

SEC Fines Accounting Firm for Auditor Independence Violations and an Unrelated Company Pulls Prior Financial Statements Audited by Same Firm Due to Inappropriate Personal Relationship

July 17, 2014 | Client Update | 2-minute read

For actively helping two public company clients lobby congressional staff members about pending legislation, the SEC [charged](#) Ernst & Young (EY) with violating the auditor independence rules by unlawfully advocating on behalf of audit clients. Although the clients were involved with EY in the lobbying activities, neither were named in the SEC cease-and-desist proceedings against EY, and there appears to be no impact on the companies' financial statements.

Prior to 2009, Washington Council EY (WCEY) helped an audit client communicate with House leadership about a pending bill. WCEY passed along a letter from a top executive at the client addressed to House leadership and supporting passage of the bill to congressional staff. On another occasion, WCEY sent letters signed by the client to Senate and House leadership, listing specific provisions to include in pending legislation. WCEY urged Congress to pass the legislation beneficial to the client's business interests, and communicated with staffers about the client's letters and the bills.

Another client retained WCEY to assist in defeating a legislative proposal. WCEY met with congressional staff to dissuade them from supporting the proposal and provided draft amendments that the client wanted to the staffers, as well as working with a staffer on an alternative bill that incorporated suggestions from the client.

The SEC found that EY violated Regulation S-X each time the firm issued an audit report for one of the two audit clients, or issued a consent related to the report, since those reports incorrectly stated that the audits were performance in accordance with PCAOB standards, which require auditors to be independent of their clients. Through their conduct, EY caused both audit clients to violate the Exchange Act requirements that financial statements included in SEC filings be audited by an independent accountant.

While the SEC order did not appear to impact the public companies subject to the violations of auditor independence from EY lobbying actions, another public company disclosed an auditor independence issue related to EY that had more severe consequences. Ventas [reported](#) non-reliance on two years of prior financial statements after EY informed the company that it was not independent for the 2012 and 2013 fiscal years because of "an inappropriate personal relationship" between the EY lead audit partner, who was previously an audit engagement partner during the 2012 and 2013 audits, and the company's chief accounting officer and controller. The same 8-K indicates that the executive has left the company, and new auditors have been retained.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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