

After EY Cheating Scandal, Will The 'Big Four' Finally Get It?

By **Al Barbarino**

Law360 (July 1, 2022, 7:38 PM EDT) -- The U.S. Securities and Exchange Commission's record \$100 million fine against Ernst & Young over an internal cheating scandal did turn some heads recently, but following a similar case in 2019 against KPMG, questions remain if this enforcement action will prevent Wall Street's accounting gatekeepers from similar wrongdoing in the future.

In a June 28 **settlement**, EY admitted that nearly 50 audit professionals "sent and/or received" answer keys to CPA ethics exams from 2017 to 2021. Hundreds of others cheated on related courses, and the firm later withheld evidence of the cheating, the SEC said. In addition to the fine, EY will need to undertake various reviews, both internally and through independent consultants.

Ronald Colombo, a law professor at Hofstra University, called it a classic case of "who's watching the watchers," when the gatekeepers break the rules. He called the withholding of evidence "particularly egregious" and even "pretty stupid."

"This is beyond just bad. 'Once you get caught 101': You fess up, you turn over what you know, and you don't continue to deceive," he said.

Securities law experts who spoke with Law360 agreed that the \$100 million fine — the largest imposed by the SEC against an audit firm — sends a strong message. But it remains to be seen if the case will prevent other instances of cheating at the so-called Big Four firms down the road. After all, it's not the first time it has happened.

The SEC's outrage was palpable in June 2019, after another of the Big Four — KPMG LLP — struck a \$50 million deal with the agency. In that case, the firm admitted to altering audit work after receiving stolen information about inspections, and that its audit professionals cheated on training exams.

At the time, Stephanie Avakian, then-co-director of the enforcement unit, called the conduct "particularly troubling because of the unique position of trust that audit professionals hold."

Echoing this in the SEC's announcement about the EY settlement, and adding a bit of flair, Gurbir S. Grewal, director of the agency's Enforcement Division, called it "simply outrageous that the very professionals responsible for catching cheating by clients cheated on ethics exams of all things."

Jesse L. Jensen, a partner at Bernstein Litowitz Berger & Grossmann LLP, was among others who were shocked by the details of the wrongdoing outlined in the settlement, noting it "almost defies credulity" how widespread the misconduct appeared.

"When you have these watchdogs of the capital markets willing to cheat, it raises very alarming implications about what other corners they are willing to cut," Jensen said.

In addition to the cheating itself, EY admitted it made a June 2019 submission to the SEC conveying that it didn't have any issues with cheating, when in fact a tipster had alerted the firm about it.

The firm also admitted that it failed to correct the submission in October of that year, even after it launched an internal investigation and its senior lawyers discussed it with senior management.

While the news was "very disheartening," Jensen of Bernstein Litowitz said he was pleased to see the SEC following through with recent promises to crack down on wrongdoing among the largest accounting firms.

"The SEC has had a lot of tough talk, but that tough talk needs to be backed up," Jensen said. "This is a promising sign that the SEC is continuing to take its role very seriously."

An EY spokesperson told Law360 after the settlement was announced that the firm is complying with the SEC's requirements and has already begun taking a "thorough, extensive and effective" approach to the "unacceptable past behavior."

"We will continue to take extensive actions, including disciplinary steps, training, monitoring and communications that will further strengthen our commitment in the future," the firm said. "Nothing is more important than our integrity and our ethics. These core values are at the forefront of everything we do."

A KPMG spokesperson said in an emailed statement that "we are a stronger firm as a result of the actions taken since 2017 to strengthen our culture, our governance and our compliance program."

The EY settlement was viewed generally as the strictest admonishment yet of repeat wrongdoing among large firms, but it came as little surprise given that SEC Chair Gary Gensler has imposed a generally heavy rulemaking agenda, some of which is focused on expanding the agency's enforcement authority.

The SEC is also reportedly conducting a sweep of potential conflicts of interest between accounting firms' consulting work and what are supposed to be independent audits.

And in a December speech, Grewal said he had a "firm commitment ... to continue to target deficient auditing by auditors," acknowledging prior enforcement actions didn't always have the "desired deterrent effect" and that the accounting behemoths had treated fines as simply a "cost of doing business."

According to Columbia Law School professor John C. Coffee, the record \$100 million fine reflects "the new toughness" in SEC enforcement.

In fact, he compared it to getting "hit with a cement bucket," adding that it represents a reputation blow for EY.

But it's still hardly a dent in billion-dollar revenues — and won't do much to sway the firm's competitive dominance and committed client base, he added.

"It's a reputational loss, and it's getting publicity. [But] I don't think the fine alone is going to come close to putting any firm out of business," Coffee said.

The Big Four — KPMG and EY, along with Deloitte and PwC — dominate the current market, auditing over 80% of U.S. public companies as of 2021, according to a report this year from Statista.

"They can handle the largest companies and the very large banks with offices all over the globe, which need someone who can do an audit in all of those places," Coffee said. "And so they don't have much competition, meaning that they can accept some reputational hits as long as they don't fall substantially behind the rest of the pack and become a kind of symbol of incompetence."

So what's needed to truly ensure there's no more cheating? An outright suspension, Coffee said.

"I would tell people that the next time you get caught, we are going to suspend you from representing U.S. clients for one year," he said. "They could well have suspended [the firm] from practice for several years. I think that would have been even more appropriate."

But Colombo, the Hofstra professor, sees things a bit differently, believing the settlement will have significant impacts to deter future cheating.

"These accounting firms and auditors and other specialists in the marketplace have got to have the message clearly now. There's no denying that they're under a microscope," he said.

Colombo thinks other big firms, in addition to EY, will respond by clamping down on employees' activity, "tightening up their standards internally," and reevaluating their processes and controls.

"No one wants to be next, and no one wants to be made an example of," he said. "And yes, I would imagine that these other firms will indeed take measures to prevent this from happening there."

But Colombo was uneasy about aspects of the settlement that deal with EY's attorneys. The settlement notes that the firm failed to update the October 2019 submission although senior management and "various EY senior attorneys understood" that a tipster had reported the cheating internally.

That appears to have led to stipulations in the settlement that will include probes into the "ethics and integrity applicable to accountants and attorneys." EY must also hire an independent consultant to review its policies and procedures, including assessing the "reasonableness of how entities and attorneys have responded to subpoenas, document requests and/or information requests."

The SEC may be straddling a potentially dangerous line in targeting EY attorneys given the sacredness of attorney-client privilege, Colombo said, calling it an "extremely sensitive area" and one that's potentially "fraught with peril."

The settlement points to instances where the attorney-client privilege will be honored, but in the case of the independent consultant also notes that "EY shall not seek to invoke the attorney-client privilege ... to prevent the [consultant] from transmitting any information, reports or documents to commission staff."

"If you start smoking out the attorneys, you will uncover a lot," Colombo said. "But then attorneys have a diminished role, because people will start cutting them out. ... So I hope serious thought is paid to what the limits are on these sorts of investigations."

--Editing by Philip Shea and Orlando Lorenzo.