Securities Regulation Daily Wrap Up, ACCOUNTING AND AUDITING—Accounts with audit client subsidiary raise independence questions, (Feb. 13, 2019)

Securities Regulation Daily Wrap Up

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Dozens of Deloitte Japan employees, including its CEO, had personal financial relationships with a client's subsidiary. The amounts of these account balances compromised the firm's independence.

Deloitte Touche Tohmatsu LLC will pay $2 million to settle charges that it violated the auditor independence rules. According to the SEC, Deloitte's former CEO, and almost 90 other employees, maintained bank accounts with an audit client's subsidiary bank that exceeded deposit insurance limits, violating Regulation S-X and calling the firm's independence into question (*In the Matter of Deloitte Touche Tohmatsu LLC, Futomichi Amano, and Yuji Itagaki,*Release No. 34-85115, February 13, 2019).

Accounts balances over the limit. Deloitte served as external auditor for a financial holding company ("the Company") headquartered in Tokyo, Japan. In February 2014, a periodic inspection found that Futomichi Amano, Deloitte's CEO, had a bank account balance at a banking subsidiary of the Company that exceeded the amount insured by the Deposit Insurance Corporation of Japan. Under Rule 2-01(c)(1)(ii)(B) of Regulation S-X, an accountant is not independent if covered persons at the firm have certain financial relationships with a bank that is an audit client if the account balance exceeds the deposit insurance limit. The staff and director of Deloitte's Office of Independence did not appreciate the significance of this violation and did not report it to the audit engagement team or the Company until several months had passed.

Further investigation revealed that between 2012 and 2016, 88 covered persons had personal financial relationship violations with respect to the Company. A number of these employees, including Deloitte's director of independence, Yuji Itagaki, were in violation due to outstanding credit card balances owed to a subsidiary of the Company.

Quality controls deficient. The Commission found that Deloitte lacked a system of quality controls that would assure that the firm and its covered persons maintained independence from audit clients. For example, Deloitte twice paid its partners year-end compensation that was deposited as lump sum payments directly into their personal accounts with the Company's bank subsidiary; this caused the account balances of certain partners to exceed the insured deposit limit. In addition, the firm's Office of Independence was understaffed and lacked training about the provisions of Regulation S-X related to insurance deposit limits.

Melissa Hodgman, associate director of the SEC's Division of Enforcement said: "Auditor independence is critical to the integrity of the financial reporting process." She added that "auditor independence rules addressing bank account balances that exceed deposit insurance limits are clear, and audit firms must devote adequate resources to ensuring the independence of the firm and its personnel."

Violations. As a result of these violations, every time Deloitte signed an audit report for the Company during this period, it directly violated Rule 2-02(b) of Regulation S-X by incorrectly stating that the audits were performed in accordance with GAAS. In addition, Deloitte caused the Company to falsely report to the Commission that its financial statements had been audited by independent public accountants.

The Commission concluded that the respondents engaged in improper professional conduct and caused the audit client to violate its reporting obligations. Deloitte agreed to disgorge $971,722, plus prejudgment interest of $159,397.70, and to pay a civil money penalty $880,000. Amano was suspended from practice as an accountant for two years, and Itagaki was suspended for one year. The Commission noted that Deloitte had taken a

many remedial actions including: prohibiting covered persons from holding bank accounts with audit clients or subsidiaries; increasing independence staff; and enhancing independence training.

The release is No. 34-85115.

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