UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File Nos. 3-14872, 3-15116

In the Matter of	
BDO CHINA DAHUA CPA CO., LTD., ERNST & YOUNG HUA MING LLP, KPMG HUAZHEN (SPECIAL GENERAL PARTNERSHIP), DELOITTE TOUCHE TOHMATSU CERTIFIED PUBLIC ACOUNTANTS LTD., and PRICWATERHOUSECOOPERS ZHONG TIAN CPAs LIMITED	

DIVISION OF ENFORCEMENT'S PETITION FOR REVIEW OF THE INITIAL DECISION

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The Division of Enforcement ("Division") of the U.S. Securities and Exchange Commission ("SEC" or "Commission"), pursuant to the Commission's Rule of Practice 410(a), hereby petitions the Commission for review of the Initial Decision rendered by Administrative Law Judge Cameron Elliot on January 22, 2014. The Initial Decision concluded that all of the Respondents, foreign public accounting firms located in the People's Republic of China ("China"), had willfully violated the securities laws by failing to produce audit workpapers and related documents to the SEC upon request, and should be subject to remedies under Commission Rule of Practice 102(e). The Division now seeks review under Rule of Practice 411(b)(2)(ii) of the scope of the remedies imposed by the Initial Decision. Specifically, the Division seeks review of the Initial Decision's conclusions and findings that (1) Respondent BDO China Dahua CPA Co., Ltd. ("Dahua") should not be denied the privilege of practicing or appearing before the Commission; and (2) that Respondents Deloitte Touche Tohmatsu Certified Public Accountants Ltd. ("DTTC"), Ernst & Young Hua Ming LLP ("EYHM"), KPMG Huazhen (Special General Partnership) ("KPMG"), and PricewaterhouseCoopers Zhong Tian CPAs Limited ("PwC") should not be denied for a period longer than six months the privilege of practicing or appearing before the Commission, and that the Commission may not have authority to impose only a partial practice bar (of any duration) on Respondents.

A. Background

Respondents have been registered with the Public Company Accounting Oversight Board ("PCAOB" or "Board") since between 2004 and 2006. As relevant to this proceeding, Respondents performed audit work for ten U.S. issuers whose securities were registered with the Commission and whose operations are principally based in China. *See* Initial Decision at 3. The issuers, known in these proceedings as Clients A through I and DTTC Client A, were or are the

focus of fraud investigations by the Division. *See id.* Pursuant to Section 106 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), 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 ("Sarbanes-Oxley 106"), the Division served requests for audit workpapers 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. *See id.* None of the Respondents produced any of the requested workpapers to the SEC in response to the Sarbanes-Oxley 106 requests.

B. The Initial Decision

The Initial Decision properly found that all Respondents should be sanctioned pursuant to Commission Rule of Practice 102(e)(1)(iii) for willfully violating Section 106 of Sarbanes-Oxley and the Securities Exchange Act of 1934 ("Exchange Act"). *See* Initial Decision at 2. Sarbanes-Oxley 106 provides, in relevant part, 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). As the Initial Decision correctly found, each Respondent "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." Initial Decision at 97. The Initial Decision properly concluded that, at a minimum, a censure is warranted as to all Respondents. *See* Initial Decision at 2.

Respondents contend that they were prohibited under Chinese law from producing documents directly to the SEC in response to the Sarbanes-Oxley 106 requests that they

received. But, as the Initial Decision found, this alleged conflict of law did not excuse their failure to produce documents. All of the Respondents knew about the potential conflict when they registered with the Board almost a decade ago. *See* Initial Decision at 5 (Dahua), 10 (EYHM), 21 (KPMG), 31 (DTTC), and 40 (PwC). All Respondents understood then – long before they performed the audit work that gave rise to the requests at issue in this proceeding – that they could be required to produce documents to U.S. regulators regardless of Chinese law. *See id.* at 105. Furthermore, when Congress amended Section 106 in 2010, "[e]ach Respondent knew that Dodd-Frank imposed additional requirements on it pertaining to Sarbanes-Oxley 106," *id.*, including that it must designate a U.S. agent for receipt of service of document requests. Thus, "[e]ach 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.'" *Id.* Respondents did not act in good faith in subsequently deciding not to produce documents in response to the requests. *See id.*

The Initial Decision rejected Respondents' contentions that they should not be subject to a practice bar because of alleged "'substantial negative collateral consequences.'" *Id.* at 106 (quoting Respondents' Post-Hearing Brief). Respondents argued "[i]n sum . . .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.* But as the Initial Decision correctly concluded, "[c]ollateral consequences to existing investors are not the determining factor in evaluating sanctions in the public interest. . . . 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." *Id.* (internal citations and quotations omitted). Furthermore, "potential indirect harm to Respondents such as loss of business, reputational damage, and investment losses" did not weigh strongly against a practice bar, because "the overriding concern in Rule 102(e) cases is protection of the integrity of the Commission's processes." *Id* (internal citations and quotations omitted).[1]

As to Respondents DTTC, EYHM, KPMG, and PwC ("the Big Four"), the Initial Decision found, analyzing the factors identified in *Steadman v. SEC*, 603 F.2d 1126 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981), that (1) these Respondents "have failed to recognize the wrongful nature of their conduct;" (2) "their occupation presents opportunities for future violations;" and (3) "their assurances against future violations are insincere." Initial Decision at 109. In light of these and other conclusions and findings (including the ones discussed above),[2] the Initial Decision imposed a "total six-month practice bar" on the Big Four. *Id.*

The Initial Decision, however, did not impose a similar practice bar on Respondent Dahua. As to this fifth Respondent, the Initial Decision found that the firm "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." *Id.* at 5 (emphasis added); *see also id.* at 9 ("Dahua has stopped taking on any new China-based U.S. issuers as clients and terminated its existing contracts with such clients."). Based on these

[1] The Initial Decision also found that, "[f]actually, Respondents' predicted consequences are not credible." Initial Decision at 107.

[2] The Initial Decision also concluded that the following "non-*Steadman* public interest factors [drawn from Commission precedents] . . . weigh in favor of a heavy sanction:" the age of the violation, the extent to which the sanction will have a deterrent effect, whether there is a reasonable likelihood of violations in the future, and the combination of sanctions against the respondent. Initial Decision at 109; *id.* at 102

findings, the Initial Decision concluded, "I see no point to barring [Dahua] from a segment of the industry that it has already withdrawn from." *Id.* at 109.

The Initial Decision also rejected the Division's proposed remedy that would have barred the Big Four and Dahua from targeted portions of their practice on a permanent basis. Specifically, the Division had sought an order denying Respondents the privilege of appearing or practicing before the Commission in the following respects:

(1) a bar against Respondents serving as principal auditors and issuing audit opinions ("Principal Auditor Bar"); and

(2) a bar against Respondents playing a 50% or greater role in the preparation or furnishing of an audit report filed with the Commission ("50% Role Bar").[3]

The Initial Decision rejected the Division's proposed remedy, among other reasons, because "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)." Initial Decision at 109. Instead, the Initial Decision barred the Big Four from performing any and all services for U.S. issuers (regardless of the percentage) for a period of six months.

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[3] *See* Initial Decision at 102. The 50% Role Bar would prohibit Respondents from performing:

(A) Audit work that a public accounting firm uses or relies on in issuing all or part of its audit report with respect to any issuer, where the engagement hours or fees for such services constitute 50% or more of the total engagement hours or fees, respectively, provided by the principal auditor in connection with the issuance of all or part of its audit report with respect to any issuer; and

(B) The majority of audit work with respect to a subsidiary or component of any issuer, the assets or revenues of which constitute 50% or more of the consolidated assets or revenues of the issuer.

See Division of Enforcement's Pre-Hearing Brief at 64-65 (filed 6/24/13); Division of Enforcement's Post-Hearing Reply Brief at 47 & n.32 (filed 9/20/13).

C. The Division Takes Exception To The Initial Decision's Determination Not To Impose Any Practice Bar on Dahua

The Division takes exception to that portion of the Initial Decision that would exclude Dahua from a practice bar imposed on the Big Four. The Commission should include Dahua in any such bar.

The Initial Decision's rationale for excluding Dahua from the practice bar was the Initial Decision's finding that Dahua "has already withdrawn from" the relevant "segment of the industry." Initial Decision at 109. This finding, in turn, was apparently based on the hearing testimony of Ji Feng ("Ji"), Dahua's executive partner in charge of quality control during the relevant time period. *See id.* at 5. But Ji's testimony does *not* make clear that Dahua is refraining – or intends to refrain – from providing services to *all* U.S. issuers. Significantly, as the Initial Decision noted, Dahua continues to maintain its registration with the PCAOB. *See id.* at 105. Furthermore, Ji's specific testimony was that "Dahua is no longer taking the responsibility of providing services to *Chinese companies* listed in the U.S. market." Transcript of 7/24/13 Hearing, at 2051 ("Tr.") (emphasis added); *see also* Tr. 2097-2098 ("Dahua has stopped to take any new clients who are *Chinese companies* listed in the U.S. market." (emphasis added)). Crucially, Ji did not clarify what he meant by "Chinese companies," nor did he rule out the possibility that Dahua would continue to perform services for other types of companies (such as multinationals) that have some operations in China. In particular, Dahua could be assisting other public accounting firms in conducting audits of companies that have operations in China but which Dahua does not consider "Chinese."

As a result, the Initial Decision possibly creates an anomaly: the Big Four would be barred from all work before the Commission for a period of six months, including not only principal auditor work for so-called Chinese companies, but also any audit work that is relied

upon by other public accounting firms in issuing audit reports for other types of U.S. issuers. Dahua, however, has expressly withdrawn only from the former type of work, and, therefore, might still consider itself available for the latter.

Notably, other parts of the record indicate this possible anomalous result. First, Respondents' expert defined "Chinese Issuers" to consist *only* of issuers with securities trading in U.S. markets that either are incorporated in China or have 100 percent of their revenues or assets in China. *See* 07/02/2013 Respondents' Disclosures of Their Expert Witnesses, Expert Report of Laura Simmons ¶¶ 27-28. To the extent Ji incorporated this definition into his own use of the term "Chinese companies," Ji implied a wide swath of U.S. issuers for which Dahua could still perform work. Specifically, Dahua could still perform work for companies incorporated outside China that have up to 99 percent of their revenues or assets in China. *See id.* ¶ 29.

Second, Ji stated in his testimony that, if Dahua were to lose its PCAOB registration as a result of sanctions imposed in these proceedings, "Dahua would lose all its business in the U.S. market" and its investment in capabilities for servicing that market. Tr. 2096-2097; *see also* Initial Decision at 9. This testimony further indicates that Dahua may still be serving U.S. issuers other than issuers that it regards as "Chinese."[4]

[4] Given this record, the Initial Decision's broad statement that Dahua "[withdrew] from the U.S. issuer market," Initial Decision at 105, may not be an entirely accurate characterization of Dahua's actions. Similarly, the statement of Dahua's outside U.S. counsel during the hearing, "they do have no current U.S. issuer clients and they are standing down," Tr. 2069, is unsubstantiated by the record. To date, Dahua's public filings with the PCAOB do not contain information about the firm's audit engagements other than its principal auditor engagements. Accordingly, those filings shed no light on the other types of engagements that Dahua historically may have had with U.S. issuers, or the identities of those issuers. Before the hearing, the Division sought issuance of a subpoena requiring Dahua to provide information about its non-principal auditor engagements, similar to information about the Big Four that the Division already had obtained from the PCAOB. *See* Initial Decision at 73; 06/07/13 Division's Request for the Issuance of Subpoenas Directed at Respondents, at 5-6 (seeking details about BDO China's substantial role and referral work), Ex. 1, Item 6 (proposed subpoena directed to BDO China). The Division's request was denied, however. *See* 06/26/2013 Order Granting In Part Subpoena Request, at 2-3 & n.2.

Because of the possibility of Dahua's ongoing role in U.S. markets, the better course is prophylactically to bar Dahua from appearing and practicing before the Commission on the same terms as the other Respondents. If the Big Four are precluded from performing audit services for any and all U.S. issuers – the result of a complete practice bar – so too should Dahua be precluded. There is no legitimate reason for distinguishing Dahua, whose conduct was substantially identical to that of the Big Four. If in fact Dahua has not withdrawn from performing audit services for all U.S. issuers, then any claim that it has "recognized the wrongful nature" of its conduct is severely undermined; its occupation would "present[] opportunities for future violations;" and its "assurances against future violations are insincere." Initial Decision at 109; *see Steadman*, 603 F.2d at 1140.

Even assuming Dahua has, in fact, withdrawn from *all* aspects of the U.S. market, the better course, the Division respectfully submits, is for any bar equally to apply to Dahua. Dahua testified only that it had given up certain U.S. work "[f]or the time being." Tr. 2051.[5] In the event the Commission determines to uphold the complete six-month practice bar, as a practical matter (in the light of this appeal and possible future appeals in the federal courts) this bar may not be implemented until after an additional, substantial period of time has passed. The bar should apply equally to Dahua to foreclose any possible opportunistic change of position by Dahua that would jeopardize Commission processes during the period of the bar.[6] And to the extent Dahua has indeed withdrawn from performing work for U.S. issuers, then imposition of

[5] The temporary nature of Dahua's withdrawal from work for U.S. issuers was further highlighted during the hearing by Dahua's counsel, who stated that it was untrue that Dahua "had basically abandoned the Chinese-based issuer market." Tr. 2068. Although Dahua was "not currently pursuing that market. They hope to. If these things resolve themselves, then I think they would come back and re-enter." *Id.*

[6] The Initial Decision correctly found that Dahua had failed to act in good faith because it had waited until after the OIP was issued before withdrawing from certain U.S. work. And because Dahua continued to maintain registration with the Board, its "assurances against future violations are . . . not entirely sincere." Initial Decision at 105.

the bar on Dahua would impose no collateral consequences beyond those already imposed by the Initial Decision.

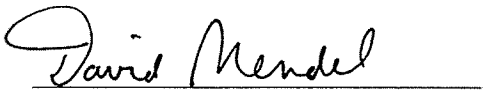
D. The Division Takes Exception To The Initial Decision's Conclusions About The Length of the Proposed Bar And The Commission's Ability to Impose A "Role" Bar

The Division takes exception to that portion of the Initial Decision that limits to only six months the practice bar that would be imposed on Respondents. The Commission should consider, based on all the facts and circumstances presented by the record before it, whether a longer bar (including a permanent bar) is appropriate. These facts and circumstances include, but are not limited to, the nature of Respondents' prior conduct, Respondents' failure to recognize their wrongful conduct, and the likelihood of future violations.

The Division also takes exception to that portion of the Initial Decision questioning the authority of the ALJ or the Commission to impose a "role" bar on Respondents under Rule 102(e). In *Ernst & Young LLP*, 82 S.E.C. Docket 2472, 2004 WL 824099, at *60 (Apr. 16, 2004) (Initial Decision), the law judge determined that the Commission should exercise its authority under Section 4C of the Exchange Act and Rule 102(e) to bar the respondent accounting firm, in light of the misconduct at issue in that case, from accepting audit engagements for new SEC registrant audit clients for a period of six months. This was effectively a "role" bar, because the respondent was allowed to continue its audit engagements for existing clients. Similarly here, the Commission may exercise its discretion to limit aspects of Respondents' practice before it. In particular, the Commission may bar engagements that require Respondents to perform a certain level of work for clients. Accordingly, the Commission has authority to bar Respondents from issuing audit reports filed with the Commission and playing a fifty percent or greater role in the preparation or furnishing of an audit report filed with the Commission.

Dated: February 12, 2014

Respectfully submitted,



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