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2022 DEVELOPMENTS FOR AUDITOR REGULATION UNDER THE U.S. SECURITIES LAWS

In this article the authors begin by discussing “stunning ethical lapses” by Ernst & Young addressed by the SEC in enforcement proceedings against the firm. They then discuss the SEC’s announced “firm commitment” to target auditor independence cases. They close discussing potential progress on addressing audit quality for China-based audits.

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Access to the United States capital markets turns on numerous third-party “gatekeepers,” including perhaps most prominently public accounting firms, who provide independent audits of the financial statements for publicly traded companies.¹ As courts have noted, the integral role of the independent audits in particular effectively transforms the firms into a “public watchdog” for investors.² Yet, over the past years, commentators have raised increasing concerns about the state of auditing, with Oxford professor Karthik Ramanna writing in 2019 that there was a “crisis of

trust” in auditing — “an especially perverse situation given the audit’s central role in fostering trust in markets.”³ An alarming series of high-profile audit failures and revelations of auditor misconduct since then has only worsened this crisis of trust.

Indeed, later that same year, one of the so-called Big Four accounting firms — KPMG — admitted to stealing confidential information concerning KPMG’s regulatory inspections. That scheme led to prison sentences for KPMG personnel, and KPMG agreed to pay a \$50 million penalty and retain an independent consultant to assess the firm’s ethics and integrity to settle charges of its own admitted wrongdoing.⁴ More recently, during the

¹ See, e.g., *SEC v. Worldcom, Inc.*, No. 02 CIV. 4963 (JSR), 2003 WL 22004827, at *17 (S.D.N.Y. Aug. 26, 2003) (“[B]oards of directors, outside auditors and outside counsel are the gatekeepers of behavior standards who are able to prevent damage before it occurs if they are alert, and above all if they are willing to act when necessary.”).

² *United States v. Arthur Young & Co.*, 465 U.S. 805, 817-818 (1984) [104 S.Ct. 1495, 1503, 79 L.Ed.2d 826]; see also, *In re Parmalat Sec. Litig.*, 375 F.Supp.2d 278, 289 (S.D.N.Y. 2005) (“Independent auditors serve a crucial role in the functioning of world capital markets because they are reputational intermediaries.”).

³ K. Ramana, Building a culture of challenge in audit firms, Sept. 2019, available at <https://www.pwc.co.uk/who-we-are/future-of-audit/building-a-culture-of-challenge-in-audit-firms.pdf>.

⁴ SEC Press Release, *KPMG Paying \$50 Million Penalty for Illicit Use of PCAOB Data and Cheating on Training Exams* (June 17, 2019); J. Godoy, *Ex-KPMG Partner Gets Year In Prison For Regulatory Fraud*, LAW360, Sept. 11, 2019, available at <https://www.law360.com/articles/1197762/ex-kpmg-partner-gets-year-in-prison-for-regulatory-fraud>.

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