

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 72602 / July 14, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3566 / July 14, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15970

In the Matter of

ERNST & YOUNG LLP,

Respondent.

**ORDER INSTITUTING PUBLIC
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTIONS 4C AND 21C OF THE
SECURITIES EXCHANGE ACT OF 1934
AND RULE 102(e) OF THE COMMISSION'S
RULES OF PRACTICE, MAKING FINDINGS,
AND IMPOSING REMEDIAL SANCTIONS
AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission” or “SEC”) deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 4C(a)(2)¹ and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 102(e)(1)(ii)² of the Commission’s Rules of Practice against Ernst & Young LLP (“Respondent” or “EY”).

¹ Section 4C(a)(2) provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct.

² Rule 102(e)(1)(ii) provides, in pertinent part, 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 . . . to be lacking in character or integrity or to have engaged in unethical or improper professional conduct.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission’s Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds that:

A. SUMMARY

These proceedings arise out of certain legislative advisory services provided by Washington Council EY (“WCEY”), which has been part of EY since 2000.³ Prior to 2009, certain conduct related to WCEY’s provision of legislative advisory services violated the independence rules with respect to two of EY’s SEC-registrant audit clients. For example, WCEY sent letters urging passage of bills to congressional staff on behalf of one of its clients (hereinafter, “Client A”). These bills were important to Client A’s business interests. In another instance, WCEY asked congressional staff to insert into a bill a provision favorable to Client A. For another audit client (hereinafter, “Client B”), WCEY attempted to persuade congressional offices to withdraw their support for legislation detrimental to that client’s business interests. In addition, WCEY worked closely with congressional staff in drafting an alternative bill more favorable to Client B. WCEY also marked up a draft of the alternative bill, inserting specific language written by Client B, and sent the mark-up to congressional staff.

Despite providing the services described herein, EY repeatedly represented that it was “independent” in audit reports issued on Client A’s and Client B’s financial statements, which were included or incorporated by reference in public filings with the Commission. By doing so, EY violated Rule 2-02(b)(1) of Regulation S-X and caused Client A and Client B to violate Section 13(a) of the Exchange Act and Rule 13a-1 thereunder. EY’s conduct also constituted improper professional conduct pursuant to Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.

B. RESPONDENT

EY is a professional services limited liability partnership, headquartered in New York City, with offices located throughout the United States. It is a member firm of Ernst & Young

³ In May 2000, Washington Counsel, P.C. merged into EY. The firm now operates as Washington Council EY.

Global Limited and provides auditing, consulting, and tax services to a variety of companies, including companies whose securities are registered with the Commission and trade in the U.S. markets.

C. RELEVANT ISSUERS

At all relevant times, Client A and Client B had shares registered with the Commission pursuant to Exchange Act Section 12(b) and filed annual Reports on Form 10-K with the Commission.

D. FACTS

WCEY

1. WCEY's legislative advisory services include meeting with congressional staff and attempting to influence pending legislation on behalf of its clients. At the time of the conduct discussed herein, some of WCEY's clients were also SEC-registrant audit clients of EY.

2. EY issued a written independence policy intended to provide guidance on the provision of legislative advisory services to audit clients. While EY provided some guidance on the policy, it did not provide WCEY with formal, in-person training specifically tailored to the policy.

Legislative Advisory Work for Client A

3. On at least three occasions prior to 2009, WCEY's provision of legislative advisory services for Client A placed WCEY, and therefore EY, in the position of being an advocate for an audit client in violation of the independence rules.⁴ Each instance involved legislation important to Client A.

4. On the first occasion, WCEY learned about an upcoming vote in the U.S. House of Representatives. WCEY informed Client A about the vote and obtained a letter from a top executive at Client A addressed to the House leadership and supporting passage of the bill. Just a few hours before the scheduled vote, WCEY e-mailed the letter to staff in various congressional offices. In the e-mail, WCEY congratulated the congressional staff on bringing the bill to the floor and noted that the attached letter encouraged immediate passage of the bill. After the vote, WCEY e-mailed Client A to inform it that the letters made it to the House prior to the vote.

5. On the second occasion, WCEY sent a letter signed by Client A to the leadership in the U.S. Senate and House of Representatives. The letter urged Congress to pass certain legislation of strategic importance to Client A. The letter also listed specific items to be included in the legislation.

⁴ The services described herein, with respect to both Client A and Client B, occurred over a several-year period in the mid-2000s, ceasing in 2008.

6. On the third occasion, Client A was interested in inserting a specific provision into a pending bill. Client A asked WCEY to raise the issue with a U.S. Senate staffer. WCEY reported back to Client A, stating that the firm had asked the Senate staffer about the provision. The Senate staffer indicated that it would be difficult to get the provision included in the bill, but WCEY said it could make a case for it. Several months later, WCEY again contacted the Senate staffer about the chance of having the specific provision included in the legislative package.

Legislative Advisory Work for Client B

7. On at least two occasions prior to 2009, WCEY's provision of legislative advisory services for Client B placed WCEY, and therefore EY, in the position of being an advocate for an audit client in violation of the independence rules. This instance involved legislation important to Client B.

8. Client B retained WCEY in an effort to defeat a legislative proposal that Client B believed would be detrimental to its business interests.

9. WCEY met with staff representing U.S. Senators who were in favor of the proposal. The purpose of these meetings was for WCEY to persuade the Senate staff to withdraw their support for the proposal.

10. After these meetings, Client B sought an amendment related to the proposal. WCEY identified third parties and urged them to approach a U.S. Senator and ask for an amendment. WCEY provided the third parties with two alternative draft amendments to be presented to the Senator.

11. WCEY also developed a strategy to push for an alternative bill more favorable to Client B than the original proposed legislation. Specifically, WCEY and Client B worked closely with a staffer for a U.S. House of Representatives member who planned to introduce the alternative bill. WCEY exchanged drafts of the alternative bill with the staffer. In an e-mail to WCEY, the staffer acknowledged that the current draft incorporated a number of suggestions from WCEY.

12. Subsequently, WCEY and Client B met again with the House staffer and provided additional suggestions for the alternative bill. The House staffer provided WCEY with a draft of the alternative bill and requested additional feedback. WCEY then shared the draft with Client B. When a Client B employee saw the draft, he said he was highly encouraged because his language was included.

13. WCEY conferred further with Client B and then conveyed to the House staffer additional suggestions for the alternative bill. For example, WCEY told the staffer about concerns that Client B had about some specific language in the alternative bill. WCEY provided the staffer with new language that had been written by Client B.

14. WCEY pointed to its influence in a memorandum to Client B's president. WCEY wrote that it "helped to tamp down activity" on legislation that would have harmed Client B's business. WCEY described how it worked with congressional staff prior to the introduction of the bill to minimize any impact on Client B's business.

E. LEGAL ANALYSIS

Basic Principles

15. “Public faith in the reliability of a corporation’s financial statements depends upon the public perception of the outside auditor as an independent professional.” SEC v. Arthur Young, 465 U.S. 805, 819 n.15 (1984). In fact, “[i]f investors were to view the auditor as an advocate for the corporate client, the value of the audit function itself might well be lost.” Id.

16. The Commission has stated that it

will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant’s engagement. In determining whether an accountant is independent, the Commission will consider all relevant circumstances, including all relationships between the accountant and the audit client, and not just those relating to reports filed with the Commission.

Rule 2-01(b) of Regulation S-X (emphasis added).

17. “In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service . . . places the accountant in a position of being an advocate for the audit client.” Preliminary Note to Rule 2-01 of Regulation S-X, ¶ 2; see “Revision of the Commission’s Auditor Independence Requirements,” Exchange Act Rel. 42994, 45 Fed. Reg. 43148, 43149 (July 12, 2000) (Proposing Release) (“an accountant is not independent whenever, during the audit and professional engagement period, the accountant . . . acts as an advocate for the audit client”).

Violations

18. As a result of the conduct described above, EY violated Rule 2-02(b)(1) of Regulation S-X, which requires that each accountant’s report state whether the audit was made in accordance with generally accepted auditing standards. Exchange Act Release No. 49708 provides that, for financial statements dated after May 24, 2004, the Rule’s reference to “generally accepted auditing standards” means the standards of the PCAOB and the applicable Commission regulations, both of which require an auditor to be independent of its client. See, e.g., PCAOB Auditing Standards, Independence, AU § 220.03. A violation occurred each time that EY issued an audit report for one of the two audit clients (or issued a consent for the filing of an audit report in later filings) that incorrectly stated that the audits were performed in accordance with the standards of the PCAOB, where either the period covered by the audit, or the period of the audit work, or both, overlapped with prohibited conduct.

19. As a result of the conduct described above, EY caused Client A and Client B to violate Section 13(a) of the Exchange Act and Rule 13a-1 thereunder, which require that financial statements included in annual reports filed with the Commission be audited by an independent

accountant. EY knew, or should have known, that its conduct would cause the audit clients to violate these provisions.

20. As a result of the conduct described above, EY also engaged in improper professional conduct, within the meaning of Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

EY's Remedial Efforts

21. In determining to accept the Offer, the Commission considered remedial acts undertaken by Respondent and cooperation afforded the Commission staff. For example, in June 2012, EY voluntarily issued new guidance restricting such legislative advisory services. EY issued similar final guidance in May 2013.

F. FINDINGS

Based on the foregoing, the Commission finds that Respondent EY: (a) committed violations of Rule 2-02(b)(1) of Regulation S-X; (b) caused violations of Exchange Act Section 13(a) and Exchange Act Rule 13a-1 by Client A and Client B; and (c) engaged in improper professional conduct pursuant to Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Respondent EY shall cease and desist from committing or causing any violations and any future violations of Rule 2-02(b)(1) of Regulation S-X, Section 13(a) of the Exchange Act, and Rule 13a-1 promulgated thereunder.

B. Respondent EY is hereby censured.

C. Respondent EY shall, within ten (10) days of the issuance of this Order, pay disgorgement of \$1,240,000, together with prejudgment interest thereon of \$351,925.98, and a civil money penalty of \$2,480,000, for a total of \$4,071,925.98, to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying EY as a Respondent in these proceedings, and the file number of these proceedings. A copy of the cover letter and check or money order must be simultaneously sent to Scott W. Friestad, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549.

By the Commission.

Jill M. Peterson
Assistant Secretary