

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 78872 / September 19, 2016**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 3802 / September 19, 2016**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-17552**

In the Matter of

**ERNST & YOUNG LLP AND**  
**GREGORY S. BEDNAR, CPA,**

Respondents.

**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”) deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 4C(a)(2)<sup>1</sup> and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 102(e)(1)(ii)<sup>2</sup> of

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<sup>1</sup> Section 4C 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 . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations issued thereunder.

<sup>2</sup> Rule 102(e)(1)(ii) provides, in pertinent part, that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

the Commission's Rules of Practice against Ernst & Young LLP ("EY" or the "Firm")<sup>3</sup> and Gregory S. Bednar ("Bednar" and, together with EY, the "Respondents").

## II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (each, an "Offer" and, together, the "Offers"), 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 them and the subject matter of these proceedings, which are admitted, and, except as provided herein in Section V, Respondents consent 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 Respondents' Offers, the Commission finds that:<sup>4</sup>

### A. SUMMARY

This matter arises from an inappropriate close personal relationship between Bednar, a former EY partner, and the former chief financial officer of a New York-based EY audit client ("Issuer") that caused EY to violate the auditor independence rules in 2012, 2013, and 2014. Other members of EY's audit team were aware of Bednar's relationship with the CFO, and they and members of EY management failed to act on red flags that should have alerted them to the nature and extent of the relationship.

Despite this relationship, EY represented that it was independent in audit reports issued on the Issuer's financial statements, which were included or incorporated by reference in public filings with the Commission. By so doing, EY violated Rule 2-02(b)(1) of Regulation S-X and caused the Issuer to violate Section 13(a) of the Exchange Act and Rule 13a-1 thereunder. Bednar aided and abetted and caused EY's violation of Rule 2-02(b)(1) of Regulation S-X and caused the Issuer to violate Section 13(a) of the Exchange Act and Rule 13a-1 thereunder. EY's and Bednar'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.

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<sup>3</sup> Contemporaneously with this Order, the Commission is issuing *In the Matter of Ernst & Young LLP, Robert J. Brehl, CPA, Pamela J. Hartford, CPA, and Michael T. Kamienski, CPA*, Exchange Act Rel. No. 78873 (September 19, 2016).

<sup>4</sup> The findings herein are made pursuant to EY's and Bednar's Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

## **B. RESPONDENTS**

1. **EY** is a professional services firm headquartered in New York, New York. EY provides auditing, consulting, and tax services to various entities, including companies with securities registered with the Commission and traded in U.S. markets. EY served as the Issuer's auditor from 1996 to August 2015.

2. **Bednar**, age 56, resides in Glenview, Illinois. Bednar is an accountant and CPA licensed in Illinois since September 1994. Bednar was employed by EY from August 1982 until June 2015, when he was asked by EY to leave the firm. Bednar served as EY's coordinating partner on the Issuer's audit team from May 2010 to March 2015.

## **C. RELEVANT ISSUER AND INDIVIDUAL**

3. During the relevant period of time, the **Issuer's** securities were registered under Section 12(b) of the Exchange Act and were traded on the New York Stock Exchange. The Issuer filed annual reports on Form 10-K with the Commission.

4. The **CFO**, age 55, is an accountant and CPA licensed in New York since 1987. The CFO served as the Issuer's chief financial officer for over two decades, until he retired in 2015. Prior to working for the Issuer, the CFO was employed as an accountant at an auditing firm.

## **D. FACTS**

### **Background of EY's Relationship with the Issuer**

5. EY served as the Issuer's auditor from 1996 until August 2015, when the Issuer terminated EY. In 2010, the Issuer, including the CFO, expressed dissatisfaction with certain aspects of EY's performance. As a result, in 2010, the Issuer informed EY that it was considering changing audit firms.

6. In response, EY presented the Issuer with a replacement audit team led by Bednar, who would serve as coordinating partner. "Coordinating partner" was the term used by EY to describe the lead partner on this audit engagement. The Issuer's audit committee decided to continue to retain EY as its auditor.

7. The senior EY partner who helped select Bednar to serve as coordinating partner on the replacement audit team told Bednar at the outset that the Issuer was a "troubled account." Accordingly, Bednar understood that his responsibilities as coordinating partner would include "developing" and "mending" EY's relationship with the Issuer.

8. The replacement audit team also included engagement partners who reported to Bednar. The engagement partners were responsible for day-to-day oversight of the audit, while Bednar had overall responsibility for the audit and focused on the "relationship piece" with the Issuer.

Bednar and the engagement partners assumed their new roles on the Issuer's engagement team in or around May 2010.

### **EY's Relevant Independence-Related Policies**

9. At all relevant times, EY maintained policies concerning independence; client-related expense incurrence and reimbursement; travel; and gifts. EY professionals, including Bednar, received training on these policies.

10. Among other things, EY's internal policies in place during the relevant time period required all activities with clients to have a "valid business purpose requiring an expectation that meaningful business discussions or activity will take place." The policies forbade certain EY employees, including partners like Bednar, from giving gifts or "hospitality" to audit clients, or receiving gifts or "hospitality" from clients, "that are not commensurate with the normal courtesies of business and social life."

11. Additionally, EY's independence policies acknowledged that close personal relationships between engagement team members and audit client employees in an accounting or financial reporting oversight role could create "independence issues from an appearance perspective." EY's policies also prohibited partners from taking vacations with audit client employees, and warned that the amount of leisure time spent by a partner with an audit client employee in a financial reporting oversight role should be limited.

### **Bednar's Relationship with the CFO and the CFO's Family**

12. Bednar repeatedly violated the above policies throughout 2012, 2013, and 2014 by developing and maintaining a close personal relationship with the CFO and members of the CFO's family that was inappropriate for an independent auditor. Bednar spent extensive leisure time, including frequent overnight, out-of-town trips, with the CFO and his family. In all, Bednar and the CFO took at least seven out-of-town trips together during the relevant period, all of which were social in nature and did not have a valid business purpose, as that phrase was defined in EY's independence and hospitality and gifts policies. In addition to these trips, Bednar and the CFO attended sporting events and socialized near the Issuer's headquarters in the greater New York City area to an excessive degree. Bednar also gifted tickets to sporting events and other things of value to the CFO.

13. Bednar, sometimes accompanied by his wife, stayed overnight as a guest at the CFO's primary residence in New York and his vacation home in South Carolina on numerous occasions. Likewise, on one occasion, the CFO stayed overnight at Bednar's apartment in Chicago, Illinois, and on one other occasion, the CFO and his son stayed overnight in a guest apartment in Bednar's apartment building.

14. These frequent social events, gifts, and overnight, out-of-town trips took place during each of the 2012, 2013, and 2014 audit and professional engagement periods and, in the aggregate, violated EY policy.

15. For example, in January 2012, Bednar gifted tickets to two successive professional football games to the CFO for he and his family to attend. Neither Bednar nor any other EY employee attended these games with the CFO and his family.

16. The following week, Bednar and his wife took a trip to Green Bay, Wisconsin with the CFO and the CFO's son to attend a professional football playoff game. Bednar purchased the tickets for the group, and they stayed in the same hotel near Green Bay.

17. Two months later, in March 2012, Bednar, who was in South Carolina for a separate golf outing, visited the CFO at the CFO's brother-in-law's vacation home in Hilton Head. Bednar stayed overnight in that vacation home, where the CFO was also staying.

18. In October 2012, the CFO stayed overnight at Bednar's apartment while on a business trip to Chicago. Bednar and the CFO then planned a joint overnight trip to Nashville, Tennessee the following month to, among other things, play golf and attend a professional football game. While the CFO ultimately cancelled the trip, Bednar and his wife travelled to Nashville and attended the football game with Bednar's brother and the CFO's son, both of whom lived in Nashville.

19. In April 2013, Bednar, the CFO, and members of their respective families again traveled to Nashville to celebrate Bednar's birthday and attend a professional hockey game together. Later that same month, Bednar and his wife, along with the CFO and his son, traveled to Augusta, Georgia to attend the Masters golf tournament. Another EY partner also attended this trip. The Bednars, the other EY partner, the CFO, and the CFO's son stayed in the same hotel during this trip.

20. In October 2013, the CFO and his son traveled to Chicago for the purpose of visiting Bednar and his wife, and attending a professional football game and a golf outing with them. The CFO and his son stayed overnight in the guest apartment in Bednar's building during this trip.

21. In April 2014, Bednar and his wife traveled to South Carolina for the purpose of spending leisure time and attending a golf tournament with the CFO and his family over Easter weekend, staying three nights as guests at the CFO's vacation home. After the trip, Bednar thanked the CFO and his family for "treating us to such a wonderful time"; the CFO responded, "I can see many more of these ahead in the coming years . . . we appreciate how generous you are with us as well."

22. In December 2014, Bednar, the CFO, and their respective wives flew to Nashville to attend a professional hockey game with the CFO's son, among others. In an email to the CFO and members of the CFO's family after the trip, Bednar described the trip as a "Great 24 Hour Extravaganza," writing "We had a blast (as usual) being with all of you."

23. In or around February 2015, Bednar began planning a second overnight trip to the Masters golf tournament in April 2015 with the CFO, the CFO's son, and another EY partner, among others. Bednar planned to treat the trip in part as a retirement party for the CFO, and intended to spend approximately \$20,000 of his own money to rent three houses in Augusta, Georgia for the trip. Bednar and his wife expected to spend five nights in Augusta, while other attendees were expected to

spend three nights. The CFO and the other EY partner did not attend this trip, after EY received a regulatory inquiry in March 2015 regarding Bednar's relationship with the CFO.

24. In addition to these repeated out-of-town trips, Bednar and the CFO attended sporting events and socialized near the Issuer's headquarters in the greater New York City area to an excessive degree. On a number of occasions, Bednar flew to the greater New York City area for the purpose of attending a sporting event with the CFO and then left without visiting the Issuer's headquarters or otherwise performing any audit-related work. On at least two other occasions, Bednar traveled to the greater New York City area for the purpose of having dinner at the CFO's home with the CFO, the CFO's family, the CFO's neighbors, and other members of the audit engagement team, and then left without visiting the Issuer's headquarters or otherwise performing any audit-related work.

25. On at least three other occasions, Bednar gifted sports tickets to the CFO, the CFO's family, or friends of the CFO's son for use when Bednar was not present. Bednar also gifted hundreds of dollars' worth of sports memorabilia to the CFO.

26. Bednar's frequent entertainment of the CFO and his family caused Bednar to incur significant entertainment, travel, and lodging expenses. In total, Bednar incurred approximately \$109,000 in entertainment-related expenses—meals, sports tickets, and related travel and lodging—in connection with the Issuer's 2012, 2013, and 2014 audits. In 2012, he spent approximately \$29,545; in 2013, he spent approximately \$52,119; and in 2014, he spent approximately \$27,333. This level of entertainment-related spending was not "commensurate with the normal courtesies of business and social life."

27. Bednar obtained most of the sports tickets described above from an EY employee responsible for procuring tickets for client entertainment. In a few other instances, Bednar purchased the tickets himself and then sought reimbursement from EY. Bednar entered the other entertainment-related expenses described above into EY's Global Time and Expense system for reimbursement.

28. Bednar charged the entertainment-related expenses described in paragraph 26 above, with the exception of sports tickets obtained through the EY ticket administrator, to a billable time code associated with the Issuer, even though many of these expenses personally benefitted himself and the CFO (and, in some cases, their respective family members). The majority of these entertainment-related expenses were ultimately billed to the Issuer as audit expenses. Bednar continued to charge entertainment-related expenses back to the Issuer after EY's September 2014 Hospitality and Gifts Global Policy made clear that "reception and entertainment expenses should be charged to non-billable charge codes, not billable codes."

29. Bednar's relationship with the CFO and the CFO's family was marked not only by significant entertainment spending, but also by a close personal friendship. During the relevant period, Bednar and the CFO exchanged hundreds of personal texts, emails, and voicemails that did not include meaningful business-related discussions. Bednar and the CFO frequently referred to each other in emails as a "friend." The CFO also shared personal information, including sensitive health information and other information not typically shared with a solely professional colleague, with Bednar. In 2013, the CFO and his wife invited Bednar to spend Thanksgiving at their home, but Bednar decided to visit his father instead.

## **EY Failed to Act on Red Flags Regarding Bednar's Relationship with the CFO**

30. EY partners other than Bednar, including EY partners senior to Bednar, were made aware of certain facts related to Bednar's entertainment expenses and his relationship with the CFO during the relevant time period.

31. For example, in October 2012, two senior EY partners—one the head of Bednar's practice group and Bednar's immediate manager ("Senior Partner A"), and the other a senior partner with national management responsibilities ("Senior Partner B")—learned that Bednar's expense spending was "by far the highest in the practice," after Bednar sought their help in obtaining reimbursement for certain spousal travel unrelated to the Issuer. Senior Partner B asked Senior Partner A to "get a better understanding of [Bednar's] spending . . . and the market impact it's having."

32. Thereafter, Senior Partner A sent Bednar an email with the subject line "Controllable expenses" that attached a spreadsheet titled "Bednar Q1 FY13." The spreadsheet reflected total expenses, across all of Bednar's audit engagements, of \$80,359; \$31,852 of these expenses were for "Entertainment" associated with several clients, including the Issuer. The spreadsheet stated, "The top Spender in all of FSO ASU [Assurance] – total spend is double the next highest individual." Senior Partner A then spoke to Bednar about reducing his expense spending. Bednar claimed that the large volume of expenses was due in part to the fact that he was catching up on submitting older expenses. Neither Senior Partner A nor Senior Partner B inquired into whether these levels of expenditures could suggest a violation of EY's policies or the existence of an inappropriate personal relationship with any of Bednar's audit clients.

33. In addition, one of the engagement partners on the audit team was aware of at least four overnight, out-of-town trips that Bednar and the CFO took together, some of which included members of the CFO's family. This engagement partner attended one of these trips.

34. The same engagement partner received information regarding Bednar's entertainment spending in connection with the Issuer's audits. Specifically, in September 2014, a senior Issuer employee who worked for the CFO asked EY for more detail on the expenses it was billing to the Issuer. The senior manager on the engagement team sent the Issuer a four-line expense summary table showing the total amount owed divided into three sub-categories: transportation, lodging, and meals. The Issuer responded that the table was too summarized and asked for a replacement showing the expenses incurred by each member of the engagement team.

35. Bednar, the engagement partner, and the senior manager then reviewed a spreadsheet showing all of the expenses charged by the engagement team to the 2014 audit code. The spreadsheet contained four tabs, including a summary tab that broke out the expenses incurred by each engagement team member into 17 different categories, including "entertainment" and "lodging." The summary tab showed that Bednar had already charged more than \$18,000 in expenses coded as "entertainment" to the 2014 audit code, although some of these expenses had in fact been incurred during the prior audit period. Neither the engagement partner nor the senior manager inquired as to whether Bednar's level of entertainment-related spending complied with EY's independence policy or alerted others at EY.

36. After reviewing this spreadsheet, the engagement team created a new spreadsheet to provide to the Issuer. As requested, the new spreadsheet broke out the expenses incurred by each engagement team member across the three categories previously provided: transportation, meals, and lodging. It also included a fourth category called “Summit,” which referred to an offsite finance meeting between EY and the Issuer. Expenses classified as “entertainment” expenses in the internal EY spreadsheet were classified as “meals” in the spreadsheet given to the Issuer. The senior manager then sent the new spreadsheet to the Issuer.

37. The Issuer responded with five questions about the expenses, including the following: “Greg [Bednar] has \$32k in expenses, but only \$2,400 is the Summit. Seems really high, given he has not been in [the Issuer’s headquarters] too often over the last few months. What is in here?” The senior manager forwarded the Issuer’s email to Bednar and the engagement partner, saying, “I’ll work on the responses but just wanted to share.” The senior manager, however, never responded to the Issuer, and neither Bednar nor the engagement partner followed up.

38. In February 2015, the engagement partner and members of EY’s management were again alerted to Bednar’s excessive client entertainment spending. On February 7, 2015, Bednar wrote an email to the invitees of the planned April 2015 trip to attend the Masters golf tournament. Among the recipients was the engagement partner who had reviewed the spreadsheet listing the engagement team’s (including Bednar’s) expenses five months earlier. After explaining that he was going to rent three houses for all of the invitees to stay in, Bednar said that he would “pick up the tickets for the Wednesday round under the guise of this being a ‘business’ meeting.”

39. On February 12, 2015, Bednar wrote an email to Senior Partner A and another senior EY partner with regional management responsibilities (“Senior Partner C”) to inform them about the planned April 2015 trip to the Masters. Bednar explained that he had invited 13 people, including the CFO, the CFO’s wife, the CFO’s son, the engagement partner, the engagement partner’s spouse, and other clients; that he had rented three houses for the trip; and that he had decided to turn it into a client event in addition to celebrating the retirement of the CFO. Bednar asked if EY would help pay for the tickets, but that he didn’t “want to create an issue if you think it would raise eyebrows.”

40. Senior Partner C responded by saying that EY would not be able to pay for the tickets, but thanked Bednar for his “continued focus on building long lasting client relationships.” He then apologized for not being able to help, writing “it sounds like a great event.” Neither Senior Partner A nor Senior Partner C questioned Bednar about the level of his expense spending or his relationship with the CFO, nor did they take any other steps to ensure that Bednar was complying with EY’s independence policies.

41. Between 2012 and 2015, EY also had access to certain facts about Bednar’s entertainment of, and relationship with, the CFO as a result of Bednar’s entertainment expense submissions to the Firm’s time and expense system. Although some of Bednar’s expense submissions contained certain incorrect information, these expense submissions, when taken together, constituted red flags that Bednar was violating EY’s independence and gift and hospitality policies. EY did not, however, review Bednar’s or other partners’ aggregate entertainment expenses to ensure compliance with its independence policies during the relevant period. Similarly, while EY generated certain



expense summaries by region, it did not maintain any systems that would alert the Firm when a partner's entertainment expenses reached aberrational levels or were improperly charged to a billable client account.

**EY's Independence Procedures Did Not Specifically Inquire  
About Close Personal Relationships**

42. During the relevant period, EY maintained or followed policies and procedures regarding auditor independence. As noted above, EY maintained internal policies regarding auditor independence and it trained and tested its audit professionals on those policies. EY required audit engagement teams for public company clients, including the Issuer, to follow certain annual audit and quarterly review procedures to assess EY's independence from those audit clients. Generally, those procedures addressed possible familial, employment, and financial relationships between the Issuer and EY that are expressly prohibited by the Commission's auditor independence rules. They also required each audit engagement team member to certify that he was independent of the audit client and that he had read, understood, and was in compliance with EY's policies on independence.

43. In addition, and outside of procedures that were specific to individual audit clients, EY required all audit professionals to again certify on an annual basis, and audit professionals at the level of Manager and above on a quarterly basis, that they read, understood, and were in compliance with EY's internal policies on independence.

44. Although EY's independence policies recognized that a non-familial close personal relationship between an engagement team member and a client employee in an accounting or financial reporting oversight role could present an independence problem, in the context of assessing its independence from the Issuer, EY never specifically asked members of the engagement team for the Issuer, or employees who served in accounting or financial reporting oversight roles at the Issuer, whether they were involved in such a relationship. The individual certifications regarding independence that engagement team members signed, both those that were specific to the Issuer and those that were generally applicable, expressly asked about possible employment relationships between the engagement team member and the Issuer, but they did not similarly ask about possible close personal relationships between that team member and any employees at the Issuer who were in accounting or financial reporting oversight roles.

45. EY's policies on independence also provided that the lead audit partner on an audit engagement team bears ultimate responsibility for independence matters related to that engagement and should consult with EY's U.S. Independence group regarding threats to independence. Bednar conducted no such consultations with EY's U.S. Independence Group regarding his relationship with the CFO. In addition, in each of years 2012, 2013, and 2014, Bednar certified that he understood the Firm's independence policies, had complied with those policies with respect to the Issuer, and was independent from the Issuer.

46. Bednar also caused EY to sign the 2012 and 2013 audit reports and the Public Company Accounting Oversight Board ("PCAOB") Rule 3526 letters to the Issuer's audit committee in 2012 and 2013 that incorrectly certified that EY was not aware of any matters that could bear on its independence.

## **EY Also Violated the Commission’s Auditor Independence Rules by Failing to Obtain the Necessary Pre-Approvals to Perform Certain Non-Audit Services for the Issuer**

47. Prior to 2012, EY was engaged by a private company unaffiliated with the Issuer to perform certain permissible non-audit services. In March 2012, the Issuer acquired the private company. EY continued to perform these non-audit services for the formerly private company, which by then had become a subsidiary of the Issuer, in 2012 and 2013.

48. Under Rule 2-01(c)(7) of Regulation S-X and PCAOB Rule 3525, EY was required to seek approval from the Issuer’s audit committee to continue performing the permissible non-audit services. EY did not, however, seek the Issuer’s approval in a timely manner. Furthermore, when EY did seek the Issuer’s approval for 2012, it also incorrectly sought (and obtained) approval for a multi-year engagement that included 2013 when, under applicable PCAOB standards, EY should have returned to the audit committee to seek a separate pre-approval for the 2013 engagement. EY did not obtain the necessary separate approval for the 2013 engagement until January 2014.

### **E. LEGAL ANALYSIS**

#### **Basic Principles of Auditor Independence**

49. As the Commission has long recognized, “[i]ndependent auditors have an important public trust. . . . It is the auditor’s opinion that furnishes investors with critical assurance that the financial statements have been subjected to a rigorous examination by an objective, impartial, and skilled professional, and that investors, therefore, can rely on them.” *Revision of the Commission’s Auditor Independence Requirements*, Exchange Act Rel. No. 43602, 2000 WL 1726933, at \*2 (Nov. 21, 2000) (Adopting Release). Accordingly, Rule 2-02(b)(1) of Regulation S-X requires each auditor’s report on a public issuer’s financial statements to state “whether the audit was made in accordance with generally accepted auditing standards” (“GAAS”), including auditing standards set forth in PCAOB rules and Commission regulations.<sup>5</sup> GAAS, in turn, requires auditors to be independent from their clients in both fact and appearance. PCAOB Rule 3520; PCAOB Auditing Standards, Independence, AU § 220.03. Independence in fact and appearance are “equally important under the securities laws.” *In the Matter of Ernst & Young LLP*, Exchange Act Rel. No. 46821, 2004 WL 824099, at \*30 (Apr. 16, 2004); *see also United States v. Arthur Young & Co.*, 465 U.S. 805, 819 n.15 (1984) (“It is therefore not enough that financial statements *be* accurate; the public must also *perceive* them as being accurate.”)

50. The circumstances in which an auditor will—and will not—be deemed independent are set forth in Rule 2-01 of Regulation S-X. Rule 2-01(c) provides a non-exclusive list of specific relationships that render an accountant non-independent. Rule 2-01(b) provides the “general

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<sup>5</sup> The Commission has stated that for audit reports issued on or after May 24, 2004, the reference in Rule 2-02(b)(1) to GAAS means the standards of the PCAOB and the applicable Commission regulations, both of which require an auditor to be independent of its client. *See Commission Guidance Regarding the Public Company Accounting Oversight Board’s Auditing and Related Professional Practice Standard No. 1*, Exchange Act Rel. No. 49708, 2004 WL 1439831, at \*2 (May 14, 2004); *see also* PCAOB Rule 3520 (“A registered public accounting firm and its associated persons must be independent of the firm’s audit client throughout the audit and professional engagement period.”); PCAOB Auditing Standards, Independence, AU § 220.03.

standard” for auditor independence, which all auditors must meet even if their conduct does not fall within one of the specific prohibitions in Rule 2-01(c). Under the general standard,

[t]he Commission 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.

17 C.F.R. § 210.2-01(b) (emphasis added). This standard applies with equal force to individual accountants and the audit firms in which they practice. *See* 17 C.F.R. § 210.2-01(f)(1).

### **Violations**

51. As a result of the conduct described above, Bednar lacked independence from the Issuer under Rule 2-01(b)’s general standard for the 2012, 2013, and 2014 audit and professional engagement periods. A reasonable investor with knowledge of all relevant facts and circumstances concerning Bednar’s personal relationship with the CFO would conclude that Bednar was not capable of exercising objective and impartial judgment with respect to the audits of the Issuer.

52. As a result of the conduct described above, EY lacked independence from the Issuer for the 2012, 2013, and 2014 audit periods. As the Commission noted in the Adopting Release for the revisions to Rules 2-01 and 2-02, the “[t]he definition of ‘accountant’ includes the accounting firm in which the auditor practices. The definition makes clear that an individual accountant’s lack of independence may be attributed to the firm.” *Revision*, Exchange Act Rel. No. 43602, 2000 WL 1726933, at \*86.

53. As a result, EY violated Rule 2-02(b)(1) of Regulation S-X by falsely certifying that its reports for the 2012, 2013, and 2014 audit periods were conducted in accordance with PCAOB standards, when in fact the Firm lacked independence during each of those audit and professional engagement periods.

54. Bednar aided and abetted and caused EY’s violations of Rule 2-02(b)(1).

55. Bednar and EY also caused the Issuer to violate Section 13(a) of the Exchange Act and Rule 13a-1 thereunder in 2012 and 2013. Section 13(a) and Rule 13a-1 require public issuers to file annual reports with the Commission that have been audited by an independent accountant. Bednar and EY caused the Issuer’s violation of Section 13(a) and Rule 13a-1 because they each knew or should have known that Bednar’s relationship with the CFO deprived the Issuer of an independent auditor.

56. Rule 102(e)(1)(iv) and Section 4C(b)(2) of the Exchange Act define negligent “improper professional conduct” to include: “(i) [a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards” in circumstances in which the

“accountant,” in the case of Rule 102(e), or “registered public accounting firm or associated person,” in the case of Section 4C(b)(2), “knows, or should know, that heightened scrutiny is warranted”; and “(ii) [r]epeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.” 17 C.F.R. § 201.102(3)(1)(iv); 15 U.S.C. § 78d-3(b)(2).

57. The Commission has made clear that auditor independence is always an area requiring heightened scrutiny. *See* Adopting Release for Rule 102(e), Rel. Nos. 33-7593, 34-40567, 1998 WL 729201, at \*8 (Oct. 19, 1998) (“Because of the importance of an accountant’s independence to the integrity of the financial reporting system, the Commission has concluded that circumstances that raise questions about an accountant’s independence always merit heightened scrutiny. Therefore, if an accountant acts highly unreasonably with respect to an independence issue, that accountant has engaged in ‘improper professional conduct.’”) Likewise, the Commission has found negligent conduct where an auditor, when it knew or should have known that independence was implicated, failed to gather all the salient, relevant facts pertinent to the independence determination. *Matter of KPMG Peat Marwick LLP*, Rel. No. 34-43862, 54 S.E.C. 1135, 1182-83 (Jan. 19, 2001), *reconsideration denied*, Rel. Nos. 34-44050 and AAER-1374 (Mar. 8, 2001), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002).

58. As a result of the conduct described above, EY and Bednar engaged in improper professional conduct under both prongs of the definition set forth in Rule 102(e)(1)(iv)(B) and Section 4C(b)(2) of the Exchange Act.

## **F. FINDINGS**

59. Based on the foregoing, the Commission finds that (a) EY violated Rule 2-02(b)(1) of Regulation S-X; (b) Bednar aided and abetted and caused EY’s violations of Rule 2-02(b)(1) of Regulation S-X; (c) Bednar and EY caused violations of Section 13(a) of the Exchange Act and Rule 13a-1 thereunder by the Issuer; and (d) Bednar and EY engaged in 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.

### **EY’s Remedial Efforts**

60. In determining to accept EY’s Offer, the Commission considered remedial acts promptly undertaken by EY. EY has improved its policies, procedures, training, controls, and reporting around client entertainment and related expenses. Specifically, EY has enhanced its policies and procedures to include additional guidance concerning expenses and entertainment; issued new guidance that reinforced the potential independence implications of client entertainment activities and how to analyze client entertainment to determine whether it raises independence concerns; and introduced additional mandatory training for all employees concerning expenses and hospitality. In addition, EY revised its annual audit and quarterly review independence procedures to require that EY audit engagement team members inquire whether management of an audit client or audit engagement team members are aware of, among other things, any close relationships between an audit engagement team member or any individuals employed by or associated with the audit client; and make inquiries concerning frequent entertainment of audit client employees or their family members; and vacations taken by EY employees and audit client employees or their family members. EY also developed a

system to help monitor and analyze expense information, including the frequency and amount of entertainment expenses. Finally, EY is developing an incremental program to monitor and periodically review the information it obtains through these revised policies and procedures in order to identify and address potentially problematic activity.

#### IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the Respondents' Offers.

Accordingly, it is hereby ORDERED that:

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

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

C. Respondent EY is censured.

D. Respondent Bednar is denied the privilege of appearing or practicing before the Commission as an accountant.

E. After three years from the date of this order, Bednar may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Bednar's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or
2. an independent accountant. Such an application must satisfy the Commission that:
  - (a) Bednar, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

- (b) Bednar, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in Bednar's or the firm's quality control system that would indicate that Bednar will not receive appropriate supervision;
- (c) Bednar has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and
- (d) Bednar acknowledges his responsibility, as long as Bednar appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

F. The Commission will consider an application by Bednar to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Bednar's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

G. Respondent EY shall, within 10 days of the entry of this Order, pay disgorgement of \$3,562,400, together with prejudgment interest thereon of \$212,600, and a civil money penalty of \$1,200,000, for a total of \$4,975,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Section 21F(g)(3) of the Exchange Act. If timely payment of disgorgement and prejudgment interest is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. If timely payment of a civil money penalty is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

H. Respondent Bednar shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$45,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Section 21F(g)(3) of the Exchange Act. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

I. Payment must be made in one of the following ways:

- (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondents 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) Respondents 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's or Bednar's name as the applicable Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Senior Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, Suite 400, New York, NY 10281-1022.

J. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of either Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, each Respondent agrees that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against either Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

**V.**

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, the findings in this Order are true and admitted by Respondent Bednar, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent Bednar under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent Bednar of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. § 523(a)(19).

By the Commission.

Brent J. Fields  
Secretary