he has taught courses in securities law, company law, and civil law. Tang Rep. at 3. Tang noted that unrelated to this matter he has also been engaged as an expert by the CSRC to educate their local branches on securities laws and regulations, he participated in the drafting and revising of the Measures for Administration on Acquisition of Listed Companies that was promulgated by the CSRC, and he was a member of the CSRC Reviewing Commission for Mergers and Acquisitions for its first two terms. Id. Tang is a native speaker of Chinese (Mandarin). Tang Rep., Ex. 4.

[REDACTED]

21

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]




3. James Feinerman

Respondents offered James V. Feinerman, the James. M. Morita Professor of Asian Legal Studies at Georgetown University Law Center, as an expert witness, and he concluded that Respondents acted reasonably and responsibly in approaching the CSRC, and if they had produced documents directly to the Commission without approaching the CSRC, they would have violated Chinese law. Expert Declaration of Feinerman (Feinerman Decl.) at 1, 3, 16.²²

²² Feinerman received a bachelor's degree from Yale College in Chinese studies, and between 1971 and 1973, he spent two years teaching and studying at the Chinese University of Hong Kong. Feinerman Decl. at 1. He received a Ph.D. in East Asian languages and literature at Yale University, and a J.D. from Harvard Law School, where he specialized in East Asian legal studies. Id. Feinerman studied at Peking University for one year and received a post-graduate certificate, and in the fall of 1980, he spent four months as a Visiting Scholar at the Institute of Law of the Chinese Academy of Social Sciences. Id. at 1-2. For over twenty-five years, he has taught at Georgetown University Law Center and also as a visiting professor at Harvard and Yale Law Schools. Id. at 2. He teaches a course in Chinese law and a seminar in Asian law and policy studies at Georgetown. Id. From 2005 through 2006, he taught as Fulbright Distinguished Senior Lecturer on Law at the Law School of Tsinghua University, Beijing, China. Id. He speaks Mandarin and Cantonese dialects of Chinese and can also read Chinese. Id.

Feinerman reviewed the statutes, regulations, and cases that Respondents' expert Tang cited in his expert declaration and he agreed with Tang's analysis and conclusions. Id. at 3.

[REDACTED]

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[REDACTED]

4. Paul S. Atkins

Respondents offered Paul S. Atkins (Atkins), former Commissioner of the Securities and Exchange Commission, to provide an expert opinion on: the Commission's current and historical efforts to attract foreign private issuers to U.S. markets and to otherwise facilitate capital formation; the Commission's implementation of Sarbanes-Oxley, including approving PCAOB rules related to non-U.S. accounting firms; the Commission's historical approach to the use of memoranda of understanding to attempt to resolve international conflict-of-law issues; the significance of the recently executed MOUEC between the PCAOB, CSRC, and MOF; the inconsistency of this proceeding with the Commission's historical approach; the lack of a remedial purpose of potential sanctions; and the impact of potential sanctions on the U.S. markets, including the likely effect on non-U.S. issuers operating in China, multinational companies operating in China, and investors. Expert Report of Paul S. Atkins (Atkins Rep.) at 1,

3.²⁴ Atkins testified that the only person's views he expressed in his expert report and during his testimony were his own. Tr. 2668-69.

Atkins opined that the Commission has a long and successful history of working collaboratively with foreign regulators to mitigate conflict-of-law issues, and in the 1970s the Commission began to be more accommodating to foreign private issuers for the benefit of U.S. investors with the goal of cementing the status of the U.S. as the center of global capital markets. Atkins Rep. at 5. He stated that the Commission has taken steps to adopt new rules to attract foreign private issuers, and since the 1970s the Commission has accommodated foreign private issuers through informal procedures that reflect their unique considerations as well as certain formal rule changes, including directing foreign private issuers to file annual reports on Form 20-F, rather than the more burdensome Form 10-K, and providing certain accommodations for the independence of audit committees for foreign private investors to avoid irreconcilable conflicts between U.S. law and the foreign private issuer's organic corporate law. Id. at 6. Atkins noted that even after the commencement of the DTTC proceeding in May 2012, the Commission has continued to approve the effectiveness of the registration statements of Chinese foreign private issuers audited by Respondents. Id. at 7.

Atkins opined that in connection with the final registration rules for accounting firms approved by the Commission in 2003, the Commission and PCAOB made numerous accommodations for non-U.S. accounting firms based in part on concerns from the international community that the PCAOB's proposed rules might conflict with foreign laws. Id. Included among these accommodations was PCAOB Rule 2105, allowing non-U.S. firms to withhold certain information on their Forms 1 if they could demonstrate that providing the information would conflict with non-U.S. law. Id. at 8. According to Atkins, in approving the PCAOB registration rules, the Commission encouraged the PCAOB to continue its reasoned approach when considering its oversight role, especially with respect to non-U.S. firms, and applauded the PCAOB's initiative to work with its foreign counterparts to accomplish the goals of Sarbanes-Oxley without subjecting foreign firms to unnecessary burdens or conflicting requirements. Id. at 8-9. Atkins stated that the final PCAOB registration rules recognized the conflict-of-law

²⁴ Atkins received a bachelor's degree from Wofford College in 1980 and a J.D. from Vanderbilt University School of Law in 1983. Atkins Rep., Appx. A. Atkins served as Chief of Staff to Commission Chairman Richard C. Breeden from 1990 to 1993 and served as Counsellor to Commission Chairman Arthur Levitt from 1993 to 1994. From 1994 to 2002, Atkins was a Partner at PricewaterhouseCoopers LLP (and predecessor firm Coopers & Lybrand L.L.P.) where his practice included providing consulting services on securities and investment management industry matters. Id. Atkins served as a Commissioner of the Securities and Exchange Commission from 2002 to 2008 where his duties included considering and voting on thousands of rule-related actions and enforcement matters and serving as an intermediary between the Commission and foreign jurisdictions regarding the extraterritorial effect of various proposed Commission rules and actions. Id. He currently serves as Non-Executive Chairman of the Board of BATS Global Markets, Inc., and the Chief Executive Officer of Patomak Global Partners, LLC, where his significant projects have included providing Dodd-Frank Act regulatory advice to foreign and domestic financial service firms, conducting reviews of supervisory, compliance, and operational policies for clients, and acting as an expert witness. Id.

issues that may arise from the Commission's requests for documents to foreign entities and contained provisions for foreign applicants to address those issues. Id. at 9. Atkins pointed out that although the Commission and PCAOB knew of the difficulty regarding the potential non-production of audit work papers, the PCAOB nevertheless permitted registration of China-based auditing firms, and he disagreed with the Division's assertion that Respondents should have anticipated that the conflict-of-law issues would not be resolved between sovereign states and that Respondents would assume legal exposure. Id. at 9-10.

Atkins further opined that the policy of the Commission, when faced with conflicts between its programmatic needs and foreign legal impediments, has traditionally been to turn to bilateral or multilateral cooperative agreements to advance investor protection while working with foreign counterparts. Id. at 10. Atkins noted that the Commission was one of the first signatories to the MMOU developed by IOSCO, which was a non-binding multilateral enforcement information-sharing and cooperation arrangement describing the terms under which any signatory can request information or cooperation from another signatory as part of an investigation of securities law violations in the requestor's jurisdiction. Id. at 13-14. Atkins stated that the CSRC joined IOSCO in 1995 and signed the MMOU in 2007. Id. at 14. In Atkins' experience at the Commission, the Commission's policy was to use bilateral cooperative agreements to enhance international enforcement cooperation. Id.

Atkins explained that in 1994 the Commission entered into a MOU with the CSRC under which both parties have worked together for nearly two decades; however, the MOU did not establish a direct obligation for document production and explicitly allowed for the denial of assistance requested by the Commission "[w]here the provision of assistance would be contrary to the public interest of [China.]" Id. at 15 (quoting the MOU). According to Atkins, in 2006, the Commission and the CSRC agreed to the Terms of Reference for Cooperation and Collaboration, specifically providing for improving cooperation in cross-border securities enforcement matters, and stating in part, "the CSRC and SEC will work to communicate quickly on such matters and to provide timely and thorough assistance to one another, *consistent with domestic laws.*" Id. Atkins opined that in light of this progress between the CSRC and the Commission, Respondents would have been entirely rational to anticipate that the sovereigns would resolve their conflict-of-law issues as outlined in these agreements. Id. at 16.

Atkins stated that the May 2013 MOUEC between the PCAOB, CSRC, and MOF provided that each party would "seek to improve the accuracy and reliability of audit reports so as to protect investors" and expressly allowed the PCAOB to share information obtained through cooperation under the MOUEC with the Commission if advance notice is given to the Chinese regulators. Id. at 16. Atkins contends that the MOUEC represents an acknowledgement by the parties that the appropriate path for U.S. regulators to pursue requests for the production of documents from firms such as Respondents is through the CSRC. Id. at 17. Atkins noted that the PCAOB signed the MOUEC even though it includes language permitting the withholding of information if disclosure would violate domestic law, and stated that it would be inconsistent with the Commission's historical policy to pursue sanctions against Respondents in the face of the PCAOB's embrace of the CSRC's right under the MOUEC to withhold consent to the production of documents. Id. at 17-18. During his cross-examination, Atkins' testimony was unclear as to whether he knew the Commission had made a request for work papers relating to Deloitte Client A to the CSRC in June 2010; [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED] Tr. 2683.

Atkins stated that imposition of the sanctions the Division is seeking in this proceeding – a censure, a permanent bar from issuing audit reports filed with the Commission, and a permanent bar from playing a fifty percent or greater role in the preparation or furnishing of an audit report filed with the Commission – would be inconsistent with Commission policy and have no remedial effect. Atkins Rep. at 18. Atkins opined that if such sanctions are imposed it is unlikely that any Chinese-based issuer of U.S. securities will be able to find a qualified and independent auditor because potential replacement auditors may be unwilling or unqualified or the issuer’s audit committee may not accept the replacement. Id. at 19. Atkins stated that any replacement would be subject to the same CSRC prohibitions regarding the production of documents and would face similar sanctions when unable to produce documents, and if the Commission were to sanction Respondents, other Chinese audit firms would likely de-register with the PCAOB to avoid similar proceedings. Id. He asserted that Chinese issuers’ only option would be to enlist small local auditing firms with little or no prior experience auditing U.S.-listed companies, and these local firms would be far less experienced and perhaps somewhat unfamiliar with the U.S. definition of independent reviews. Id. Atkins opined that the Division’s proposed sanctions were inconsistent with the Commission mission to protect investors because they would inevitably undermine the quality of audit services available in China. Id. at 20. During cross-examination, Atkins admitted that Respondents were not infallible in their audits, [REDACTED]

[REDACTED]
[REDACTED] Tr. 2670-71.

Atkins stated that imposing sanctions on Respondents could cripple the ability of Chinese issuers to list their securities on U.S. markets and that it would be bad policy to impose sanctions that could effectively cut off Chinese companies from the U.S. capital markets. Atkins Rep. at 21-22. He opined that the Commission “must take steps to open more doors than it closes” and that the failure to do so will drive investments elsewhere. Id. at 22. Atkins asserted that if Chinese companies cannot find auditors, they will be unable to meet the Commission’s requirement to file audited financial statements, and will be unable to list their securities on U.S. exchanges. Id. at 23. He stated that issuers forced to move to the over-the-counter market could face less liquidity and transparency, which would raise the cost of trading in their securities for investors. Id. Atkins asserted that restrictions may prevent certain categories of institutional investors from maintaining positions in non-listed securities, and a sudden forced liquidation by pension funds could have negative consequences for other U.S. investors. Id. In addition, Atkins opined that the uncertainty caused by the changes in Commission policy may have a chilling effect on not only Chinese, but all foreign issuers and foreign companies considering listing their securities in the U.S. Id. He testified that sanctioning Respondents would result in a real harm to American investors because they will not be able to diversify their investments into Chinese companies and will not have the protection of U.S. securities laws if they choose to do so. Tr. 2667.

During cross-examination, Atkins testified that he thought the Commission’s action here is a departure from its long-term policies with respect to international comity. Tr. 2675-76. [REDACTED]

Atkins testified that the Commission should “do whatever it takes to get the information,” including escalating the issue to the Secretary of the U.S. Department of Treasury or having the U.S. President address the issue with his counterpart in China, but he did not think the Commission would obtain the materials any sooner through this administrative proceeding than by some other means. Tr. 2685.

5. Anthony C. Jordan, CPA

i. Expert Report of Anthony C. Jordan, CPA, CFF, and Hearing Testimony

The Division offered Anthony C. Jordan (Jordan), CPA, to provide accounting expert analysis and testimony and to opine specifically on: 1) the relevance and importance of audit work papers to a Division investigation of potential financial misreporting and issuer fraud; and 2) the impact to Respondents of potential remedies that may be imposed in this proceeding. Expert Report of Anthony C. Jordan, CPA, CFF (Jordan Rep.) at 2.²⁵ Jordan testified that he understood the Division’s proposed remedy in this case to be a bar prohibiting Respondents from being a principal auditor for U.S. issuers as well as playing a 50% or greater role in the audit of U.S. issuers. July 31, 2013, Sealed Tr. 9.

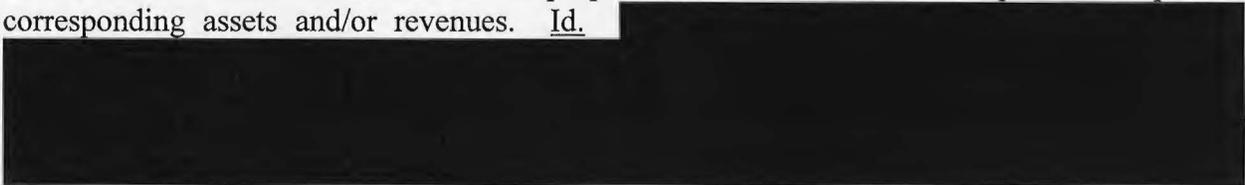
Jordan opined that audit work papers and related documents are a critical source of substantive information for the Division when investigating potential financial misstatements that may have resulted in violations of the securities laws or the Commission’s rules. Jordan Rep. at 6. He stated that Division staff use audit work papers to determine what information the auditor was provided with by management and whether the information shared suggests management fraudulently influenced or misled the auditor. Id. at 7. According to Jordan, audit work papers often constitute the best contemporaneous documentary evidence of the financial state of an issuer, and he is not aware of any other single set of documentary evidence that would

²⁵ Jordan is a partner of StoneTurn Group, LLP. Jordan Rep. at 1. He is a certified public accountant in the Commonwealth of Massachusetts, and is certified in financial forensics by the American Institute of Certified Public Accountants. Id. He has specialized in forensic accounting investigations and issues surrounding Generally Accepted Accounting Principles, Generally Accepted Auditing Standards, and the auditing and professional practice standards of the PCAOB for more than 15 years. Id. Prior to joining StoneTurn Group, LLP, Jordan was employed at the Commission and served as the Accounting Branch Chief in the Commission’s Boston regional office. Id. From 1995 to 1997, Jordan was employed by Ernst & Young LLP; from 1997 to 2001 he was employed by Arthur Andersen LLP; and from 2001 to 2003 he was employed by Deloitte and Touche LLP. Id., Ex. 1.

represent an alternative source for this information. Id. He further explained that accounting investigations by the Division often include an assessment of the adequacy of the audit work performed, which requires reviewing the independent auditor's work papers. Id. at 8. In Jordan's experience, audit work papers documenting audit areas such as the search for and testing of related party transactions, revenue recognition procedures, and the verification of assets, have been key sources of information for Division investigations. Id. at 11.

Jordan calculated the number of firms for which Respondents fulfilled the role of principal auditor and issued audit opinions, which may be affected by any proposed bar or partial bar of Respondents. Id. at 13. Jordan reviewed Respondents' PCAOB Form 2 filings (Form 2)²⁶ and determined that Respondents issued a total of 265 audit opinions – 63, 103, and 99 for each of the 12 months ended March 31, 2010, 2011, and 2012, respectively. Id. at 3, 14. Jordan determined that all of the engagements reported in the Form 2 filings related to China-based companies; Jordan did not identify any engagements for any multinational companies based in the U.S. or elsewhere.²⁷ Id. at 3, 14-15.

Jordan also calculated the number of additional, non-principal auditor engagements that may be affected by a bar or partial bar based on a review of data submitted by Respondents KPMG, DTTC, PwC, and E&Y in response to certain PCAOB requests (Engagement Data).²⁸ Id. at 17. Those Respondents submitted a variety of data with respect to their "substantial role" or "referred work" engagements.²⁹ Id. Jordan analyzed the data to determine the magnitude of the subsidiaries or components of registrants subject to Respondents' procedures based on assets and revenues of those entities as a proportion of the consolidated parent companies' corresponding assets and/or revenues. Id.



²⁶ Pursuant to Rule 2200 of the PCAOB's Rules, each registered public accounting firm must file with the Board an annual report on Form 2. Rule 2200 (Public Company Accounting Oversight Board), effective pursuant to Exchange Act Release No. 34-60497, File No. PCAOB-2008-04 (Aug. 13, 2009), 96 SEC Docket 19769.

²⁷ Jordan determined the primary base of operations for each issuer based on the location of its principal executive offices disclosed in publicly available data. Id. at 14-15.

²⁸ Jordan understood that the Engagement Data he received from the Commission was requested by and submitted to the PCAOB by KPMG, DTTC, PwC, and E&Y relating to referred and other non-principal audit work performed during the three years ended March 31, 2010, 2011, and 2012 (Engagement Data Period). Id. at 2 n.2. There is no engagement data for Dahua. Id.

²⁹ For purposes of his report, Jordan used the PCAOB's definition of "substantial role" set forth in PCAOB Rule 1001(p)(ii), which states that an auditor who performs "the majority of audit procedures with respect to a subsidiary or component of any issuer the assets or revenues of which constitute 20% or more of the consolidated assets or revenues of such issuer necessary for the principal accountant to issue an audit report on the issuer." Id. at 5 n.6.

[REDACTED]

[REDACTED]

Jordan testified that he understood that the engagements for which Respondents performed audits of components or subsidiaries that represented 50% or more of the assets or revenues of the parent issuer would be impacted by the Division's proposed bar. July 31, 2013, Sealed Tr. 11.

The Engagement Data also included information about the fees received for the substantial role and referred work engagements. Jordan Rep. at 19. Jordan used that data to categorize the amount of engagement fees received by those Respondents by the percentage of assets or revenues of the consolidated registrant/parent company and to determine the proportion of audit fees for each category. Id. at 20. Jordan noted that the results of this inquiry presented a less consistent picture and he opined that one may not necessarily expect a direct correlation between the total fees and the number of subsidiaries or components of registrants subject to audit work because the size and complexity of audit engagements can vary greatly based on the entity and the auditor's assessment of audit risk and required procedures. Id. at 20-21. Jordan stated he would need to review the audit work papers for the engagements, which he did not have the opportunity to do, to understand the variances and the level of work performed for each engagement. Id.

With respect to KPMG, [REDACTED]

With respect to PwC, [REDACTED]

With respect to DTTC and E&Y, [REDACTED]

[REDACTED]

Based upon the Engagement Data and his review of publicly available company filings and other relevant information, Jordan determined whether each consolidated entity for which KPMG, DTTC, PwC, and E&Y played a substantial role in auditing had operations primarily based in China or whether they were multinationals based in the U.S. or other countries outside of China. *Id.* at 22. For purposes of his analysis, Jordan assumed that when audited subsidiaries or components made up 100% of a consolidated registrant's assets, that registrant was China-based, and he also started with a baseline assumption that if Chinese subsidiaries and components of a registrant made up 50% to 99% of the assets of a consolidated registrant, that entity was also China-based.³⁰ *Id.* Jordan also determined the audit fees related to the entities in the primary location of operations groupings. *Id.* at 27.

With respect to KPMG, [REDACTED]

With respect to DTTC, [REDACTED]

With respect to PwC, [REDACTED]

With respect to E&Y, [REDACTED]

[REDACTED]

Jordan stated that following submission of his expert report, Respondents provided additional fee data, and he has analyzed that data for the principal auditor work and a subset of the substantial role work performed by Respondents in light of their total

³⁰ With respect to those consolidated entities for which a Chinese subsidiary or component made up 50% to 99% of its assets, Jordan did review annual filings to identify any entities that were actually non-China-based multinationals despite the high percentage and he created a chart with those entities that were identified. *Id.* at 22, Ex. 6.

audit fees. Id.



ii. Rebuttal to Jordan's Expert Report by Respondents' Expert Witness

Respondents' expert witness, Laura E. Simmons (Simmons),³² submitted a Rebuttal Disclosure (Simmons Rebuttal Rep.) that includes her responses to some of Jordan's findings and opinions. Simmons Rebuttal Rep. at 1. Simmons noted that the 2013 Form 2 annual reports for Respondents and other China-based, PCAOB-registered firms are now available and she has updated Jordan's analysis to reflect the current information. Id. at 9. Simmons asserted that Jordan's report generally does not provide any details about the issuers for which Respondents issued audit opinions, and Jordan failed to consider the size of the companies that would be affected and thereby fails to fully reflect the magnitude of the proposed bar and potential effect on U.S. investors. Id. at 9-10.

Simmons asserted that Respondents issued audit reports for 85 issuers during the 2013 reporting period and these issuers had an aggregate market capitalization of approximately \$94 billion as of June 30, 2013. Id. at 10. She opined that at least 76 of these issuers have their principal listing on a U.S. exchange and the total market value of the outstanding U.S.-traded shares of these issuers was almost \$79 billion as of June 30, 2013. Id. Simmons noted that the purpose of Jordan's conclusion that all of the issuers for which Respondents have issued audit opinions have their primary base of operations in China was unclear because all of the issuers have securities traded on exchanges in the U.S. and therefore have existing investors in the U.S. who would bear the costs if the issuers were forced to change auditors or were delisted. Id. at 10-11.

³¹ Jordan noted that Dahua has not provided audit fee information for individual engagements. Id. at 12 n.43.

³² Simmons has been a Senior Advisor with Cornerstone Research, a consulting firm that specializes in analysis of finance, accounting, economics, and other business issues, since 2008. Simmons Rep. at 1. She received a BBA degree in accounting from the University of Texas at Austin in 1986; a MBA degree from the University of Houston in 1992; and a Ph.D. in accounting from the Kenan-Flagler Business School at The University of North Carolina at Chapel Hill. Id. at Appendix (App.) A. Simmons is a certified public accountant and from 1986 to 1991, she was employed as an accountant at Price Waterhouse. Id. at 2, App. A. Simmons was a principal at Cornerstone Research from 1996 to 2007. Id. at App. A. From 2007 to 2008, she was an Adjunct Professor and Visiting Assistant Professor of Accounting at Old Dominion University and from 2008 to 2011 she was an Assistant Professor of Accounting at William & Mary. Id.



Simmons opined that an issuer's revenues and assets will vary from period to period depending on its financial performance and therefore whether the 50% threshold of an issuer's assets or revenues imposed by the Division's proposed bar is met may not be predictable to the issuer. Id. at 13. She noted that Jordan's analysis of the application of the 50% threshold relied on information on the issuer's revenues and assets that was typically for the fiscal year ended December 31, 2011.³⁴ Id. at 14.

To update Jordan's data, Simmons identified issuers for which Respondents had performed audit work relating to more than 40% but less than 50% of that issuer's revenues or assets during any of the 2010-2012 reporting periods and determined whether those issuers had more than 50% of their revenue or assets in China during the calendar year ended December 31, 2012. Id. at 14.



6. Laura E. Simmons

i. Expert Opinion of Laura E. Simmons and Hearing Testimony

Simmons was retained by Respondents to conduct research and analysis of certain topics, including the number and characteristics of accounting firms registered with the PCAOB and located in China, the number and characteristics of issuers of securities traded in the U.S. that either are incorporated in China or have significant operations in China, and the likely consequences of an order permanently barring Respondents from issuing audit reports or playing

³³ Simmons stated that the Division's proposed bar would prohibit Respondents from performing audit work if that audit work comprises 50% or more of the principal auditor's total hours or fees, but Jordan did not include total hours or fee data in his analysis, and therefore Jordan's analysis may understate the number of issuers affected by the proposed bar. Simmons Rebuttal Rep. at 11 n.15. During cross-examination, Jordan testified that he did not analyze the engagement hours or fees aspect of the proposed sanction, and that the Engagement Data did not reflect the total audit hours performed by the firms. July 31, 2013, Sealed Tr. at 33-34, 50-51.

³⁴ During cross-examination, Jordan agreed that the Engagement Data on which he relied would have pertained largely to year end 2011, and in any event no later than March 31, 2012. July 31, 2013, Sealed Tr. 30-31.

a 50% or greater role in the preparation or furnishing of an audit report for issuers with securities traded in the U.S. Expert Report of Simmons (Simmons Rep.) at 2-3.

Simmons opined that, according to information available on the PCAOB's website, the number of firms located in China that were registered with the PCAOB increased significantly between 2004 and 2012. Id. at 5. According to Simmons, in 2004, 11 firms registered with the PCAOB, including DTTC, PwC, E&Y and KPMG (Dahua registered in 2006), and, according to the PCAOB's website, 45 firms located in China were registered with the PCAOB as of June 30, 2013. Id.

As part of Simmons' analysis, she provided the PCAOB category for each of these 45 firms for the 2012 reporting year. Id. at 6, Ex. 1. According to the PCAOB, a Category A firm has issued an audit report for at least one issuer; a Category B firm has not issued an audit report for an issuer but has played a substantial role in the audit of at least one issuer; a Category C firm has neither issued an audit report for an issuer nor played a substantial role in any issuer audits, but issued a report on the financial statements of at least one broker-dealer; a Category D firm does not fall into any of the prior categories; and a Category E firm has not yet filed a Form 2. Id. at 6-7.

Simmons opined that Respondents have substantially more experience issuing audit reports than other PCAOB-registered firms located in China, and, in 2012, Respondents were responsible for almost all the audit work performed by PCAOB-registered firms located in China in terms of the number of audit reports issued. Id. at 8. According to Simmons, Respondents together issued 100 audit reports for issuers in 2012, whereas other PCAOB-registered firms located in China that have indicated their inability to produce documents to the Commission or PCAOB under Chinese law or otherwise (Other Non-Consenting Firms) issued only 8 audit reports, and other PCAOB-registered firms located in China that have not indicated their inability to produce documents (Potential Substitute Firms) issued only 3 audit reports.³⁵ Id. at 7-8.

Simmons opined that Respondents were also responsible for the majority of audits in which a substantial role was reported by a PCAOB-registered firm located in China. Id. at 8. She stated that according to 2012 Form 2 annual reports, Respondents played a substantial role in the audits of at least 25 issuers, the Other Non-Consenting Firms did not play a substantial role in any audits, and the Potential Substitute Firms played a substantial role in audits of 18 issuers.³⁶ Id. According to Simmons, data for 2011 and 2010 showed similar results. Id.

³⁵ According to Simmons, the firms categorized as Other Non-Consenting Firms did not complete Item 9.1 (Affirmation of Understanding of, And Compliance With, Consent Requirements) in their Forms 2 for the 2012 reporting year, like Respondents, and the firms categorized as Potential Substitute Firms provided an affirmation of consent by either completing Item 9.1 in their most recent Form 2 or in Item 8 on their Form 1 application for registration. Id. at 7.

³⁶ Simmons noted that according to the instructions to Item 4.2 on the Form 2, a Category A firm is not required to provide the number of audit reports in which they played a substantial role. Simmons Rep. at 6, 8. Therefore, with the exception of KPMG, a Category B firm, the

Simmons also opined that Respondents were responsible for the majority of audit work in terms of the aggregate size of the issuers audited. Id. For 2012, the aggregate market capitalization of the issuers for which Respondents issued audit reports or in whose audits they played a substantial role was \$553 billion, while the aggregate market capitalization of issuers audited by all other firms combined was only \$121 billion. Id. at 8-9. She stated that data for 2010 and 2011 shows a similar pattern. Id. at 9. In addition, Simmons noted that Respondents as a group are much larger in size than the other categories of PCAOB-registered firms located in China. Id. at 9. According to Simmons, in 2012, the median number of certified public accountants employed by Respondents was 974, while Other Non-Consenting Firms and Potential Substitute Firms employed 373 and 24, respectively. Id.

During cross-examination, Simmons testified that while the Potential Substitute Firms provided an affirmation of consent, i.e., have not indicated their inability to produce documents, they may or may not actually be able to replace Respondents on any engagements Respondents may be forced to give up if the Division's proposed bar is imposed because these firms may or may not have the ability to step into the roles previously performed by Respondents. July 31, 2013, Sealed Tr. 75. She also testified that it was her understanding that a Non-Consenting Firm could change its mind and agree to comply with a request for documents to the PCAOB in the future. July 31, 2013, Sealed Tr. 80-81. When asked whether it would change her opinion regarding the category of Potential Substitute Firms if she learned that auditors located outside of China could obtain legal permission to produce to the Commission their work papers for audits inside of China, she said that it would not because she was not going to speculate. July 31, 2013, Sealed Tr. 84.

According to Simmons, the relief requested by the Division would prohibit Respondents from continuing to perform the majority of the audit work they reported in their Form 2 annual reports (as well as work not reported in their Form 2 annual reports because firms that have issued an audit opinion are not required to provide the number of audit reports for which they have played a substantial role). Simmons Rep. at 9. Simmons opined that such an order would require the affected issuers to attempt to engage new auditors to replace Respondents and that academic literature shows that changing auditors can impose significant costs on issuers. Id.

Simmons stated that it was unlikely that the Other Non-Consenting Firms would be willing to take over Respondents' audit work because these proceedings have highlighted to those firms the risks of auditing U.S. issuers in the current environment. Id. at 10. She also opined that the Category A and B Potential Substitute Firms are substantially less experienced in providing audit reports – only 3 of these firms have ever issued an audit report for a Commission registrant – and they are substantially smaller than Respondents. Id. Namely, in 2012, Category A Potential Substitute Firms considered together employed only 232 certified public accountants. Id. at 10, Ex. 4. Simmons represented that in 2012, 6 Category B Potential Substitute Firms played a substantial role in the audit of an issuer, and together these 6 firms played a substantial role in the audits of 18 issuers and employed 1,206 certified public accountants, whereas, in 2012, Respondents employed nearly 6,000 certified public accountants, issued audit reports for 100 issuers, and played a substantial role in the audits of an additional 25 issuers. Id. at 10-11.

number of audit reports in which Respondents and other Category A firms played a substantial role is likely to be understated. Id. at 8.

Simmons further opined that the total market capitalization of firms audited by Respondents is substantially larger than that for the Category A Potential Substitute Firms. Id. at 10, Ex. 7.

Simmons also collected and analyzed data on current issuers of equity securities traded in the U.S. that either are incorporated in China, or, regardless of where incorporated, have 50% or more of their revenues or assets in China based on their 2012 financial information. Id. at 11. She opined that 169 Chinese Issuers³⁷ are currently traded on U.S. exchanges or the OTC Bulletin Board and have an aggregate market capitalization of over \$643 billion as of December 31, 2012. Id. at 12. According to Simmons, those companies included 7 companies with market capitalizations in excess of \$10 billion and 1 company in excess of \$250 billion. Id. Respondents, or their network affiliates, were the accounting firms for all but 1 of these 7 companies. Id. In addition, Simmons opined that 35 Multinational Corporations³⁸ are currently traded on U.S. exchanges or the OTC Bulletin Board and they had an aggregate market capitalization in excess of \$92 billion as of December 31, 2012. Id. at 13. According to Simmons, 3 of those companies had market capitalizations in excess of \$10 billion on that date. Id. Taken together, the Chinese Issuers and Multinational Corporations had an aggregate market capitalization of almost \$736 billion, and of that amount, Respondents issued audit reports for approximately \$83 billion of the market capitalization and Respondents' network affiliates issued audit reports for an additional \$637 billion.³⁹ Id. at 13-14. Simmons concluded, therefore, the potential consequences of this proceeding extended to companies with approximately \$720 billion in market capitalization, but she testified that figure included approximately \$550 billion of shares listed outside of the U.S. Id. at 14; July 31, 2013, Sealed Tr. 101.

Simmons additionally opined with respect to the impact on issuers and investors from changing audit firms and delisting from exchanges. Simmons Rep. at 15. Simmons asserted that larger audit firms are able to invest more in training and technology, and academic research has established that larger audit firms have a reputation for performing higher quality audits than smaller firms. Id. She stated that changing from a large, well-known audit firm to a smaller, less well-known audit firm had the following negative effects as documented in academic literature: 1) companies experience an increase in the cost of debt, particularly newer companies where monitoring is viewed as more important; and 2) companies experience a statistically significant stock price decline upon announcement of a change to a smaller auditor and reduced market responses to positive earnings surprises. Id. at 15-16. Simmons pointed to a study conducted by the U.S. General Accounting Office on the potential effects of mandatory audit firm rotation that

³⁷ Simmons defined Chinese Issuers as companies that are incorporated in China or have 100% of their revenues or assets in China. Id. at 12.

³⁸ Simmons defined Multinational Corporations as companies that are incorporated outside of China but have 50% or more (but less than 100%) of their revenues or assets in China. Id. at 12.

³⁹ Simmons acknowledged that the \$637 billion figure included all clients that had 50% or greater of their revenues or assets in China that were audited by the network affiliates of Respondents irrespective of whether Respondents were involved, but testified that she updated the figure in her rebuttal report to account for the fact she gained access to data indicating which audits Respondents were involved in. July 31, 2013, Sealed Tr. 103.

she stated concluded that the costs of mandatory audit rotation would exceed the benefits. Id. at 16.

Simmons further explained that large accounting firms generally have an advantage in developing significant industry experience, in part due to their ability to invest more in training, and when companies switch from auditors with specialized industry knowledge to auditors without relevant industry experience, the stock market response is negative. Id. at 17. Simmons offered a chart reflecting Respondents' experience issuing audit reports categorized by industry as compared to the experience of Category A Potential Substitute Firms from 2010 through 2012. Id. at 18, Ex. 14. It reflected that DTTC and E&Y had experience in 8 out of 10 industry categories shown on the chart (industries); PwC had experience in 6 out of 10 industries; and Dahua had experience in 4 out of 10 industries. Id., Ex. 14. In contrast, it reflected that 2 of the 3 Category A Potential Substitute Firms each had experience in 1 of the 10 industries (2 in total) and the industry was unavailable for 3 of the issuers' audit reports. Id., Ex. 14.

According to Simmons, if an issuer is unable to engage new auditors to replace Respondents, or is unable to engage them quickly enough to file timely financial statements, issuers could be delisted from the U.S. exchanges where they are traded. Id. at 18. She opined that academic research reflects that stock prices of delisted companies that are forced to trade on the over-the-counter markets experience an average drop of 50% for stocks listed on the New York Stock Exchange and 19% for stocks listed on the Nasdaq, in addition to increased spreads and volatility. Id. at 18-19. Simmons concluded that if the decline in stock prices noted above was applied to the Chinese Issuers and Multinational Corporations identified in Exhibits 8 and 9 to her expert report, the predicted decline in value of U.S.-traded shares around their delisting date would be \$115 billion, i.e., investors could incur losses of that amount. Id. at 19; July 31, 2013, Sealed Tr. 92. Simmons testified that figure assumed a complete delisting of all clients for whom Respondents' served as principal auditor or performed a 50% or greater role in auditing. July 31, 2013, Sealed Tr. 95.

In her rebuttal report, Simmons noted that Form 2 annual reports for the reporting period ended March 31, 2013, were now available for the majority of PCAOB-registered firms located in China and she updated her prior analysis to include this data. Simmons Rebuttal Rep. at 5. She opined that as of June 30, 2013, 45 firms located in China were registered with the PCAOB, and those same firms continued to be registered as of July 15, 2013. Id. Simmons stated that in 2013, Respondents together issued 85 audit reports for issuers of securities registered in the U.S., while the Other Non-Consenting Firms issued 11 audit reports and the Potential Substitute Firms issued 1. Id. at 7. According to the available 2013 Form 2 annual reports, Respondents played a substantial role in the audits of at least 21 issuers and all other firms combined reported playing substantial roles in the audits of only 11 issues.⁴⁰ Id. Simmons asserted that as of March 31, 2013, the aggregate market capitalization of the issuers for which Respondents issued audit reports or in whose audits they played a substantial role was approximately \$520 billion for

⁴⁰ As noted in her prior report, Simmons stated that firms that issue at least 1 audit opinion in a given year are not required to report the number of audit reports in which they played a substantial role on their Form 2 annual reports and so the number of audit reports in which those firms played a substantial role is likely to be understated. Simmons Rebuttal Rep. at 6.

2013, while in contrast the aggregate market capitalization of issuers audited by all other firms was approximately \$117 billion. Id.

Simmons' rebuttal report concluded that a total of 118 issuers with a combined market capitalization of approximately \$870 billion and market value of U.S. shares of \$464 billion would potentially be forced to attempt to change auditors and could face delisting if replacements were not found. Id. at 15. That included 76 issuers for which Respondents provided an audit opinion and 42 issuers for which Respondents played a 50% or greater role. July 31, 2013, Sealed Tr. 62-64; Simmons Rebuttal Rep., Ex. K. She predicted the decline in value of their U.S.-traded shares around the delisting date to be \$209 billion, assuming a complete delisting of all clients for whom Respondents served as a principal auditor or performed a 50% or greater role in auditing. Id. at 16; July 31, 2013, Sealed Tr. 95. During cross-examination, Simmons testified she did not think it was likely that none of the clients would be able to find a replacement auditor, but, on the other hand, it was not likely that a majority of those firms would be able to find a replacement auditor. July 31, 2013, Sealed Tr. 95-96.

ii. Rebuttal to Simmons' Expert Report by Jordan

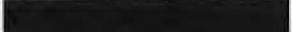
Jordan's expert rebuttal report includes his responses to some of Simmons' findings and opinions. Jordan Rebuttal Rep. at 1. Jordan first noted certain methodological differences between the two experts' reports. Id. at 3-4. The most significant difference between their approaches was the divergence between the data sets they relied on – he relied on Respondents' Form 2 annual reports and the Engagement Data, while Simmons relied entirely on alternative sources that are publicly available. Id. Jordan believed that his reliance on the Engagement Data was more accurate and relevant. Id. at 5.

As a second methodological difference, Jordan noted that Simmons categorized Chinese Issuers as entities that are incorporated or have 100% of their assets or revenues based in China, whereas Jordan characterized China-based companies as including most, but not all, companies that had between 50% and 99% of their assets in China, in addition to all companies with 100% of their assets in China. Id. Simmons' definition of Multinational Corporation was broader than Jordan's and included all entities that are incorporated outside of China that had between 50% and 99% of their assets or revenues based in China, whereas Jordan defined some of these entities as China-based companies. Id. at 4. Jordan did not offer an opinion as to which approach was correct. Id.

Jordan opined that Simmons did not analyze the correct population of issuers likely to be affected by the Division's proposed bar. Id. at 6. Jordan determined that a total of 161 majority-China issuers would have been affected if the proposed bar were in place between 2010 and 2012

while Jordan noted that Simmons' expert report did not provide an exact number of issuers affected but offered tables purporting to summarize the universe of majority-China issuers, comprising 204 entities with a market capitalization of \$736 billion. Id. at 6-7. He also challenged Simmons' conclusion that the potential consequences of the Division's proposed

remedy would extend to companies with approximately \$720 billion in market capitalization.⁴¹ Id. at 7. He pointed out that only \$271 billion of the \$720 billion market capitalization comprises shares listed or traded in the U.S., and Simmons provided no basis for assessing the extent to which the non-U.S. market capitalizations would be affected by the proposed remedy. Id.

Jordan also challenged Simmons' calculation of the \$720 billion market capitalization figure. First, Jordan noted that Simmons calculated that figure by combining market capitalizations of majority-China issuers for which Respondents issued audit reports (\$83 billion) and for which Respondents' network affiliates issued audit reports (\$637 billion). Id. Jordan stated that when Simmons' data is compared to the Engagement Data, 



⁴¹ Jordan agreed during cross-examination that he was not offering an opinion as to whether Respondents' clients would suffer market capitalization losses as a result of the Division's proposed bars. July 31, 2013, Sealed Tr. 24.

⁴² During cross-examination, Simmons agreed that Exhibit 4 to Jordan's rebuttal report set forth the parent companies for which affiliates of Respondents signed audit reports and for which Respondents were not involved in the audit. July 31, 2013, Sealed Tr. 108. She testified that the network affiliates signed the audit opinions and therefore they must have found someone to perform audit work in China other than Respondents. July 31, 2013, Sealed Tr. 108.

⁴³ Jordan noted that because Dahua did not provide Engagement Data, he did not know if any of those companies engaged Dahua to perform substantial role work and so for purposes of his analysis he assumed Dahua did not perform a 50% role in any of the audits in question. Jordan Rebuttal Rep. at 7 n.24.

⁴⁴ Simmons opined in her rebuttal report that as of June 30, 2013, Yum! Brands, Inc., a U.S.-based multinational issuer with a market capitalization of over \$30 billion, derived 50.6% of its revenues from its China segment during 2012. Simmons Rebuttal Rep. at 14-15. During cross-examination, Simmons testified that she did not believe that she had reviewed the Commission Form 10-Q of Yum! Brands, Inc., filed for the period ending June 15, 2013. July 31, 2013, Sealed Tr. 107-08. When asked whether she was aware that Yum! Brands, Inc., had reported that its revenues and assets in China both were below 50% in the year-to-date, Simmons testified that the company must be very close to 50% because she had observed fluctuation around the

[REDACTED]

Jordan further opined that the Simmons' expert report appeared to overstate the proposed bar's likely impact on investors, and he specifically disputed Simmons' opinion that the predicted decline in the value of majority-China Issuers' shares around their delisting date would be \$115 billion. Id. at 9. Referring back to his previous discussion of certain companies that should have been excluded from Simmons' market capitalization calculation, Jordan opined that the \$271 billion U.S.-traded market capitalization that forms the basis for the projected \$115 billion price decline should have been reduced by 9%, and applying that reduction to the baseline results in the projected \$115 billion price decline being reduced to \$106 billion. Id.

Jordan also challenged the sources Simmons relied on in concluding that affected issuers would experience a 43% decline in stock price as a result of delisting, citing the report of the Division's Expert, Chyhe Becker (Becker), discussed in greater detail infra, which opined that the effect of delisting on an issuer's stock price varies substantially depending on the reason for delisting. Id. at 9-10. [REDACTED]

Jordan stated that he did not believe Simmons' assumption that none of Respondents' existing clients would be able to engage qualified replacements if the proposed bar were ordered, and they would end up delisting from U.S. exchanges, was adequately supported.⁴⁶ Id. at 11. Jordan asserted that 99 of the 204 majority-China Issuers described in Simmons' report are not clients of Respondents and they rely on alternatives to Respondents, including Respondents' affiliates, Other Non-Consenting Firms, Potential Substitute Firms, and others not included in Simmons' report, such as PCAOB-registered firms located in Hong Kong. Id. at 11 & n.39. Jordan believed it was unduly speculative to conclude that the Other Non-Consenting Firms would not continue to provide audit services if the proposed bar is imposed because these firms

50% threshold and even if the company fell below the threshold for a particular quarter, the company was very likely to face the Division's proposed bar in a subsequent quarter. July 31, 2013, Sealed Tr. 107-08.

⁴⁵ [REDACTED] Jordan Rebuttal Rep. at 8 n.27. In addition, in Jordan's opinion, the Simmons' Report erroneously excluded 5 entities that appeared in the Form 2 annual report data he used in his expert report, and on December 31, 2012, their market capitalization was \$2 billion. Id.

⁴⁶ Jordan agreed during cross-examination that he was not offering an opinion as to whether Respondents' U.S.-listed audit clients would be unable to find replacement auditors or the likelihood that those clients would have to delist as a result of an inability to find replacement auditors. July 31, 2013, Sealed Tr. 24-25.

could decide to consent to provide certain documents to the PCAOB as a general matter and/or to comply with specific future production requests from the Commission and PCAOB.⁴⁷ Id. at 11 & n.37.

7. Chyhe K. Becker

The Division offered Becker as a rebuttal expert to summarize the economic research on the economic impact of enforcing U.S. securities regulations and the expected economic impact of the proposed sanctions for the securities of Respondents' current audit clients. Rebuttal Summary Report of Becker (Becker Rep.) at 2-3.⁴⁸

In support of the opinions she provided in her rebuttal summary report, Becker reviewed articles published only in the top journals in finance, as identified by the Journal Citation Report by Thomson Reuters, the list of journals used by the WP Carey School of Business to rank financial research institutions and universities based on their publications in the top five finance journals, and the top twenty finance journals as identified in a published research article. Id. at 6, App. 5.

Becker opined that economic research indicates that investors, issuers, and markets benefit from the enforcement of U.S. securities regulations. Id. at 3. She explained that investors benefit from higher stock prices, less aggressive accounting practices, and more discipline on management; and issuers benefit from a lower cost of capital. Id. Becker stated that economic research shows that enforcement of securities laws is associated with more robust markets, as indicated by higher market capitalization, trading volume, and the number of initial public offerings. Id. She asserted that these results, taken together, support the conclusion that investors and issuers are helped by a strong program of securities law enforcement. Id. Becker opined that studies indicate that the Commission's enforcement program as to cross-listed companies needs to be enhanced, and studies of Chinese companies indicate that minority shareholders of these companies may be particularly vulnerable. Id. at 3-4. She concluded that

⁴⁷ During cross-examination, Jordan testified he was not providing an opinion regarding whether the companies affected by the Division's proposed bar would be able to find suitable replacement auditors nor was he opining that firms located outside of China would be viable replacement auditors, although he noted, based on his data, that firms outside China appear to have performed audit work for some of the issuers at question during the time frame he analyzed. July 31, 2013, Sealed Tr. 39-40.

⁴⁸ Becker is currently the Assistant Director of the Division of Economic and Risk Analysis at the Commission where she performs economic analysis in support of the Division and supervises a staff of financial economists who support the Division through economic and quantitative analysis and research. Becker Rep. at 1, App. 1. She received a bachelor's degree with honors from Yale University in 1985; a MBA degree in finance from the University of Chicago in 1997; and a Ph.D. in finance from the University of Chicago in 1998. Id. at App. 1. She worked at Deloitte & Touche LLP in Chicago, Illinois, as a senior manager and later as an economist and principal from 2002 to 2005, and at Deloitte Financial Advisory Services LLP as an economist and principal from 2005 to 2006. Id. From 2006 to 2008, Becker was a principal at Chicago Partners, LLC, where she specialized in securities litigation. Id. She joined the Commission in 2008 as the Assistant Chief Economist in the Office of Economic Analysis. Id.

while Respondents' current audit clients may incur costs from the enforcement of laws requiring production of audit work papers, the broader population of investors and issuers on U.S. exchanges would benefit. Id. at 4.

Becker found that economic research shows that enforcement of securities laws benefits investors. Id. at 7. Among others, Becker cited a paper studying the consequences of the Commission's adoption of Exchange Act Rule 12h-6, which made it easier for foreign firms to deregister with the Commission and avoid disclosure requirements. Id. at 7-8 & n.8; Nuno Fernandes et al., Escape from New York: The Market Impact of Loosening Disclosure Requirements, 95 J. Fin. Econ. 129-47 (2010). According to Becker, that study found that the stock prices of foreign firms that were registered with the Commission dropped in response to the announcement of this rule, and for companies located in countries with low disclosure requirements, the mean and median stock price reactions of -0.56% and -0.92%, respectively, were statistically significant, while the stock price reaction for companies based in countries with high disclosure or high judicial efficiency was not statistically significant. Becker Rep. at 7-8. Becker opined that the study suggested that if Commission rules were not enforced in this proceeding there would be adverse consequences for foreign issuers listed on U.S. exchanges. Id. at 8.

Becker also offered several published studies to support the assertion that the Commission should support its enforcement actions on behalf of investors in cross-listed foreign firms. Id. at 9-11. For example, Becker cited a study reporting that the Commission tends to be more effective at enforcing cases against companies with geographic proximity to Commission offices and that nearby companies respond with better and more accurate disclosures. Id. at 10 & n.14; Simi Kedia & Shiva Rajgopal, Do the SEC's Enforcement Preferences Affect Corporate Misconduct?, 51 J. Acct. & Econ. 259-78 (2011). Becker opined that this administrative proceeding presents a visible opportunity for the Commission to reinforce its commitment to protect minority shareholders of foreign companies that are cross-listed in the U.S. Becker Rep. at 10.

In support of the proposition that the cost of capital is lower when disclosure rules are enforced, Becker cited a published study of international differences in the cost of equity capital across forty countries that found, even after controlling for firm and country risk, that firms from countries with more extensive disclosure requirements, stronger securities regulation, and stricter enforcement mechanisms have a significantly lower cost of capital, and for countries where securities markets are not well-integrated with global markets, moving from the 25th percentile on securities regulation to the 75th percentile reduces the cost of equity capital by about 200 basis points. Id. at 11-12 & n.18; Luzi Hail & Christian Leuz, International Differences in the Cost of Equity Capital: Do Legal Institutions and Securities Regulation Matter?, 44 J. Acct. Res. 485, 488 (2006). Becker opined that the implication for this matter is that enforcing the Commission's disclosure requests would benefit the broader population of issuers on U.S. exchanges by facilitating capital formation. Becker Rep. at 12.

Becker also offered several published studies to support the assertion that markets are more robust when public agencies have more resources to enforce securities laws. Id. at 12-14. Becker cited a paper, prepared in response to studies concluding that public enforcement of securities laws is an ineffective approach to developing capital markets, which finds that allocating more resources to public enforcement is positively associated with robust capital

markets, as measured by market capitalization, trading volume, the number of domestic firms, and the number of initial public offerings. Id. at 12-13 & n.21; Howell E. Jackson & Mark J. Roe, Public and Private Enforcement of Securities Laws: Resource-Based Evidence, 93 J. Fin. Econ. 207-38 (2009). Becker asserted that even the papers that find public enforcement is not as powerful as private enforcement find evidence that stock markets benefit from laws mandating disclosure and facilitating private enforcement through liability rules. Becker Rep. at 13.

Becker opined that Simmons likely overestimated the drop in market price if Respondents' current audit clients are forced to delist from U.S. exchanges. Id. at 4. She asserted that the primary reason for delisting in the research Simmons quoted was performance failure, such as bankruptcy or the failure to meet minimum thresholds for stock price or market capitalization, and because any delisting of Respondents' current clients would be unrelated to financial and economic distress of the issuers, Simmons' figures do not provide an accurate basis for estimating a price decline. Id. Becker also stated that Simmons did not appear to consider research on voluntary delisting that provides substantially smaller estimates of stock price reactions to delisting. Id. at 5. According to Becker, taken together, this suggests Simmons overstated the consequences of proposed sanctions for Respondents' current audit clients and their shareholders. Id.

Becker asserted that the stock price reaction to delisting depends on the circumstances. Id. at 14. Among others, she cited a paper studying firms that filed a form 15 with the Commission to voluntarily deregister their stock but continued to trade on the over-the-counter markets. Id. at 16 & n.31; Christian Leuz et al., Why Do Firms Go Dark? Causes and Economic Consequences of Voluntary SEC Deregistrations, 45 J. Acct. & Econ. 182 (2008). According to Becker, that paper reported that the decision to "go dark" is associated with a negative market reaction of approximately -10%, which Becker contended was substantially smaller than the typical reactions reported by Simmons. Becker Rep. at 16. Moreover, Becker opined that this paper included only domestic companies in its analysis, and this raises the question whether the returns would be similar for foreign companies. Id.

Becker also offered a paper studying all of the U.S.-listed foreign companies that delisted from U.S. exchanges and deregistered with the Commission between 1990 and 2006. Id. at 16-17 & n.33; Andras Marosi & Nadia Massoud, 'You Can Enter but You Cannot Leave . . .': U.S. Securities Markets and Foreign Firms, 63 J. Fin. 2477-2506 (2008). That paper reported that the stock prices of the firms that delisted and deregistered experienced statistically significant returns of -0.85% in response to the announcement, and the magnitude is smaller in the post-Sarbanes-Oxley period. Becker Rep. at 17. Becker testified that she believed the fact this study addressed foreign companies was relevant to this proceeding because when a U.S.-based company delists from a U.S. exchange it moves from the exchange to the pink sheets, whereas companies that are simultaneously listed on a foreign exchange, as in the study, are subject to the other exchange's listing requirements, which may be part of the reason why the stock price reaction observed is substantially smaller. Tr. 2587.

Becker testified during cross-examination that there are studies that come up with figures similar to Simmons' figures for the stock price reaction to delisting, but she did not include those studies in her report because they examined companies experiencing financial distress and bankruptcy, or U.S. companies being delisted from U.S. exchanges, and she did not believe they were "good comparables." Tr. 2599. Simmons, on the other hand, testified that she disagreed

with Becker's criticism that the studies she relied on were inappropriate. Simmons testified that a proper understanding of the studies reveals that the effects of the financial stress were "impounded" into the stock price prior to the delisting event and therefore the market price decline from the delisting event is separate from any distress-related event. July 31, 2013, Sealed Tr. 69. According to Simmons, the papers she referred to in her expert report also included a governance-related category for delisting, which would include a company's inability to file audited financial statements, and that delisting effect, in terms of price decline, was equal to or higher than the delisting effect she applied in her expert report. July 31, 2013, Sealed Tr. 69-70.



Id. at 17-18 & n.34; Bin Ke et al., Hong Kong Stock Listing and the Sensitivity of Managerial Compensation to Firm Performance in State-Controlled Chinese Firms, 17 Rev. Acct. Stud. 168 (2012).

During cross-examination, Becker was asked about a paper cited in her report, Jeffrey Harris, et al., Off But Not Gone: A Study of Nasdaq Delistings, Fischer C. Bus. Working Paper, 2008, at 16; see Tr. 2643-45; Becker Rep. at 15 & n.28. The paper stated that it tested whether the deterioration in market quality is related to the severity of the reason for delisting, and Becker testified that she agreed that the paper stated that it found the deterioration in market quality to be the largest for bankruptcy followed by "corporate (e.g., governance SEC disclosure)." Tr. 2645. Becker also agreed that part of corporate governance is having audited financial statements. Tr. 2645-46.

III. DISCUSSION AND ANALYSIS

A. Construction of Sarbanes-Oxley 106

The parties vigorously dispute the meaning of Sarbanes-Oxley 106(e), which provides that a "willful refusal to comply . . . with any request by the Commission . . . under this section, shall be deemed a violation of this Act." 15 U.S.C. § 7216(e). The Division contends that a knowing failure to produce documents in response to a Sarbanes-Oxley 106 request constitutes "willful refusal to comply." Div. Br. at 45. Respondents contend that "willful refusal" requires proof of bad faith or bad intent. Resp. Br. at 8-13, 17. As between these two proposed interpretations, the Division's is closer to what I find to be correct: "willful refusal to comply" means "choosing not to act after receiving notice that action was requested," without regard to good faith.

1. “Refusal”

I do not write on an entirely blank slate. Board Rule 5103 permits the Board to issue an accounting board demand for audit work papers in the possession of a “registered public accounting firm or any associated person thereof, wherever domiciled,” that is, without regard to Sarbanes-Oxley 106. Rule 5103(a) (Public Company Accounting Oversight Board), effective pursuant to Exchange Act Release No. 34-49704, File No. PCAOB-2003-07 (May 14, 2004), 82 SEC Docket 3468 (emphasis added).⁴⁹ Board Rule 5110(a)(1) permits the Board to institute a disciplinary proceeding if a registered public accounting firm or an associated person thereof has “failed to comply with an accounting board demand.” Rule 5110(a)(1) (Public Company Accounting Oversight Board), effective pursuant to Exchange Act Release No. 34-49704, File No. PCAOB-2003-07 (May 14, 2004), 82 SEC Docket 3468; see also Resp. Ex. 24. Rule 5110(a)(1) contrasts with both Sarbanes-Oxley 106(e) and Sarbanes-Oxley 105(b)(3), which permits imposition of sanctions against a registered public accounting firm or any associated person thereof specifically for “refus[al] to testify, produce documents, or otherwise cooperate with the Board in connection with an investigation.” 15 U.S.C. § 7215(b)(3) (emphasis added).

In other words, the Board has determined, with the approval of the Commission, that it may sanction a registered public accounting firm, wherever domiciled, for mere failure to comply with a request for audit work papers. Its reason is clear: “Although [Sarbanes-Oxley 105(b)(3)] authorizes the Board to impose sanctions . . . if a registered firm or associated person ‘refuses’ to testify, produce documents, or otherwise cooperate, . . . any noncooperating registered firm or associated person could then avoid [Sarbanes-Oxley 105(b)(3)] sanctions merely by refraining from expressly articulating a refusal to cooperate.” R.E. Bassie & Co., PCAOB File No. 105-2009-001 (Public Company Accounting Oversight Board Final Decision, Oct. 6, 2010) at 9, aff’d, Accounting and Auditing Enforcement Release No. 3354 (Jan. 10, 2012), 102 SEC Docket 50082. On appeal, the Commission fully affirmed the Board, and although it alluded to the Board’s interpretation, it did not squarely address it. See R.E. Bassie & Co., 102 SEC Docket at 50101 n.43.

Although the Board’s interpretation and the Commission’s affirmance are not directly on point, because they deal with Sarbanes-Oxley 105 and not specifically with Sarbanes-Oxley 106(e), their reasoning is persuasive. Accordingly, I conclude that “refusal” in the context of Sarbanes-Oxley 106(e) should be read as “failure.” See Societe Internationale Pour Participations Industrielle et Commerciales, S.A. v. Rogers, 357 U.S. 197, 207 n.1 (1958) (context determines whether “refusal” in Federal Rule of Civil Procedure (FRCP) 37 means refusal or mere failure).

2. “Willful”

Respondents argue that under Sarbanes-Oxley 106(e), “only an accounting firm’s ‘willful refusal’ to produce documents violates the federal securities laws.” Resp. Br. at 16 n.13

⁴⁹ The parties did not object to my taking official notice of Board cases and Rules that have been the subject of Commission Releases, pursuant to Rule 323. Tr. 1231-32; 17 C.F.R. § 201.323. The Board’s Rules and Final Decisions are available at <http://pcaobus.org>.

(emphasis omitted). Even though Sarbanes-Oxley 106(e) does not use the term “only” or the like, the Division does not appear to dispute Respondents’ reading. Accordingly, I assume that only a willful refusal to comply with a request under Sarbanes-Oxley 106 constitutes an actionable violation.

“[W]hen the statute’s language is plain, the sole function of the courts – at least where the disposition required by the text is not absurd – is to enforce it according to its terms.” Lamie v. U.S. Trustee, 540 U.S. 526, 534 (2004) (citations omitted). The terms “willful” and “willful refusal” are not defined in Sarbanes-Oxley, and I conclude that the statutory language is not plain. Legislative history and “the policies underlying the statutory provision” should therefore be analyzed to determine its proper scope. Bowsher v. Merck & Co., 460 U.S. 824, 831 n.7 (1983) (quoting Rose v. Lundy, 455 U.S. 509, 517 (1982)). I have found nothing pertinent in the legislative history of Dodd-Frank, which amended Sarbanes-Oxley by adding Sarbanes-Oxley 106(e). Respondents contend that the legislative history of Dodd-Frank supports their position, but cite only to testimony by the Commission’s Chief Accountant before the House Committee on Financial Services, and a comment in a U.S. Senate report pertaining to Sarbanes-Oxley 105(b)(5)(C), neither of which are helpful. Resp. Br. at 11-13. I have accordingly relied principally on analogous provisions of the Exchange Act (an approach explicitly authorized by Section 3 of Sarbanes-Oxley), the language of Sarbanes-Oxley overall, and pertinent opinions and releases from the Board and the Commission. 15 U.S.C. § 7202(b)(1) (a violation of Sarbanes-Oxley “shall be treated for all purposes in the same manner as a violation of the [Exchange Act]”).

Sarbanes-Oxley 106(e) is somewhat unusual compared to most securities statutes at issue in Commission administrative proceedings. The usual statutory format includes an identification of what is “unlawful,” and associated sections dealing with sanctions. For example, Section 10(b) of the Exchange Act states that it “shall be unlawful” to use or employ, under certain circumstances, “any manipulative or deceptive device or contrivance in contravention of” Commission regulations. 15 U.S.C. § 78j(b). Other sections of the Exchange Act authorize the Commission to impose sanctions for such “unlawful” conduct, including Sections 15(b)(6) (associational bars), 21B (civil penalties), 21B(e) and 21C(e) (disgorgement), and 21C(a) (cease-and-desist orders). See 15 U.S.C. §§ 78o(b)(6), 78u-2, 78u-3.

A second feature of the usual statutory format is that willfulness is not an element of the unlawful conduct, but it is sometimes an element of a particular administrative sanction. See 15 U.S.C. § 78u(d)(3) (no willfulness requirement for imposition of civil penalties by district court); SEC v. Blavin, 760 F.2d 706, 713 (6th Cir. 1985) (holding that, in district court, disgorgement is an equitable remedy available if a defendant has “violated” the securities laws). For example, under the Exchange Act, a willful violation may be required to impose an associational bar, but it is not required to impose a cease-and-desist order. Compare 15 U.S.C. § 78o(b)(4)(D), (6)(A)(i) with 15 U.S.C. § 78u-3(a). Prior to the enactment of Dodd-Frank, which took effect July 22, 2010, disgorgement (except in the case of cease-and-desist proceedings) and civil penalties pursuant to the Exchange Act were authorized only in the case of willful misconduct. See 15 U.S.C. § 78u-2(a)(1), (e) (2006); 15 U.S.C. § 78u-3(e) (2006). Section 929P of Dodd-Frank amended the Exchange Act (as well as the Securities Act of 1933, the Investment Advisers Act of 1940 (Advisers Act), and the Investment Company Act of 1940) by making civil penalties

available in cease-and-desist proceedings without a showing of willfulness. See Pub. L. No. 111-203, 124 Stat. 1376 (2010); 15 U.S.C. § 77h-1(g)(1) (2010); 15 U.S.C. § 78u-2(a)(2) (2010); 15 U.S.C. § 80b-3(i)(1)(B) (2010); 15 U.S.C. § 80a-9(d)(1)(B) (2010). Similarly, Section 4C of the Exchange Act, which is essentially the statutory version of Rule 102(e)(1), authorizes the Commission to censure or deny the privilege of appearing or practicing before it to persons who have “violated” the securities laws, but only if the violation was willful. 15 U.S.C. § 78d-3(a)(3).

Sarbanes-Oxley overall sometimes follows a similar statutory format. For example, Section 102 of Sarbanes-Oxley makes it “unlawful” for any person that is not a registered public accounting firm to prepare or issue “any audit report with respect to any issuer, broker, or dealer.” 15 U.S.C. § 7212(a). Section 105(c) authorizes the Board to initiate disciplinary proceedings and impose sanctions for such unlawful conduct. 15 U.S.C. § 7215(c)(1), (4). Section 105(c)(4) sets forth the various sanctions available, and Section 105(c)(5) divides the sanctions into those requiring proof of a particular state of mind and those requiring no such proof. 15 U.S.C. § 7215(c)(4), (5).

Sarbanes-Oxley 106, however, is not consistent with the usual statutory format. Instead of declaring that a “refusal to comply . . . with any request by the Commission” is unlawful, it declares that a “willful refusal . . . shall be deemed a violation of [Sarbanes-Oxley].” 15 U.S.C. § 7216(e). This suggests that willfulness is an element of the violation, and not of the sanction. Had Sarbanes-Oxley 106 been written in the usual statutory format, it would appear as something like “it shall be unlawful to willfully refuse to comply with any request by the Commission or the Board under this section.” This would seem to carry the same meaning as “a willful refusal, and only a willful refusal, to comply with any request by the Commission or the Board under this section, shall be deemed a violation.” But the definition of “willfully refuse” remains unresolved.

There is some similarity between the definition of willfulness under the Exchange Act and Rule 102(e)(1)(iii), on the one hand, and the state of mind required for sanctions under Sarbanes-Oxley, on the other. Compare Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (willfulness under the Exchange Act means “intentionally committing the act which constitutes the violation”) and Horton & Co., Initial Decision Release No. 208 (July 2, 2002), 77 SEC Docket 3677, 3688 (citing Wonsover) (same as to Rule 102(e)(1)(iii)), with 15 U.S.C. § 7215(c)(5)(A) (“intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard”); see also Warwick Capital Mgmt., Inc., Advisers Act Release No. 2694 (Jan. 16, 2008), 92 SEC Docket 1410, 1421 n.20 (willfulness under the “federal securities laws” means “intentionally committing the act which constitutes the violation”). This similarity is superficial; in fact, Sarbanes-Oxley 105(c)(5) requires a state of mind that might be roughly characterized as more than willfulness, as that term is used in the Exchange Act, and less than scienter. See Gately & Assoc., LLC, Exchange Act Release No. 62656 (Aug. 5, 2010), 99 SEC Docket 31023, 31037-39 & n.31 (noting that the state of mind requirement under Sarbanes-Oxley 105(c)(5) is similar to the state of mind requirement under Rule 102(e)(1)(iv), and that recklessness under Sarbanes-Oxley 105(c)(5) involves an extreme departure from the standard of care); Marrie v. SEC, 374 F.3d 1196, 1205 (D.C. Cir. 2004) (no intent to defraud need be shown in cases brought under Rule

102(e)(1)(iv)(A)). Sarbanes-Oxley 105(c)(5) is thus of little help in interpreting Sarbanes-Oxley 106(e).

Greater help is provided by a few other provisions of Sarbanes-Oxley. Sarbanes-Oxley 105(c)(7) makes it “unlawful” for any person barred or suspended from association with a registered public accounting firm “willfully to become or remain associated with” a registered public accounting firm or an issuer, broker, or dealer in an accounting or financial management capacity. 15 U.S.C. § 7215(c)(7)(A), (B). Again, “willfully” is not defined, but the whole point of an associational bar is to prevent barred persons from associating with a registered public accounting firm, issuer, broker, or dealer. Thus, it would be nonsensical for “willfully” in Sarbanes-Oxley 105(c)(7) to mean something other than what it means under the Exchange Act and Rule 102(e)(1)(iii): “intentionally committing the act which constitutes the violation.” Wonsover, 205 F.3d at 414. Similarly, Sarbanes-Oxley 107(d)(3) states:

The Commission may . . . remove from office or censure any person who is, or at the time of the alleged misconduct was, a member of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that such member – (A) has willfully violated any provision of this Act, the rules of the Board, or the securities laws; [or] (B) has willfully abused the authority of that member.

15 U.S.C. § 7217(d)(3). This language is similar to the language in Section 4C of the Exchange Act and in Rule 102(e)(1)(iii) concerning the Commission’s authority to sanction persons practicing before the Commission. See 15 U.S.C. § 78d-3(a)(3); 17 C.F.R. § 201.102(e)(1)(iii). This suggests that “willfully” in Sarbanes-Oxley 107(d)(3) has the same meaning it has in the Exchange Act and in Rule 102(e)(1)(iii).

Lastly, some cases suggest that an omission, as opposed to an affirmative act, is willful only if the respondent was on actual or constructive notice that action was required, that is, the respondent must have made a choice. See Oppenheimer & Co., 47 S.E.C. 286, 287 (1980); Herbert Moskowitz, Initial Decision Release No. 163 (Apr. 26, 2000), 72 SEC Docket 912, 925, rev’d on other grounds, 55 S.E.C. 658 (2002). Other cases state that the “failure to make a required report, even though inadvertent, constitutes a willful violation,” with no knowledge requirement. Robert G. Weeks, Initial Decision Release No. 199 (Feb. 4, 2002), 76 SEC Docket 2609, 2662, aff’d, 56 S.E.C. 1297 (2002); see also Jesse Rosenblum, 47 S.E.C. 1065, 1067 (1984), pet. denied, 760 F.2d 260 (3d Cir. 1985); Amaroq Asset Mgmt., LLC, Initial Decision Release No. 351 (July 14, 2008), 93 SEC Docket 7932, 7943. Because it is essentially undisputed that Respondents actually knew they had received Sarbanes-Oxley 106 requests, I conclude that willfulness requires notice that a request had been made, followed by a choice to act or not to act. Notably, this is not the same as knowledge that one’s conduct violates the law. See Ratzlaf v. U.S., 510 U.S. 135, 137 (1994); Boyce Motor Lines, Inc. v. U.S., 342 U.S. 337, 345 (1952) (Jackson, J., dissenting) (distinguishing between “factual knowledge” and “knowledge of the law”).

3. “Willful Refusal to Comply” Means “Choosing Not to Act After Receiving Notice That Action Was Requested”

In summary:

- Sarbanes-Oxley 106(e) can be rephrased as “it shall be unlawful to willfully refuse to comply with any request by the Commission or the Board under this section.”
- To “refuse to comply” means to “fail to comply”; otherwise, regulated entities would have a perverse incentive to be less cooperative than they should be.
- A violation of Sarbanes-Oxley is treated as a violation of the Exchange Act. 15 U.S.C. § 7202(b)(1).
- Although Sarbanes-Oxley does not define the terms “willful” or “willfully,” under the Exchange Act (and Rule 102(e)(1)(iii)), “willfully” means, as to omissions, “choosing to act or not to act after receiving notice that action was requested.”
- Such a definition of “willfully” is consistent with its usage in Sections 105(c)(7) and 107(d)(3) of Sarbanes-Oxley.
- The addition of the qualifier “willful” to “refusal” may have been intended to ensure that in any administrative proceeding under the Exchange Act, no sanction could be imposed for a violation of Sarbanes-Oxley 106(e), even in cease-and-desist proceedings, without proof of willfulness.

Taken together, these findings lead to the conclusion that “willfully” means “choosing to act or not to act after receiving notice that action was requested,” “refusal to comply” means “failure to comply,” with no particular state of mind requirement, and “willful refusal to comply” means “choosing not to act after receiving notice that action was requested.” I view this as equivalent to the Division’s proposed definition, and to Respondents’ characterization of the Division’s proposed definition: “a conscious decision not to produce the requested documents.” DTTC Prehearing Br. at 24. Under such a definition, the motive for the choice is irrelevant, so long as the Respondent knew of the request and made a choice not to comply with it. Thus, bad faith need not be demonstrated, and good faith is not a defense.

4. Respondents’ Arguments

Respondents raise a number of unpersuasive arguments against this conclusion. First, they cite to Arthur Andersen LLP v. U.S., 544 U.S. 696 (2005), and Federal Power Commission v. Metropolitan Edison Co., 304 U.S. 375 (1938), for the proposition that “willful refusal” requires consciousness of wrongdoing or a lack of good faith. Resp. Br. at 11. In Arthur Andersen, the accounting firm (Andersen) was Enron’s auditor, and instructed its employees to destroy documents pursuant to its document retention policy in 2001, at a time when Enron’s financial difficulties became public. 544 U.S. at 698. Andersen was then convicted of obstruction of justice pursuant to a criminal statute, 18 U.S.C. § 1512(b)(2)(A) and (B), which

makes it unlawful to “knowingly . . . corruptly persuade[]” another person with intent to cause that person to withhold documents from an official proceeding. *Id.* at 698, 704. The Supreme Court held that “knowingly” and “corruptly” have distinct meanings that must each be given effect, so that a conviction under 18 U.S.C. § 1512(b)(2) requires proof both of consciousness of wrongdoing (i.e., knowledge) and of wrongful intent (i.e., corruption). *Id.* at 705. In Metropolitan Edison, the Federal Power Commission (FPC) ordered Metropolitan Edison (Edison) to appear for an administrative hearing, and also ordered document production. 304 U.S. at 385. Edison obtained an injunction against the FPC’s administrative proceeding, and the Supreme Court reversed. *Id.* at 379-80, 387. The Supreme Court identified certain legal provisions that protected Edison’s due process rights, including the fact that failure to comply with the FPC’s order, although a crime, was only punishable upon proof of “willful” failure or refusal to comply: “The qualification that the refusal must be ‘willful’ fully protects one whose refusal is made in good faith and upon grounds which entitle him to the judgment of the court before obedience is compelled.” *Id.* at 387.

Arthur Andersen and Metropolitan Edison address criminal liability, and are therefore inapposite. Willfulness in some criminal contexts may be negated by subjective good faith. See Cheek v. U.S., 498 U.S. 192, 202 (1991); Ratzlaf, 510 U.S. at 142 n.10. This is because criminal willfulness generally requires a bad purpose or knowledge that one’s conduct violates the law, which are inconsistent with good faith. See Bryan v. U.S., 524 U.S. 184, 191-92 & nn.12-13 (1998); Ratzlaf, 510 U.S. at 137, 142 n.10. But in the general civil case, and in the Exchange Act, Rule 102(e)(1)(iii), and Sarbanes-Oxley 105(c)(7) and 107(d)(3), willfulness merely “differentiates between deliberate and unwitting conduct.” Bryan, 524 U.S. at 191. Respondents have offered no reason to import criminal willfulness into Sarbanes-Oxley 106(e). They cite Safeco Insurance Co. of America v. Burr, 551 U.S. 47, 60 (2007), for the proposition that the use of a “paired modifier” suggests Congressional intent to impose heightened, criminal-like culpability. DTTC Prehearing Br. at 18. Respondents misread Safeco, which actually supports the Division’s position: “in the criminal law ‘willfully’ typically narrows the otherwise sufficient intent, making the government prove something extra, in contrast to its civil-law usage, giving a plaintiff a choice of mental states” to prove. Safeco, 551 U.S. at 60.

Second, Respondents argue that because “willful” modifies “refusal,” and “refusal” presupposes a willful act, interpreting “willful refusal” to not require good faith reads the term “willful” out of the statute. Resp. Br. at 9-10. To be sure, statutes should be read so as to give effect to each word. See Astoria Fed. Savings & Loan Ass’n v. Solimino, 501 U.S. 104, 112 (1991). But there are at least two canons of construction that point in the opposite direction: a term appearing in several places in a statutory text is generally read the same way each time it appears, and a court may reject words as surplusage “if repugnant to the rest of the statute.” Chickasaw Nation v. U.S., 534 U.S. 84, 94 (2001) (quotations omitted); see Ratzlaf, 510 U.S. at 143. As noted, willfulness appears in Sections 105(c)(7) and 107(d)(3) of Sarbanes-Oxley, and it apparently has the same meaning in those sections that it has in the Exchange Act and in Rule 102(e)(1)(iii). This suggests that it has the same meaning in Sarbanes-Oxley 106(e). Also, “refusal” appears in Sarbanes-Oxley 105(b)(3), and the Board’s interpretation of that term as “failure” is persuasive. Applying the canon that a term appearing in several places in a statutory text is generally read the same way each time it appears, “willful refusal,” which is properly read as “willful failure,” is equivalent to “choosing not to act after receiving notice that action was

requested.” Moreover, there is nothing in Sarbanes-Oxley suggesting that a violation of Sarbanes-Oxley 106 should require proof of a state of mind higher than willfulness. A contrary interpretation would be repugnant to the rest of the statute.

Third, Respondents argue that if compliance with a Sarbanes-Oxley 106 request would result in a criminal conviction in the accounting firm’s home jurisdiction, it would present a catch-22: fail to comply, and be banned from practicing before the Commission under Rule 102(e)(1)(iii), or comply, and be banned from practicing before the Commission under Rule 102(e)(2). DTTC Prehearing Br. at 19 n.11 (citing 17 C.F.R. § 201.102(e)(2) (providing for “forthwith” suspension from practice for conviction of a felony or misdemeanor involving moral turpitude)). This argument is wildly speculative, even fanciful. Nothing about this case suggests that the Commission would bring a Rule 102(e)(2) proceeding against Respondents (or anyone else) for complying with Sarbanes-Oxley 106. Furthermore, it would very likely not be in the public interest to sanction Respondents (or anyone else) for a foreign criminal conviction allegedly brought about by the Commission’s own investigative demand.

Fourth, Respondents analogize Sarbanes-Oxley 106 to other securities laws that, they argue, do not require a showing of willful refusal, suggesting that Congress intended a particularly stringent state of mind requirement for a violation of Sarbanes-Oxley 106. Resp. Br. at 19-20; DTTC Prehearing Br. at 19-20. To be sure, proof of willfulness is sometimes required in Commission administrative proceedings, as noted above, and it is generally not required in civil proceedings. See 15 U.S.C. § 78u(d)(3) (no willfulness requirement for imposition of civil penalties by district court); Blavin, 760 F.2d at 713 (holding that, in district court, disgorgement is an equitable remedy available if a defendant has “violated” the securities laws); 15 U.S.C. §§ 77v(b), 78u(c). But the correct construction of the term “refusal” in Sarbanes-Oxley 106(e) is “failure,” regardless of what other statutes say. That Sarbanes-Oxley 106(e) contains the term “willful refusal” is more likely to reflect Congress’ intent to require proof of willfulness in every case, regardless of sanction, rather than proof of some uniquely heightened state of mind. Dominick & Dominick, Inc., 50 S.E.C. 571 (1991), does not support Respondents’ argument; it is a settled case and therefore of limited precedential value, and the Dominick respondents acted willfully in any event. 50 S.E.C. at 580 (“Dominick has willfully violated Section 17(a)(1) of the Exchange Act); see SIG Specialists, Inc., 58 S.E.C. 519, 537 n.36 (2005) (settled cases “have limited precedential value”); Carl L. Shipley, 45 S.E.C. 589, 591-92 n.6 (1974). Dagong Global Credit Rating Co., Exchange Act Release No. 62968 (Sept. 22, 2010), 99 SEC Docket 32724, also does not support Respondents’ argument; the Commission’s allegation that Dagong was “unable to comply” with the securities laws, rather than that it “willfully violated” them, in no sense “tacitly acknowledged” that a willful violation had not occurred. Dagong, 99 SEC Docket at 32727; Resp. Br. at 20.

Fifth, Respondents analogize this proceeding to discovery disputes in district court which, they argue, require proof of lack of good faith. Resp. Br. at 8-13, 21-22; DTTC Prehearing Br. at 24-25. The analogy is inapt. This proceeding is one to vindicate the Commission’s right to regulate who practices before it, rather than one to compel production of documents. In civil cases, FRCP 37 generally governs discovery disputes. See Rogers, 357 U.S. at 207. Failure to comply with a discovery order may result in any of several sanctions, including contempt. See FRCP 37(b)(2)(A); FRCP 45(g) (contempt may be found for failure to

comply with subpoena). It is one matter for a U.S.-regulated entity that cannot fulfill its statutory duties to be barred in the public interest from doing business in the U.S.; it is another matter for a party haled into court to be fined or otherwise held in contempt despite making a good faith effort to comply with a court order. Thus, the various civil discovery-related cases Respondents cite are inapposite. See Rogers, 357 U.S. at 212 (dismissal inappropriate as a sanction under FRCP 37); Shcherbakovskiy v. Da Capo Al Fine, Ltd., 490 F.3d 130, 140 (2d Cir. 2007) (default judgment inappropriate as sanction under FRCP 37); Cochran Consulting, Inc. v. Uwatec USA, Inc., 102 F.3d 1224, 1231-32 (Fed. Cir. 1996) (pretrial injunction inappropriate as a sanction under FRCP 37); In re Westinghouse Electric Corp. Uranium Contracts Lit., 563 F.2d 992, 994, 996 (10th Cir. 1977) (finding of contempt, and daily fines, inappropriate as sanction under FRCP 45); Tiffany (NJ) LLC v. Qi Andrew, 276 F.R.D. 143, 148, 160-61 (S.D.N.Y. 2011) (denying motion to compel compliance with subpoena duces tecum); Smith v. O'Neill, No. CIV.A. 99-00547 ESH/DAR, 2001 WL 950219 (D.D.C. Aug. 3, 2001) (recommending dismissal as discovery sanction under FRCP 37). Indeed, Rogers suggests that good faith is relevant, if at all, only to the sanction, and not to the fact of noncompliance. 357 U.S. at 208 (“Whatever its reasons, petitioner did not comply with the production order. Such reasons, and the willfulness or good faith of petitioner, can hardly affect the fact of noncompliance and are relevant only to the path which the District Court might follow in dealing with petitioner's failure to comply.”). The criminal cases Respondents cite are similarly inapposite. See U.S. v. Maccado, 225 F.3d 766, 772-73 (D.C. Cir. 2000) (affirming criminal sentence which included enhancement for obstruction of justice); U.S. v. Wendy, 575 F.2d 1025, 1030 (2d Cir. 1978) (reversing civil contempt judgment arising from criminal case).

Lastly, Respondents argue at length that the principle of prescriptive comity precludes my construction of “willful refusal to comply.” Under the principle of prescriptive comity, ambiguous statutes should be construed so as “to avoid unreasonable interference with the sovereign authority of other nations.” F. Hoffman-La Roche Ltd. v. Empagran S.A., 542 U.S. 155, 164-65 (2004) (citing Hartford Fire Ins. Co. v. California, 509 U.S. 764, 817 (1993) (Scalia, J., dissenting)).



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B. Respondents Chose Not to Act After Receiving Notice That Action Was Requested

Each Respondent was a foreign public accounting firm, and was properly served with at least one Sarbanes-Oxley 106 request pertaining to a client or former client, as to which that Respondent had “perform[ed] audit work,” all within the meaning of Sarbanes-Oxley 106. Each Respondent chose not to comply with at least one Sarbanes-Oxley 106 request after receiving at least constructive notice of it, and therefore willfully refused to comply with such request.

1. Dahua

Dahua is a foreign public accounting firm within the meaning of Sarbanes-Oxley 106(g). Tr. 2053-54. It designated BDO USA as its U.S. agent for service of Sarbanes-Oxley 106 requests, pursuant to Sarbanes-Oxley 106(d). Div. Ex. 165A at 25-28. It performed audit work for Client A and generated associated audit work papers. Tr. 2060. It received a Sarbanes-Oxley 106 request pertaining to Client A via its U.S. agent on or about February 1, 2012. Tr. 2108; Div. Ex. 34. Dahua chose not to produce its Client A audit work papers pursuant to the Sarbanes-Oxley 106 request. Div. Ex. 35. Admittedly, Ji testified that Dahua had no choice but to withhold its audit work papers. Tr. 2125, 2131. To the extent Ji’s testimony conflicts with Dahua’s written communication to Weinstein that Dahua had “decided” not to produce the audit work papers voluntarily, I place no weight on it, both because it conflicts with Dahua’s written response and because it defies common sense that Dahua made no choice.

2. E&Y

E&Y is a foreign public accounting firm within the meaning of Sarbanes-Oxley 106(g). Tr. 1399-1400. It designated Ernst & Young LLP as its U.S. agent for service of Sarbanes-Oxley 106 requests, pursuant to Sarbanes-Oxley 106(d). Div. Ex. 165A at 11-12. It performed audit work for Client B. Tr. 496, 1547. It completed an audit of Client C. Tr. 270, 1743. It received a Sarbanes-Oxley 106 request pertaining to Client B via its U.S. agent on or about April 26, 2012. Tr. 1521; Div. Ex. 46. It received a Sarbanes-Oxley 106 request pertaining to Client C via its U.S. agent on or about February 2, 2012. Tr. 1454-57; Div. Ex. 55. E&Y chose not to produce its Client B or Client C audit work papers pursuant to the Sarbanes-Oxley 106 requests. Tr. 1523.

3. KPMG

KPMG is a foreign public accounting firm within the meaning of Sarbanes-Oxley 106(g). Tr. 2247. It designated KPMG LLP as its U.S. agent for service of Sarbanes-Oxley 106 requests, pursuant to Sarbanes-Oxley 106(d). Tr. 2250; Div. Ex. 165-A at 16. It performed audit work for Client D and generated audit work papers. Tr. 2145-46. It performed audit work for Client E

and generated audit work papers. Tr. 2148. It performed audit work for Client F and generated audit work papers. Tr. 2150, 2283. It received a Sarbanes-Oxley 106 request pertaining to Client D via its U.S. agent on or about February 6, 2012. Div. Ex. 66. It received a Sarbanes-Oxley 106 request pertaining to Client E via its U.S. agent on or about February 9, 2012. Div. Ex. 73. It received a Sarbanes-Oxley 106 request pertaining to Client F via its U.S. agent on or about February 3, 2012. Div. Ex. 84. KPMG chose not to produce its Client D, E, or F audit work papers pursuant to the Sarbanes-Oxley 106 requests. Tr. 2004-05, 2269.

4. DTTC

DTTC is a foreign public accounting firm within the meaning of Sarbanes-Oxley 106(g). Tr. 1677. It designated Deloitte & Touche LLP as its U.S. agent for service of Sarbanes-Oxley 106 requests, pursuant to Sarbanes-Oxley 106(d). Div. Ex. 165-A at 5-6. It completed multiple audits of DTTC Client A, and DTTC Client A remained its client as of April 2013. Tr. 1645. It performed audit work for Client G and generated audit work papers. Tr. 1637, 1652. It received a Sarbanes-Oxley 106 request pertaining to DTTC Client A via its U.S. agent on or about March 11, 2011. Div. Ex. 127. It received a Sarbanes-Oxley 106 request pertaining to Client G via its U.S. agent on or about February 14, 2012. Div. Ex. 93. DTTC chose not to produce its DTTC Client A or Client G audit work papers pursuant to the Sarbanes-Oxley 106 requests. Tr. 1719-23.

5. PwC

PwC is a foreign public accounting firm within the meaning of Sarbanes-Oxley 106(g). Tr. 1344. It designated PricewaterhouseCoopers LLP as its U.S. agent for service of Sarbanes-Oxley 106 requests, pursuant to Sarbanes-Oxley 106(d). Div. Ex. 165-A at 20. It performed audit work for Client H and generated audit work papers. Tr. 1833-34. It performed audit work for Client I and generated work papers. Tr. 1835, 1839. It received a Sarbanes-Oxley 106 request pertaining to Client H via its U.S. agent on or about February 8, 2012. Tr. 869-70; Div. Ex. 106. It received a Sarbanes-Oxley 106 request pertaining to Client I via its U.S. agent on or about March 22, 2012. Div. Ex. 117. PwC chose not to produce its Client H or Client I audit work papers pursuant to the Sarbanes-Oxley 106 requests. Tr. 1359, 1890-91, 1893.

Therefore, each Respondent willfully refused to comply with at least one request under Sarbanes-Oxley 106.

C. Sarbanes-Oxley 106(f)

Sarbanes-Oxley 106(f) provides that “the staff of the Commission or the Board may allow a foreign public accounting firm that is subject to this section to meet production obligations under this section through alternate means, such as through foreign counterparts of the Commission or the Board.”⁵¹ 15 U.S.C. § 7216(f). By virtue of the filing of the DTTC OIP

⁵¹ Certain aspects of Sarbanes-Oxley 106(f) are problematic. First, it is unclear whether it constitutes an affirmative defense, or an element of the alleged violation, or something else. The parties have not briefed this issue, but even assuming that the Division has the burden of proving

and Omnibus OIP, the staff of the Commission, in this case, the Division, has not allowed Respondents to so produce their audit work papers.

I conclude that this disallowance was correct, for two reasons. 



that alternate production means are inappropriate, the Division has carried it, as explained *infra*. Second, Sarbanes-Oxley 106(f) sets forth no standard by which to judge the appropriateness of a disallowance, nor do there appear to be any rules or regulations establishing such a standard. I have therefore applied the general administrative law standard applicable to judicial review of agency actions. *See* 5 U.S.C. § 706. In particular, I have considered whether the disallowance was arbitrary, capricious, an abuse of discretion, otherwise not in accordance with law, or unsupported by substantial evidence, and I conclude that it was not. 5 U.S.C. § 706(2)(A), (E). Lastly, the statutory delegation of authority to the “staff of the Commission” is unusual, and not explicitly subject to administrative review, and it is therefore of questionable validity. *See* 17 C.F.R. §§ 200.30-1 through 200.30-18 (listing officials with delegated authority); 17 C.F.R. § 201.430 (authorizing review of decisions made pursuant to delegated authority). In this case, however, the matter has been presented for administrative review, namely, through the present proceeding. Also, inasmuch as the Commission’s issuance of the OIPs constitutes a ratification of the Division’s disallowance of alternate production means, the disallowance has, in effect, been decided by the Commission rather than by its staff. Also, as to Client D and DTTC Client A, the Commission in effect decided the disallowance itself by virtue of authorizing those Clients’ respective Sarbanes-Oxley 106 requests.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

There exist multiple possible avenues for obtaining documents, some of which may be more effective than others. Nothing compels the Commission to use one avenue rather than another, and it should have discretion to seek documents in whatever fashion the law permits.

[REDACTED]

D. Affirmative Defenses

Most issues Respondents raise as affirmative defenses are not true affirmative defenses, and instead are legal and factual arguments. To the extent such arguments are not addressed in Respondents' post-hearing briefs, they are rejected because they have not been properly

⁵² Nor is it arbitrary for the Commission to pursue the present proceeding while permitting registration of securities by China-based U.S. issuers, for the reasons I explained during the hearing and the Division explained in its post-hearing brief. Tr. 44-45; Div. Br. at 110-12; Resp. Br. at 113 n.91.

presented. To the extent such arguments are addressed in Respondents' post-hearing briefs, they are generally discussed elsewhere in this Initial Decision. However, some arguments, such as the propriety of service of the OIP, have already been resolved, particularly by my Order on Motions for Summary Disposition as to Certain Threshold Issues. BDO China Dahua CPA Co., Ltd., Admin. Proc. Rulings Release No. 763 (Apr. 30, 2013), 106 SEC Docket 67617. Two arguments, however, have not been addressed elsewhere. First, Respondents argue that international comity, as opposed to prescriptive comity, bars enforcement of the Sarbanes-Oxley 106 requests. Resp. Br. at 63-76. This argument misses the point. I ruled on summary disposition that the Division did not have to pursue enforcement of the Sarbanes-Oxley 106 requests under Sarbanes-Oxley 106(b)(1)(B) in order to bring the present proceeding. BDO China, 106 SEC Docket at 67623; see Resp. Br. at 76 n.63. Because judicial enforcement of the Sarbanes-Oxley 106 requests is not a prerequisite to this proceeding, it is irrelevant whether the Sarbanes-Oxley 106 requests are enforceable.

Second, Respondents argue that they did not act willfully because their legal obligations under Sarbanes-Oxley 106 were "objectively unclear." Resp. Br. at 76-79. This argument is based principally on Safeco, which is inapposite because it pertains to the use of "willfully" in a different context. Safeco, 551 U.S. at 56-58. As discussed supra, the term "willfully" in Sarbanes-Oxley 106(e) means, simply, "choosing to act or not to act after receiving notice that action was requested." Moreover, there is nothing objectively unclear about Sarbanes-Oxley 106 or the Sarbanes-Oxley 106 requests. Respondents knew exactly what was expected of them, as demonstrated by, for example, their written responses to the Sarbanes-Oxley 106 requests.

There are only two issues that might colorably be considered true affirmative defenses, both of which are asserted by all five Respondents: the Commission lacks the authority to require production of documents prior to the enactment of Dodd-Frank, and the present proceeding violates due process and equal protection and constitutes selective prosecution. Dahua Omnibus OIP Answer at 10-11; E&Y Omnibus OIP Answer at 12; KPMG Omnibus OIP Answer at 11-12; DTTC Omnibus OIP Answer at 18; DTTC OIP Answer at 9-10; PwC Omnibus OIP Answer at 16-17. Respondents do not explicitly address these defenses in their post-hearing filings, and they are meritless in any event. I am aware of no authority barring the use of a Sarbanes-Oxley 106 request to obtain documents created prior to Dodd-Frank's effective date. To the contrary, even the pre-Dodd-Frank version of Sarbanes-Oxley 106 required Respondents to produce audit work papers to the Commission. 15 U.S.C. § 7216(b)(1)(A) (2002). Although I doubt I have the authority to consider due process and equal protection claims, there is no evidence of such violations here. Jonathan Feins, 54 S.E.C. 366, 378 (1999) ("Administrative due process is satisfied where the party against whom the proceeding is brought understands the issues and is afforded a full opportunity to meet the charges during the course of the proceeding."); see also William C. Piontek, 57 S.E.C. 79, 90 (2003); see Robert Radano, Advisers Act Release No. 2750 (June 30, 2008), 93 SEC Docket 7495, 7509-10 n.74 (decision to initiate administrative proceedings, or not, is "committed to agency discretion"). Indeed, Respondents received at least one significant procedural advantage in this case compared to what they would have received in district court: they were allowed to present hearsay regarding the oral directives of Chinese regulators, and thus did not have to call any such regulators as witnesses.

IV. CONCLUSIONS OF LAW

Each Respondent willfully refused to comply with at least one Sarbanes-Oxley 106 request, the disallowance of the production of audit work papers by alternate means was appropriate, and no affirmative defense has been established. Accordingly, Respondents willfully violated Sarbanes-Oxley 106. Sarbanes-Oxley 106 is a federal securities law within the meaning of Rule 102(e)(1)(iii). 15 U.S.C. § 7202(b)(1). Thus, because Respondents willfully violated a provision of the federal securities laws, they may be censured or denied the privilege of appearing or practicing before the Commission, if it is in the public interest to do so. Altman v. SEC, 666 F.3d 1322, 1329 (D.C. Cir. 2011); Robert W. Armstrong, 58 S.E.C. 542, 584 (June 24, 2005); Russell Ponce, 54 S.E.C. 804, 820 (2000).

V. SANCTIONS

The Division requests that Respondents be censured, permanently barred from issuing audit reports filed with the Commission, and permanently barred from playing a fifty percent or greater role in the preparation or furnishing of an audit report filed with the Commission. Div. Br. at 114.

A. The Public Interest

When considering whether an administrative sanction serves the public interest, the Commission considers the factors identified in Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981): the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations (Steadman factors). Altman, 666 F.3d at 1329; Gary M. Kornman, Advisers Act Release No. 2840 (Feb. 13, 2009), 95 SEC Docket 14246, 14255, pet. denied, 592 F.3d 173 (D.C. Cir. 2010). Other factors the Commission has considered include the age of the violation (Marshall E. Melton, 56 S.E.C. 695, 698 (2003)), the degree of harm to investors and the marketplace resulting from the violation (id.), the extent to which the sanction will have a deterrent effect (see Schield Mgmt. Co., Exchange Act Release No. 53201 (Jan. 31, 2006), 87 SEC Docket 848, 862 & n.46), whether there is a reasonable likelihood of violations in the future (KPMG Peat Marwick LLP, 54 S.E.C. 1135, 1185 (2001), recon. denied, 55 S.E.C. 1, pet. denied, 289 F.3d 109 (D.C. Cir. 2002)), and the combination of sanctions against the respondent (id. at 1192). See also WHX Corp. v. SEC, 362 F.3d 854, 859-61 (D.C. Cir. 2004). The Commission weighs these factors in light of the entire record, and no one factor is dispositive. KPMG, 54 S.E.C. at 1192; see Gary M. Kornman, 95 SEC Docket at 14255.

Respondents' actions involved the flouting of the Commission's regulatory authority, which may not be as egregious as, say, accounting fraud, but is still egregious enough that it weighs against leniency. Dahua's infraction was isolated, because it involved only one violation; KPMG's infractions were recurrent, because they involved three violations; and the other Respondents' infractions were recurrent, although only barely so. I place only a little weight on this factor, because whether the infractions were isolated or recurrent depended largely on the Division's conduct rather than Respondents'. It was apparently just happenstance that the

Division investigated only one Dahua client but three KPMG clients, and there is no evidence that Respondents would have reacted differently if additional Sarbanes-Oxley 106 requests had been served on them. Respondents have failed to recognize the wrongful nature of their conduct, and because they are all registered with the Board as public accounting firms, their occupation obviously presents opportunities for future violations. I place considerable weight on these two factors, because Respondents are so oblivious to them that they actually argue that recognition of the wrongfulness of their conduct is an inapplicable factor, and that their occupation presents no opportunities for future violations. Resp. Br. at 88-89.

As for the non-Steadman public interest factors, the violations are relatively recent, the degree of harm to investors and the marketplace varied but was clearly present in at least some instances, any sanction will presumably have a strong general deterrent effect on other Chinese-based accounting firms, future violations are virtually certain because Respondents consider themselves unable to produce audit work papers directly to the Commission even under any future Sarbanes-Oxley 106 request, and the combination of a practice bar and a censure is only slightly more burdensome than a practice bar alone.

B. Good Faith and Chinese Law

Although Respondents' good faith or lack thereof is irrelevant to evaluating liability, it is relevant to evaluating the appropriate sanction, especially scienter and the sincerity of Respondents' assurances against future violations. Good faith in this context means that Respondents had "attempted all which a reasonable man would have undertaken in the circumstances to comply with" the Sarbanes-Oxley 106 requests. Rogers, 357 U.S. at 201. Respondents urge a finding of good faith in connection with numerous specific issues in this case, and present their argument in various ways, but it can be summarized simply: Respondents were ready, willing, and able to produce documents, but were unable to do so because Chinese law prevented it.

Although all parties have urged me to interpret Chinese law in their favor, and have presented expert testimony to that end, I may not have the authority to do so. See Richmark Corp. v. Timber Falling Consultants, 959 F.2d 1468, 1474 n.7 (9th Cir. 1992) ("We have neither the power nor the expertise to determine for ourselves what PRC law is."). For purposes of this Initial Decision, I assume that I have such authority.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

⁵³ The Division contends that testimony regarding the Chinese regulators' oral directives is inadmissible as hearsay. Div. Br. at 91. Respondents contend that such testimony is not hearsay at all. Resp. Br. at 31-32. Such testimony has been offered, in part, to prove that potential substitute auditing firms "would, like Respondents, be unable to produce requested workpapers directly to the SEC." Resp. Br. at 93. For that purpose, such testimony is plainly hearsay because it has been offered to prove that other Chinese auditing firms would be barred from direct production of audit work papers. However, it meets the standard set forth in, among other cases, Joseph Abbondante, 58 S.E.C. 1082, 1101 & n.50 (2006). Specifically: it is highly probative; it is corroborated by multiple witnesses who all testified generally consistently about it; it is generally consistent with the documentary evidence, particularly Reg 29; the declarants were, practically speaking, unavailable to testify because they are Chinese government officials; and there is no reason to believe that such officials would be biased. See id. Although other Abbondante factors weigh against admissibility, overall I find this hearsay probative and reliable, and I see no undue unfairness in relying on it.

This fact does not weigh entirely in Respondents' favor, however, because I agree with the Division that, to the extent Respondents found themselves between a rock and a hard place, it is because they wanted to be there. A good faith effort to obey the law means a good faith effort to obey all law, not just the law that one wishes to follow. See Richmark, 959 F.2d at 1479 ("when [Appellant] availed itself of business opportunities in this country, it undertook an obligation to comply with the lawful orders of United States courts"). Each Respondent registered with the Board knowing that it might be required to provide audit work papers to the Board. Each Respondent was thereafter notified by the Board that it was subject to all applicable U.S. laws. And yet each Respondent thereafter performed audit work for U.S. issuers, hopeful, but not certain, that the regulators would iron out any potential problems. Each Respondent knew that Dodd-Frank imposed additional requirements on it pertaining to Sarbanes-Oxley 106. Each Respondent designated a U.S. agent for service of Sarbanes-Oxley 106 requests. And yet each Respondent continued thereafter to perform audit work for U.S. issuers, knowing that a failure to directly produce documents pursuant to Sarbanes-Oxley 106 might be a violation of Sarbanes-Oxley.

I am unpersuaded by Respondents' contention that it would have been irrational for them to invest in their U.S. issuer practices if they had known they would "face a bar such as that proposed here." Resp. Br. at 109 n.90. The evidence demonstrates unequivocally that Respondents did know that they might face a bar, first when they registered with the Board, which has the authority to revoke their registrations, and second when they filed their Sarbanes-Oxley 106 agent designations with the Commission, which has the authority to impose a practice bar. Given the rarity of Rule 102(e) proceedings for, in essence, failure to cooperate, it would not have been irrational for Respondents to take a calculated risk, as they did here. Also, I have not found a lack of good faith merely from the fact that Respondents registered with the Board while knowing of legal impediments to full compliance with Sarbanes-Oxley 106. Resp. Br. at 7 n.6. Respondents could have stopped auditing U.S. issuers after Dodd-Frank was enacted, but they did not.

I have little sympathy for Respondents on this issue. Respondents operated large accounting businesses for years, knowing that if called upon to cooperate in a Commission investigation into their business, they must necessarily fail to fully cooperate and might thereby violate the law. Then, when actually called upon to fully cooperate, Respondents complained that they should be relieved from that duty because, among other things, they invested money and effort in building up their accounting businesses. Such behavior does not demonstrate good faith, indeed, quite the opposite – it demonstrates gall. Each Respondent made the affirmative decision, no later than the time it filed its Sarbanes-Oxley 106 designation of agent, to conduct its auditing business "at risk." That alternate production means under Sarbanes-Oxley 106(f) might be available changes nothing, because Respondents had no control over the applicability of Sarbanes-Oxley 106(f). Even Dahua, the Respondent which came closest to acting in good faith, failed to do so because it did not withdraw from the U.S. issuer market until after the OIP issued. I find that Respondents did not act in good faith, that Dahua's assurances against future violations are generally but not entirely sincere (because they continue to maintain registration with the Board), and that the other Respondents' assurances are not sincere at all.

By contrast, although Respondents may have acted willfully and with a lack of good faith, they did not act with scienter. They obviously had no intent to defraud, nor were they reckless, in the sense that their conduct was an “extreme departure” from the standards of care. Wendy McNeeley, CPA, Exchange Act Release No. 68431 (Dec. 13, 2012), 105 SEC Docket 61684, 61706; Gately, 99 SEC Docket at 31037-38 & n.32. The Division’s perfunctory argument that willfulness amounts to scienter is meritless. Div. Br. at 119; Div. Reply at 51. Granted, scienter is not limited to an intent to defraud (including recklessness), and, particularly in Rule 102(e) cases, must be viewed through a “wider lens.” Michael C. Pattison, CPA, Exchange Act Release No. 67900 (Sept. 20, 2012), 104 SEC Docket 58890, 58906-07 & n.58. Respondents clearly knew what they were doing, and knew that their choice to not comply with the Sarbanes-Oxley 106 requests would likely violate U.S. law. See id. at 58906 (suggesting that knowing or intentional misconduct in general qualifies as scienter). But even given their knowledge, and their decision to operate “at risk,” their state of mind at the time of their respective violations was driven by their concerns over potentially draconian Chinese law. Under the circumstances, it would be unfair to characterize their state of mind as equivalent to that of, say, a swindler, or even of an accountant whose unreasonable conduct caused his client’s reporting violations. E.g., Gregory M. Dearlove, CPA, Exchange Act Release No. 57244 (Jan. 31, 2008), 92 SEC Docket 1867, 1913, 1917-18 (accountant barred under Rule 102(e)(1)(iv) for repeated instances of unreasonable conduct), pet. denied, 573 F.3d 801 (D.C. Cir. 2009). I place great weight on this factor, because by analogy to associational bars, the presence of scienter can be the decisive factor in imposing a bar. E.g., Melton, 56 S.E.C. at 713.

C. Effect of a Practice Bar

Respondents argue at length that a practice bar would have “substantial negative collateral consequences.” Resp. Br. at 90-109. In sum, they argue that if barred, no other auditing firms could adequately replace them (and even if they could be replaced, issuers would incur costs doing so), China-based U.S. issuers would no longer be able to trade on U.S. exchanges, the market capitalization of such issuers would plummet, and investors would be harmed. Id. This argument is unpersuasive on both legal and factual grounds.

Legally, Steadman focuses on the nature of Respondents’ conduct (i.e., egregiousness, recurrence, and scienter) and contrition and the likelihood of future violations (i.e., assurances against future violations, recognition of wrongful conduct, and a respondent’s occupation), and the non-Steadman factors focus on related issues: recency, harm caused to victims, deterrence, and the combination of sanctions. Collateral consequences to existing investors are not the determining factor in evaluating sanctions in the public interest. Nature’s Sunshine Prods., Inc., Exchange Act Release No. 59268 (Jan. 21, 2009); 95 SEC Docket 13488, 13500-01; Gateway Int’l Holdings, Inc., Exchange Act Release No. 53907 (May 31, 2006), 88 SEC Docket 430, 438-39, 441; Outsource Int’l, Inc., 55 S.E.C. 382, 393 (2001); Verdi Dev. Co., 38 S.E.C. 553, 557-58 (1958); Great Sweet Grass Oils Ltd., 37 S.E.C. 683, 698 (1957). In this case the need to protect future investors outweighs the need to protect current investors, because of “the risks associated with public audits conducted without the benefit of Board [or Commission] oversight.” Gately, 99 SEC Docket at 31042. I have also considered the potential indirect harm to Respondents, such as loss of business, reputational damage, and investment losses, but the overriding concern in Rule 102(e) cases is protection of “the integrity of the Commission’s processes.” McNeeley,

105 SEC Docket at 61708; Steven Altman, Esq., Exchange Act Release No. 63306 (Nov. 10, 2010), 99 SEC Docket 34405, 34437, pet. denied, 666 F.3d 1322 (D.C. Cir. 2011). That some Respondents will suffer more than others from the same sanction is completely irrelevant. Resp. Br. at 106-11. In sum, although I have considered the collateral consequences Respondents predict, they are entitled to little weight and I do not consider collateral consequences to be a barrier to imposition of a practice bar.

Factually, Respondents' predicted consequences are not credible. Respondents contend that the Division "has failed to provide a single concrete example of an accounting firm qualified, ready, and willing to take on Respondents' clients." Resp. Br. at 91. This contention is false. The Division persuasively demonstrates that China-based U.S. issuers may engage adequate substitutes for Respondents. Div. Reply at 55-59. It is uncontroverted that Crowe Horwath (with a Hong Kong affiliate as component auditor), GHP Horwath, Patrizio & Zhao, Frazer Frost, and PKF (collectively, the "five firms") all conducted audit work, including audit reports, and produced audit work papers without raising any issues regarding state secrets or archival material and without even the need for a Sarbanes-Oxley 106 request. Tr. 191-92, 206, 374-75, 479-80, 699-700. All are located in the U.S. except PKF, which is located in Hong Kong. Tr. 375. Additionally, although there is no evidence that Marcum, another U.S. firm, produced audit work papers, Marcum was able to adequately audit Client H, as evidenced by its qualified audit opinion. Resp. Ex. 380 at 103, F-2.

Becker agreed that larger auditing firms (such as Respondents) have reputations for performing higher quality audits than smaller auditing firms. Tr. 2625-27. However, it does not follow that smaller firms would not be "adequate" as auditors.⁵⁴ Resp. Br. at 91-92. [REDACTED]

Such a practice is expressly anticipated by Sarbanes-Oxley 106(b), which permits registered public accounting firms in the U.S. (or anywhere else) to rely on foreign public accounting firms in China (i.e., firms not necessarily registered with the Board) for performing "material services." 15 U.S.C. § 7216(b). [REDACTED]

Id. In short, one of Simmons' basic assumptions, that only PCAOB-registered firms can do any of the auditing work, is flatly wrong, and I find her expert testimony on this point to be unpersuasive. Simmons Rep., App. C. Atkins' opinion, which involved a similar assumption, is similarly unpersuasive. Atkins Rep. at 18-20.⁵⁵

⁵⁴ Admittedly, Patrizio & Zhao would no longer be considered an adequate substitute for Respondents, but it did produce audit work papers without complaint.

⁵⁵ Other than his opinion regarding the effect of sanctions, Atkins' report and testimony were entirely irrelevant.

Moreover, even assuming that switching to smaller and less experienced auditors would impose costs on China-based U.S. issuers, as Simmons opined, the magnitude of those costs is unclear because Simmons did not quantify them. Simmons Rep. at 15-18. Becker opined (without persuasive rebuttal from Simmons) that the effect on stock price of delisting depends on the reason for the delisting, and I see no reason not to apply the same principle to changing auditors. Becker Rep. at 14-17. That is, an issuer's stock price after changing auditors seems more likely to remain stable if the reason for changing auditors is disciplinary action against the auditor, rather than an underlying problem with the issuer.

[REDACTED]

[REDACTED]

[REDACTED]

Accordingly, Respondents' dire predictions of investor losses, delisting, and loss of market capitalization, which are generally predicated on a lack of

adequate substitute auditors, are unrealistic and unpersuasive, and the expert evidence on the subject is generally irrelevant. Div. Reply at 53-62; Resp. Br. at 90-109.

D. Censure and a Complete, Temporary Bar are Warranted Except as to Dahua

The Steadman factors are mixed. On the one hand, Respondents (except Dahua) have failed to recognize the wrongful nature of their conduct, their occupation presents opportunities for future violations, and their assurances against future violations are insincere. On the other hand, their violations were not particularly egregious, the recurrent nature of their violations carries little weight, and they did not act with scienter, a fact to which I assign great weight. As for the non-Steadman public interest factors, all weigh in favor of a heavy sanction, except that the degree of harm to investors and the marketplace is somewhat uncertain. Overall, a permanent practice bar is not warranted, but censure by itself will be ineffective as a remedy, and in particular will have little deterrent effect. As the Commission has noted in the context of associational bars, a practice bar “serves a remedial purpose of protecting investors from persons who have refused to cooperate with investigations of possible securities law violations, and deters other securities participants . . . from engaging in similar conduct.” vFinance Invs., Inc., Exchange Act Release No. 62448 (July 2, 2010), 98 SEC Docket 29918, 29940. In my estimation, the public interest factors weigh in favor of a total six-month practice bar.

The Division’s requested “role” bar is rejected, for two reasons. First, it is not clear that I have authority to impose such a bar. Unlike the Exchange Act, which explicitly permits the placement of “limitations” on the activities of a registrant or associated person, Rule 102(e) explicitly permits only a censure and a practice bar. 17 C.F.R. § 201.102(e); 15 U.S.C. § 78o(b)(4), (6)(A). The Division has not pointed to any precedent authorizing a role bar under Rule 102(e), nor am I aware of any such authority. Second, if Respondents only take on, say, a forty percent role, the Division will still be unable to obtain direct production of about forty percent of audit work papers in any future investigation. The proposed role bar would therefore be insufficient to remedy the potential harm caused by any future violation.

As for Dahua, I see no point to barring it from a segment of the industry that it has already withdrawn from. However, some sanction is necessary for deterrence purposes, because Dahua and other Chinese-based firms need to understand that entry or reentry into the U.S. issuer market will place them in the same “at risk” condition Dahua was in until several months ago. Accordingly, a censure alone is appropriate to remedy Dahua’s violation.

Under the Exchange Act, a censure and an associational bar may be imposed for the same violative conduct. See vFinance, 98 SEC Docket at 29941; Clarence Z. Wurts, 54 S.E.C. 1121, 1134 (2001). Although I am unaware of any authority under Rule 102(e) addressing the appropriateness of such a tandem sanction, the language of Rule 102(e), which speaks of censuring “or” denying the privilege of appearing before the Commission, is similar to the language of Exchange Act Section 15(b)(6)(A), which speaks of censuring “or” barring a registrant from association, among other sanctions. 17 C.F.R. § 201.102(e); 15 U.S.C. § 78o(b)(6)(A). Accordingly, because it is justified in light of the public interest factors and, practically speaking, adds no more burden to Respondents than what is already imposed by the practice bar, I find that censure is appropriate as to all Respondents.

RESPONDENTS' MOTION TO SUPPLEMENT THE RECORD

As noted, Respondents filed their Supp. Motion on November 20, 2013, seeking to add evidence pertaining to events occurring after I closed the record on September 18, 2013. Supp. Motion at 2. I agree with Respondents that the evidence they seek to add is potentially exculpatory, but the probative value of this new evidence is at least as unclear as the probative value of the post-hearing evidence admitted in September 2013. I simply cannot evaluate the relevance and weight of such evidence without hearing from live witnesses, and I see no good cause to reopen the record. I therefore deny the Supp. Motion. I note again that the better approach in this situation is for the parties to petition the Commission to adduce additional evidence if the matter is appealed. See 17 C.F.R. § 201.452; e-Smart Tech., Inc., 57 S.E.C. 964 (2004).

RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), I certify that the record includes the items set forth in the revised Record Index issued by the Secretary of the Commission on January 22, 2014.

The Office of the Secretary issued a Record Index on January 6, 2014. This Office received the Division's Proposed Corrections to the Office of the Secretary's Record Indices (Division's Proposed Corrections) on January 16, 2014, and received the Division's Additional Proposed Corrections to the Office of the Secretary's Record Indices (Division's Additional Proposed Corrections) on January 22, 2014. The Division's Proposed Corrections and Additional Proposed Corrections pertain entirely to filings maintained by the Office of the Secretary and are therefore not directed to me. This Office received Respondents' Proposed Corrections to the Record Index (Respondents' Proposed Corrections) on January 17, 2014. The Respondents' Proposed Corrections largely pertain to filings maintained by the Office of the Secretary, however, the first two proposed corrections pertain to the Exhibit List prepared by this Office and attached to the Record Index.

Respondents' Proposed Corrections are rejected. The first proposed correction pertains to Div. Exs. 359-61, which I admitted by Order on September 18, 2013, and which therefore need not be listed on the Exhibit List. BDO China, 2013 SEC Lexis 2769. The second proposed correction pertains to various declarations and their attached exhibits filed in support of the Supp. Motion, which are necessarily part of the administrative record and normally would not be on an Exhibit List.

ORDER

IT IS ORDERED that, pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, BDO China Dahua CPA Co., Ltd., is CENSURED.

IT IS FURTHER ORDERED that, pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, ERNST & YOUNG HUA MING LLP is CENSURED and is DENIED the privilege of appearing or practicing before the Commission for six months.

IT IS FURTHER ORDERED that, pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, KPMG HUAZHEN (SPECIAL GENERAL PARTNERSHIP) is CENSURED and is DENIED the privilege of appearing or practicing before the Commission for six months.

IT IS FURTHER ORDERED that, pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, DELOITTE TOUCHE TOHMATSU CERTIFIED PUBLIC ACCOUNTANTS LTD. is CENSURED and is DENIED the privilege of appearing or practicing before the Commission for six months.

IT IS FURTHER ORDERED that, pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice, PRICEWATERHOUSECOOPERS ZHONG TIAN CPAs LIMITED is CENSURED and is DENIED the privilege of appearing or practicing before the Commission for six months.

IT IS FURTHER ORDERED that Respondents' Motion to Supplement the Record is DENIED.

IT IS FURTHER ORDERED that Respondents' Proposed Corrections to the Record Index, to the extent they are directed to me, are REJECTED.

IT IS FURTHER ORDERED that the Initial Decision (Public) is publicly available, and that the Initial Decision (Sealed) may only be reviewed by the following persons:

- a. The Commission and its personnel, including contractors;
- b. Outside consultants, investigators, and/or experts retained by the parties in connection with these proceedings, including any appeals from such proceedings;
- c. Any Division witness in these proceedings;
- d. Respondents' Counsel of Record in these proceedings and their partners, employees, and/or agents assisting such counsel in connection with these proceedings, including any appeals from such proceedings; and
- e. Other persons upon order of the hearing officer or a court, and on such conditions as may be agreed or ordered.

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will

enter an order of finality unless a party files a petition for review or motion to correct manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

A handwritten signature in cursive script, appearing to read "Cameron Elliot", written over a horizontal line.

Cameron Elliot
Administrative Law Judge