

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72140 / May 9, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3553 / May 9, 2014

Admin. Proc. 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
ACCOUNTANTS LTD., and
PRICEWATERHOUSECOOPERS ZHONG
TIAN CPAS LIMITED

ORDER GRANTING LEAVE TO
ADDUCE ADDITIONAL
EVIDENCE AND GRANTING THE
PETITIONS FOR REVIEW

These administrative proceedings, instituted pursuant to Rule of Practice 102(e)(1)(iii), center on respondents' alleged willful refusal to provide the Commission with audit work papers in violation of their obligations under Section 106 of the Sarbanes-Oxley Act as amended by Section 929J of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).¹ Four of the five 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), have petitioned for review of the initial decision issued by the law judge on January 22, 2014.² The Division of Enforcement (Division) has filed a petition for review as to the scope of the remedies imposed by the initial decision. In addition, the same four respondents also filed a motion for leave to adduce additional evidence. The Division opposes this motion and, in the alternative, seeks leave to adduce its own additional evidence. We have determined to grant the motions to adduce additional evidence and the petitions for review.

¹ 15 U.S.C. § 7216(b)(1); 17 C.F.R. § 201.102(e)(1)(iii).

² *BDO China Dahua CPA Co.*, Initial Decision Release No. 553, 2014 WL 242879 (Jan. 22, 2014). The remaining respondent, BDO China Dahua CPA Co., Ltd., did not file a petition for review. Its counsel, DLA Piper LLP, filed a notice of withdrawal of appearance, which the Division has moved to strike. These matters will be addressed by a separate order, which is being issued concurrently with this one.

BACKGROUND

A. The orders instituting proceedings

We issued the orders instituting proceedings in May 2012 and December 2012 and consolidated them for hearing.³ The OIPs alleged that each respondent is a foreign public accounting firm located in China and, within China, supervised and regulated by, *inter alia*, the China Securities Regulatory Commission (CSRC). Respondents performed audit work for ten clients—DTTC Client A and Clients A through I—based in China. The Division had or has ongoing fraud investigations concerning those clients, each of which is a U.S. issuer whose securities were registered with the Commission.

According to the OIPs, at various times between March 2011 and April 2012, the Division served requests for audit work papers pertaining to those clients on respondents through respondents' designated U.S. agents. These requests were made pursuant to Section 106(b) of the Sarbanes-Oxley Act, which provides that a foreign accounting firm that, among other things, "issues an audit report, performs audit work, or conducts interim reviews" is required to "produce the audit work papers . . . and all other documents of the firm related to any such audit work or interim review to the Commission . . . , upon request of the Commission."⁴ The OIPs alleged that each respondent, after receiving the Commission's requests, informed the staff that it would not produce the documents on the ground that it interpreted Chinese law as preventing firms from giving audit work papers directly to U.S. regulators. As of the issuance of the OIPs, the Commission did not have possession of any of the requested work papers.

The OIPs alleged that respondents violated Section 106(e), which provides that a "willful refusal" of an accounting firm to "comply, in whole or in part, with any request by the Commission . . . shall be deemed a violation" of the Sarbanes-Oxley Act.⁵ The Division sought to impose remedies under Rule of Practice 102, which provides that the "Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found by the Commission" to have "willfully violated . . . any provision of the Federal securities laws."⁶

³ *Deloitte Touche Tohmatsu Certified Pub. Accountants Ltd.*, Exchange Act Release No. 66948, 2012 WL 1612081 (May 9, 2012); *BDO China Dahua CPA Co.*, Exchange Act Release No. 68335, 2012 WL 5994345 (Dec. 3, 2012).

⁴ 15 U.S.C. § 7216(b)(1). Unless otherwise specified, all references to statutory sections will be to the Sarbanes-Oxley Act, as amended by Section 929J of the Dodd-Frank Act.

⁵ *Id.* § 7216(e). A violation of the Sarbanes-Oxley Act is "treated for all purposes in the same manner as a violation" of the Securities Exchange Act of 1934. *Id.* § 7202(b)(1).

⁶ 17 C.F.R. § 201.102.

B. The law judge's initial decision

Before the law judge, respondents argued that they did not "willfully refuse" to comply with the Commission's requests and that they acted in good faith. They claimed that they were willing to produce the requested work papers, but that Chinese law prevented them from doing so directly. They argued that they had offered to provide the CSRC with the documents and believed that the Commission would be able to obtain them after discussions with the CSRC. After hearing testimony, the law judge issued an initial decision finding that respondents had willfully violated Section 106 and imposing remedies pursuant to Rule 102(e).

In large part, the law judge credited respondents' assertion that their refusal to produce the work papers was "driven by their concerns over potentially draconian Chinese law."⁷ But he concluded that, as a matter of law, the motive for respondents' refusal was immaterial to whether they had "willfully refused" to comply with the Commission's requests within the meaning of Section 106(e).⁸ According to the initial decision, "'willful refusal to comply' means 'choosing not to act after receiving notice that action was requested,' without regard to good faith."⁹

Next, the initial decision rejected respondents' reliance on Section 106(f), which provides that "the staff of the Commission . . . may allow a foreign public accounting firm . . . to meet production obligations . . . through alternate means, such as through foreign counterparts of the Commission."¹⁰ Respondents argued that the Commission had tried to obtain the work papers for certain clients through the CSRC, and therefore could not sanction them for refusing to directly produce the work papers. The law judge disagreed. He concluded that Section 106 authorized the Commission to pursue "multiple possible avenues for obtaining documents" and that "[n]othing compels the Commission to use one avenue rather than another."¹¹

Turning to the issue of remedies, the initial decision denied, for a period of six months, the privilege of practicing or appearing before the Commission to the four appealing respondents; it also censured respondent Dahua. The law judge determined, among other things, that remedial measures were warranted on the ground that "future violations [were] virtually certain because Respondents consider themselves unable to produce audit work papers directly to the Commission even under any future Sarbanes-Oxley 106 request."¹²

Finally, the law judge denied respondents' post-hearing motion to supplement the record with exhibits showing, in respondents' view, that the Commission can feasibly obtain work

⁷ *BDO China Dahua CPA Co.*, 2014 WL 242879, at *80.

⁸ *Id.* at *70.

⁹ *Id.* at *64.

¹⁰ 15 U.S.C. § 7216(f).

¹¹ *BDO China Dahua CPA Co.*, 2014 WL 242879, at *76.

¹² *Id.* at *78.

papers through the CSRC. According to respondents, several sets of work papers have already been turned over to the Commission and substantial progress has been made with respect to the remainder. The law judge stated that the evidence, which respondents sought to add after the close of the record, was "potentially exculpatory."¹³ But he found that there was "no good cause to reopen the record" because the "probative value" of the evidence was "unclear" and because he could not "evaluate the relevance and weight of such evidence without hearing from live witnesses."¹⁴ He believed that the "better approach" was for respondents "to petition the Commission to adduce additional evidence" when the matter was appealed.¹⁵

DISCUSSION

We have determined to grant respondents' motion for leave to adduce additional evidence, the Division's cross-motion in the alternative for leave to adduce other additional evidence, and the petitions for review.

A. The motion and cross-motion for leave to adduce additional evidence

Respondents seek leave to adduce the exhibits that the law judge declined to admit, as well as several other documents reflecting subsequent production activity through the CSRC ("Respondents' Additional Evidence").¹⁶ They argue that the evidence proves that their production obligations as to many of the requested work papers have already "been satisfied under Section 106(f)." They also argue that it demonstrates that the "CSRC is an alternative means of production," which both vindicates respondents' good faith and makes the Section 106 requests unenforceable. Respondents further contend that their additional evidence "undermines the sanction proposed by the Initial Decision" by showing that the Commission will be able to obtain work papers through the CSRC in the future.

The Division opposes respondents' motion on the ground that Respondents' Additional Evidence is not, in the Division's view, material. According to the Division, that evidence merely "support[s] legal theories that the Initial Decision and other [law judge] rulings properly rejected." It argues that the evidence has "no bearing" on whether respondents violated Section 106(e) or the remedial measures to be imposed under Rule 102 because the "Initial Decision rejected all of respondents' legal arguments that could conceivably make [Respondents'] Additional Evidence relevant." Finally, and in the alternative, the Division cross-moves for

¹³ *Id.* at *83.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Respondents' Additional Evidence consists of proposed Exhibits 654 through 677.

leave to adduce its own evidence (the "Division's Additional Evidence") that provides context as to the extent, completeness, and timeliness of the productions through the CSRC.¹⁷

We have determined to grant respondents' motion and the Division's cross-motion. Rule of Practice 452 permits a party to submit additional evidence "at any time prior to issuance of a decision by the Commission" as long as the party can "show with particularity" (1) that such additional evidence is material" and (2) "that there were reasonable grounds for failure to adduce such evidence previously."¹⁸ Each of these elements is satisfied here.

We find that the materiality element of Rule 452 is satisfied at this juncture of the proceedings. We appreciate that the parties fundamentally disagree as the correct construction of Section 106 and as to the inferences that should be drawn from the proffered evidence. At bottom, the Division's opposition is premised on the immateriality of the evidence in light of the Division's *own* reading of Section 106. In other words, the Division argues that the evidence could not possibly make a difference under its theory of the case, which prevailed before the law judge. We are unwilling to deny respondents' motion on this basis, as doing so would be tantamount to summarily affirming the initial decision.¹⁹ Instead, we will defer assessment of the probative value that should ultimately be afforded the additional evidence until we have received the benefit of full briefing and argument, reviewed the record in its entirety, and resolved the merits of the petitions for review.²⁰ Like any other ruling on admissibility, our ruling in this regard is by nature subject to revision until issuance of a final decision.²¹

It is undisputed that Rule 452's timeliness element is satisfied, and we so find. The developments relating to productions through the CSRC did not take place until after the close of

¹⁷ The Division's Additional Evidence consists of proposed Exhibits 359 through 375. Respondents do not oppose the cross-motion to adduce the Division's Additional Evidence.

¹⁸ 17 C.F.R. § 201.452.

¹⁹ *Cf.* Rule 411(e)(2), 17 C.F.R. § 201.411(e)(2) ("The Commission may grant summary affirmance if it finds that no issue raised in the initial decision warrants consideration by the Commission of further oral or written argument.").

²⁰ Put another way, we will take into consideration the additional evidence, but we do not in so doing commit ourselves to giving it any particular—or, indeed, any—weight in exculpation or mitigation. *See generally Morris v. Sec'y, Dep't of Corr.*, 677 F.3d 1117, 1131 (11th Cir. 2012); *Time Warner Entm't Co., L.P. v. FCC*, 56 F.3d 151, 175 (D.C. Cir. 1995).

²¹ *optionsXpress, Inc.*, Exchange Act Release No. 70698, 2013 WL 5635987, at *3 & n.12 (Oct. 16, 2013). As respondents correctly recognize, the "Commission can resolve the exact legal import" of the additional evidence "in the course of [the] appeal."

the hearing and the evidence, which reflects those developments, was unavailable earlier.²² We find that there are "reasonable grounds for failure to adduce" the evidence earlier.

For the above reasons, we have determined that the requirements of Rule 452 are satisfied as to Respondents' Additional Evidence and the Division's Additional Evidence. Accordingly, it is ORDERED that respondents' motion to adduce additional evidence and the Division's cross-motion to adduce additional evidence are GRANTED. Respondents' Additional Evidence and the Division's Additional Evidence are hereby received into the record.

B. The petitions for review

We turn next to the parties' petitions for review. Upon due consideration, and pursuant to Rule of Practice 411, the petitions for review of the law judge's initial decision are GRANTED.²³ Pursuant to Rule of Practice 411(d), the Commission also will determine what sanctions, if any, are appropriate in this matter.²⁴

We designate respondents as the side that will file the opening brief.²⁵ Accordingly, IT IS ORDERED, pursuant to Rule of Practice 450(a), that briefs shall be filed as follows:²⁶

Respondents' opening brief: E&Y, KMPG, DTTC, and PwC shall file a single consolidated brief, not to exceed 28,000 words, by June 23, 2014.

Division's principal and response brief: The Division shall file a brief, not to exceed 28,000 words, by August 7, 2014. This brief must address the issues presented by the Division's petition for review and respond to respondents' opening brief.

²² E.g., *Citizens Capital Corp.*, Exchange Act Release No. 67313, 2012 WL 2499350, at *8 (June 29, 2012); *Vladlen Larry Vindman*, Exchange Act Release No. 53654, 2006 WL 985308, at *9 n.51 (Apr. 14, 2006).

²³ 17 C.F.R. § 201.411.

²⁴ 17 C.F.R. § 201.411(d).

²⁵ Adopting Release, *Rules of Practice*, Exchange Act Release No. 35833, 1995 WL 368865, at *91 (June 9, 1995), 60 Fed. Reg. 32738, 32778 (June 23, 1995).

²⁶ 17 C.F.R. § 201.450(a).

Respondents' response and reply brief: E&Y, KMPG, DTTC, and PwC shall file a single consolidated brief, not to exceed 16,000 words, by August 27, 2014.

Division's reply brief: The Division may file a reply brief, not to exceed 2,000 words, by September 8, 2014. This brief must be limited to the issues presented by the Division's petition for review.

By separate order, the Commission shall provide for briefing on the Division's petition for review insofar as it seeks to challenge the scope of remedies imposed on Dahua.²⁷ As provided by Rule of Practice 450(a), no briefs in addition to those specified in this schedule may be filed without leave of the Commission.²⁸ Pursuant to Rule of Practice 180(c), failure to file a brief in support of the petition may result in dismissal of this review proceeding.²⁹

It is further ORDERED that the parties shall confer and prepare an appendix that reproduces without argument or commentary the foreign law materials in the record upon which they rely (including any applicable orders, regulations, directives, or letters), along with translations of any document in a foreign language.³⁰ The materials shall be set out in chronological order by date of issuance or promulgation and must be consecutively paginated to facilitate citation to the appendix in the parties' briefs. The appendix must contain a table of contents describing each item included, the original location of that item in the record, and the page of the appendix on which it begins. Respondents shall file and serve the appendix at the same time that they file and serve their opening brief.

Finally, it is ORDERED that the Stipulated Protective Order entered by the law judge on May 9, 2013, as modified by the Joint Stipulation and Amendment to Stipulated Protective Order entered July 29, 2013, shall remain in effect. Two versions of each document containing information subject to the protective order must be filed: (1) a complete version of the document marked "CONFIDENTIAL" for filing under seal and (2) a redacted version of the same document for the public file. The Commission reserves the authority to reach a different

²⁷ See *supra* note 2.

²⁸ Attention also is called to Rules of Practice 150-153, 17 C.F.R. §§ 201.150-153, with respect to form and service, and Rule of Practice 450(b) and (c), 17 C.F.R. §§ 201.450(b), 201.450(c), with respect to content and length limitations (except as modified in this order). Requests for extensions of time to file briefs or for additional words are disfavored.

²⁹ 17 C.F.R. § 201.180(c).

³⁰ Where an agreed translation is unavailable, each party shall submit its own preferred version along with any applicable translator's certificate. See, e.g., *Pittway Corp. v. United States*, 88 F.3d 501, 503 n.1 (7th Cir. 1996).

conclusion regarding the confidentiality of the information covered by the May 9 and July 29 orders at any time before it finally determines the issues raised in this proceeding.³¹

By the Commission.

Lynn M. Powalski
Deputy Secretary

³¹ See, e.g., *Kevin Hall*, Exchange Act Release No. 60346, 2009 WL 2149222, at *2 (July 20, 2009).