
PCAOB Announces First Settled Order with Admissions

OCTOBER 9, 2015

Last week, the Public Company Accounting Oversight Board (PCAOB) joined the list of regulators who will, in certain circumstances, seek admissions of liability from audit firms and individuals in settlements. Although the conduct described in the first such settled order, *In the Matter of David A. Aronson, CPA, P.A., and David A. Aronson, CPA*¹, was egregious in that it involved multiple failures across numerous engagements over a long period of time (some of which occurred after the respondents were put on notice of the violations during a Board inspection and, in one instance, even after the Division of Enforcement had opened its investigation), the new approach has much broader implications, particularly for larger firms and their professionals.

Summary of the Settled Order

In *Aronson*, the Board entered a settled disciplinary order against a firm and its sole owner based on their repeated violations of the independence rules and engagement quality review requirements.² The Board found that Aronson and his firm had violated the independence rules by issuing audit reports related to public companies for five audit engagements in which Aronson's son had acted in an accounting role during the periods under audit.³ Aronson was aware that the audit clients had hired a bookkeeping firm owned by his son because Aronson recommended his son's firm for the work.⁴ The Board also found that the firm and Aronson failed to obtain an engagement quality review, as required under Auditing Standard No. 7 (AS 7), in ten separate audits.⁵ These violations continued even after the Board's inspectors had brought them to Aronson's attention and he had agreed with their conclusions that engagement quality reviews were required.⁶ For one of the cited audits, Aronson failed to obtain an engagement quality review despite the fact that the Division of Enforcement had notified him that it had opened an inquiry into the firm's compliance with AS 7.⁷

Based on this slew of violations, the Board permanently revoked the Firm's registration and barred Aronson from associating with a registered accounting firm.⁸

In all of its prior settled orders, the Board has included language noting that the settling parties neither admitted nor denied the Board's findings. The Aronson settlement is different in that it includes a statement that the settling parties admitted to "the facts, findings, and violations set forth in the order."⁹

Factors to Be Used in Seeking Settlements with Admissions

In prepared remarks given the same day that the *Aronson* order was announced, the PCAOB's Director of Enforcement, Claudius B. Modesti, said that, going forward, the Division now will consider requiring admissions "in appropriate matters where heightened accountability and acceptance of responsibility are in the public interest."¹⁰ He then provided a non-exhaustive set of factors that will inform the Division's thinking on whether to recommend to the Board that it require the respondent to admit to the underlying facts or violations as part of any settlement.¹¹ Those factors will include, but are not limited to, situations where the matter involves:

- egregious and intentional misconduct where the respondent knowingly and intentionally violated applicable laws, rules or standards;
- misconduct that obstructs the Board's processes, such as noncooperation with an inspection or investigation;
- significant harm or risk of harm to investors or the securities markets;
- situations where an admission can send a particularly important message to audit firms, their associated persons or the public; and
- situations where the wrongdoer poses a particular future threat to investors (e.g., recidivists).¹²

In announcing the order, Director Modesti said, "Obtaining admissions from auditors who engage in egregious misconduct enhances accountability and serves the interests of investors. Here, Aronson and his firm engaged in precisely that sort of misconduct, violating clear requirements and standards and continuing to do so even after repeated notice."¹³

Legal and Practical Implications of the New Policy

Most immediately, the new policy of seeking admissions may alter the calculus of those deciding whether to litigate or to settle disciplinary proceedings, particularly given the collateral consequences that may flow from any such admissions in parallel civil litigation or regulatory proceedings. Director Modesti acknowledged this possibility when he noted that the Division of Enforcement's interest in avoiding "extended nonpublic disciplinary proceedings" will result in most of its settlements continuing to include language stating the respondent has neither admitted nor denied the Board's findings.¹⁴

It remains to be seen how the Division and the Board will weigh these factors in specific cases, as they leave room for a significant amount of judgment in their application. Indeed, the factors are so broad that they provide little guidance at all concerning when the Board will seek admissions—a criticism that the SEC has faced in announcing the analogous factors that it considers in determining whether to seek admissions in a given case. Perhaps most concerning is the Board's "send a message" factor. It may be that the Division and/or the Board will, in the future, determine that an admission from a larger firm or from one of its associated professionals would be more likely to "send a particularly important message to audit firms, their associated persons, or the public."

¹ PCAOB Rel. No. 105-2015-0234 (Oct. 2, 2015).

²*Id.* at 1.

³*Id.* at p. 3

⁴*Id.* at p. 10.

⁵*Id.* at 3.

⁶*Id.* at 5, 7.

⁷*Id.* at 8.

⁸*Id.* at 1.

⁹*Id.*

¹⁰ Claudius B. Modesti, Director of Enforcement, "[Modification to Settlement Recommendations for Disciplinary Proceedings](#)," Address Before the American Law Institute Accountants' Liability 2015: Confronting Enforcement and Litigation Risks (Oct. 2, 2015).

¹¹*Id.*

¹²*Id.*

¹³ Press Release, Public Company Accounting Oversight Board, "[PCAOB Imposes Sanctions Against Auditor who Admitted Violating Independence Requirements and PCAOB Standards](#)" (Oct. 2, 2005).

¹⁴ Remarks by Director Modesti, *supra* note 13.

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