



PCAOB's Tough Enforcement Likely to Continue in 2023

By Robert Cox and Steven Richards – Republished with Permission from LAW360

In November 2021, the U.S. Securities and Exchange Commission appointed four new board members, including Chair Erica Williams, to the five-member Public Company Accounting Oversight Board.^[1]

Like the SEC, the PCAOB has recently taken a more vigorous approach to enforcement of board rules and auditing standards. Throughout 2022, the new board took significant steps to overhaul the enforcement program and to establish new priorities leading to levying record civil money penalties totaling \$11 million.

The board has signaled through its increased enforcement activity and significantly higher monetary penalties that there is a new sheriff in town.

Tougher Enforcement in 2022 Likely to Continue in 2023

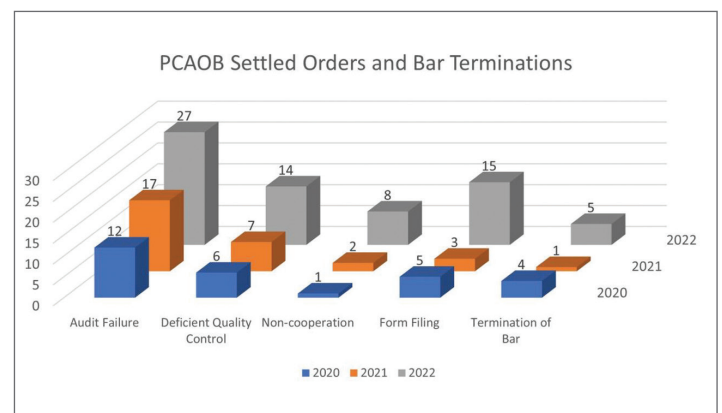
In a Law360 article last year, we predicted that:

With four new members of the board, including a new chair, who appear to be more in step with the progressive enforcement goals of SEC Chairman Gary Gensler and SEC Enforcement Director Gurbir Grewal, and a budget increase of 8% in 2022, we expect more robust inspections and enforcement activity in 2022.^[2]

That prediction proved to be accurate. Both the PCAOB's new chair and the new acting director of its Division of Enforcement and Investigations, or DEI, stated in public speeches that strengthened enforcement would be one of three priorities for the PCAOB in 2022 and 2023.

After four years of lower enforcement activity, PCAOB enforcement experienced a significant uptick in 2022 in terms of both the number of settled orders made public and the amount of civil money penalties assessed. In 2022, the PCAOB made public 41 settled orders and one adjudicated disciplinary order.^[3]

In contrast, 2018 through 2021 were years marked by a significant drop in the number of settled orders, from a high of 54 settled orders made public in 2017.^[4]



Note: Settled orders may be classified in more than one category.

In public speeches, Williams and enforcement staff have signaled their intent to strengthen enforcement going forward. In two speeches in 2022, Williams noted the board's intention "to use every tool in our enforcement toolbox and impose significant sanctions, including substantial penalties, to ensure there will be consequences for putting investors at risk."^[5]

Williams also stated that the DEI would be pursuing enforcement actions involving certain types of violations for the first time, and by increasing the use of sweeps against firms where there may be a violation of PCAOB standards or rules.^[6]

In addition, the board appears to be lowering the bar for bringing enforcement actions. Where the bar used to be a single act of reckless conduct or multiple acts of negligent conduct, Williams has noted that “a single, serious wrongful act, whether reckless or negligent” can be “serious enough to put investors at risk.”^[7]

SEC Commissioner Hester Peirce has raised concerns that such an approach to enforcement “could devolve quickly into bringing enforcement actions for minor infractions.”^[8]

Enforcement Priorities in 2023

Some key takeaways from the 2022 settled orders are:

- Both firms and individuals settling enforcement matters with the PCAOB paying on average over 300% more in civil money penalties than in 2021;
- Continued focus on violations of board processes — e.g., noncooperation with inspections due to improper alteration and backdating of audit work papers;
- Sweeps against firms related to Form AP and Form 3 filings;
- Four orders against three foreign affiliates of a Big Four firm, resulting in \$7.7 million civil money penalties imposed on the firms;
- Continued focus on cross-border audits and non-U.S. firms — 11 orders involved foreign auditors and more than half of civil money penalties were assessed against firms and individuals outside the U.S.; and
- Renewed focus on quality control violations — e.g., the KPMG exam cheating case.

In his presentation to the December 2022 American Institute of Certified Public Accountants conference, DEI acting Director Mark Adler stated that the DEI would strengthen enforcement through:

- Rigorous enforcement;
- Significant sanctions;
- Increased transparency; and
- Collaboration with other regulators.

In 2023, we anticipate the following to be enforcement trends:

- Substantially higher civil money penalties;
- Continued focus on violations of board processes — e.g., work paper alteration and backdating — including noncompliance with the board’s reporting requirements;
- Renewed focus on cross-border audits by foreign registered firms, particularly in mainland China as a result of the new cooperation agreement between the PCAOB and Chinese regulatory authorities;
- Continued focus on deficient quality controls; and
- Potentially more actions against nonpartner personnel.

High Civil Money Penalties Likely in 2023

In the past, the PCAOB has been criticized for assessing civil money penalties that were considered modest.^[9] In remarks to the December 2022 AICPA conference, Adler stated that the board is imposing stronger sanctions, including increasing penalties to promote greater accountability and deter misconduct.

Over the last five years, the PCAOB assessed penalties against individuals less than half of the time, and firms only about 86% of the time. In 2021, civil money penalties totaled only \$1.1 million, and in 2020, only \$1.5 million.

In contrast, the board assessed civil money penalties in 2022 in 100% of its settled orders, for a record total of \$11 million.^[10] Of the \$11 million, \$10.1 million was from firms and \$900,000 from individuals. Small firms got hit the most, with an increase in average civil money penalties of close to 200% between 2021 and 2022, compared to an increase of less than 70% for large firms.^[11]

Total penalties imposed against individuals more than quadrupled. New records for the PCAOB’s highest civil money penalty against an individual were set twice in 2022, with a penalty of \$100,000 in April 2022, and a penalty of \$150,000 in October 2022.^[12]

The average civil money penalty imposed on individuals associated with small firms in 2022 was only \$5,000 lower than that imposed on individuals associated with the largest six firms and their foreign affiliates,^[13] and was more than \$9,000 higher than that imposed on individuals associated with other large firms and their foreign affiliates.

The PCAOB is not alone among regulators in assessing higher civil money penalties. The U.K.'s audit regulator, the Financial Reporting Council, meted out a record £43 million (\$53.2 million at today's exchange rates) in fines to audit firms in 2022. This represents a 300% increase from 2021.

Higher civil money penalties raise heightened concerns for small firms and their associated persons. A substantial civil money penalty can be a death sentence for a small firm, and can deplete the life savings of a small firm auditor.

In four orders in 2022, involving one firm and four individuals, the PCAOB considered the financial resources of the respondents in imposing a lower civil money penalty.^[14] These orders stated what the penalty would have been prior to the reduction. In the case of the firm, the firm was a small firm that had ceased operations. In the case of the four individuals, all were associated persons of a Big Four firm.

However, the PCAOB provides little guidance as to when and how the financial resources of a firm or individual are taken into account by the board in assessing the respondent's ability to pay, and determining whether the civil money penalty should be reduced.

Continued Board Focus on Violations of Board Processes

Noncooperation with inspections continues to be an enforcement priority. Firms who improperly alter or backdate work papers, or otherwise mislead PCAOB inspectors, have received the highest civil money penalties.

The largest civil money penalty of 2022 was a \$4 million fine sanctioning KPMG's Colombia affiliate.^[15] KPMG Colombia failed to prevent or detect widespread document alteration and backdating in advance of a PCAOB inspection and failed to prevent or detect improper answer sharing in connection with internal training and related tests.

The firm was required to pay a \$4 million penalty, complete undertakings to improve its system of quality control, engage an independent consultant and agree to admissions in the settled order. PCAOB also sanctioned three associated persons of the firm.

The PCAOB has recently focused on firms' use of an unregistered firm in a substantial role on an audit. In three matters, the board sanctioned KPMG South Africa, KPMG U.K. and WWC PC for using unregistered firms to circumvent PCAOB registration requirements.^[16]

The PCAOB also conducted enforcement sweeps related to Form AP and Form 3, with seven orders against firms who failed to timely file Form AP, and six against firms who failed to timely file Form 3.

In 2022, the board sanctioned, in total, 15 firms, including two orders were not part of the sweeps, for violating PCAOB Rule 2203, on special reports, by failing to timely file Form 3 (six firms) and PCAOB Rule 3211, covering auditor reporting of certain audit participants, by failing to timely file Form AP (nine firms).

One of the 15 firms was also sanctioned for violating PCAOB Rule 2200, on annual reports, by failing to file Form 2 accurately.^[17]

Cross-Border Audit Enforcement

The PCAOB continues its focus on non-U.S. firms. Over half of the 41 settled orders in 2022 — 22 — and the sole adjudicate disciplinary order involved foreign firms and individuals.

\$9.7 million of the \$11 million civil money penalties the board imposed in 2022 were against foreign registered firms and their associated persons. The PCAOB sanctioned KPMG's South Korea affiliate and two individuals for audit failures related to accounts receivable and improper creation and alteration of work papers to cover up failures.^[18]

The firm received a \$350,000 civil money penalty and undertakings. The two individuals were each barred for three years, and received \$50,000 and \$40,000 civil money penalties, respectively.

After the Holding Foreign Companies Accountable Act was enacted in August 2022, the board signed a statement of protocol agreement with the Chinese authorities. The agreement allows the PCAOB to conduct inspections and investigations of PCAOB-registered public accounting firms in China and Hong Kong.

In December 2022, the PCAOB announced that it secured complete access to inspect and investigate registered public accounting firms in mainland China and Hong Kong. In 2023, with this new access, we anticipate that the DEI will be pursuing more investigations of Chinese auditors.

Quality Control

Quality control is a new enforcement priority. PCAOB inspectors have been increasingly focused on accounting firms' quality control systems, and 2022 saw an increase in enforcement activity in this area.

In 2022, 14 orders involved quality control violations, including seven against foreign affiliates of Big Four accounting firms. This compares to seven orders in 2021, of which two were against foreign affiliates of Big Four accounting firms.

In KPMG LLP (United Kingdom),^[19] the PCAOB sanctioned KPMG's U.K. affiliate for quality control violations involving exam cheating, and imposed a \$2 million civil money penalty and undertakings requiring the firm to revise existing quality control policies, and adopt new ones.

In another exam cheating case involving quality control standard violations, the PCAOB imposed a \$750,000 penalty and undertakings on PwC Canada.^[20]

The PCAOB sanctioned KPMG India for quality control violations for implementing and monitoring policies regarding documenting and dating of audit documentation.^[21] KPMG engagement team members signed and dated blank audit work papers, and then went back and completed the work papers after the audit opinion was issued, but before the end of the 45-day audit documentation period. The board imposed a \$1 million civil money penalty and undertakings on the firm.

Conclusion

In 2023, we expect more robust PCAOB enforcement efforts. The DEI will continue to focus on significant audit failures, quality control, audit integrity and compliance.

Both large and smaller firms and their associated persons should be prepared to face substantially higher civil money penalties in settling enforcement investigations. In addition, we expect that the DEI will be more aggressive in including multiple violations, some of which may not have been charged in the past.

We also anticipate that the PCAOB will continue its broadened use of undertakings in settled orders against firms, particularly when the violations involve quality control policies and procedures.

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Notes

- [1] Board member Duane DesParte, who was appointed to the Board in 2018, was the only Board member to survive the SEC's 2021 house cleaning.
- [2] Cox and Richards, "Expect More Robust PCAOB Enforcement This Year," Law360 (Feb. 9, 2022), <https://www.law360.com/articles/1461339/expect-more-robust-pcaob-enforcement-this-year>.
- [3] PCAOB also announced five orders terminating a bar of an accountant which are not included in the 41 settled disciplinary orders. See *In re Hyung Seung Lee*, PCAOB Rel. No. 105-2022-008 (May 24, 2022); *In re Gale Moore*, PCAOB Rel. No. 105-2022-018 (Sept. 27, 2022); *In re Alexandria Yi*, PCAOB Rel. No. 105-2022-023 (Oct. 4, 2022); *In re Marco Aurélio Paulino Neves*, PCAOB Rel. No. 105-2022-016 (Aug. 29, 2022); *In re Susan Lunn Powell*, PCAOB Rel. No. 105-2022-030 (Nov. 30, 2022).
- [4] The PCAOB made public 20 settled orders in 2018, 30 settled orders in 2019, 17 settled orders in 2020, and 21 settled orders in 2021.
- [5] Speech, Erica Y. Williams, Council of Institutional Investors (July 28, 2022), PCAOB Chair Williams Remarks on 20th Anniversary of Sarbanes-Oxley Act and Establishment of the PCAOB, pcaobus.org.
- [6] *Id.*
- [7] Speech, Erica Y. Williams, Council of Institutional Investors Fall Conference (Sept. 22, 2022), <https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-chair-williams-delivers-remarks-at-cii-fall-conference>; see also *id.* ("For any violation of PCAOB standards that is serious enough to put investors at risk, the excuse that 'it only happened once' simply won't cut it. We will not hesitate to bring cases that hinge on only a single, serious wrongful act, whether reckless or negligent").
- [8] Statement, Commissioner Hester M. Peirce, "PCAOB's Ballooning Budget" (Dec. 23, 2022), [SEC.gov](https://www.sec.gov).
- [9] In September 2019, the Project on Government Oversight published an analysis criticizing PCAOB enforcement and civil money penalties. POGO noted that only \$6.5 million in civil money penalties had been assessed against Big Four accounting firms from 2003 to 2019 and auditors at Big Four firms were fined only \$40,000 during that same period. Ellen Graper, "PCAOB on pace for record year of financial penalties," *Accounting Today* (Aug. 19, 2022).
- [10] Speech, Erica Y. Williams, Council of Institutional Investors (Jul. 28, 2022), PCAOB Chair Williams Remarks on 20th Anniversary of Sarbanes-Oxley Act and Establishment of the PCAOB, pcaobus.org.
- [11] Large firms include the 2022 Annually Inspected Firms published by the PCAOB and their foreign affiliate.
- [12] *In re Scott Marcello*, CPA, PCAOB Rel. No. 105-2022-004 (April 5, 2022) (\$100K penalty against former vice chair of KPMG LLP for failure to supervise); *In re Jonathan B. Taylor*, CPA, PCAOB Rel. No. 105-2022-025 (Oct. 18, 2022) (\$150K penalty against partner of a small firm for non-cooperation involving altering and backdating audit work papers).
- [13] The largest six firms, as referred to in this article, are BDO, Deloitte, Ernst & Young, Grant Thornton, KPMG and PricewaterhouseCoopers.
- [14] *In re KPMG Inc., Cornelis Van Niekerk and Coenraad Basson*, PCAOB Rel. No. 105-2022-015 (Aug. 29, 2022) (one individual); *In re Hall & Company Certified Public Accountants & Consultants Inc. and Anthony J. Price, CPA*, PCAOB Rel. No. 105-2022-029 (Nov. 3, 2022) (firm had ceased operations); *In re José Daniel Meléndez Giménez*, PCAOB Rel. No. 105-2022-035 (Dec. 6, 2022); *In re Edgar Mauricio Ramírez Rueda*, PCAOB Rel. No. 105-2022-036 (Dec. 6, 2022); *In re Marco Alexander Rodríguez Ramírez*, PCAOB Rel. No. 105-2022-037 (Dec. 6, 2022).
- [15] *In re KPMG S.A.S.*, PCAOB Rel. No. 105-2022-034 (Dec. 6, 2022).
- [16] *In re WWC P.C.*, PCAOB Rel. No. 105-2022-006 (Apr. 19, 2022); *In re KPMG Inc., Cornelis Van Niekerk and Coenraad Basson*, PCAOB Rel. No. 105-2022-015 (Aug. 29, 2022); *In re KPMG LLP (United Kingdom)*, PCAOB Rel. No. 105-2022-031 (Dec. 6, 2022).
- [17] See *In re Spielman Koenigsberg & Parker LLP*, PCAOB Rel. No. 105-2022-024 (Oct. 18, 2022).
- [18] *In re KPMG Samjong Accounting Corp.*, PCAOB Rel. No. 105-2022-012 (Aug. 16, 2022); *In re Jin Tae Kim*, PCAOB Rel. No. 105-2022-013 (Aug. 16, 2022) (3-year bar and \$50,000 penalty); *In re Se Woon Jung*, PCAOB Rel. No. 105-2022-014 (Aug. 16, 2022) (3-year bar and \$40,000 penalty).
- [19] *In re KPMG LLP (United Kingdom)*, PCAOB Rel. No. 105-2022-032 (Dec. 6, 2022).
- [20] *In re PricewaterhouseCoopers LLP*, PCAOB Rel. No. 105-2022-002 (Feb. 24, 2022).
- [21] *In re KPMG Assurance and Consulting Services LLP and Sagar Pravin Lakhani*, PCAOB Rel. No. 105-2022-033 (Dec. 6, 2022).

ABOUT US

Briglia Hundley was founded in 1993 and practices throughout the mid-Atlantic region. Our practice features attorneys who have been listed as "Legal Elite" by Virginia Business magazine, named to Super Lawyers, and listed in Best Lawyers.

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