

[Securities Regulation Daily Wrap Up, TOP STORY—Auditors' close personal relationships with EY audit clients violated independence rules, \(Sept. 19, 2016\)](#)

Securities Regulation Daily Wrap Up

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By [Jacquelyn Lumb](#)

The SEC has announced its first enforcement actions against auditors that violated the independence rules by developing close personal relationships with their audit clients, one platonic and the other romantic. SEC Enforcement Director Andrew Ceresney noted that most of the SEC's independence violation cases have centered on financial rather than personal relationships. The auditors were employed by Ernst & Young LLP, which agreed to pay \$9.3 million to settle the charges (*In the Matter of Ernst & Young LLP*, [Release No. 34-78872](#), September 19, 2016; *In the Matter of Ernst & Young LLP*, [Release No. 34-78873](#), September 19, 2016).

Platonic relationship. Gregory Bednar, a former EY partner, developed an inappropriate close relationship with the then-chief financial officer of a New York-based audit client after being asked by the firm to improve relationships with what was considered a troubled account. The issuer had considered replacing the firm, but retained it after Bednar was named the coordinating partner of a new audit team.

High expenditures. EY had policies relating to independence, including directives on travel and gifts, but Bednar repeatedly violated these policies throughout 2012-2014, incurring entertainment expenses of over \$100,000 for activities involving the CFO. The majority of the expenses were billed to the issuer as audit expenses. According to the SEC's order, Bednar's relationship with the CFO and his family developed into a close personal friendship in addition to the significant entertainment spending.

A number of EY partners were aware of Bednar's expenditures and his relationship with the CFO. One partner asked him to reduce his expense spending but did not question whether the levels of his expenditures suggested a violation of EY's policies or the existence of an inappropriate personal relationship. The issuer also inquired about the expenses that Bednar was billing. The SEC's [order](#) notes that EYs' independence procedures did not specially inquire about close personal relationships. EY also failed to obtain preapprovals to perform certain non-audit services for the issuer.

Penalties. Bednar was ordered to pay a civil money penalty of \$45,000. He was censured and denied the privilege of appearing or practicing before the Commission as an accountant, with the right to request reinstatement in three years. EY paid disgorgement of \$3,562,400, together with prejudgment interest of \$212,600 and a civil money penalty of \$1.2 million. EY also improved its policies, procedures, training, controls, and reporting with respect to client entertainment and expenses.

Romantic relationship. In the second [administrative proceeding](#), Pamela Hartford, then an EY partner, was involved in a romantic relationship with an audit client's chief accounting officer, Robert Brehl, while she was part of the engagement team that performed audit and review services for the issuer. Michael Kamienski, the coordinating partner on the engagement team, was aware of the romantic relationship but did not raise concerns with the firm's independence group. Hartford and Brehl attempted to hide the relationship but a number of employees observed interactions that raised concerns about a possible inappropriate relationship.

Whistleblower complaint. Kamienski discussed the possible relationship with EY vice presidents, but never asked Hartford about it. He bore the ultimate responsibility for independence issues on the engagement. One of the vice presidents made an internal whistleblower complaint to the issuer about the relationship. The issuer instituted an internal investigation which revealed the romantic relationship between Hartford and Brehl.

Withdrawal of audit reports. Following its own investigation, EY had to withdraw its audit reports on the 2012-2013 financial statements along with the reports on the effectiveness of internal control over financial reporting. The issuer hired another firm to re-audit the financial statements, and no restatement was made. Hartford and Brehl were terminated and Kamienski left the firm after EY requested his resignation.

Penalties. Hartford, Kamienski are denied the privilege of appearing or practicing before the Commission as accountants for three years, and Brehl for one year. EY was ordered to pay disgorgement of \$3,168,500 in audit fees, prejudgment interest of \$198,151, and a civil money penalty of \$1 million. Hartford and Brehl were ordered to pay \$25,000 each.

As a result of this matter, EY also improved its annual audit and quarterly review independence policies and procedures, training, controls, and reporting regarding close personal relationships and the impact of those relationships on EY's independence.

All of the respondents settled the proceedings without admitting or denying the findings. In the [news release](#) announcing the proceedings, the SEC acknowledged the assistance of the PCAOB with its investigation. Ceresney would not confirm whether PCAOB inspections played a role in the discovery of the violations.

The releases are [Nos. 34-78872](#) and [34-78873](#).

Companies: Ernst & Young LLP

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