

Chapter 8

Defending Clients in Public Company Accounting Oversight Board Investigations

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Bruce M. Bettigole and Jeffrey F. Robertson, *Defending Clients in Public Company Accounting Oversight Board Investigations*, ch. 8 from Mark P. Goodman and Daniel J. Fetterman, *Defending Corporations and Individuals in Government Investigations* (2011). Reprinted with permission (Thomson Reuters/Thomson West) for marketing purposes. Individual chapter may not be commercially sold. Entire work is available for purchase at <http://west.thomson.com/defending-corporations-individuals-in-government-investigations-2011/161391/40824893/productdetail>.

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I. INTRODUCTION

§ 8:1 Scope

This chapter is intended to provide an overview of the enforcement mechanism—investigations and disciplinary proceedings—of the Public Company Accounting Oversight Board (“PCAOB” or “Board”). After discussing events leading to the PCAOB’s formation, its responsibilities, objectives and structure, this chapter summarizes two key elements of the PCAOB’s enforcement apparatus—those related to its registration and inspections responsibilities and to its investigation and enforcement authority. Thereafter, the chapter summarizes the potential violations and sanctions available to the PCAOB before concluding with a start to finish overview of the key rules, procedures and considerations related to Board investigations and disciplinary proceedings.

II. BACKGROUND

§ 8:2 Formation

Historically, regulation of the public accounting profession and enforcement of its standards largely were dependent on the profession itself. The American Institute of Certified Public Accountants (“AICPA”), a private trade organization, was the primary self-regulatory authority. It inspected public accounting firms through peer reviews designed to ensure that financial statement audits were performed consistently with the profession’s standards. AICPA could impose enforcement actions for violations, but the system was flawed because the AICPA depended on industry funding, which had been cut off in order to curtail enforcement efforts.

Buttressing this self-regulation, the state boards of accountancy and the Securities and Exchange Commission (“SEC”) also participated in oversight of the accounting profession. State boards have the ability to grant and revoke licenses, but they are hampered by limited budgets and a lack of effective investigative

and disciplinary mechanisms.¹ The SEC has the authority to make and enforce accounting and auditing rules but, as with state boards, its resources are constrained, so the SEC limits its enforcement efforts to the most egregious violations.

By 2002, many observers concluded that a systemic problem existed with the disciplinary function of the public accounting industry's self-regulation, and that changes were needed. The AICPA had never disciplined a major accounting firm,² and less than one in five accountants who had been sanctioned by the SEC for unprofessional conduct faced disciplinary action by the AICPA.³

In response to the major accounting scandals involving Enron, WorldCom and similar corporate governance issues that arose in 2001 and 2002, Congress created the Public Company Accounting Oversight Board ("PCAOB" or the "Board"). As a cornerstone of the Sarbanes-Oxley Act of 2002 ("Sarbanes Oxley"),⁴ the PCAOB's immediate mission was to restore investor confidence in the securities markets by ensuring the integrity of the accounting firms that audit financial statements for publicly traded companies.⁵ According to Sarbanes-Oxley, the Board's purpose is to "oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies

[Section 8:2]

¹U.S. Gen. Accounting Office, No. 02-411, *The Accounting Profession: Status of Panel on Audit Effectiveness Recommendations to Enhance the Self-Regulatory System* 6 (May 2002).

²Lisa K. Bukser-Schulz, *Congratulations to Arthur Andersen: Why Self-Regulation of the Accounting Industry Doesn't Work*, 4 *Institutional Investor Advocate: A Securities Fraud and Corporate Governance Quarterly* 2 (2002) (first quarter), available at http://www.blbglaw.com/news/publications/advocate/2002/01/_res/id=sa_File1/adv2002Q1.pdf.

³Lisa K. Bukser-Schulz, *Congratulations to Arthur Andersen: Why Self-Regulation of the Accounting Industry Doesn't Work*, 4 *Institutional Investor Advocate: A Securities Fraud and Corporate Governance Quarterly* 2 (2002) (first quarter), available at http://www.blbglaw.com/news/publications/advocate/2002/01/_res/id=sa_File1/adv2002Q1.pdf.

⁴Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28 and 29 U.S.C.A.).

⁵See Weiss, *Some Thoughts on an Agenda for the Public Company Accounting Oversight Board*, 53 *Duke L. J.* 491, 492 (2003).

the securities of which are sold to, and held by and for, public investors.”⁶

The PCAOB is a private-sector, nonprofit organization. It is not a government agency, and its Board members and staff are not officers, employees, or agents of the Federal Government. As provided by Sarbanes-Oxley, the PCAOB is funded by accounting support fees paid by public companies based on their market capitalization.⁷ The amount of a company’s annual accounting support fee is based on its share of the average monthly U.S. equity market capitalization of publicly traded companies, investment companies and other equity issuers. As a result, the fee allocation is weighted more heavily to larger issuers. The Board must establish a budget for each fiscal year, subject to SEC approval.⁸ The overall budget for the PCAOB for its fiscal year 2011 is \$204 million.⁹ At the end of 2009, the PCAOB had 567 employees in offices in Washington, DC, Atlanta, Chicago, Dallas, Denver, Irvine, New York and San Mateo as well as satellite offices in Boston, Detroit, Houston and Tampa.¹⁰

Sarbanes-Oxley establishes the Board’s primary responsibilities: (i) registration of accounting firms that audit public companies trading in U.S. securities markets; (ii) inspections of registered public accounting firms; (iii) establishment of auditing and related attestation, quality control, ethics and independence standards for registered accounting firms; and (iv) investigation and discipline of registered accounting firms and their associated persons for violations of specified laws or professional standards.¹¹

⁶Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 101(a), 116 Stat. 745 (codified at 15 U.S.C.A. § 7211(a)).

⁷Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 101(a), 109, 116 Stat. 745 (codified at 15 U.S.C.A. §§ 7211(a), 7219).

⁸Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 101(a), 109, 109(b), 116 Stat. 745 (codified at 15 U.S.C.A. §§ 7211(a), 7219, 7219(b)).

⁹The following five programmatic areas received the largest allocations in the Board’s 2011 budget: Division of Registration and Inspections (\$91 million); Office of Administration (\$58 million); Division of Enforcement and Investigations (\$17 million); Office of Research and Analysis (\$9 million); Office of the Chief Auditor (Standards) (\$7 million); and Office of General Counsel (\$5 million). See PCAOB Budget by Program Area (2009–2011), available at <http://pcaobus.org/About/Ops/Documents/Fiscal%20Year%20Budgets/2011.pdf>.

¹⁰PCAOB, 2009 Annual Report 11, available at <http://pcaobus.org/About/Ops/Documents/Annual%20Reports/2009.pdf>.

¹¹Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 101(c)(1) to (8), 116 Stat. 745 (codified at 15 U.S.C.A. § 7211(c)(1) to (8)).

§ 8:3 Responsibilities

The PCAOB is responsible for overseeing a diverse population of registered public accounting firms including firms based in the United States and abroad. These firms range from sole proprietorships to large audit firms with extensive global networks. The PCAOB also faces challenges due to the concentration of the audit market. According to the PCAOB, the four largest accounting firms audit 98% of the global market capitalization of public companies whose securities trades on U.S. exchanges. In contrast, midsized and smaller audit firms audit almost 80% of the more than 3,600 smallest companies (*i.e.*, those with revenues of less than \$100 million).¹

§ 8:4 Responsibilities—Registration

Section 102 of Sarbanes-Oxley prohibits accounting firms that are not registered with the Board from preparing or issuing, or participating in the preparation or issuance of, audit reports on United States public companies.¹ Registration of accounting firms is the basis for the Board's inspection, enforcement and related functions.

While most public accounting firms registered with the PCAOB in 2003 and 2004, the PCAOB continues to receive new applications for registration, most of which involve firms located outside the United States. Currently, there are approximately 2,400 accounting firms registered with the Board, including 900 non-U.S. firms.² During 2009 and 2010, more than 500 firms that audit broker-dealers, but not public companies, registered with the PCAOB.³ The PCAOB gained the authority to establish and enforce audit and related practice standards for broker-dealer

[Section 8:3]

¹See Public Company Oversight Board Strategic Plan (2010–2014) 15 (Nov. 2010).

[Section 8:4]

¹See PCAOB, 2009 Annual Report 5, available at <http://pcaobus.org/About/Ops/Documents/Annual%20Reports/2009.pdf>.

²James R. Doty, PCAOB Chairman, “Testimony Concerning the Role of the Accounting Profession in Preventing Another Financial Crisis” before the U.S. Senate Committee on Banking, Housing and Urban Affairs (April 6, 2011), available at http://pcaobus.org/News/Speech/Pages/04062011_DotyTestimony.aspx.

³See PCAOB, Public Company Accounting Oversight Board Strategic Plan (2010–2014) 15, n.3 (Nov. 2010), available at <http://pcaobus.org/About/Ops/Documents/Strategic%20Plans/2010–2014.pdf>.

audits in July 2010 with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act.⁴

§ 8:5 Responsibilities—Inspections

Sarbanes-Oxley requires the PCAOB to conduct a continuing program of inspections to assess the compliance of registered public accounting firms and their associated persons with Sarbanes-Oxley, PCAOB rules, SEC rules and professional standards in connection with audits, issuance of audit reports and related matters involving public companies.¹ Since 2003, the PCAOB has conducted more than 1,600 inspections of firms' quality controls and reviewed aspects of more than 7,000 public company audits. The PCAOB uses a variety of analytical techniques to select high-risk engagements and audit areas that are likely to raise challenging or difficult issues.²

The Board's rules provide for two types of inspections—"regular" inspections and "special" inspections.³ Regular inspections occur at regular intervals—annually for the approximately 875 registered firms that regularly audit more than 100 issuers and triennially for all other firms. Sarbanes-Oxley authorizes the PCAOB, with SEC approval, to adjust the frequency of its inspections.⁴ Special inspections are conducted at the request of the SEC or the Board. They are not subject to an inspection schedule and are commenced as circumstances warrant.⁵

In 2010, the PCAOB inspected 245 registered accounting firms. Of these, 9 had audited more than 100 public companies during the prior year. The other 236 firms included 172 U.S. firms and

⁴See Public Company Accounting Oversight Board Strategic Plan at (2010–2014) 16 (Nov. 2010).

[Section 8:5]

¹Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 104, 116 Stat. 745 (codified at 15 U.S.C.A. § 7214).

²James R. Doty, PCAOB Chairman, "Testimony Concerning the Role of the Accounting Profession in Preventing Another Financial Crisis" before the U.S. Senate Committee on Banking, Housing and Urban Affairs (April 6, 2011), available at http://pcaobus.org/News/Speech/Pages/04062011_DotyTestimony.aspx.

³PCAOB Rules 4001, 4002, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_4.aspx.

⁴Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 104(b)(2), 116 Stat. 745 (codified at 15 U.S.C.A. § 7214(b)(2)).

⁵See PCAOB Rule 4002, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_4.aspx#rule4002.

64 non-U.S. firms located in 20 jurisdictions.⁶ PCAOB inspectors reviewed portions of more than 350 audits performed by nine firms subject to annual inspection, and portions of more than 600 audits performed by the remaining 245 inspected firms.⁷

The PCAOB continues to refine its inspection program, including changes that have resulted in more, and more sophisticated, inspection referrals. In 2009, following an internal evaluation of its non-U.S. inspection program, the PCAOB revised its inspection methodologies to better address audits of large, networked firms or multi-national companies and created a central office to oversee its non-U.S. inspection program.⁸

Even so, PCAOB inspectors have not been able to inspect all of the non-U.S. firms it is required to inspect. Approximately 70 firms in 24 jurisdictions—including in the European Union, Switzerland and China—had inspection deadlines in 2010 or earlier that have not been met. Addressing this issue is one of the PCAOB's highest priorities. Recently, the PCAOB reached agreements with the United Kingdom and Switzerland to permit joint inspections by the Board and home-country regulators that will enable PCAOB inspectors to evaluate audit work in these countries on which U.S. investors rely. These arrangements are the first cooperative agreements that the PCAOB has concluded since the passage of Dodd-Frank, which amended Sarbanes-Oxley to permit the PCAOB to share confidential information with its non-U.S. counterparts under certain conditions.⁹

§ 8:6 Responsibilities—Adoption of professional standards

Sarbanes-Oxley directs the Board to establish auditing, related

⁶See James R. Doty, PCAOB Chairman, “Testimony Concerning the Role of the Accounting Profession in Preventing Another Financial Crisis” before the U.S. Senate Committee on Banking, Housing and Urban Affairs (Apr. 6, 2011), available at http://pcaobus.org/News/Speech/Pages/04062011_DotyTestimony.aspx.

⁷James R. Doty, PCAOB Chairman, “Testimony Concerning the Role of the Accounting Profession in Preventing Another Financial Crisis” before the U.S. Senate Committee on Banking, Housing and Urban Affairs (Apr. 6, 2011), available at http://pcaobus.org/News/Speech/Pages/04062011_DotyTestimony.aspx.

⁸See PCAOB, 2009 Annual Report 12, available at <http://pcaobus.org/About/Ops/Documents/Annual%20Reports/2009.pdf>.

⁹James R. Doty, PCAOB Chairman, “Testimony Concerning the Role of the Accounting Profession in Preventing Another Financial Crisis” before the U.S. Senate Committee on Banking, Housing and Urban Affairs (Apr. 6, 2011), available at http://pcaobus.org/News/Speech/Pages/04062011_DotyTestimony.aspx.

attestation, quality control, independence and ethics standards to be used by registered public accounting firms in preparing and issuing audit reports.¹ It also authorizes the Board to establish rules needed to implement auditor independence requirements.²

The Board elected not to exercise its authority to designate a group of accountants or an advisory group as a source of auditing standards.³ Instead, the Board decided it would set the auditing standards for the profession.⁴ To assist it in standard-setting, the Board convened a Standing Advisory Group (“SAG”) to advise it about establishing auditing and related professional practice standards.⁵ The SAG is comprised of 30 individuals with expertise in a variety of fields, including accounting, auditing, corporate finance, corporate governance, and investing in public companies.⁶

The Board also invites public participation in the standard-setting process, recognizing that the development of such standards should be an open, public process in which investors, the accounting profession, the preparers of financial statements, and others can contribute. In addition, the Board’s staff assists to draft proposed standards and to advise the Board in its standard-setting. When appropriate, the Board also may establish ad hoc task forces to assist the staff with drafting technical language, among other things.

After completing the development process, including consultation with the SAG and others, the Board’s staff recommends proposed standards to the Board in an open meeting. Proposed standards approved by the Board ordinarily will be published for public consideration and comment. After the Board and its staff evaluate the comments received, in an open meeting the Board’s staff recommends a final standard, revised as necessary and appropriate based on the comments received. Final standards

[Section 8:6]

¹Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 103(a)(1), 116 Stat. 745 (codified at 15 U.S.C.A. § 7213 (a)(1)).

²Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 103(b), 116 Stat. 745 (codified at 15 U.S.C.A. § 7213(b)).

³Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 103(a)(4), 116 Stat. 745 (codified at 15 U.S.C.A. § 7213(a)(4)).

⁴See Order Regarding Section 103(a)(3)(B) of the Sarbanes-Oxley Act of 2002, Securities Act Release No. 8222, 80 SEC Docket 142 (Apr. 25, 2003).

⁵Press Release, PCAOB, Board Establishes Standing Advisory Group (Apr. 15, 2004).

⁶Press Release, PCAOB, Board Establishes Standing Advisory Group (Apr. 15, 2004).

adopted by the Board are submitted to the SEC for approval and do not become effective unless approved by the Commission.

§ 8:7 Responsibilities—Enforcement

Under the rules, the Board and its staff may conduct investigations¹ concerning any acts or practices, or omissions to act, by registered public accounting firms and persons associated with such firms, or both, that may violate the following: (i) any provision of Sarbanes-Oxley; (ii) Board rules; (iii) the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants thereto, including SEC rules issued under Sarbanes-Oxley; or (iv) professional standards. The Board's rules require registered accounting firms and their associated persons to cooperate with Board investigations, including producing documents and providing testimony. The rules also permit the Board to seek information from other persons, including clients of registered firms.

Federal securities laws, including Sarbanes-Oxley, allow for concurrent enforcement jurisdiction over auditor's conduct by the SEC and the PCAOB. Pursuant to Sarbanes-Oxley and PCAOB rules, the PCAOB closely coordinates its enforcement efforts with those of the SEC.² A typical scenario will involve a PCAOB investigation of the auditor's conduct and an SEC inquiry focused on the public company, its management and other parties over whom the PCAOB lacks jurisdiction. Where the SEC takes responsibility for an investigation, the PCAOB has, in some instances, refrained from commencing disciplinary proceedings at the request of the SEC's Division of Enforcement. In other cases, both the SEC and the PCAOB bring charges for alleged auditor failures.³ Sarbanes-Oxley also provides that information gathered in PCAOB investigations may be shared with the U.S. Depart-

[Section 8:7]

¹See §§ 8:16 to 8:32.

²Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 105(b)(4)(A), 116 Stat. 745 (codified at 15 U.S.C.A. § 7215(b)(4)(A)).

³A recent example involved settled proceedings filed against auditors for Satyam Computer Services Ltd., for alleged auditing failures. Pursuant to their overlapping authority, both the PCAOB and SEC imposed substantial fines and undertakings. See *In re Matter of Price Waterhouse, Bangalore, et al.*, PCAOB Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions, PCAOB Release No. 105-2011-002 (April 5, 2011) and *In re Lovelock & Lewes, et al.*, SEC Order Instituting Proceedings, Securities Exchange Act of 1934 Rel. No. 64184 (Apr. 5, 2011).

ment of Justice, certain federal banking regulators, states attorneys general and state regulatory authorities.⁴

The Board also is authorized to impose a range of disciplinary sanctions⁵ against registered accounting firms and associated persons who violate those laws, rules or standards. The PCAOB has publicly announced the resolution of 37 enforcement proceedings. These proceedings include 29 sanctions on firms, including revocation of 19 firms' registrations, preventing them from auditing public companies in the future, and 40 sanctions on individuals. Sanctions have also included significant monetary penalties.⁶

While many deficient auditing practices are addressed through the inspection and remediation process,⁷ the Board's enforcement authority is an important though, as yet, largely untested tool. Where it deems it appropriate, the Board takes disciplinary actions against firms and audit professionals for perceived violations.⁸

§ 8:8 Organizational structure—Board

Sarbanes-Oxley provides that the Board has five members, appointed by the SEC, in consultation with the Federal Reserve and the Treasury Department. The members must be “prominent individuals of integrity and reputation who have a demonstrated commitment to the interests of investors and the public, and an understanding of the responsibilities for and nature of the financial disclosures required of issuers under the securities laws and the obligations of accountants with respect to the preparation and issuance of audit reports with respect to such disclosures.”¹ Two of the five members must be accountants. Members serve on a full-time basis, cannot pursue other profes-

⁴Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 105(b)(4)(B), 116 Stat. 745 (codified at 15 U.S.C.A. § 7215(b)(4)(B); see also § 8:30.

⁵See §§ 8:33 to 8:50.

⁶James R. Doty, PCAOB Chairman, “Testimony Concerning the Role of the Accounting Profession in Preventing Another Financial Crisis” before the U.S. Senate Committee on Banking, Housing and Urban Affairs (Apr. 6, 2011), available at http://pcaobus.org/News/Speech/Pages/04062011__DotyTestimony.aspx (hereafter “4/6/11 Doty Testimony”).

⁷See § 8:9.

⁸See § 8:10.

[Section 8:8]

¹Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 101(e)(1), 116 Stat. 745 (codified at 15 U.S.C.A. § 7211(e)(1)).

sional or business activity and cannot share in profits from public accounting firms or receive other payments from such firms, other than fixed retirement payments.²

§ 8:9 Organizational structure—Division of Registration and Inspection

The Board's Division of Registration and Inspections ("DRI") is responsible for overseeing the registration and periodic inspection of public accounting firms. Its staff, which represents half of the Board's workforce, is located across the United States, including a Washington D.C. office and regional offices in Atlanta, Chicago, Dallas, Denver, New York, Los Angeles and San Francisco. By the end of 2009, the DRI included 315 employees.¹ According to the PCAOB, in 2007, the inspection team leaders responsible for large firm inspections had an average of more than 23 years of relevant experience, with the overall inspection team members averaging 15 years of relevant experience.² DRI senior management consists of a Director and four Deputy Directors—one each for domestic inspections, international inspections, inspection analysis, and registration.

Sarbanes-Oxley requires the Board, in accordance with its rules, to take the following steps in each inspection:

- Identify any act, practice or omission to act by the firm, or by any associated person thereof, revealed by such inspection that may be in violation of Sarbanes-Oxley, Board or SEC rules, or the firm's own quality control policies or professional standards;
- Report any such act, practice, or omission, if appropriate, to the Commission and each appropriate State regulatory authority; and
- Begin a formal investigation or take disciplinary action, if

²Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 101(e)(2), (3), 116 Stat. 745 (codified at 15 U.S.C.A. § 7211(e)(2), (3)).

[Section 8:9]

¹See Performance Review: Internal Control Review of the Public Company Accounting Oversight Board's Inspection Activities (IOPA-2005-003) 2 (Dec. 14, 2005) and PCAOB 2009 Annual Report at 13.

²PCAOB, 2007 Annual Report 7, available at http://pcaobus.org/About/Op_s/Documents/Annual%20Reports/2007.pdf.

appropriate, with respect to any such violation, in accordance with Sarbanes-Oxley and Board rules.³

Section 4 of the PCAOB's rules establishes the basic framework for the Board's inspection process, including reporting the results of inspections, notifying the SEC regarding possible violations of Sarbanes-Oxley or other requirements, and communicating with registered firms regarding the inspection results. The inspection process involves reviews of specific audits as well as assessments of the quality control environment at registered firms. As part of inspections, firms are asked to respond to the inspection team's written comments on issues related to the accounting and audit work being inspected.

PCAOB inspections typically review portions of selected audit engagements performed in the prior year by the registered firm being inspected. During the 2004 to 2007 period, DRI inspected between 348 and 521 issuer audits each year.⁴ The selected engagements, as well as specific portions of engagements, are chosen for inspection based on the Board's assessment of the risk of material misstatements or significant audit deficiencies, as well as other firm-specific risks. The Board's Office of Research and Analysis assists PCAOB inspectors to select audit engagements and the risks within each engagement to be reviewed.⁵

Beyond specific engagements, PCAOB inspections also review certain firms' practices, policies and procedures that relate to audit quality more generally. For larger firms, these reviews have addressed quality control systems concerning the following areas: tone at the top; partner evaluation, compensation, admission, assignment and disciplinary actions; independence implications of non-audit services, business arrangements and alliances; client acceptance and retention practices; practices concerning consultations on accounting, auditing and SEC matters; internal

³See PCAOB Rules 4002, 4003, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_4.aspx.

⁴See Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms, PCAOB Rel. No. 2008-008, at 5 (Dec. 5, 2008).

⁵See Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms, PCAOB Rel. No. 2008-008, at 9 (Dec. 5, 2008).

inspection programs; staffing procedures; and supervision by U.S. audit engagement teams of work performed by foreign affiliates.⁶

DRI prepares written reports summarizing its inspections. The DRI Director must submit to the Board a written draft report. The rules set forth the process by which a draft inspection report will be made available to a firm under review in order that the firm may submit any comments or other views concerning the draft report.⁷

Pursuant to Sarbanes-Oxley, final inspection reports include a portion that is publicly available.⁸ The public portion describes deficiencies noted (ordinarily on an audit-by-audit basis) that reach a certain level of significance. The threshold for inclusion in the public portion of an inspection report is that the deficiency is of such significance that it appeared to the inspection team that the firm, at the time it issued its audit report, had not obtained sufficient competent evidential matter to support its opinion on the issuer's financial statements.⁹ Sarbanes-Oxley provides that inspection reports will be made available to the public, subject to certain statutory limits on public disclosure.¹⁰ The public portions of inspection reports are available on the PCAOB's web site and provide a revealing summary of significant auditing deficiencies uncovered during PCAOB inspections.¹¹

If an inspection gives rise to concerns about a firm's quality control system, the issues are described in a nonpublic portion of the report.¹² Remediation of perceived deficiencies is an important goal, pursuant to which the PCAOB requires that firms address

⁶See Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms, PCAOB Rel. No. 2008-008, at 5, 6-7 (Dec. 5, 2008).

⁷PCAOB Rule 4007(a), (b).

⁸Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 104(g)(2), 116 Stat. 745 (codified at 15 U.S.C.A. § 7214(g)(2)).

⁹See Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms, PCAOB Rel. No. 2008-008, at 7 (Dec. 5, 2008).

¹⁰Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 104(g)(2), 116 Stat. 745 (codified at 15 U.S.C.A. § 7214(g)(2)).

¹¹See Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms, PCAOB Rel. No. 2008-008, at 10 (Dec. 5, 2008).

¹²See Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms, PCAOB Rel. No. 2008-008, at 7-8 (Dec. 5, 2008).

areas of concern in a timely manner.¹³ As such, quality control issues remain nonpublic unless the firm fails to address them to the PCAOB's satisfaction within 12 months of the date of the inspection report. The Board's determination about whether a firm has made sufficient progress requires consideration and deliberation and typically concludes some time after the running of the 12-month period for remediation.¹⁴ As of December 2008, all of the domestic annually inspected firms had submitted to the PCAOB evidence of their remediation of defects noted in the 2004 and 2005 inspection reports.¹⁵ During 2009, the Board made determinations of quality control remediation efforts concerning 93 inspection reports. For 77 of the reports, the Board made favorable determinations and, therefore, did not publish the nonpublic portions of the reports. The remaining 16 reports were published because the Board concluded that issues had not been remediated.¹⁶

The PCAOB attempts to issue its inspection reports in a timely manner to permit firms to address and remediate any quality control deficiencies during the inspection process. In 2009, the actual average time to issue inspection reports was 8 months for annual inspections and 11 months for triennial inspections.¹⁷

Sarbanes-Oxley requires the PCAOB to transmit inspection reports in appropriate detail to the SEC and each appropriate state regulatory authority.¹⁸ In the most serious cases, matters identified during inspections may be referred to the Division of Inspections and Enforcement for potential investigation and disciplinary action, or may be reported (outside the context of an inspection report) to other authorities, such as the SEC or the relevant state board of accountancy. Referrals to the SEC may

¹³PCAOB, 2007 Annual Report 8, available at <http://pcaobus.org/About/Op s/Documents/Annual%20Reports/2007.pdf>.

¹⁴PCAOB, 2007 Annual Report 11, available at <http://pcaobus.org/About/Op s/Documents/Annual%20Reports/2007.pdf>.

¹⁵See Report on the PCAOB's 2004, 2005, 2006, and 2007 Inspections of Domestic Annually Inspected Firms, PCAOB Rel. No. 2008-008, at 8 (Dec. 5, 2008).

¹⁶PCAOB, 2009 Annual Report at 14.

¹⁷PCAOB, 2009 Annual Report at 53.

¹⁸Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 104(g)(1), 116 Stat. 745 (codified at 15 U.S.C.A. § 7214(g)(1)).

relate to potential violations by persons or entities other than a firm, including a firm's public company clients.¹⁹

While information prepared or received by the Board in connection with inspections of a registered public accounting firm is confidential, the PCAOB's rules permit it to publish summaries, compilations, or general reports concerning the results of various inspections, so long as doing so does not identify the firm or firms to which the criticisms relates.²⁰

§ 8:10 Organizational structure—Division of Enforcement and Investigations

Sarbanes-Oxley grants the PCAOB broad investigative and disciplinary authority over registered public accounting firms and persons associated with such firms, and directs the Board to establish fair procedures for the investigation and discipline of registered public accounting firms and their associated persons.¹ The Board established the Division of Enforcement and Investigations (“DEI”) to carry out the Board's investigative and enforcement responsibilities.

The Board has implemented its investigatory and disciplinary programs attempting to accomplish four subsidiary goals:

- **Speed.** The Board believes it is important that it immediately investigate significant instances of apparent “audit failure” (*i.e.*, instances in which it appears that a registered public accounting firm has issued an unqualified opinion with respect to financial statements that are later determined to have been materially inaccurate). Investigations that occur many months after the public becomes aware of the material defects in financial statements on which it has relied are unlikely to promote confidence in the auditing profession and in the Board's oversight. Conversely, prompt investigations should help to restore confidence.

¹⁹Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 104(g)(1), 116 Stat. 745 (codified at 15 U.S.C.A. § 7214(g)(1)).

²⁰PCAOB Rule 4010, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_4.aspx#rule4010. In December 2008, for instance, the PCAOB published a report containing observations during its 2004–2007 inspections of the eight domestic public accounting firms that have been inspected annually since the PCAOB's inception. See PCAOB's Inspection Report. This report provides a useful overview of issues and trends related to quality control systems.

[Section 8:10]

¹Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 104(h)(3), 116 Stat. 745 (codified at 15 U.S.C.A. § 7214(h)(3)).

- ***Fairness.*** The Board is committed to the principle that persons charged with violations should have a full and fair opportunity to present relevant evidence and arguments in their defense before any final determination is made.
- ***Thoroughness.*** Disciplinary proceedings will be based on a comprehensive investigation of the underlying facts. The Board believes that, before any person subject to its jurisdiction is charged with a violation and required to incur the expense and burden of mounting a defense, an ample investigatory record, which affords reasonable support for the charges, should be compiled.
- ***Accountability.*** The Board will strive to strike an appropriate balance between the need to foster the diligence and creativity of its staff and its responsibility to oversee and supervise the enforcement program. The Board wishes to avoid unnecessary bureaucracy and procedural impediments to swift and effective disciplinary proceedings, without compromising due process. At the same time, the members of the board recognize, and intend to discharge, their responsibility under Sarbanes-Oxley to actively supervise the enforcement program.²

Currently, DEI senior management consists of a Director and three Deputy Directors. At the end of 2009, the DEI included 44 full-time regular personnel consisting of attorneys, accountants, administrative staff, paralegals, and research analysts, all based in Washington, DC and New York.³

Section 5 of the PCAOB's Rules establishes the framework for the PCAOB's investigation and adjudication process, including conducting inquiries and investigations; commencing disciplinary proceedings; imposing related sanctions; and conducting Board hearings.⁴

Under the Board's adopted rules, the Board and its staff may investigate any act or practice, or omission to act, by registered public accounting firms and persons associated with such firms, or both, that may violate any provision of Sarbanes-Oxley, the

²PCAOB Working Paper Regarding Board Investigations and Disciplinary Proceedings 2 (Apr. 21, 2003).

³PCAOB, 2009 Annual Report at 15.

⁴The PCAOB proposed comprehensive rules relating to its investigations and enforcement actions, which the SEC adopted on May 14, 2004. See Board Adopts Rules on Investigations, Registration Withdrawal, PCAOB Rel. No. 2003-015 (Sept. 29, 2003); see also Order Approving Proposed Rules Relating to Investigations and Adjudications, SEC Release No. 34-49704, 82 SEC Docket 3076 (May 14, 2004).

rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants, including as relates to professional standards.⁵ The PCAOB's rules require registered public accounting firms and their associated persons to cooperate with Board examinations, including producing documents and providing testimony. Although the rules also permit the Board to seek information from other persons, including clients of registered firms, the PCAOB lacks a direct enforcement mechanism related to non-registered persons or entities.

When violations are detected, the Board will provide an opportunity for a hearing, and in appropriate cases, impose sanctions designed to deter a possible recurrence and to enhance the quality and reliability of future audits. The sanctions may be as severe as revoking a firm's registration or barring a person from participating in audits of public companies. Lesser sanctions include monetary penalties and requirements for remedial measures, such as training, new quality control procedures, and the appointment of independent monitors.

Because the Board's investigations and disciplinary actions are nonpublic, it is difficult to quantify the full extent of its enforcement-related efforts. According to the PCAOB's most recent annual report, during 2009 the Board initiated 13 formal investigations and continued work on existing investigations; at the end of 2009, there were 17 open formal investigations.⁶ Another insightful metric is that the Board's 2011 budget allocated less than 10 percent of the Board's resources to the DEI, well behind the Board's registration and inspection program, which received nearly 44 percent of the Board's total budget.⁷ The PCAOB has indicated that its goal is to resolve formal investigations—by instituting contested disciplinary proceedings, settling instituted disciplinary proceedings, or closing formal investigations without a recommendation to institute disciplinary ac-

⁵See §§ 8:16 to 8:32.

⁶See PCAOB, 2009 Annual Report 15, available at <http://pcaobus.org/About/Ops/Documents/Annual%20Reports/2009.pdf>.

⁷The Division of Enforcement and Inspections' budget was approximately \$17 million. By contrast, the Division of Registration and Inspections received \$91 million of the Board's \$204 million overall budget. See <http://www.pcaobus.org>.

tions—within three years.⁸ According to the PCAOB, it did so 69 percent of the time during 2009.⁹

From its inception through March 2011, the Board has announced at least 34 settled disciplinary proceedings involving registered accounting firms and persons associated with those firms.¹⁰ These proceedings concern alleged violations of PCAOB rules and auditing standards involving, among other things, audit deficiencies, independence and audit documentation issues. Sanctions imposed through settlements involving registered firms have ranged from censures to \$1 million civil fines to revocation of registrations. Settlements involving associated persons have ranged from public censures and educational and training requirements, imposition of a \$25,000 civil penalty in one matter, and bars and suspensions from associating with registered firms.

Unlike settled matters, under Sarbanes-Oxley and PCAOB rules, contested disciplinary proceedings are nonpublic at least until final action by the Board.¹¹ Thus far, only two contested proceedings have resulted in final Board action, though it is difficult to know for certain how many contested matters are pending.¹²

§ 8:11 SEC oversight

Although the PCAOB is a private-sector entity, Sarbanes-Oxley gives the SEC broad oversight authority over the Board. In addition to appointing Board members, the SEC has the authority to censure and remove PCAOB members for cause, inspect the Board, relieve the Board of any of its enforcement responsibilities, or to impose limitations upon the activities, functions, and operations of the Board if it finds that the Board is unable or

⁸Public Company Oversight Board Strategic Plan (2008–2013) 25 (Jan. 2008) (citing GAO Report to Congressional Addressees: Audits of Public Companies — Continued Concentration in Audit Market for Large Public Companies Does Not Call for Immediate Action, Report GAO-08-163).

⁹PCAOB Strategic Plan (2010-2014) 39 (Nov. 2010)

¹⁰See PCAOB Disciplinary Proceedings, available at http://www.pcaobus.org/Enforcement/Disciplinary_Proceedings/index.aspx.

¹¹PCAOB Rule 5108, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5108.

¹²PCAOB, 2009 Annual Report at 17 (“At the end of 2009, a number of such nonpublic proceedings either were being litigated before the PCAOB’s hearing officer or were on appeal.”).

unwilling to enforce compliance.¹ The SEC also must approve the PCAOB's budgets and rules, including auditing standards, and may review appeals of adverse Board inspection reports and disciplinary actions against registered firms. Two other key areas of SEC oversight are Board rulemaking² and disciplinary actions.³

§ 8:12 SEC oversight—Rulemaking

With limited exceptions for initial or transitional auditing standards, no rule of the Board becomes effective without SEC approval.¹ The SEC must approve a proposed rule if it finds that the rule is consistent with the requirements of Sarbanes-Oxley and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors.²

Moreover, Section 19(b) of the Exchange Act, which governs the SEC's review of the rules of certain securities industry self-regulatory organizations, apply to proposed rules of the board, as fully as if the Board were a "registered securities association," with certain modifications to reflect the Board's purpose and responsibilities. Similarly, Section 19(c) of the Exchange Act, which permits the SEC to modify the rules of certain securities industry self-regulatory organizations, also applies to the Board, again with certain exceptions.³

§ 8:13 SEC oversight—Disciplinary actions

The Board must promptly notify the SEC of any final sanction it imposes against a registered public accounting firm or an as-

[Section 8:11]

¹Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 107(a), 107(d)(1), 107(d)(2), 116 Stat. 745 (codified at 15 U.S.C.A. § 7217(a), (d)(1), (d)(2)).

²See § 8:12.

³See § 8:13.

[Section 8:12]

¹Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 107(b)(2), 103(a)(3), 116 Stat. 745 (codified at 15 U.S.C.A. §§ 7217(b)(2), 7213(a)(3)).

²Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 107(b)(3), 116 Stat. 745 (codified at 15 U.S.C.A. § 7217(b)(3)).

³Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 107(b)(1), 116 Stat. 745 (codified at 15 U.S.C.A. § 7217(b)(1)).

sociated person.¹ The SEC may enhance, modify, cancel, reduce or require the remission of a Board sanction, if it finds that the sanction is either: (i) not necessary or appropriate in furtherance of Sarbanes-Oxley or the securities laws; or (ii) excessive, oppressive, inadequate, or otherwise not appropriate to the finding or the basis on which the sanction was imposed.

Application to the SEC for review, or institution by the SEC of review, of any Board disciplinary action operates as a stay of any such disciplinary action, although the SEC may terminate the stay. The SEC must establish an expedited procedure for considering the duration of the stay pending review of the underlying action by the Board under review.²

Board rules provide for an automatic stay of any final disciplinary action until the latter of the following: (i) SEC action to dissolve the stay or (ii) the expiration of the period during which, on its own motion, or upon application pursuant to Section 19(d)(2) of the Exchange Act, the SEC may institute review of the action.³

§ 8:14 Sanctions

Board sanctions may be imposed based on a finding that a party has committed an act or omission in violation of the securities laws relating to audits and accountants, Board or applicable SEC rules, or professional standards.¹ Whenever the Board imposes sanctions, it must state each of the acts, practices or omissions to act that formed a basis for all or a part of a sanction, the specific provision that was violated, the sanction imposed, and a justification for the sanction.²

[Section 8:13]

¹Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 107(c)(1), 116 Stat. 745 (codified at 15 U.S.C.A. § 7217(c)(1)).

²Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 105(e), 116 Stat. 745 (codified at 15 U.S.C.A. § 7217(e)).

³PCAOB Rule 5206, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5206; see also *In re Gately & Associates, LLC*, Securities Exchange Act of 1934, Rel. No. 63167 (Oct. 22, 2010) (terminating stay following Commission affirmance of PCAOB disciplinary sanctions).

[Section 8:14]

¹PCAOB Rule 5300(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5300.

²Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 105(c)(3), 116 Stat. 745 (codified at 15 U.S.C.A. § 7215(c)(3)).

§ 8:15 Available remedies

For violations of the securities laws, Board and applicable SEC rules, or professional standards, remedies available to the Board include the following:

- (i) temporary suspension or permanent revocation of registration;
- (ii) temporary or permanent suspension or bar of a person from further association with any registered public accounting firm;
- (iii) temporary or permanent limitation on the activities, functions, or operations of such firm or person (other than in connection with required additional professional education or training);
- (iv) a civil money penalty for each violation, in an amount (a) not more than \$100,000 for a natural person or \$2 million for any other person; and (b) in the case of intentional or knowing misconduct, not more than \$750,000 for a natural person or \$15 million for any other person;
- (v) censure;
- (vi) any other appropriate sanction provided for by Board rules.

To revoke registration, bar or suspend from association, limit activities, and impose civil money penalties, Sarbanes-Oxley requires the Board to find either:

- Intentional or knowing conduct, including reckless conduct, that results in violation of applicable statutory, regulatory, or professional standards; or
- Repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.¹

Limitations on activities can include prohibiting a firm from accepting new audit clients for a period of time, requiring a firm to assign a reviewer or supervisor to an associated person, requiring a firm to terminate one or more audit engagements, and requiring a firm to make functional changes in supervisory personnel organization and/or in engagement team organization.²

In addition, PCAOB rules add additional sanctions related to appointment of an independent monitor, including:

[Section 8:15]

¹Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 105(c)(5), 116 Stat. 745 (codified at 15 U.S.C.A. § 7215(c)(5)).

²Note to PCAOB Rule 5300(a)(3), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5300.

- (i) engagement of an independent monitor, counsel or a consultant to design compliance policies;
- (ii) requirement to adopt or implement policies to improve audit quality or compliance with the securities laws and Sarbanes-Oxley; and
- (iii) requirement for independent review and report on one or more engagements.³

Slightly different sanctions may be imposed if the Board finds that a party has failed to comply with an accounting board demand, has given false testimony, or has otherwise failed to cooperate in an investigation.⁴ Available remedies in such situations include: (i) revocation of registration; (ii) bar from association; (iii) suspensions; (iv) limitations on activities; (v) civil money penalties; (vi) censure; (vii) requiring a firm to engage a special master or independent monitor, appointed by the hearing officer, to monitor and report on the firms' compliance with an accounting board demand or with future accounting board demands; and (viii) authorizing the hearing officer to retain jurisdiction to monitor compliance with accounting board demands.⁵

The Board has stated that the more serious the violation is, the more severe the appropriate penalty, and the Board has discretion to assess the seriousness of the violation and the severity of the penalty.⁶

III. PCAOB INVESTIGATIONS

§ 8:16 Sources of PCAOB investigations

The Board has a number of sources of information that may prompt an investigation. As noted, the DRI conducts regular and special inspections of registered public accounting firms and may recommend that the Board follow up through an investigation. The DEI may also recommend a formal investigation. Other sources include information garnered from issuer disclosures, such as auditor changes and restatements; public news sources; tips from the public; other regulators; and the Board's Office of Research & Analysis. Similar to the SEC, FINRA and others, the

³PCAOB Rule 5300(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5300.

⁴PCAOB Rule 5300(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5300.

⁵PCAOB Rule 5300(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5300.

⁶Comment to Rule 5300 in Notice of Filing of Proposed Rules, SEC Release No. 34-49454, 82 SEC Docket 1731 (Mar. 19, 2004).

PCAOB also welcomes enforcement-related “tips” from the public.¹ In fact, the DEI has formalized this process by creating a TIPS manual, which outlines internal procedures for DEI to organize, document, track and close tips and complaints.² In addition, using information from various data providers, DEI research analysts review restatement announcements, auditor changes/dismissals, and news sources that are provided to DEI management regarding potential inquiries.³

§ 8:17 Conduct of PCAOB investigations

The DEI conducts two types of investigations: informal inquiries and formal investigations. By law, PCAOB inquiries and investigations are confidential and non-public.¹ Pursuant to Sarbanes-Oxley and PCAOB rules, PCAOB staff coordinate their investigations with the SEC’s Division of Enforcement and other regulators.

§ 8:18 Informal inquiries

DEI staff conduct informal inquiries to determine whether to recommend that the Board open a formal investigation regarding a matter. The DEI is authorized to institute an informal inquiry when it appears that a registered public accounting firm or an associated person has violated any applicable provision of the se-

[Section 8:16]

¹See, e.g., PCAOB Center for Enforcement Tips, Complaints and Other Information, available at <http://www.pcaobus.org/Enforcement/Tips/index.aspx>.

²As of March 2006, the DEI had received over 200 tips, approximately nine of which were the source of ongoing inquiries or formal investigations. See Performance Review: Internal Control Review of the Public Company Accounting Oversight Board’s Division of Enforcement and Investigations (IOPA-2006-002) 4 (July 18, 2006).

³See Performance Review: Internal Control Review of the Public Company Accounting Oversight Board’s Division of Enforcement and Investigations (IOPA-2006-002) 3–4 (July 18, 2006).

[Section 8:17]

¹See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 105(b)(5), 116 Stat. 745 (codified at 15 U.S.C.A. § 7215(b)(5)); PCAOB Rule 5108, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section__5.aspx#rule5108.

curities laws, PCAOB rules, or professional standards that apply to accountants.¹

During an informal inquiry, DEI staff may request documents, information or testimony from, or an interview with, any person.² The DEI may not, however, issue accounting board demands during an informal inquiry. The DEI Director decides whether to open or close such inquiries, or recommend that the Board authorize a formal investigation into the same matter.

§ 8:19 Formal investigations—Commencement and closure procedures

The Board may commence a formal investigation when it appears that an act or omission of a registered public accounting firm, or of an associated person, may violate applicable provisions of the securities laws, PCAOB rules, or professional standards.¹ The Board commences a formal investigation by issuing an order of formal investigation. In formal investigations, DEI staff may demand that any registered firm and associated person provide sworn testimony or documents, including workpapers, relevant or material to an investigation.²

At the conclusion of a formal investigation, the Board may issue an order terminating or suspending a formal investigation for a specified period of time. The Board may do so on its own initiative, or based on a recommendation from the DEI's Director.³

§ 8:20 Order of formal investigation

The order of formal investigation may designate particular staff members, or an entire PCAOB division or office, to issue ac-

[Section 8:18]

¹PCAOB Rule 5101(a)(1), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5101.

²PCAOB Rule 5100(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5100.

[Section 8:19]

¹PCAOB Rule 5101, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5101.

²PCAOB Rules 5102, 5103, available at <http://pcaobus.org/Rules/PCAOBRules/Pages/default.aspx>.

³PCAOB Rule 5101(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5101.

counting board demands.¹ Additionally, the order may otherwise require or request the cooperation of any person where relevant to the contents of the order of formal investigation.²

§ 8:21 Accounting board demands and requests

In connection with formal inquiries, the Board, or staff designated in the order of formal investigation, may issue “accounting board demands” (to registered firms and associated persons) or “accounting board requests” (to any firm or person other than registered firms and associated persons) for testimony, or for the production of documents or information.¹ The demand or request must give “reasonable notice” of the time and place for taking testimony, or indicate a reasonable time and place for production. Two to three weeks notice is typical, but there may be circumstances when less than 21 or even 14 days notice is deemed appropriate.

Accounting board demands can be made to registered public accounting firms, or to any person associated with a registered public accounting firm. A demand for production may require production of documents or information in the possession of a registered public accounting firm or any associated person thereof, wherever domiciled. However, the Board may not issue an accounting board demand to non-associated persons, such as issuers. Instead, the Board may issue such persons an accounting board request for testimony or production under Rule 5105. The Board may also request a Commission subpoena of any person pursuant to Rule 5111.

The Board may demand to examine the books and records of any registered public accounting firm or associated person in order to verify the accuracy of documents or information supplied in the course of an informal inquiry or formal investigation.² With the approval of the Director of Enforcement and Investigations, the staff may be designated in the order of formal investigation to do the same.

[Section 8:20]

¹PCAOB Rule 5101(a)(2), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5101.

²PCAOB Rule 5101, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5101.

[Section 8:21]

¹PCAOB Rules 5102, 5103, available at <http://pcaobus.org/Rules/PCAOBRules/Pages/default.aspx>.

²PCAOB Rule 5104, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5104.

Rule 5107 establishes uniform definitions and rules of construction that are deemed incorporated by reference into all accounting board demands and requests for information. The Board may also define other terms specific to a particular inquiry or investigation, use abbreviations, or use a more narrow definition of a term already defined by Rule 5107.

§ 8:22 Procedure for production

Accounting board demands or requests for production must indicate a reasonable time and place for production.¹ The Board also may request a Commission subpoena for production of documents.² Copies of the requested documents may be produced unless the demand expressly requires the production of originals.³ Where copies are produced, the originals must be maintained and be readily available for inspection by the staff, and cannot be destroyed without the staff's consent. Electronic documents must be produced in electronic format unless the accounting board demand expressly requests or permits the production of copies.

§ 8:23 Testimony

Testimony is conducted under oath and is transcribed by a reporter designated by the Board's staff.¹ An accounting board demand for testimony must indicate how the testimony will be recorded.²

Persons who testify pursuant to an accounting board demand or request, or pursuant to a Commission subpoena, may be accompanied by counsel. However, such counsel must state for the record, or in a notice of appearance, that he or she represents the witness. A firm's in-house counsel, or any other counsel, who does not affirmatively state that he or she represents the witness may not attend. Additionally, if counsel represents both the firm and

[Section 8:22]

¹PCAOB Rules 5103, 5105, available at <http://pcaobus.org/Rules/PCAOBRules/Pages/default.aspx>.

²PCAOB Rule 5111, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5111.

³PCAOB Rule 5103, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5103.

[Section 8:23]

¹PCAOB Rule 5102(c), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5102.

²PCAOB Rule 5102(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5102.

the witness becomes aware of a conflict during the testimony that would prohibit him or her from continuing to represent the witness, he or she must leave the examination.³

Only the witness, his or her counsel, Board members and staff, the reporter, and other individuals permitted by the Board or designated staff may attend the examination. Except for the witness, persons who have been or may be examined in the investigation are prohibited from attending, including third parties who may be required to testify pursuant to a Commission subpoena.⁴

Testimony demands made to a firm must describe the subject matter of the examination with reasonable particularity.⁵ A registered public accounting firm that is required to testify may designate one or more persons to testify on its behalf in accordance with Rule 5102(c)(4), which is modeled on Rule 30(b)(6) of the Federal Rules of Civil Procedure. The firm may designate the matters on which each person will testify, and the designated persons are required to testify regarding matters known or reasonably available to the firm.⁶

The Board may not issue an accounting board demand for testimony to non-associated persons, such as issuers or other parties. Instead, the Board may issue such persons an accounting board request for testimony or a Commission subpoena.⁷ The procedures for accounting board requests are similar to those for an accounting board demands—they must give adequate notice (subject to the needs of the investigation), indicate how the testimony will be recorded, and describe the subject matter of the examination with reasonable particularity if the request is made to a firm rather than a natural person.

Examinations conducted pursuant to accounting board requests follow the procedures outlined above for examinations pursuant to accounting board demands. Accounting board requests are not mandatory in nature, but failure to comply with a request may cause the Board to seek a Commission subpoena to compel testimony.

³PCAOB Rule 5109(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5109.

⁴PCAOB Rule 5102(c)(3), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5102.

⁵PCAOB Rule 5102(c)(4), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5102.

⁶PCAOB Rule 5102(c)(4), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5102.

⁷PCAOB Rules 5105, 5111, available at <http://pcaobus.org/Rules/PCAOBRules/Pages/default.aspx>.

Witnesses generally have 15 days after being notified that the testimony transcript is available to make any necessary changes. The Director of Enforcement and Investigations may extend this deadline. To make changes in form or substance, the witness must sign a statement reciting the changes and the reasons for making them.⁸

§ 8:24 Assertion of privileges

PCAOB rules permit parties to assert claims of privilege in response to an accounting board demand for information.¹ To do so, the party must identify the nature of the privilege (including attorney work product) and provide additional information to provide a basis for the assertion of privilege, unless divulging the additional information would disclose privileged information. The additional information includes, for example, the date of the document or communication, the author and addressees of a document, and the name of the person who made an oral communication and the names of others present when the communication was made.²

This information must be provided during the deposition for claims of privilege made during testimony if the information is readily available. Otherwise the information should be in writing within five business days after the deposition if it is not readily available, unless the Board or the staff agrees to do otherwise. If a claim of privilege is made outside of an examination or deposition, supporting information must be provided in writing when responding to the accounting board demand, unless the Board or staff agrees otherwise.

The Board has indicated that it will not “invade the province” of valid assertions of privilege against self-incrimination under the Fifth Amendment. Therefore, such assertions will not be viewed as non-cooperation. However, the Board has also made clear its intention to use Fifth Amendment assertions as evidence during Board disciplinary proceedings and as a basis for negative inferences against the person asserting the privilege. Whether it will succeed in doing so is unclear, especially in light of the fact

⁸PCAOB Rule 5102(d), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5102.

[Section 8:24]

¹PCAOB Rule 5106, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5106.

²PCAOB Rule 5106, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5106.

that the Board has stipulated in prior litigation that the Board should be regarded as a governmental entity for constitutional purposes. The Board has stated that it may also report assertions of Fifth Amendment privilege to other appropriate authorities, pursuant to its authority to share information with the SEC and other entities.

§ 8:25 Rights of witnesses in inquiries and investigations

Witnesses in PCAOB investigations have the right to review a formal order, be represented by counsel, and review the transcript of his or her own testimony.¹

A person who testifies or produces documents pursuant to a Commission subpoena, an accounting board demand, or an accounting board request has a right to review the Board's order of formal investigation. Whether the person may be given a copy of the order is within the discretion of the DEI Director, and if the person does receive a copy, the Director may impose limitations on further dissemination. This discretion is intended to protect the nonpublic nature of the formal order, but the Board has stated that it does not intend for this discretion to be used routinely to inhibit legitimate uses of the document, such as sharing the document subject to a joint defense agreement.²

Witnesses who testify pursuant to a Commission subpoena, an accounting board demand, or an accounting board request, may be accompanied by counsel. However, the witness's counsel must state on the record or provide a notice of appearance that indicates that the counsel represents the witness. The counsel cannot be a person who has been or is reasonably likely to be examined in the investigation.

A witness has a right to inspect the official transcript of the witness's own testimony upon written request to the Director of Enforcement and Investigations. A person who has testified or produced documents in an informal inquiry or formal investigation may also request a copy of the evidence or testimony. The cost of reproduction must be paid by the person making the request. If the evidence or testimony has not yet been presented in the proceeding or released, the Director of Enforcement and Investigations may deny the request for good cause.

[Section 8:25]

¹PCAOB Rule 5109, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5109. This rule is adapted from Rule 7(b) of the SEC's Rules Relating to Investigations.

²PCAOB Rule 5109, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5109.

§ 8:26 Rule 5109(d) notices

Similar to the “Wells” process utilized by the SEC, FINRA and others, under Rule 5109(d), the Board’s staff may advise registered public accounting firms and associated persons who become involved in an informal inquiry or formal investigation of the general nature of the investigation, including the violations as they pertain to those persons. The Board may do this upon request or on its own initiative. Practitioners accustomed to SEC and FINRA notices that provide only the barest of information related to the proposed allegations will be surprised by the detailed allegations that have been included in PCAOB Rule 5109(d) notices. Past notices have included specific factual allegations and a comprehensive recitation of the rules or standards the DEI staff believes were violated.

The staff typically sets a timeframe for the firm or associated person to prepare and submit a statement prior to the staff’s submission of a recommendation that the Board commence a disciplinary proceeding. However, these procedures are discretionary, and if the staff determines that advance notice of particular charges might undermine an investigation or would otherwise be undesirable, it has the option to forego such notice.

§ 8:27 Rule 5109(d) submissions

At any time, a registered public accounting firm and associated persons may submit a written statement to the Board setting forth their interests and positions regarding the subject matter of an investigation, in accordance with Rule 5109(d). As explained by the Board, the purpose of this rule is to assist the Board in its decision-making, but there is no right to make a submission or to have a certain amount of time in every case where the opportunity to submit a statement is provided. If the staff recommends that the Board commence a disciplinary proceeding, submissions by interested persons are forwarded to the Board with the recommendation.

§ 8:28 Non-cooperation—Grounds for proceeding

Sarbanes-Oxley provides that, if a registered public accounting firm or associated person refuses to testify, produce documents, or otherwise cooperate with the Board in an investigation, the Board may:

- Suspend or bar such person from being associated with a registered public accounting firm, or require the registered public accounting firm to end such association;

- Suspend or revoke the registration of the public accounting firm; and
- Invoke such other lesser sanctions as the Board considers appropriate, and as specified by Board rules.¹

The Board may institute disciplinary proceedings for non-cooperation. An investigation may be based on one of four grounds: (i) failing to comply with an accounting board demand; (ii) knowingly making a material misstatement or using documents or other material that contain material misstatements; (iii) abusing the Board's process to obstruct an investigation; or (iv) otherwise failing to cooperate with an investigation.² Under this last broad category, the Board has said that depending on the nature of the conduct, the staff may provide notice that it views certain conduct as non-cooperative, providing the party the opportunity to cease and cure the conduct before the staff recommends non-cooperation proceedings. For conduct categorized as abuse of the Board's process, the Board has indicated that scienter is required, and that the Board will not regard every arguable abuse of the Board's process as non-cooperation as long as the party's conduct is reasonable. The Board will not, however, consider any proper invocation of a witness's Fifth Amendment privilege against self-incrimination, or any other legitimately asserted privilege under prevailing law, as non-cooperation.

An associated person's non-cooperation does not create vicarious non-cooperation liability for a firm, but the firm's registration status may be at risk if the firm fails either to secure the associated person's cooperation with the Board, or to end its association with the person.

§ 8:29 Non-cooperation—Expedited procedures

In general, normal hearing procedures apply to disciplinary proceedings for non-cooperation. However, special streamlined procedures apply to govern the contents of the order instituting proceeding; establish sanctions for non-cooperation, including revocation of registration and bar on association; allow applications for relief from sanctions based on remedy of the non-cooperation; drastically shorten the time for filing an answer to five days after service; permit inspection and copying of documents relating to

[Section 8:28]

¹Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 105(b)(3)(A), 116 Stat. 745 (codified at 15 U.S.C.A. § 7215(b)(3)(A)).

²PCAOB Rules 5110, 5200(a)(3), available at <http://pcaobus.org/Rules/PCAOBRules/Pages/default.aspx>.

the non-cooperation within seven days after the proceedings are instituted; permit the hearing officer to render an initial decision without allowing post-hearing briefs; and require filing a petition for review within 10 days after service of the initial petition.

§ 8:30 Coordination—SEC referrals

Because the PCAOB and SEC have overlapping enforcement jurisdiction, they closely coordinate their efforts. Under Sarbanes-Oxley, the Board must notify the SEC of any pending Board investigation involving a potential violation of the securities laws, and thereafter coordinate with the Commission's Division of Enforcement, as necessary to protect any ongoing Commission investigation.¹ PCAOB rules require that the Board's Secretary send a copy of orders of formal investigation to the Commission as soon as practicable after the entry of the order.² Moreover, DEI has established written guidelines on referrals, communicating, and sharing documents and other information with the SEC's Division of Enforcement.³ DEI staff coordinate their work with the SEC's Division of Enforcement where necessary to protect an ongoing Commission investigation, in order to avoid duplication of efforts and unintentional missteps. To maximize coordination, DEI staff regularly meet with staff from the SEC's Enforcement Division and the SEC's Chief Accountant for Enforcement to discuss significant developments in DEI's investigations and inquiries.⁴

§ 8:31 Other referrals

The Board may refer any investigation to the Commission, and may refer an investigation concerning an institution's audit report to an appropriate federal regulator. At the direction of the Commission, the Board may also refer any investigation to the U.S. Attorney General, one or more state attorneys general, and appropriate state regulatory authorities.

[Section 8:30]

¹Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 105(b)(4)(A), 116 Stat. 745 (codified at 15 U.S.C.A. § 7215(b)(4)(A)).

²PCAOB Rule 5112, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5112.

³See Performance Review: Internal Control Review of the Public Company Accounting Oversight Board's Division of Enforcement and Investigations (IOPA-2006-002) 4–5 (July 18, 2006).

⁴See Performance Review: Internal Control Review of the Public Company Accounting Oversight Board's Division of Enforcement and Investigations (IOPA-2006-002) 5 (July 18, 2006).

§ 8:32 Conduct of PCAOB investigations—Confidentiality

Information obtained by the Board during an inspection or investigation is confidential and enjoys evidentiary privilege in all state and federal courts and administrative agencies.¹ The Board is, however, specifically authorized to share information obtained during inquiries and investigations with the Commission, and if the Board deems it necessary to protect investors or accomplish the purposes of Sarbanes-Oxley, it may share such information with the U.S. Attorney General, appropriate federal regulators, with respect to an institution's audit report, state attorneys general, with regard to criminal activity, and appropriate state regulatory authorities.

Information the Board shares with other regulators or agencies, however, continues to be confidential and protected in the hands of the Board, and each agency must maintain the information as confidential and privileged. Such information is exempt from disclosure under the Freedom of Information Act, "or otherwise" (presumably including state open records laws), unless and until it is presented pursuant to a public proceeding or released as required in connection with disciplinary proceedings.²

IV. DISCIPLINARY PROCEEDINGS**§ 8:33 Initiation of disciplinary proceedings**

If the Board elects to commence disciplinary proceedings, a hearing will be held to determine whether a registered firm or associated person violated the securities laws relating to audits and accountants; Board and SEC rules, or professional standards; failure to supervise; or failure to cooperate with an investigation.¹ Such hearings are not public, unless otherwise ordered by the Board for good cause shown, with the consent of the parties. If any party objects to the hearing being made public, the hearing

[Section 8:32]

¹PCAOB Rule 5108; Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 105(b)(5), 116 Stat. 745 (codified at 15 U.S.C.A. § 7215(b)(5)).

²Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 105(c), 116 Stat. 745 (codified at 15 U.S.C.A. § 7215(c)).

[Section 8:33]

¹PCAOB Rule 5200(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5200. Proceedings under PCAOB Rule 5500 for approval or denial of a registration application are not treated in these materials.

will be nonpublic.² To date, no respondent has consented to public disclosure of pending proceedings.

The PCAOB believes that non-public hearings create an incentive for respondents to litigate, rather than settle. The Board has complained that litigation postpones—often for several years—the day on which the public learns that the PCAOB has charged an auditor or firm, the nature of the charges and the content of adverse findings. It believes the non-public aspect of its proceedings has negative consequences, including keeping the public in the dark about alleged misconduct. Even after a hearing and adverse findings, investors are unaware that companies in which they invest are being audited by accountants who have been charged by the PCAOB. For these reasons, the PCAOB is lobbying Congress to amend Sarbanes-Oxley to permit public disclosure of its enforcement proceedings.³

To initiate disciplinary proceedings, the Board issues an Order Instituting Proceedings (“OIP”).⁴ Each firm or person charged in the OIP must be given “appropriate notice” of the OIP.⁵ In emergency or expedited actions, “appropriate notice” may be given prior to formal service of the OIP by any means calculated to give actual notice that a hearing will be held.⁶

Parties are entitled to notice of a hearing within a time reasonable under the circumstances.⁷ If a hearing date is set in the OIP, which will typically only be in non-cooperation proceedings, the timing for “reasonable notice” of the hearing may be less than 90 days or 60 days.⁸ In cases where no hearing date is set in the OIP, the parties are likewise entitled to reasonable notice, but in

²Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 105(c)(2), 116 Stat. 745 (codified at 15 U.S.C.A. § 7215(c)(2)).

³James R. Doty, PCAOB Chairman, “Testimony Concerning the Role of the Accounting Profession in Preventing Another Financial Crisis” before the U.S. Senate Committee on Banking, Housing and Urban Affairs (Apr. 6, 2011), available at http://pcaobus.org/News/Speech/Pages/04062011_DotyTestimony.aspx.

⁴PCAOB Rules 5200(a), 5201(a), available at <http://pcaobus.org/Rules/PCAOBRules/Pages/default.aspx>.

⁵PCAOB Rule 5201(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5201.

⁶Comment to Rule 5201, SEC Release No. 34-49454 (Mar. 19, 2004).

⁷PCAOB Rule 5201(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5201.

⁸Comment to Rule 5201, SEC Release No. 34-49454 (Mar. 19, 2004).

either case there is no minimum time set.⁹ The hearing officer is, however, expected to exercise his or her discretion to schedule a hearing date prudently and fairly.¹⁰

§ 8:34 Settlements—procedures

Any firm or person who is or may become a party to a proceeding may, at any time, propose a written offer of settlement.¹ Offers of settlement must conform to the requirements of Rule 5205, and must be signed by the party (not counsel) and submitted to the DEI Director.² The Director will then present the offer to the Board with his or her recommendation unless the recommendation is unfavorable.³ In the case of an unfavorable recommendation, the Director will not present the offer to the Board unless the person who made the offer requests that the Director to do so.⁴ If the Board rejects the offer, the offer is deemed withdrawn and is not part of the record in any proceeding against the person making the offer.⁵

§ 8:35 Settlements—Waivers

Settlement offers must include certain specified waivers. If the offer is accepted, the person making the offer waives all procedural rights, such as hearings, post-hearing briefs and proposed findings of fact and conclusions of law, proceedings before a hear-

⁹PCAOB Rule 5201(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5201; Comment to Rule 5201, SEC Release No. 34-49454 (Mar. 19, 2004).

¹⁰Comment to Rule 5201, SEC Release No. 34-49454 (Mar. 19, 2004).

[Section 8:34]

¹PCAOB Rule 5205(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5205.

²PCAOB Rule 5205(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5205.

³PCAOB Rule 5205(c)(1), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5205.

⁴PCAOB Rule 5205(c)(1), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5205.

⁵PCAOB Rule 5205(c)(4), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5205.

ing officer and an initial decision by the hearing officer, post-hearing procedures, and judicial review by any court.¹

Additionally, if the offer is accepted, the person making the offer waives any Board Rules that would prevent a member of the Board's staff from participating in the preparation of any order, opinion, finding of fact, or conclusion of law entered pursuant to the order, and waives any right to claim bias or prejudice by the Board based on consideration of or discussions concerning the settlement offer or any part of the proceeding.² If the offer is rejected, these final waivers remain valid with respect to any discussions concerning the rejected settlement offer.³

§ 8:36 Contested proceedings—Types of proceedings

The Board is authorized under Rule 5200(a) to institute disciplinary proceedings in three situations.¹

(1) Failure to cooperate

The Board may institute proceedings for failure to cooperate with an investigation, in accordance with Rule 5110.² Although hearings for non-cooperation generally follow normal hearing procedures, Rule 5110 subjects these hearings to expedited procedures in particular areas.³ For instance, specific rules govern the contents of an OIP for non-cooperation; establish sanctions for noncompliance; allow applications for relief from sanctions upon remedy of the non-cooperation; shorten the time for filing an answer to five days; permit inspection and copying only of documents relating to the non-cooperation within seven days after the proceedings are instituted; permit the hearing officer to render an initial decision without allowing post-

[Section 8:35]

¹PCAOB Rule 5205(c)(2), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5205.

²PCAOB Rule 5205(c)(3), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5205.

³PCAOB Rule 5205(c)(4), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5205.

[Section 8:36]

¹PCAOB Rule 5200(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5200.

²PCAOB Rule 5200(a)(3), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5200.

³PCAOB Rule 5110(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5110.

hearing briefs; and require filing a petition for review within 10 days after service of the initial petition.⁴

(2) Failure to supervise

The Board may institute proceedings to determine whether a registered public accounting firm, or its supervisory personnel, has failed reasonably to supervise an associated person to prevent violations of applicable provisions of the securities laws relating to audits and accountants, the Rules of the Board or applicable rules of the Commission, or professional standards.⁵ The Board states that disciplinary proceedings may be instituted under this provision for a single negligent act, although more severe sanctions are reserved for intentional or knowing conduct or repeated instances of negligent conduct.⁶ A firm and any of its personnel who play a supervisory role are subject to liability for failure to supervise.⁷

(3) Violations of Sarbanes-Oxley, PCAOB Rules, securities laws and other provisions

The Board may institute proceedings to determine whether a registered public accounting firm, or an associated person, has committed an act or omission in violation of the provisions of the securities laws relating to audits and accountants, Board or SEC rules, or professional standards.⁸ It is expected that most of the Board's disciplinary proceedings will fall into this category, including matters that are discovered in Board inspections or investigations.

§ 8:37 Contested proceedings—Order Instituting Proceedings

The charging document in Board disciplinary proceedings is an Order Instituting Proceedings (“OIP”) that is approved by the Board. The OIP must include a short and plain statement of fact and law with respect to each person charged, with specific information required for each of the three different types of disciplin-

⁴See PCAOB Rule 5110(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section__5.aspx#rule5110.

⁵PCAOB Rule 5200(a)(2), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section__5.aspx#rule5200.

⁶Comment to Rule 5200, SEC Release No. 34-49454 (Mar. 19, 2004).

⁷PCAOB Rule 5200(a)(2), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section__5.aspx#rule5200; Comment to Rule 5200, SEC Release No. 34-49454 (Mar. 19, 2004).

⁸PCAOB Rule 5200(a)(1), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section__5.aspx#rule5200.

ary proceedings.¹ In the case of a proceeding for alleged non-cooperation, the OIP must include the hearing date.²

As soon as practicable after the issuance of the OIP, a hearing officer is appointed by the Board.³ At present, the Board employs a single hearing officer, David M. FitzGerald, an experienced administrative law judge formerly affiliated with Financial Institutions Regulatory Authority (“FINRA”) (and before that, the National Association of Securities Dealers, Inc.).

Under Rule 5201(d), the hearing officer may amend the OIP to include new facts or laws that are within the scope of the original OIP.⁴ The Board may amend the OIP to include any new material.⁵

§ 8:38 Contested proceedings—Pre-hearing procedures— Case management order

Disciplinary proceedings before Hearing Officer FitzGerald are likely to be subject to a case management order (“CMO”) that governs certain pre-hearing and hearing matters. The CMO, utilized in prior contested proceedings, contained the following key provisions:

- **Ex Parte Communications.** As provided by Rule 5403, there can be no ex parte communications with the Hearing Officer. Questions regarding the proceeding must be directed to the assigned case administrator.
- **Meet and Confer Obligations.** Parties must make a good-faith effort to meet and confer before filing a motion (except a motion for summary disposition or for withdrawal of a party’s representative) to attempt to agree on the issues raised by the motion, and must include a certification with the motion confirming that they undertook such an effort. Parties failing to file a timely opposition may be deemed to have consented to the relief requested in the motion.

[Section 8:37]

¹PCAOB Rule 5201(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5201.

²PCAOB Rule 5201(b)(3), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5201.

³PCAOB Rule 5200(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5200.

⁴PCAOB Rule 5201(d)(2), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5201.

⁵PCAOB Rule 5201(d)(1), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5201.

- **Reply Papers.** There is no right to reply to oppositions to motions. To file a reply, parties must file a motion requesting permission to do so within five days after opposition papers are served, with the proposed reply attached. The Hearing Officer may, however, rule on any motion before the expiration of this period.
- **Summary Disposition Procedures.** In addition to the requirements of Rule 5427, which governs motions for summary disposition, any party filing such a motion must include a statement of undisputed material facts supporting summary disposition, with citations to supporting evidence. An opposition to the motion must be accompanied by a statement responding to each allegedly undisputed fact listed by the moving party with citations to supporting evidence, plus a list of any additional disputed facts with cites to supporting evidence. The supporting evidence cited in the parties' statements must be submitted with the motion or opposition in a format designated by the Hearing Officer.
- **Extensions of Time.** Parties seeking an extension of time must request an extension for good cause as soon as they are aware of the circumstances constituting good cause. Parties may not modify or extend times without the Hearing Officer's approval, and a request for an extension is ineffective unless and until it is granted. Extensions that would require postponement or adjournment of a scheduled hearing are disfavored strongly and generally will be denied absent compelling circumstances.
- **Pre-Hearing Conferences.** A pre-hearing conference is scheduled soon after respondent's answer is filed to discuss the status of the proceeding; pending or contemplated motions; and the pre-hearing and hearing schedule. A final pre-hearing conference normally will be held shortly before the hearing. Other pre-hearing conferences may be requested by a party, or the hearing officer may schedule a conference to review the status of the proceeding or address any issues that have arisen.

**§ 8:39 Contested proceedings—Pre-hearing procedures—
Answer to OIP**

A party may file an answer in any proceeding, but is not required to file an answer unless the OIP states otherwise.¹ If the party elects to answer, the answer is due within 20 days after service of the OIP (five days for non-cooperation proceedings).²

The standards that govern the contents of the answer generally follow the Federal Rules of Civil Procedure. The answer must specifically admit or deny each allegation in the OIP, or state that the party does not have or is unable to obtain sufficient information to admit or deny an allegation.³ A statement of lack of information effects a denial.⁴ A party may deny part of an allegation, but must admit that portion of the allegation that is true.⁵ Affirmative defenses must be raised in the answer, and any allegation not denied is deemed admitted.⁶

**§ 8:40 Contested proceedings—Discovery of PCAOB
investigative record**

The staff must make certain documents available for inspection and copying no later than 14 days after the institution of disciplinary proceedings (seven days for non-cooperation proceedings).¹ Except in non-cooperation proceedings, the staff must make the following documents available, with limited exceptions:

- (i) documents and information issued during any investigation or informal inquiry that preceded the disciplinary proceeding;

[Section 8:39]

¹PCAOB Rule 5421(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5421.

²PCAOB Rule 5421(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5421.

³PCAOB Rule 5421(c), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5421.

⁴PCAOB Rule 5421(c), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5421.

⁵PCAOB Rule 5421(c), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5421.

⁶PCAOB Rule 5421(c), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5421.

[Section 8:40]

¹PCAOB Rule 5422, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5422.

- (ii) responses to and documents produced in response to any requests, subpoenas, and accounting board demands;
- (iii) testimony transcripts and exhibits, and any other verbatim records of witness statements; and
- (iv) all other documents prepared or obtained by the Division of Enforcement and Investigations in connection with the investigation prior to the institution of proceedings.²

For non-cooperation proceedings, the staff need make available only the documents upon which the Division intends to rely in seeking a finding of non-cooperation, plus relevant exculpatory evidence, such as documents that would tend to show that the person did comply with a request or that testimony was not false.³

The staff is not required to produce the following:

- (i) documents prepared by a member of the Board or of the staff that have not been disclosed to any person outside of the PCAOB and its agents;
- (ii) other privileged documents, including documents protected by the attorney work product doctrine;
- (iii) documents that would disclose the identity of a confidential source; and
- (iv) documents submitted to the hearing officer to be withheld as not relevant or for good cause shown.⁴

Good cause would include, for example, the combined facts that the staff does not intend to rely on the document, and the staff obtained the document from a foreign regulator under a confidentiality agreement.⁵ The staff may not withhold documents that contain material exculpatory evidence.⁶

If the staff withholds documents due to privilege, it must make a document log and provide the same information that a person asserting a privilege would be required to supply under Rule

²PCAOB Rule 5422(a)(1), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5422.

³PCAOB Rule 5422(a)(2), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5422; Comment to Rule 5422, SEC Release No. 34-49454 (Mar. 19, 2004).

⁴PCAOB Rule 5422(b)(1), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5422.

⁵Comment to Rule 5422, SEC Release No. 34-49454 (Mar. 19, 2004).

⁶PCAOB Rule 5422(b)(2), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5422.

5106.⁷ If the staff withholds documents to protect confidential sources, or because the staff has identified the document as not relevant, or determined that it should be withheld for good cause, the staff must make a document list with a brief description of each document withheld.⁸ In camera review is available for documents identified in a document log or list.⁹

Other provisions indicate that documents are to be made available at the Board office where they are ordinarily maintained or as the parties otherwise agree; a party may not remove documents from the Board's office unless the party has specific written permission; and the costs of copying documents are to be borne by the party obtaining the copy.¹⁰ If a document is not made available to the respondent in violation of Rule 5422, the respondent must show that it was not harmless error before a rehearing or rededecision will be granted.¹¹

A respondent may move for the production of statements that pertain to or are expected to pertain to a division witness's direct testimony, and that would be required to be produced under the Jencks Act if the Board were a governmental entity.¹² It is the respondent's burden to show that a failure to produce a statement in violation of Rule 5423 was not harmless error.¹³

§ 8:41 Contested proceedings—Pre-hearing discovery

Any party may request the hearing officer to issue an accounting board demand or an accounting board request for testimony or production.¹ The application must be granted where it appears to be reasonable in scope and reasonably calculated to lead to the

⁷PCAOB Rule 5422(c)(1), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5422.

⁸PCAOB Rule 5422(c)(2), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5422.

⁹PCAOB Rule 5422(c), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5422.

¹⁰PCAOB Rule 5422(d)-(f), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5422.

¹¹PCAOB Rule 5422(g), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5422.

¹²PCAOB Rule 5423(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5423.

¹³PCAOB Rule 5423(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5423.

[Section 8:41]

¹PCAOB Rule 5424(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5424.

discovery of admissible evidence.² An application may be denied or modified if it appears to be unreasonable, oppressive, excessive in scope, unduly burdensome, designed to seek irrelevant information, or sought for the purpose of harassment or delay.³ The hearing officer may require that the party seeking the demand or request show the general relevance and reasonable scope of the testimony or evidence sought.⁴ Stipulations that would obviate the need for making demands or requests of non-parties are encouraged.⁵ Non-party witnesses must be paid reasonable expenses by the party requesting or demanding the witness's appearance.⁶

Rule 5424(b), which the Commission adopted with reservations, provides that upon application of a party or at its own initiative, the Board may seek the issuance of a Commission subpoena in connection with a hearing.⁷ A subpoena may be necessary to secure testimony or other evidence from a party who may not be inclined to cooperate with an accounting board demand or accounting board request. The availability of Rule 5424(b) is unclear based on the Commission's May 14, 2004 release, which adopted Rule 5424(b) with the "understanding" that it would be "unavailable" for use until the appropriate implementation framework is in place.⁸

Depositions are not available in PCAOB proceedings for discovery purposes, except to preserve the testimony of a witness

²PCAOB Rule 5424(a)(3), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5424.

³PCAOB Rule 5424(a)(3), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5424; Comment to Rule 5424, SEC Release No. 34-49454 (Mar. 19, 2004).

⁴PCAOB Rule 5424(a)(3), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5424.

⁵PCAOB Rule 5424(a)(3), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5424.

⁶PCAOB Rule 5424(a)(4), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5424, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5424.

⁷PCAOB Rule 5424(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5424.

⁸SEC Release No. 34-49704 (May 14, 2004). Pursuant to the Commission's directive, in October 2004, the Board issued for public comment proposed Rule 5424(c) and (d) to implement procedures governing requests for Commission subpoenas. PCAOB Rel. No. 2004-013 (Oct. 26, 2004). In the intervening period, however, the Board has not proposed a final rule for public comment or Commission approval.

who is unlikely to be able to attend the hearing.⁹ Any party seeking a discovery deposition must explain why it is necessary, including reasons why the witness will be unable to attend or testify at the hearing and the subject matter of the witness' testimony.¹⁰ The hearing officer or the Board may grant an order for deposition only upon a finding that the witness's testimony will likely be material, the witness likely will be unable to attend, and that taking the deposition would serve the interests of justice.¹¹ Deposition procedures mirror those for a witness testifying at a hearing, although specific procedures govern objections during a deposition.¹²

Parties may seek to introduce at a hearing a prior sworn statement of a nonparty witness in lieu of live testimony if the statement is otherwise admissible.¹³ Such a motion may be granted if the witness is dead; the witness is outside the U.S. (unless the witness's absence was procured by the party); the witness is unable to attend the hearing due to age, sickness, infirmity, imprisonment or other disability; the party offering the prior sworn statement has been unable to procure the attendance of the witness by accounting board demand; or using the statement would otherwise be desirable in the interests of justice.¹⁴ If the parties stipulated to accept a prior sworn statement in lieu of live testimony, convenience of the parties is also considered.¹⁵ The hearing officer may require that all or only relevant parts of the statement be introduced, as appropriate.¹⁶

§ 8:42 Contested proceedings—Motions

Motions must be made during a hearing or conference, or must

⁹PCAOB Rule 5425, note, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5425; Comment to PCAOB Rule 5425, SEC Release No. 34-49454 (Mar. 19, 2004).

¹⁰PCAOB Rule 5425(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5425.

¹¹PCAOB Rule 5425(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5425.

¹²PCAOB Rule 5425(c), (d), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5425.

¹³PCAOB Rule 5426, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5426.

¹⁴PCAOB Rule 5426, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5426.

¹⁵PCAOB Rule 5426(e), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5426.

¹⁶PCAOB Rule 5426, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5426.

be in writing.¹ Written motions must include their grounds with particularity, identify the relief sought, and be accompanied by a written brief of points and authorities.² Briefs supporting or opposing a motion are limited to 10 pages. No oral argument is allowed unless the Board or hearing officer directs otherwise.³

Opposition briefs generally must be filed within five days after service of the motion.⁴ Parties who wish to file a reply brief must request leave to do so from the hearing officer.⁵

§ 8:43 Contested proceedings—Motion for summary disposition

Motions for summary disposition are governed by Rule 5427. The staff may move for summary disposition only after a respondent has filed an answer and documents have been made available to that respondent for inspection and copying.¹ The staff may also move for summary disposition with respect to a particular respondent if the respondent has served a motion for summary disposition.² Respondents may make a motion for summary disposition at any time.³

Before filing a motion for summary disposition, the party must first request and attend a pre-motion conference to schedule a due date for submission of the motion.⁴ The hearing officer also may schedule a deadline for a response, but need not do so where

[Section 8:42]

¹PCAOB Rule 5408(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5408.

²PCAOB Rule 5408(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5408.

³PCAOB Rule 5408(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5408.

⁴PCAOB Rule 5408(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5408.

⁵PCAOB Rule 5408(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5408.

[Section 8:43]

¹PCAOB Rule 5427(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5427.

²PCAOB Rule 5427(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5427.

³PCAOB Rule 5427(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5427.

⁴PCAOB Rule 5427(c), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5427.

the hearing officer does not require a response.⁵ Additional requirements for filing a motion for summary disposition may be specified by the hearing officer as part of a case management order or during the pre-hearing conference.

Upon review of the motion, the hearing officer may deny the motion, or may instead require a response to the motion.⁶ The hearing officer cannot grant the motion until after the response deadline.⁷ Reply briefs to motions for summary disposition are discouraged.⁸ Partial summary disposition is available for the issue of liability.⁹ There is no interlocutory appeal for a denial of a motion for summary disposition.¹⁰

§ 8:44 Contested proceedings—Hearing procedures

All hearings are non-public unless the Board orders otherwise.¹ For proceedings alleging non-cooperation, failure to supervise, or violation of the securities laws, Rules of the Board, or professional standards, the Board may not order the hearing to be public unless the parties consent to a public hearing and good cause is shown.² The time and location of the hearing, if not fixed by the Board, are determined by the hearing officer.³

The staff must prove an alleged violation or failure to supervise by a preponderance of the evidence.⁴ Relevant evidence may be admissible, while irrelevant, immaterial or unduly repetitious ev-

⁵PCAOB Rule 5427(c)(1), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5427.

⁶PCAOB Rule 5427(c)(2), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5427.

⁷PCAOB Rule 5427(c)(2), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5427.

⁸PCAOB Rule 5427(e), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5427.

⁹PCAOB Rule 5427(d), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5427.

¹⁰PCAOB Rule 5427(e), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5427.

[Section 8:44]

¹PCAOB Rule 5203, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5203.

²PCAOB Rule 5203, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5203.

³PCAOB Rule 5200(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5200.

⁴PCAOB Rule 5204(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5204.

idence must be excluded.⁵ These procedures are intended to track the Commission's Rules of Practice and the Administrative Procedure Act, and evidence issues will be addressed in a manner similar to Commission administrative hearings and other administrative agency hearings.⁶ The hearing officer may refer to principles of the Federal Rules of Evidence or other authoritative sources to resolve evidentiary issues.⁷

Objections to the admission or exclusion of evidence are raised in short form, and exceptions to a ruling need not be noted at the time of the ruling.⁸ However, exceptions are deemed waived on appeal unless they are raised (1) pursuant to interlocutory review in accordance with Rule 5461; (2) in a proposed finding or conclusion filed pursuant to Rule 5445; or (3) in a petition for Board review of an initial decision filed in accordance with Rule 5460.⁹ A party may make an offer of proof when evidence is excluded from the record.¹⁰

Evidence is presented by oral or documentary evidence.¹¹ Presentation of evidence, submissions of rebuttal evidence, and cross-examinations may be conducted as the Board or hearing officer determines is required to ensure full disclosure of the facts.¹² The Board or hearing officer determines the scope and form of evidence, rebuttal, and cross examination.¹³

Discovery of expert witnesses and reports is not discussed in the PCAOB Rules, but the subject has been addressed during pre-hearing conferences. For example, parties and the hearing officer have agreed to a simultaneous exchange of initial expert reports containing disclosures mandated by Fed. R. Civ. P. 26(a)(2)(B) with the opportunity to submit supplemental, revised

⁵PCAOB Rule 5441, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5441.

⁶Comment to Rule 5441, SEC Release No. 34-49454 (Mar. 19, 2004).

⁷Comment to Rule 5441, SEC Release No. 34-49454 (Mar. 19, 2004).

⁸PCAOB Rule 5442(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5442.

⁹PCAOB Rule 5442(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5442.

¹⁰PCAOB Rule 5442(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5442.

¹¹PCAOB Rule 5444, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5444.

¹²PCAOB Rule 5444, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5444.

¹³PCAOB Rule 5444, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5444.

reports responding to opinions offered by opposing experts. Parties have also agreed the following: unless the other party objects, the hearing officer receives the expert report as the substance of the expert's direct testimony. Consequently, the expert's direct testimony is limited to the opinions, bases, reasons, data, and other information disclosed in the report, and the hearing officer may limit the expert's direct testimony at the hearing to a summary of the report. Failure to include an opinion in the report may preclude the expert from offering it at the hearing.

Written transcripts of a hearing are prepared, but only the parties may purchase transcripts of nonpublic proceedings.¹⁴ However, any person compelled to testify at a hearing may purchase a copy of that person's own testimony.¹⁵ Motions to correct the transcript must be made before the filing of post-hearing briefs or other submissions.¹⁶

§ 8:45 Contested proceedings—Post-hearing briefs

The hearing officer must prescribe a post-hearing briefing schedule in proceedings for failure to supervise and for violation of the securities laws relating to audits and accountants, the Rules of the Board or applicable rules of the Commission, or professional standards.¹ Although the hearing officer can set a different schedule for good cause, the briefing schedule generally proceeds as follows: the first party directed to file must do so within 30 days of the end of the hearing; all submissions, including oppositions and replies, must be filed no later than 90 days after the end of the hearing.² In non-cooperation proceedings, the hearing officer need not permit post-hearing briefs, or he or she may allow briefing on an expedited schedule.³

¹⁴PCAOB Rule 5440(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5440.

¹⁵PCAOB Rule 5440(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5440.

¹⁶PCAOB Rule 5440(c), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5440.

[Section 8:45]

¹PCAOB Rule 5445(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5445.

²PCAOB Rule 5445(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5445.

³PCAOB Rule 5445(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5445.

§ 8:46 Contested proceedings—Initial decision

The hearing officer is required to prepare an initial decision within 60 days (30 days for non-cooperation proceedings) after the deadline for filing post-hearing briefs or other submissions, unless the Board directs otherwise.¹ The decision must include findings, conclusions, sanctions, and the basis for each decision on a material issue of fact, law or discretion on the record.² An initial decision will be noticed as final 20 days after the lapsing of the time period for filing a petition for review of the initial decision, unless a party has filed a timely petition for review or the Board has ordered review of the initial decision.³

§ 8:47 Contested proceedings—Appeals of disciplinary actions—Board review of initial decisions

A party to the hearing may file a petition for review of the initial decision, or the Board may order review on its own initiative.¹ In proceedings based on violations of the securities laws or failure to supervise, a party must file for review within 30 days after service of the initial decision, or within 10 days after another party files a petition for review, whichever is later.² The 10-day grace period to file for review after another party files is designed to reduce gamesmanship.³ In non-cooperation proceedings, the petition must be filed within 10 days after service of the initial decision.⁴ The petition for review must take exception to

[Section 8:46]

¹PCAOB Rule 5204(b) and note, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5204.

²PCAOB Rule 5204(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5204.

³PCAOB Rule 5204(d), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5204.

[Section 8:47]

¹PCAOB Rule 5460(a), (b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5460.

²PCAOB Rule 5460(a)(2)(i), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5460.

³Comment to Rule 5460, Exch. Act Release No. 34-49454 (Mar. 19, 2004).

⁴PCAOB Rule 5460(a)(2)(ii), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5460.

specific findings and conclusions, and list the reasons for each exception.⁵

Ordinarily, the Board limits its review to issues identified in the petition for review or specified in the briefing schedule order.⁶ However, at any time prior to its decision, the Board may give notice to the parties that it will consider additional matters that it deems material.⁷ The parties will have the opportunity to present oral or written argument on additional issues raised by the Board.⁸ The Board reviews initial decisions de novo.⁹

§ 8:48 Contested proceedings—Interlocutory review

Interlocutory review is limited to “extraordinary circumstances.”¹ Even where the hearing officer has certified a ruling for interlocutory review, the Board may decline to consider it.² The Board may, however, direct that any matter be submitted to it for review.³

Before the Board will grant interlocutory review, the hearing officer must certify the ruling as appropriate for review and specify the basis for certification.⁴ Appropriate bases are limited to cases where a ruling would compel testimony by Board personnel or the production of documents in the Board’s custody, or where a party applies for review and can demonstrate that the ruling involves (i) an unsettled, controlling question of law and

⁵PCAOB Rule 5460(a)(1), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5460.

⁶PCAOB Rule 5460(d), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5460.

⁷PCAOB Rule 5460(d), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5460.

⁸PCAOB Rule 5460(d), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5460.

⁹PCAOB Rule 5460(c), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5460.

[Section 8:48]

¹PCAOB Rule 5461(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5461. This rule is based on Rule 400 of the Commission’s Rules of Practice and 28 U.S.C. § 1292(b). Comment to Rule 5461, Exch. Act Release No. 34-49454 (Mar. 19, 2004).

²PCAOB Rule 5461(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5461.

³PCAOB Rule 5461(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5461.

⁴PCAOB Rule 5461(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5461.

(ii) immediate review will materially advance the proceedings.⁵ Where interlocutory review is granted, the hearing is not stayed pending review unless the hearing officer or the Board orders otherwise.⁶

§ 8:49 Contested proceedings—Board review procedure

If a petition for review is entered or the Board orders review on its own motion, the Board will then issue a briefing schedule order.¹ The order may direct or limit the briefs to particular issues.² In general, opening briefs are due within 40 days of the date of the briefing schedule order, and opposition briefs are due 30 days after the opening briefs are due.³ Reply briefs may be filed within 14 days after the opposition briefs are due.⁴

Briefs should be succinct and must address only the particular matters at issue.⁵ Page citations to the record, citations to statutes, decisions and other authorities are required.⁶ Exceptions relating to evidence must set forth the substance of the evidence through a description in the brief or in an appendix, or by citation to the record.⁷ Reply briefs are limited to the matters in opposition briefs.⁸

The Board or a party may move for oral argument on any

⁵PCAOB Rule 5461(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5461.

⁶PCAOB Rule 5461(c), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5461.

[Section 8:49]

¹PCAOB Rule 5462(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5462. This rule is adapted from Rule 450 of the SEC's Rules of Practice. Comment to Rule 5462, Exch. Act Release No. 34-49454 (Mar. 19, 2004).

²PCAOB Rule 5462(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5462.

³PCAOB Rule 5462(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5462.

⁴PCAOB Rule 5462(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5462.

⁵PCAOB Rule 5462(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5462.

⁶PCAOB Rule 5462(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5462.

⁷PCAOB Rule 5462(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5462.

⁸PCAOB Rule 5462(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5462.

matter.⁹ A request for oral argument is made by separate motion accompanying the initial brief on the merits.¹⁰ Oral argument on whether to affirm an initial decision will be granted unless exceptional circumstances make oral argument impracticable.¹¹ Other matters before the Board are decided based solely on the filings unless the Board finds that oral argument would significantly aid the decisional process.¹² If oral argument is granted, each side is granted one-half hour unless the Board orders otherwise.¹³ If multiple parties have a common interest, they may constitute a single side for purposes of allotting time under this rule.¹⁴

The Board may allow the submission of additional evidence on its own motion or the motion of a party.¹⁵ A party must file its motion before the Board issues its decision, and must show with particularity that the additional evidence is material and that there were reasonable grounds for the party's previous failure to present the evidence.¹⁶ Other parties generally have five days to respond to the motion.¹⁷ The Board may hear the additional evidence itself, or it may remand or refer the proceeding to a hearing officer to take the additional evidence.¹⁸

⁹PCAOB Rule 5463(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5463.

¹⁰PCAOB Rule 5463(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5463.

¹¹PCAOB Rule 5463(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5463.

¹²PCAOB Rule 5463(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5463.

¹³PCAOB Rule 5463(c), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5463.

¹⁴PCAOB Rule 5463(c) and note, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5463.

¹⁵PCAOB Rule 5464, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5464. This rule was adapted from Rule 452 of the Commission's Rules of Practice. Comment to Rule 5464, Exch. Act Release No. 34-49454 (Mar. 19, 2004).

¹⁶PCAOB Rule 5464, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5464.

¹⁷PCAOB Rule 5464, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5464.

¹⁸PCAOB Rule 5464, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5464.

The Board determines each matter on the basis of the record.¹⁹ The record consists of papers filed on appeal or review, petitions for review and cross-petitions or oppositions, and items that are part of the hearing record below under Rule 5202(a).²⁰ The Board may request the Secretary to transmit documents excluded from the record where they were offered in evidence but excluded, or marked for identification but not offered.²¹

Within 10 days after service of a final order issued by the Board (or other time granted by the Board), a party may file a motion for reconsideration.²² The motion must specifically list the alleged errors, the grounds relied upon, and the relief sought.²³ No responses are permitted unless the Board requests a response.²⁴

A party may appeal a final disciplinary sanction by filing a petition for review in accordance with the Commission's Rules of Practice, or may appeal a Commission order in accordance with the Federal Rules of Appellate Procedure (or other appropriate statute, if any).²⁵ Under PCAOB Rule 5467, a firm that has filed a petition for review, or that is associated with a person who has filed such a petition, must file a notice and copy of the petition with the Secretary of the Board within 10 days after the petition is made.²⁶ This rule is to ensure the Board has notice of petitions filed by a party.²⁷

§ 8:50 Collateral consequences

It is still unclear what collateral consequences, if any, may stem from a PCAOB disciplinary action. The Board is permitted to bar or suspend individuals from associating with public ac-

¹⁹PCAOB Rule 5465, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5465.

²⁰PCAOB Rule 5465(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5465.

²¹PCAOB Rule 5465(c), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5465.

²²PCAOB Rule 5466(a), (b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5466.

²³PCAOB Rule 5466(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5466.

²⁴PCAOB Rule 5466(b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5466.

²⁵See Note to PCAOB Rule 5467, available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5467.

²⁶PCAOB Rule 5467(a), (b), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_5.aspx#rule5467.

²⁷Comment to Rule 5467, Exch. Act Release No. 34-49454 (Mar. 19, 2004).

counting firms. When it does so, it must notify the SEC (and appropriate state regulatory authorities). The SEC, state licensing authorities and the AICPA could use the Board's action as justification for their own investigations or for seeking enforcement actions against Board-sanctioned accountants.

Unlike the Board, the SEC is authorized to bar or suspend individuals from practicing before it.¹ Such a suspension or bar would prohibit not only being associated with public accounting firms, but also would prohibit participating in the financial reporting function of a public company. To date, however, there have been no public proceedings by the SEC against a Board-sanctioned accountant. Should the SEC or others elect to pursue such an action, depending on the PCAOB's findings, it may well present the opportunity to raise interesting collateral estoppel and res judicata issues.

[Section 8:50]

¹SEC Rule 102(e)(1), 17 C.F.R. § 201.102(e)(1).