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Checkosky, Rule 2(E) and the Auditor: How Should the Securities and Exchange Commission Define its Standard of Improper Professional Conduct?.

Cover Page Footnote

I am grateful to Professor Steven Thel for reading earlier drafts of this Note.

**CHECKOSKY, RULE 2(e) AND THE AUDITOR: HOW
SHOULD THE SECURITIES AND EXCHANGE
COMMISSION DEFINE ITS STANDARD OF IMPROPER
PROFESSIONAL CONDUCT?**

MARIE L. COPPOLINO*

INTRODUCTION

The Securities and Exchange Commission can use several enforcement and disciplinary tools against professionals.¹ One such tool, Rule 2(e) of the SEC's Rules of Practice, enables the SEC to bar temporarily or permanently a professional from appearing or practicing before it.² The SEC can bar from practice a professional who lacks the requisite qualifications to represent others; lacks character or integrity; engages in unethical or improper professional conduct; or willfully violates, or aids and abets the violation of, any federal securities law.³ Rule 2(e) allows the SEC "to protect its processes from incom-

* I am grateful to Professor Steven Thel for reading earlier drafts of this Note.

1. The SEC's arsenal includes the following: Rule 2(e) of the SEC's Rules of Practice and Procedure, 17 C.F.R. § 201.2(e) (1994); civil injunctive actions brought in federal district court under § 20(b) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77t (1988 & Supp. V 1993), and § 21(d) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78u (1988 & Supp. V 1993); administrative proceedings under § 15(c)(4) of the Exchange Act, 15 U.S.C. § 78o (1988 & Supp. V 1993); stop order proceedings under § 8(d) of the Securities Act to suspend the effectiveness of a registration statement, 15 U.S.C. § 77h (1988); report of investigation disseminated publicly by the Commission under § 21(a) of the Exchange Act, 15 U.S.C. § 78u (1988 & Supp. V 1993); and entry of an administrative order requiring any person to cease and desist from violation of the federal securities laws under the Securities Enforcement and Penny Stock Report Act of 1990, 15 U.S.C. §§ 77h-1, 78u-3 (Supp. V 1993). See Robert J. Haft, *Liability of Attorneys and Accountants for Securities Transactions* § 8.01, at 8-1 (1994-95 ed.) (listing SEC enforcement and disciplinary mechanisms).

2. 17 C.F.R. § 201.2(e)(1) (1994).

3. *Id.* In full, Rule 2(e)(1) provides:

The Commission may deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice of and opportunity for hearing in the matter (i) not to possess the requisite qualifications to represent others, or (ii) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct, or (iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws (15 U.S.C. §§ 77a to 80b-20), or the rules and regulations thereunder.

Id.

Practicing before the Commission includes, but is not limited to, "(1) transacting any business with the Commission; and (2) the preparation of any statement, opinion or other paper . . . filed with the Commission in any registration statement, notification, application, report or other document with the consent" of the professional. *Id.* § 201.2(g). The Commission has interpreted this section regarding practice broadly, especially as it pertains to attorneys. See Daniel L. Goelzer & Susan Ferris Wyderko, *Rule 2(e): Securities and Exchange Commission Discipline of Professionals*, 85 Nw. U.

petent, unethical, or dishonest professionals by excluding from practice (or limiting the activities of) those who have violated the federal securities laws or the standards of their own profession in the course of their prior contacts with the [SEC]."⁴ Further, the Rule "affords the Commission a vehicle to engage, to a limited degree, in professional standard-setting."⁵ While the SEC has instituted relatively few 2(e) proceedings against attorneys during the decade following the 1981 decision in *In re Carter and Johnson*,⁶ the use of Rule 2(e) against accountants who audit public companies has increased.⁷

The use of Rule 2(e) against all professionals is controversial.⁸ The SEC's statutory authority under the Rule—especially as applied to attorneys—is questionable, and state licensing bodies and professional associations perhaps can better monitor professional conduct.⁹ In addition, the SEC applies an imprecise standard of culpability to professionals practicing before the Commission. In May 1994, the Court of Appeals for the District of Columbia examined this ambiguous standard when it reviewed a suspension order by the SEC in *Checkosky v. SEC*,¹⁰ a Rule 2(e) proceeding against two Coopers & Lybrand auditors charged with misconduct during an audit. The court remanded the case to the Commission to clarify its opinion as to the standard of conduct the Commission applied to the auditors.¹¹ In a separate holding, one judge noted:

L. Rev. 652, 661 (1991) (explaining that because much of the lawyer's work involves counseling clients and preparing documents upon which the SEC and the investing public rely, there is little that a securities lawyer can do that is not covered by Rule 2(e)).

4. Goelzer & Wyderko, *supra* note 3, at 653 (citation omitted).

5. *Id.*

[B]oth the 1933 and 1934 Acts authorize the Commission to define accounting terms and to prescribe "the items or details to be shown in the balance sheet and earning statement, and the methods to be followed in the preparation of accounts, in the appraisal or valuation of assets and liabilities"

Louis Loss, *Fundamentals of Securities Regulation* 157 (2d ed. 1988) (quoting Securities Act § 19(a); Exchange Act § 13(b)). Despite this conferred power, the SEC instead has "chosen to rely for the most part on the [accounting] profession to establish generally accepted accounting principles." *Id.* at 159-60.

6. 47 S.E.C. 471 (Feb. 28, 1981). *Carter* perhaps is the most controversial Rule 2(e) decision to date. See *infra* notes 42-52 and accompanying text.

7. See *infra* note 83, subdivision (1).

8. See *infra* part I.B.

9. See *infra* notes 55-57 and accompanying text.

10. 23 F.3d 452 (D.C. Cir. 1994) (per curiam).

11. *Id.* at 454. In November 1994, the SEC issued an order scheduling the filing of briefs for the *Checkosky* remand. Exchange Act Release No. 34,983, 58 SEC Dock. 17 (Nov. 14, 1994). Parties were ordered to address the following issues in their briefs:

(1) At what minimum level of culpability may [the] Commission sanction an accountant for failure to comply with GAAP and GAAS;

(2) Need the culpability standard be specifically alleged in an order for proceedings concerning improper professional conduct;

The Commission has variously indicated that different levels of mental culpability are needed to make out a 2(e)(1)(ii) violation by professionals . . . : simple negligence as the Commission privately held in *Schulzetenberg*; gross negligence implied by the "so deficient" language of *Haskins & Sells*; recklessness hinted by the Commission in its opinion below; or willfulness or bad faith suggested by *Logan and Carter*. . . . [T]he Commission must choose its standard and forthrightly apply it to this case.¹²

This judge suggested that on remand, the Commission must prove, at a minimum, that the auditors misinterpreted Generally Accepted Accounting Principles ("GAAP") and violated Generally Accepted Auditing Standards ("GAAS").¹³ The judges, however, disagreed regarding what level of mental culpability, if any, beyond this minimum must be proven.¹⁴

Though, as the *Checkosky* court noted, the SEC has not adhered to a single standard of mental culpability in Rule 2(e) actions, a few decisions in Rule 2(e) cases during the last decade have suggested that mere negligence is sufficient to prevail against an auditor or an accounting firm.¹⁵ On the whole, however, Rule 2(e) cases show that

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- (3) Does any misinterpretation of GAAP by an accountant or any failure to conform with GAAS constitute negligence, and is it improper professional conduct;
 - (4) What constitutes recklessness for purposes of Rule 2(e)(1)(ii); and
 - (5) What facts, if any, in the record demonstrate that Respondents did or did not act recklessly or negligently.

Id.

12. *Checkosky*, 23 F.3d at 462 (Silberman, J.). The cases referred to are: *In re Schulzetenberg*, Admin. Proc. File No. 3-6881, slip. op. at 2 (Nov. 10, 1987) (holding that mere negligence does warrant disciplinary action under Rule 2(e) because "an incompetent or negligent auditor can do just as much harm to public investors and others who rely on him as one who acts with an improper motive"); *In re Carter*, 47 S.E.C. 471, 512 (Feb. 28, 1981) (holding that an attorney who exercises good faith and "exert[s] reasonable efforts to prevent violations of the law by his client" meets the professional conduct standard); *In re Haskins & Sells*, Accounting Series Release No. 73 [1937-82 Transfer Binder] ¶ 72,092, at 62,197 (Oct. 30, 1952) (holding that good faith is no defense where accountants' conduct is "so deficient" that it constitutes "their failure to give [the] professional undertaking the degree of care and inquiry it demanded under the circumstances"); *In re Logan*, 10 S.E.C. 982, 985 (Jan. 7, 1942) (suggesting in dictum that good faith is a defense to accusations of improper professional conduct).

13. *Checkosky*, 23 F.3d at 456 (Silberman, J.).

14. *Id.* (Silberman, J.) (noting that the question of whether simple negligence is sufficient to meet the standard of improper professional conduct under Rule 2(e) was not properly presented to the court and accordingly was not answered); *id.* at 480 (Randolph, J.) (concluding that negligence is the proper standard applicable to auditor's conduct under Rule 2(e)); *id.* at 494 (Reynolds, J., concurring in part, dissenting in part) (same).

15. See *Checkosky*, 23 F.3d 452, 480 (D.C. Cir. 1994) (per curiam) (Randolph, J.) ("Judge Reynolds [concurring in part, dissenting in part] and I know what the Commission determined, as does everyone who is in the least bit familiar with this case—the Commission decided that negligence is enough."); *id.* at 494 (Reynolds, J., concurring in part, dissenting in part); *Danna v. SEC*, No. C-93-4158, 1994 U.S. Dist. LEXIS 7256, at *11 (N.D. Cal. Feb. 8, 1994) ("[T]he Commission's authority to protect its

auditors frequently consent to findings of improper professional conduct when they have merely erred in matters of professional judgment.¹⁶ These orders rarely describe the auditor's level of culpability. On the contrary, the orders simply describe supposed misinterpretations of GAAP and allege violations of GAAS.

Not all errors in professional judgment violate GAAS and GAAP, and therefore not all misjudgments should violate Rule 2(e).¹⁷ Clearly erroneous violations of GAAS and GAAP, of course, must be sanctioned, and guidelines regarding such errors are set forth explicitly in these standards.¹⁸ But GAAS can not provide clear-cut guidance for all circumstances that can arise during an audit. As a result, an auditor who exercises due professional care and obtains sufficient competent evidential matter can still reach improper conclusions. Therefore, *ex post facto* criticisms of non-negligent, honest, and justified professional decisions must not be the basis for accusations of improper professional conduct.

This Note asserts that the SEC must implement a reasonable auditor standard to determine an auditor's protected range of professional judgment under Rule 2(e). Violations of GAAS and misinterpretations of GAAP that fall outside a reasonable auditor's range of professional judgment should be deemed improper professional conduct

own processes through Rule 2(e) proceedings is not necessarily limited to instances of bad faith or intentional misconduct."); *supra* note 12 and accompanying text; *see also* Haft, *supra* note 1, § 8.01, at 8-3 (claiming that negligent violations of GAAS and GAAP are sufficient for proceedings based on improper professional conduct); Joel Seligman, *Accounting and the New Corporate Law*, 50 Wash. & Lee L. Rev. 943, 957 (1993) (claiming that under Rule 2(e), "the Commission only has to prove the equivalent to negligence, rather than scienter").

On remand, the SEC is arguing that "negligence, meaning failure to comply with applicable professional standards that is unreasonable under the circumstances, constitutes the minimum level of culpability for the Commission to censure or suspend an auditor from practice before it under Rule 2(e)." Brief of the Office of the Chief Accountant on Remand at 2, *In re Checkosky*, Admin. Proc. File No. 3-6776 (Jan. 13, 1995) (on file with the *Fordham Law Review*).

16. *See infra* part II.A.5.; *see also infra* note 84 (discussing auditors' consents to settlements) and text accompanying note 141 (discussing why most Rule 2(e) cases are settled).

17. Securities regulation experts support the view that negligent conduct is actionable under Rule 2(e)(1)(ii). *See, e.g.*, Haft, *supra* note 1, § 8.01, at 8-3 (claiming that negligent violations of GAAS and GAAP are sufficient for proceedings based on improper professional conduct); Seligman, *supra* note 15, at 957 (claiming that under Rule 2(e), "the Commission only has to prove the equivalent to negligence, rather than scienter"). Because negligence is sufficient to meet Rule 2(e)'s improper professional conduct standard, the more egregious violations that are considered reckless and willful also violate the Rule.

18. *See, e.g.*, Codification of Statements on Auditing Standards ("AICPA"), Statements on Auditing Standards ("AU") § 315 (Am. Inst. of Certified Pub. Accountants 1991) (requiring that a successor auditor communicate with the predecessor auditor whom he or she is replacing); *id.* AU § 337 (requiring that an auditor obtain evidential matter relevant to litigation, claims, and assessments).

for purposes of Rule 2(e)(1)(ii).¹⁹ Part I of this Note provides a background for Rule 2(e) proceedings. It includes a brief history of the Rule, case law supporting the SEC's authority to apply the Rule, and a summary of the controversies surrounding the Rule's use. In addition, it introduces the Rule's application to auditors. Part II outlines the results of a survey of Rule 2(e)(1)(ii) decisions rendered against auditors in the past decade. These results support the need for a reasonable auditor standard. The survey compares criteria such as the most often-violated GAAS requirements and the sanctions imposed on auditors for such violations. Further, the survey observes that the Commission only addresses the level of culpability when determining the appropriate sanction for misconduct, rather than when first deciding whether an auditor's professional conduct was improper under the Rule. Part III analyzes two Rule 2(e)(1)(ii) cases in which the Commission sanctioned auditors for debatable errors in professional judgment. This part concludes that the auditors' conduct would not have been actionable under a reasonable auditor standard. Finally, part IV argues that the Commission must expound and consistently apply a reasonable auditor standard when determining whether an auditor meets the improper professional conduct standard. This standard gives the Commission the leeway necessary to protect its processes, yet does not penalize an auditor for justified errors made in exercising professional judgment.

I. RULE 2(e)'S BACKGROUND

Rule II of the Commission's Rules of Practice, the predecessor to Rule 2(e), was adopted in 1935²⁰ under the SEC's general rulemaking power granted in both the Securities Act²¹ and the Exchange Act.²² In 1938, the Rule was amended to authorize the Commission to with-

19. For example, under certain circumstances, GAAS requires that an auditor observe physical inventory counts "as he [or she] deems necessary." *Id.* AU § 331.11. While the number of counts observed is a determination left to the individual auditor, a reasonable auditor, after exercising professional judgment, would observe between 40% and 60% of the total dollar value of the inventory under specific circumstances. (These percentages are included only for purposes of this hypothetical; GAAS do not delineate specific percentages.) Observing counts comprising only 5% must be considered clearly erroneous and, therefore, outside the auditor's protected realm of professional judgment. This decision should constitute improper professional conduct under Rule 2(e)(1)(ii). Nevertheless, counting 40% where the SEC would have preferred 60% should not constitute improper professional conduct.

20. 1 Fed. Reg. 1753 (1936) (effective September 13, 1935); *see also* Goelzer & Wyderko, *supra* note 3, at 654 (referring to SEC Ann. Rep. 45-53 (1935)). After amendments in 1936, Rule II contained provisions governing admissions to practice, under which persons "of good moral character [and with] the requisite qualifications to represent others [could] be admitted to practice as an Attorney or Agent before the Commission." 2nd Ann. Rep. of the SEC 61 (1936).

21. Securities Act of 1933, § 19(a) (codified at 15 U.S.C. § 77s(a) (1988)).

22. Securities Exchange Act of 1934, § 23(a) (codified at 15 U.S.C. § 78w(a) (1988)).

hold any person's²³ privilege of appearing or practicing before it if that person did not possess the requisite qualifications to represent others, lacked character or integrity, or engaged in unethical or improper professional conduct.²⁴ The SEC again amended Rule 2(e) in September 1970 to suspend automatically any person who:

"(1) had been suspended or disbarred from practice or who has had his license to practice suspended or revoked by a state licensing authority, (2) had been convicted of a felony or of a misdemeanor involving moral turpitude, or (3) had been suspended or disbarred by a court of competent jurisdiction."²⁵

The amendments also added a third category to Rule 2(e), subparagraph (1)(iii), which provides "that the Commission may deny a professional the privilege of appearing or practicing before it for the willful violation, or the willful aiding and abetting of a violation, of the federal securities laws or the rules and regulations thereunder."²⁶ The most recent alteration to the Rule was made in 1988, when the Commission determined that all Rule 2(e) hearings must be public unless the Commission directs otherwise.²⁷ Beginning in 1993, the SEC's Division of Enforcement replaced its Office of the General Counsel²⁸ as the authority responsible for prosecuting Rule 2(e) actions.²⁹

Until the 1970s, the "universally understood purpose of Rule 2(e) was to assure the integrity of SEC processes through enforcement of appropriate conduct by professionals practicing before the SEC. Accordingly, the Rule was invoked episodically in reaction to evidence of

23. Although "person" for Rule 2(e) purposes generally has referred to only accountants and lawyers over the years, there are two reported Rule 2(e) proceedings against other professionals. See *In re Browne*, Securities Act Release No. 32,854, 54 SEC Dock. 1991, 1991 (Sept. 9, 1993) (engineer); *In re McDowell*, Securities Act Release No. 5903, 14 SEC Dock. 64, 64 (Feb. 2, 1978) (geologist).

24. See Goelzer & Wyderko, *supra* note 3, at 654; 10 Louis Loss & Joel Seligman, *Securities Regulation* 4800 (2d ed. 1989). This amendment currently is codified at Rule 2(e)(1). 17 C.F.R. § 201.2(e)(1)(i)-(ii) (1994).

25. 10 Loss & Seligman, *supra* note 24, at 4800 (quoting *In re Carter*, 47 S.E.C. 471, 476-77 (Feb. 28, 1981)).

26. *Id.* (quoting *Carter*, 47 S.E.C. at 476-77).

27. 17 C.F.R. § 201.2(e)(7) (1994).

28. The Office of General Counsel had acted on behalf of the Office of the Chief Accountant. *SEC Announces Organizational Changes as to Accountants, Consumer Affairs*, Reg., Econ. and L., 1993 Daily Exec. Rep. (BNA) No. 236, at D-3 (Dec. 10, 1993).

29. *Id.* In addition, in 1994, the Commission announced that it transferred its "delegation of authority for advice and activities concerning certain proceedings conducted" under Rule 2(e) from the Chairman's Executive Assistant to the Office of the General Counsel (hereinafter OGC). Delegation of Authority to the Office of the General Counsel, 59 Fed. Reg. 2361 (1994) (to be codified at 17 C.F.R. § 200). The OGC's responsibilities include advising the Commission and making certain procedural decisions.

derelection in the conduct of such practice."³⁰ The character and purpose of Rule 2(e) were then transformed, and the SEC began to treat "[a]ccountants and lawyers . . . as 'an enforcement arm of the SEC' to assure the good behavior of their clients, without express statutory authority from . . . Congress."³¹ Consequently, as the SEC began to focus more on these professionals, the number of Rule 2(e) proceedings increased greatly.³²

Under Rule 2(e), sanctions imposed against professionals range from censures to permanent bars from appearing or practicing before the Commission.³³ Within this realm, the SEC can suspend a professional temporarily or can set a specific period of time before a professional whose privileges before the Commission have been "permanently" denied may apply to have those privileges reinstated.³⁴ Each proceeding is decided on a case-by-case basis; the sanction that is "appropriate in the public interest depends on the facts and circumstances of each particular case and cannot be precisely determined by comparison with that taken in other proceedings."³⁵ The sanction, however, must be "limited to that necessary to protect the investing public and the Commission from the future impact [of improper professional conduct] on its processes."³⁶

30. R. James Gormley, *The Law of Accountants and Auditors* ¶ 13.04[1][b], at 13-36 (1981).

31. *Id.* ¶ 13.04[1][b], at 13-37 (quoting *SEC v. Arthur Young & Co.*, 590 F.2d 785, 788 (9th Cir. 1979)).

32. See Dennis J. Block & Jonathan M. Hoff, *SEC Moves Against Attorneys Under the Remedies Act*, N.Y.L.J., Sept. 23, 1993, at 5 (describing the 1970s as a "'reign of terror' on broker-dealers, accountants and attorneys" (quoting Robert W. Emerson, *Rule 2(e) Revisited: SEC Disciplining of Attorneys Since In re Carter*, 29 Am. Bus. L.J. 155, 176 (1991))).

33. The degrees of sanctions include censure, temporary bar, permanent bar with time specified after which the auditor can apply to have his or her privileges reinstated, and a permanent bar. See symbols a2-12 in the Appendix.

34. See *infra* note 120 and accompanying text.

35. *In re Ernst & Ernst*, 46 S.E.C. 1234, 1273 n.73 (May 31, 1978). The Commission considers the following circumstances in determining the appropriate remedy in a Rule 2(e) proceeding:

"(1) the gravity of the misconduct or other professional deficiency involved; (2) whether the misconduct or deficiency arose in connection with appearing or practicing before the Commission; (3) whether the problems which led to the proceeding appear to result more from institutional faults than individual failings; (4) the degree to which the misconduct or other deficiency casts doubt upon an individual's ability or willingness to perform competent and reliable professional services in the future; (5) whether the individual or firm involved has been the subject of any previous enforcement action or Rule 2(e) proceeding brought by the Commission; (6) the experience of the Commission's staff in conducting the investigation which led to institution of a proceeding; and (7) other similar considerations."

2 Loss & Seligman, *supra* note 24, at 736 n.299 (quoting *The Accounting Establishment: A Staff Study*, Subcomm. on Rep., Acct. & Mgmt., Senate Comm. on Gov't Operations, 94th Cong., 2d Sess. 1476-1477 (Comm. Print 1976)).

36. *In re Carter*, 47 S.E.C. 471, 477 (Feb. 28, 1981).

Most Rule 2(e) disciplinary proceedings against auditors and audit firms are settled.³⁷ Frequently, the settlements call for such steps as completion of continuing professional education programs, peer review, or review of the firm's auditing procedures by persons satisfactory to the Commission's Chief Accountant.³⁸ Occasionally, the SEC imposes a sanction that distinguishes an accountant's privilege of preparing or reviewing documents to be filed with the Commission from the ability to appear as an independent public accountant before the Commission.³⁹

A. *Rule 2(e) is Applied Differently to Accountants and Attorneys*

Various commentators have questioned whether accountants and attorneys should be treated similarly under Rule 2(e).⁴⁰ Former Com-

37. Haft, *supra* note 1, § 8.01[2], at 8-3; 2 Loss & Seligman, *supra* note 24, at 697-98. Although most Rule 2(e) cases are settled, the reasonable auditor standard proposed herein can be used to evaluate the auditor's conduct in settlement negotiations.

38. 2 Loss & Seligman, *supra* note 24, at 697-98. For example, see *In re Venezia*, Exchange Act Release No. 33,961, 56 SEC Dock. 1505 (Apr. 25, 1994), where the Commission issued a consent order denying the privilege of appearing or practicing before the Commission whereby:

Five years after the effective date of the Commission's denial of the privilege of appearing or practicing before the Commission, Venezia may apply to resume appearing or practicing before the Commission as:

1) a preparer or reviewer . . . provided that . . . his work will be reviewed by the independent audit committee of the company or in some other manner acceptable to the staff of the Commission;

2) an independent accountant upon submission of an application to the Office of Chief Accountant of the Commission containing a showing satisfactory to the Commission that:

a. Venezia, or any firm with which he is or becomes associated in any capacity, is and will remain a member of the SEC Practice Section of the American Institute of Certified Public Accountants' Division for CPA Firms;

b. Venezia, or any firm with which he is or becomes associated in any capacity, has received an unqualified report relating to his most recent peer review conducted in accordance with the guidelines adopted by the SEC Practice Section; and

c. Venezia will comply with all applicable SEC Practice Section requirements, including all requirements for periodic peer reviews, concurring partner reviews, and continuing professional education, as long as he appears or practices before the Commission as an independent accountant.

Id. at 1507-08. The consent order further provided that the "Commission's review of any application by Venezia to resume appearing or practicing before the Commission may include consideration of any other matter relating to the character, integrity, professional conduct or qualifications of Venezia to practice before the Commission." *Id.* at 1508.

39. See, e.g., *In re Silvestain*, Exchange Act Release No. 34,631, 57 SEC Dock. 1398, 1403 (Sept. 2, 1994) (imposing different requirements when auditor resumed appearing as a preparer or reviewer than when he appeared as an independent accountant); *In re Withers*, Exchange Act Release No. 34,537, 57 SEC Dock. 1048, 1056 (Aug. 17, 1994) (same).

40. See Samuel H. Gruenbaum, *The SEC's Use of Rule 2(e) to Discipline Accountants and Other Professionals*, 56 Notre Dame Law. 820, 820-21 (1981). The differ-

missioner Roberta Karmel noted: "Disciplinary action against accountants and attorneys must rest on very different legal analyses and involves very different policy questions. The Commission has confounded the very real issues involved in disciplining these two disparate professions by adhering to a single overly broad rule for enforcing professional responsibility."⁴¹ Recently, courts have recognized this difference as well.

In re Carter and Johnson,⁴² a 1981 SEC decision, involved a Rule 2(e) action against two attorneys charged with aiding and abetting securities law violations. The Commission distinguished the roles of accountants and attorneys, stating that while accountants have a duty to those who justifiably rely on their reports, lawyers, on the other hand, traditionally have a duty only to their clients, not to the public.⁴³ Despite the lawyer's limited role, the Commission may take action where an attorney becomes a "conscious participant in violations of the securities laws, or performs his professional function without regard to the consequences."⁴⁴ Concerned with the unclear obligations of securities lawyers, the Commission set forth its interpretation of Rule 2(e)(1)(ii)'s "unethical or improper professional conduct" standard:

When a lawyer with significant responsibilities in . . . [effectuating] . . . a company's compliance with the disclosure requirements of the federal securities laws becomes aware that his client is engaged in a substantial and continuing failure to satisfy those disclosure requirements, his continued participation violates professional standards unless he takes prompt steps to end the client's noncompliance.⁴⁵

The Commission did not retroactively impose this interpretation of the standard.⁴⁶

ences in applying Rule 2(e) to accountants and attorneys also is evident where commentators focus on only one of these professions when analyzing Rule 2(e). See Norman S. Johnson, *The Dynamics of SEC Rule 2(e): A Crisis for the Bar*, 1975 Utah L. Rev. 629 (focusing on attorneys); Michael J. Crane, Note, *Disciplinary Proceedings Against Accountants: The Need for a More Ascertainable Improper Professional Conduct Standard in the SEC's Rule 2(e)*, 53 Fordham L. Rev. 351 (1984) (focusing on accountants); Note, *SEC Disciplinary Proceedings Against Attorneys Under Rule 2(e)*, 79 Mich. L. Rev. 1270, 1275 (1981) [hereinafter Note, *SEC Disciplinary Proceedings*] (focusing on attorneys).

41. *In re Nielsen*, Exchange Act Release No. 16,479, 19 SEC Dock. 158, 161-62 (Jan. 10, 1980) (Karmel, Comm'r, dissenting).

42. 47 S.E.C. 471 (Feb. 28, 1981).

43. *Carter*, 47 S.E.C. at 478; cf. *Ultramares Corp. v. Touche*, 174 N.E. 441 (N.Y. 1931) (requiring privity to make auditor who makes negligent misrepresentations liable to third parties).

44. *Carter*, 47 S.E.C. at 478. Auditors are held to this same standard under Rule 2(e)(1)(iii).

45. 47 S.E.C. at 511.

46. *Id.*

Since the *Carter and Johnson* decision, the SEC has not instituted proceedings against attorneys under Rule 2(e)(1)(ii).⁴⁷ Nevertheless, commentators have argued that the SEC's authority under Rule 2(e) interferes with an attorney's ethical obligation to represent a client zealously.⁴⁸ The Commission's General Counsel responded to this criticism in 1982 by assuring that he would not recommend proceedings against lawyers appearing as advocates, because doing so could have a chilling effect on the adequate representation of clients.⁴⁹ In 1988, the Commission confirmed this policy, maintaining that the Commission did not intend to develop or apply independent standards of professional conduct for attorneys.⁵⁰ Subsequently, the SEC generally has used Rule 2(e) proceedings only where a judicial or administrative order found that an attorney's conduct violated a securities law.⁵¹ Still, the SEC's ability to apply Rule 2(e) to attorneys, as well as to accountants, continues to be a source of controversy within and outside of the Commission.⁵²

47. Goelzer & Wyderko, *supra* note 3, at 665; Haft, *supra* note 1, § 8.01[2], at 8-3; Block & Hoff, *supra* note 32, at 5. The Commission recently has instituted public administrative proceedings against attorneys under its cease-and-desist authority, derived from the Securities Enforcement Remedies and Penny Stock Reform Act of 1990. Sec. 102, Pub. L. No. 101-429, 104 Stat. 931 (1990). Use of cease-and-desist, like Rule 2(e), authority has been controversial. See Block & Hoff, *supra* note 32, at 5.

48. See, e.g., Johnson, *supra* note 40, at 644-50 (stating that the SEC's new standards are contrary to "traditional canons of the bar"); Steven C. Krane, *The Attorney Unshackled: SEC Rule 2(e) Violates Clients' Sixth Amendment Right to Counsel*, 57 Notre Dame Law. 50, 51 (1981) (claiming that Rule 2(e) has a chilling effect that violates a client's right to counsel); Harold Marsh, Jr., *Rule 2(e) Proceedings*, 35 Bus. Law. 987, 1010-11 (1980) (asserting that Rule 2(e) "substantially impairs the right of [clients] to be represented by free and unintimidated counsel"); Note, *SEC Disciplinary Proceedings*, *supra* note 40, at 1275 (arguing that SEC proceedings against lawyers undermine a client's right to effective counsel).

49. Edward F. Greene, *Lawyer Disciplinary Proceedings Before the Securities and Exchange Commission*, 14 Sec. Reg. & L. Rep. (BNA) No. 3, at 169-70 (1982); Securities Act Release No. 6783, 41 SEC Dock. 388, 394-95 (July 7, 1988). Because auditors do not prepare their clients' financial statements, but rather review, test, and issue opinions on these statements, similar arguments pertaining to accountants' roles as advocates are not applicable.

50. Specifically, the Commission claimed that "as a matter of policy, [the SEC] generally refrains from using its administrative forum to conduct *de novo* determinations of the professional obligations of attorneys." Haft, *supra* note 1, § 8.01[2], at 8-3 (citing Exchange Act Release No. 25,893, 53 Fed. Reg. 26,427, 26,431 (1988)).

Most recently, the Eleventh Circuit rejected an argument that Rule 2(e) intimidates attorneys and thus precludes attorneys from providing adequate representation for their clients. *Sheldon v. S.E.C.*, No. 93-4055, 1995 U.S. App. LEXIS 3724, at *7 (11th Cir. Feb. 24, 1995). The court asserted: "Having attorneys subject to ethical standards constitutes a safeguard for all parties in a proceeding, not intimidation." *Id.* at *8.

51. Haft, *supra* note 1, § 8.01[2], at 8-3; see also *supra* text accompanying note 47 (noting that no Rule 2(e)(1)(ii) actions have been instituted against attorneys since the *Carter and Johnson* decision).

52. Goelzer & Wyderko, *supra* note 3, at 656; Roberta S. Karmel, *Rule 2(e)—A Reprise*, N.Y.L.J., Oct. 21, 1993, at 3.

B. *Despite Judicial Acceptance, the Commission's Application of Rule 2(e) to Auditors is Questioned*

While the SEC's authority to sanction attorneys is questionable, its authority to sanction accountants is judicially well-established. Based on the statute's purpose, three courts of appeals have upheld the Commission's authority in cases involving accountants.⁵³ Despite these decisions,⁵⁴ commentators continue to question the SEC's disciplinary authority under Rule 2(e).⁵⁵ These critics maintain that the SEC lacks express statutory authority to discipline professionals (both accountants and attorneys) and that Congress never intended the Commission to have such power.⁵⁶ Many commentators agree that this regulation extends beyond the SEC's authority to protect its processes.⁵⁷

53. *Checkosky v. SEC*, 23 F.3d 452 (D.C. Cir. 1994) (per curiam); *Davy v. SEC*, 792 F.2d 1418 (9th Cir. 1986); *Touche Ross & Co. v. SEC*, 609 F.2d 570 (2d Cir. 1979).

54. See *infra* notes 58-75 and accompanying text.

55. See Arthur Best, *Shortcomings of Administrative Agency Lawyer Discipline*, 31 Emory L.J. 535, 535 (1982) (arguing that the SEC should defer its Rule 2(e) powers to the general disciplinary system); Robert A. Downing & Richard L. Miller, Jr., *The Distortion and Misuse of Rule 2(e)*, 54 Notre Dame Law. 774, 786 (1979) (contending that the Commission's objective is "to subjugate the accounting profession to [its] day-to-day control" via Rule 2(e)); Gruenbaum, *supra* note 40, at 824-28, 832-37 (finding problems with Rule 2(e) proceedings against entire firms, the Rule's standards of proof, and culpability); Johnson, *supra* note 40, at 657 (stressing problems with Rule 2(e)'s burden of proof and lack of any identifiable standard of care for lawyers); Karmel, *supra* note 52, at 3 (asserting that the Rule 2(e) controversy arose because "the [C]ommission has simply arrogated [disciplinary power under Rule 2(e)] to itself, claiming expertise and the need for private sector assistance in policing the securities markets. However, the licensing and discipline of attorneys and accountants is a matter properly committed to state licensing bodies and professional associations."); Krane, *supra* note 48, at 77-84 (arguing that the restrictions Rule 2(e) places on an attorney interfere with his or her client's right to counsel); Marsh, *supra* note 48, at 1010-15 (raising constitutional questions regarding substantive and procedural due process as applied to Rule 2(e)); Marvin G. Pickholz, *SEC Regulation of Professionals*, 4 Rev. Fin. Serv. Reg. 165, 167 (1988) (alleging that Rule 2(e) use violates Eighth Amendment prohibition against cruel and unusual punishment); Note, *SEC Disciplinary Proceedings*, *supra* note 40, at 1275-76 (claiming that Rule 2(e) proceedings against attorneys (1) undermine the adversary system and the client's right to effective counsel and (2) threaten the balance between state and federal law by federalizing professional responsibility).

56. See, e.g., *infra* part I.B.2 (providing Commissioner Karmel's criticism of SEC's use of Rule 2(e)).

57. This Note contends that the SEC has the authority to promulgate Rule 2(e) against all professionals.

Within the Commission, former Commissioner Karmel has been the strongest critic of Rule 2(e)'s application to attorneys. In an often-quoted dissent from *In re Keating*, Muething & Klekamp, 47 S.E.C. 95 (July 2, 1979), she claimed that the Commission did not possess the "mandate [or the] expertise to protect the public against unethical or incompetent attorneys," *id.* at 110, and further argued that the Rule's use "necessarily impinges upon and interferes with a client's right to counsel," *id.* at 115. Similar to her dissent in *In re Nielsen*, Exchange Act Release No. 16,479, 19 SEC Dock. 158, 159 (Jan. 10, 1980), a Rule 2(e) proceeding against an auditor, she stressed the Commission's lack of statutory power to discipline attorneys. See *infra* part I.B.2. In par-

1. Rule 2(e) Preserves the Integrity of the Commission's Processes

In *Touche Ross & Co. v. SEC*,⁵⁸ the Second Circuit upheld the SEC's authority to discipline auditors under Rule 2(e). While the court acknowledged that there was "no express statutory provision authorizing the Commission to discipline professionals appearing before it,"⁵⁹ it also recognized that this authority could be implied because the Rule had been in effect for over forty years with no court ever finding it invalid.⁶⁰ After distinguishing the Commission's authority to discipline professionals from its substantive enforcement functions, the court refused to find that the statutory scheme⁶¹ negated the SEC's implied authority under Rule 2(e).⁶² The court reasoned that Rule 2(e) regulation furthers the legitimate statutory purpose of preserving the integrity of Commission processes and that in other agency contexts, courts had upheld the authority of agencies to discipline attorneys practicing or appearing before them.⁶³

The *Touche Ross* court recognized that Rule 2(e) was "promulgated pursuant to [the Commission's] statutory rulemaking authority [and] represents an attempt by the Commission to protect the integrity of its own processes."⁶⁴ According to the court, auditors who certify financial statements must be competent and ethical; otherwise they would undermine the reliability of the disclosure process.⁶⁵ Rule 2(e) as-

titular, Commissioner Karmel opposed the Commission's findings that the internal procedures of a law firm did not meet professional responsibility standards, likening the Commission's holding to setting professional standards for attorneys. *Keating*, 47 S.E.C. at 113-14.

58. 609 F.2d 570 (2d Cir. 1979).

59. *Id.* at 582.

60. *Id.* at 578.

61. The statutory scheme refers to the Commission's rulemaking powers under the 1933 Act, the 1934 Act, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. *Id.* at 577-78 & n.12. (citations omitted).

62. *Id.* at 579-82.

63. *Id.* The other agencies referred to are the Board of Tax Appeals, the Immigration and Naturalization Service, and the International Claims Commission. *Id.* at 581 (citing *Goldsmith v. United States Bd. of Tax Appeals*, 270 U.S. 117 (1926); *Koden v. United States Dep't of Justice*, 564 F.2d 228 (7th Cir. 1977); *Herman v. Dulles*, 205 F.2d 715 (D.C. Cir. 1953)).

64. *Id.* at 582. The court discussed the need for the SEC to "protect the integrity of its own processes," *id.* at 581, noting that:

By the very nature of its operations, the Commission, with its small staff and limited resources, cannot possibly examine, with the degree of close scrutiny required for full disclosure, each of the many financial statements which are filed. Recognizing this, the Commission necessarily must rely heavily on both the accounting and legal professions to perform their tasks diligently and responsibly. Breaches of professional responsibility jeopardize the achievement of the objectives of the securities laws and can inflict great damage on public investors.

Id. at 580-81.

65. *Id.* at 582.

tures the Commission that professionals will "perform their tasks diligently and with a reasonable degree of competence."⁶⁶

In *Davy v. SEC*,⁶⁷ the Ninth Circuit also held that the Commission's authority to promulgate rules and regulations under the Exchange Act includes the specific power to discipline accountants.⁶⁸ Adopting the reasoning of *Touche Ross*, the court explained that the SEC's authority is necessary to protect its administrative procedures and the public.⁶⁹ Moreover, it acknowledged, but noted that no court had embraced, the Rule 2(e) criticisms asserted by various commentators and former Commissioner Karmel.⁷⁰

Most recently, the Court of Appeals for the District of Columbia upheld the SEC's authority in *Checkosky*.⁷¹ The court, also relying primarily on the *Touche Ross* decision, emphasized the distinction between the SEC's valid disciplinary authority over professionals appearing before it and its legitimate disciplinary authority over violations of substantive provisions of the securities laws.⁷² The latter, under the Exchange Act's jurisdictional provision, is within the exclusive jurisdiction of the federal courts.⁷³ The former, disciplinary authority over professionals, is valid if the regulations are reasonably related to the underlying statute's purpose.⁷⁴ In making this distinction, the court stressed that the Commission promulgated Rule 2(e) to

66. *Id.*

67. 792 F.2d 1418 (9th Cir. 1986).

68. *Id.* at 1421.

69. *See id.* at 1421-22. In response to an argument that the SEC cannot regulate unenumerated persons, the court noted that Rule 2(e) was promulgated under section 23(a) of the Securities and Exchange Act of 1934, which does not specifically enumerate the persons to whom it applies (unlike Section 14(b) of the 1934 Act, where such an argument was accepted). *Id.* at 1422.

70. *Id.* at 1421-22; *see also infra* part I.B.2 (summarizing Commissioner Karmel's criticisms of the SEC's authority under Rule 2(e)).

71. *Checkosky v. SEC*, 23 F.3d 452 (D.C. Cir. 1994).

72. 23 F.3d at 456 (Silberman, J.); *see id.* at 468-72 (Randolph, J.); *id.* at 493-94 (Reynolds, J., concurring in part, dissenting in part). In *Touche Ross*, the accountants claimed that district courts had exclusive jurisdiction over violations of the securities laws, and therefore, the "statutory scheme negate[d] any implied authority that the SEC may discipline accountants pursuant to Rule 2(e)." 609 F.2d at 579. The *Touche Ross* court did not accept this argument, because the Supreme Court had held that agencies can promulgate regulations "if the regulation is in furtherance of a legitimate statutory purpose." *Id.* (citing *Mourning v. Family Publications Serv., Inc.*, 411 U.S. 356 (1973)). The *Touche Ross* court then concluded that Rule 2(e) furthered a legitimate statutory purpose, holding that under Rule 2(e), the SEC attempted to "protect the integrity of its own processes. If incompetent or unethical accountants should be permitted to certify financial statements, the reliability of the disclosure process would be impaired." *Id.* at 581. Relying on this reasoning, in a separate opinion in the *Checkosky* case, one judge considered Rule 2(e) and substantive provisions of the securities law analytically distinct. 23 F.3d at 456 (Silberman, J.).

73. 15 U.S.C. § 78aa (1988).

74. *Mourning v. Family Publications Serv., Inc.*, 411 U.S. 356, 369 (1973).

protect its administrative processes and not to complement the SEC's enforcement arsenal.⁷⁵

Thus, the SEC's authority to discipline accountants under Rule 2(e) clearly has been upheld by the three circuit courts that have addressed this issue. Notably, none of these decisions ruled out the application of their holdings to Rule 2(e) actions against attorneys.

2. Former Commissioner Karmel Questions the Commission's Disciplinary Authority

More than a decade since her controversial dissent in *In re Nielsen*,⁷⁶ former Commissioner Karmel continues to question the SEC's authority to discipline accountants for professional misconduct under Rule 2(e).⁷⁷ She contends that the Commission's "statutory authority to regulate financial statement presentation and independence requirements of accountants is . . . barely sufficient" to sustain its disciplinary authority.⁷⁸ Moreover, she finds no statutory support for the SEC to discipline accountants who fail to follow GAAS.⁷⁹ In making this assertion, she distinguishes the Commission's application of general standards of ethics and character from its power to determine the standards for form and content of financial statements. Former Commissioner Karmel has urged the Commission to enunciate a reasonable standard for evaluating an auditor's professional conduct before the SEC.⁸⁰

II. SURVEY OF RULE 2(e) PROCEEDINGS AGAINST AUDITORS⁸¹

The conclusions in this part are the result of a survey of seventy-five Rule 2(e) orders⁸² issued between October 1984 and September

75. *Checkosky*, 23 F.3d at 456 (Silberman, J.); see *id.* at 468-70 (Randolph, J.); *id.* at 493 (Reynolds, J., concurring in part, dissenting in part).

76. Exchange Act Release No. 16,479, 19 SEC Dock. 158, 159 (Jan. 10, 1980) (Karmel, Comm'r, dissenting).

77. Karmel, *supra* note 52, at 3.

78. *Nielsen*, 19 SEC Dock. at 160 (Karmel, Comm'r, dissenting).

79. Karmel, *supra* note 52, at 3.

80. *In re Nielsen*, Exchange Act Release No. 16,479, 19 SEC Dock. 158, 161 (Jan. 10, 1980) (Karmel, Comm'r, dissenting); Karmel, *supra* note 52, at 3. Part IV, *infra*, addresses the need for a clear and reasonable standard for evaluating an auditor's professional conduct before the SEC.

81. The survey described in this part was performed by the author of this Note.

82. The 75 cases surveyed are set forth in the Appendix. These cases were gathered as follows: I used a listing of Rule 2(e) decisions rendered in 1984-92, set forth in 10 *Loss & Seligman*, *supra* note 24, ch. 13A at 4804-06 n.62, and did a Lexis search in the Securities Release file of the Federal Securities Library (using the search "Rule 2(e)") to uncover more recent cases. After reading the cases, I then excluded any proceedings against (1) attorneys, (2) accountants who weren't acting as auditors, and (3) accountants not charged under Rule 2(e)(1)(ii) (thus, if the auditor was *only* charged under Rule 2(e)(1)(i) or 2(e)(1)(iii), the case was excluded).

The survey of published decisions compares the following: size of firm; level of auditor; type of business in which audited company was engaged; related actions, if

1994.⁸³ The survey includes only cases involving accountants acting in their capacity as independent public accountants, who were found to have engaged in improper professional conduct, as set forth in Rule 2(e)(1)(ii).⁸⁴ Despite the claim that the Commission has not always applied the same levels of mental culpability in evaluating whether improper professional conduct violates the Rule,⁸⁵ few cases reported at the administrative level considered the issues of negligence, gross negligence, recklessness, or willfulness at all. Rather, most consent orders alleged various departures from GAAP and GAAS violations, noting audit deficiencies without classifying the auditor's conduct according to the level of culpability.⁸⁶ While a few federal courts dis-

any, against other accountants, the company, or its officials; other violations committed by the auditor; number of audits to which the action pertained; whether other investigations were ongoing during the audit; the sanction imposed; and violations found by the Commission, which included lack of due professional care, lack of sufficient competent evidence, inadequate level of professional skepticism, inadequate supervision of accountants, undue reliance on management without corroboration, lack of independence, defect in license status, inadequate planning or performing of audit procedures, inadequate representations from management or legal counsel, improper procedures regarding predecessor auditor, improper procedures regarding related parties, improper action taken with regard to client's internal control system, improper reaction to "red flags," inadequate training, and improper procedures regarding errors and irregularities.

83. The 10-year time frame for the survey is justified as follows:

1) The number of 2(e)(1)(ii) cases has increased during the past decade. My survey covers the period October 1, 1984, through September 30, 1994. (The Commission reporting year ends on September 30.) My survey includes 75 cases, which are only cases against accountants acting in their capacity as auditors. According to Professor Seligman's listing of the "greater than 120 Rule 2(e) proceedings since 1970," there were only 38 cases during the period October 1, 1974, through September 30, 1984—and these 38 cases include actions against accountants acting in capacities other than auditors (for example, as officers of companies) and attorneys. See Seligman, *supra* note 15, at 951-52 n.38. Thus, the number of Rule 2(e)(1)(ii) cases against auditors has at least doubled in the past decade.

2) There is heightened scrutiny of Rule 2(e) cases since such proceedings were required to be public in 1988. See *supra* note 27 and accompanying text.

3) A law review note published in November 1984 contended that Rule 2(e)'s improper professional conduct standard was unconstitutionally vague and proposed that the SEC enunciate a more specific standard. Crane, *supra* note 40, at 359-62, 365-66. That note proposed using a more specific standard that would enable the SEC to discipline accountants who negligently failed to comply with professional or SEC rules. *Id.* at 354. Because Congress made no changes to the improper professional conduct standard in Rule 2(e)(1)(ii) since then, that note was used as a springboard for my research.

84. Note that no orders were discovered where the auditor was found *not* to have met the standard of improper professional conduct. This is a result of the procedural history preceding the order. Most cases are settled; to settle, the auditor consents to a violation of Rule 2(e)(1)(ii).

85. See *supra* text accompanying note 12.

86. This appears to be a function of the way that the consent orders are written. Often a stipulation in the order provides:

Simultaneously with the institution of these proceedings, [respondents] have submitted Offers of Settlement ("Offers"). Under the terms of the Offers, which the Commission has determined to accept, [Respondents], without ad-

cussed mental states of culpability, these courts failed to determine a minimum culpability requirement.⁸⁷

A. Summary of Findings

Although the consent orders often neglected to define the standard of mental culpability required by Rule 2(e),⁸⁸ the survey reveals many informative similarities regarding the authority levels of the auditors disciplined, the number of audits subjected to the Rule 2(e) action, related securities violations by the auditor's client or other auditors, frequently observed GAAS violations, and sanctions. The results of this survey support the need for the proposed reasonable auditor standard.

Note that percentages included for respondent criteria⁸⁹ and sanctions may appear inflated in some instances because more than one respondent may be included in a single Rule 2(e) action.⁹⁰ This outcome occurs when an order includes actions against more than one auditor or an auditor as well as his or her firm. The criteria supporting the statistics in this survey are listed in the Appendix.

mitting or denying the findings or conclusions herein, except that they admit the jurisdiction of the Commission over them and over the subject matter of this proceeding, have consented to the issuance of this Order Instituting Proceedings and Opinion and Order Pursuant to Rule 2(e) . . . and to the sanctions set forth herein.

In re Smith, Exchange Act Release No. 33,963, 56 SEC Dock. 1514, 1515 (Apr. 26, 1994). Understandably, the findings are often slanted toward the Commission's view of the case, summarizing the facts of the case and matter-of-factly stating what violations the challenged conduct constituted. See *Downing & Miller*, *supra* note 55, at 784 n.43. These authors note:

In certain 2(e) proceedings it is questionable whether the Commission's contentions that an accountant was negligent would pass muster under judicial standards of due diligence and reasonable care. Indeed, in many 2(e) proceedings the Commission merely states that an accountant has engaged in "improper professional conduct" by virtue of some Commission-determined departure from [GAAS], and without elaboration or specific analysis or findings which clearly indicate that such departure was due to negligence or some level of conduct amounting to fault.

Id.

87. In *Danna v. SEC*, the federal district court for the Northern District of California, however, did suggest that negligence is enough. No. C-93-4158 CW, 1994 U.S. Dist. LEXIS 7256 (Feb. 8, 1994); see *infra* notes 197-202 and accompanying text.

88. Often, the findings of fact included language stating that the auditor "knew" or "should have known" certain relevant facts, or that the amount of evidence gathered was simply insufficient. Even though such language was included, the opinions failed to state whether the level of conduct found was the minimum necessary under the circumstances.

89. The term "respondent criteria" refers to whom the Rule 2(e) action was brought against (e.g., engagement partner, concurring partner, reviewing partner, audit manager, staff accountant, or the entire accounting firm).

90. In other words, the sum of percentages in one area may be greater than 100%.

1. Respondent Criteria: Against Whom Does the SEC Institute Rule 2(e) Actions?⁹¹

Engagement partners⁹²—partners in charge of the audit—were most often the subject of 2(e) proceedings, representing 55% of the cases surveyed.⁹³ This statistic demonstrates that the SEC usually institutes actions against the individual who bears primary responsibility for the audit engagement(s). Surprisingly, the SEC subjected audit managers,⁹⁴ who follow partners in the line of authority, to Rule 2(e) actions in only 20% of the cases surveyed and instituted less than 5% of these proceedings against lower-level auditors.⁹⁵ Rule 2(e), however, does not discriminate among the different authority levels within an auditing firm. Thus, to preserve completely the integrity of the Commission's processes and to protect the investing public,⁹⁶ all auditors—regardless of their authority level—should be held to Rule 2(e)'s standard of professional conduct.⁹⁷

There were nearly twice as many Rule 2(e) cases⁹⁸ against solo practitioners⁹⁹ and small- or mid-sized firms¹⁰⁰ as compared to Big Six firms.¹⁰¹ Thus, allegations that the SEC initiates actions against small-

91. Symbols *a-i* in the Appendix represent respondent criteria in the cases surveyed.

92. An engagement partner is primarily responsible both for signing the audit opinion and reviewing the work of the other auditors on the engagement.

93. In contrast, concurring partners, who review audit workpapers so they have a basis to *concur* in the engagement partner's conclusion, were the subject of Rule 2(e) sanctions in only 4% of the cases surveyed.

94. An audit manager reports to the engagement partner and supervises the junior auditors (staff accountants and their immediate supervisors, frequently called senior accountants).

95. Lower-level auditors refers to senior and staff accountants. *See supra* note 94.

96. *See supra* text accompanying notes 58-66, 69.

97. Of course, the auditor's level of authority at the time of the audit engagement must be considered in determining whether the auditor has met the reasonable auditor standard and in determining appropriate sanctions. *See infra* part IV.B. Higher level auditors make final decisions and thus are scrutinized more carefully under the reasonable auditor standard.

98. Of the 75 cases surveyed, the SEC brought 28 (37%) against solo practitioners, 17 (23%) against Big Six firms or members thereof, and 30 (40%) against CPA firms other than the Big Six or their partners/employees. *See Appendix*.

99. The term refers to auditors who work alone.

100. The term "small- and medium-sized firms" refers to all firms *except* Big Six firms and solo practitioners.

101. The term Big Six refers to the largest public accounting firms. (In earlier time periods, the reference was to Big Eight.) Currently, the Big Six firms are Arthur Anderson LLP, Coopers & Lybrand LLP, Deloitte & Touche LLP, Ernst & Young LLP, KPMG Peat Marwick LLP, and Price Waterhouse LLP. *See Rick Telberg, Big 6 Race Into LLPs, Acc't Today*, Aug. 8, 1994, at 1; *see also The Editors Look Back at a Busy and Active Year*, *The CPA J.*, Dec. 1994, at 20 (discussing recent LLP status of Big Six firms).

and mid-sized firms more often than against the large, national firms appear valid.¹⁰²

2. Average Number of Audits Under Question¹⁰³

In Rule 2(e) orders involving auditors, the SEC questioned an average of 2.07 audits performed by the auditor(s) or the audit firm under question.¹⁰⁴ While it may be reasonable for an auditor to misjudge an error once, repeated errors in judgment are unreasonable. Generally, the SEC has stronger support for a finding of improper professional conduct when GAAS violations occurred in several different audits.

3. Audit Client¹⁰⁵

No particular type of client was the primary focus of Rule 2(e) proceedings. While a wide variety of industries were audited in the decisions surveyed, broker-dealer and holding company audits were seen most often, although each constituted less than 10% of the actions. This diversity indicates that the complexity of accounting issues associated with individual businesses must be considered in determining whether an auditor has met the proposed reasonable auditor standard.

4. Related Securities Violations¹⁰⁶

Thirty-one percent of the cases surveyed included related actions against the auditor subject to the consent order. In 13% of all cases, the auditor also was charged with violating a section of Rule 2(e) other than 2(e)(1)(ii).¹⁰⁷ Usually, the related action pertained to aiding and abetting, or primarily violating, the securities laws.¹⁰⁸ Although these related violations are separately actionable under

102. See, e.g., Nina Easton, *Bias for Big Eight Seen in Enforcement*, *Legal Times*, Feb. 25, 1985, at 1. See also *infra* part II.B.1 (providing reasons why Big Six auditors are less likely to be subjected to Rule 2(e) actions).

103. Symbols *b1-e1* in the Appendix represent the number of audits addressed by the Rule 2(e) action in the cases surveyed.

104. The number of audits refers to the number of separate issuances of audited financial statements.

105. Symbols *j-u* in the Appendix represent the type of business that the audited company practiced in the cases surveyed.

106. Symbols *v-w* in the Appendix represent related actions in the cases surveyed.

107. In one case, there was a charge under Rule 2(e)(1)(i) for lacking the requisite qualifications to represent others. In seven cases there were charges under Rule 2(e)(1)(iii) for willfully violating, or aiding and abetting the violation of, the federal securities laws. Further, in two cases, auditors were temporarily suspended after being permanently enjoined for violating, or found by a court to have violated or aided and abetted the violation of, the federal securities laws. Finally, in 13 cases, the consent order referred to other securities violations imposed upon the auditor, such as previous injunctions against violation of Rule 10(b)(5) of the Exchange Act. See Appendix.

108. See, e.g., *In re Fox*, Exchange Act Release No. 34,740, 57 SEC Dock. 1746, 1747 (Sept. 28, 1994); *In re Briggs*, 50 S.E.C. 984, 985 (May 6, 1992); *In re Haney*, Securities Act Release No. 6687, 37 SEC Dock. 663, 663 (Jan. 28, 1987).

Rule 2(e)(1)(iii), they provide further support for the Commission's allegation that the auditor or firm met the standard of improper professional conduct under Rule 2(e)(1)(ii) in that a reasonable auditor¹⁰⁹ would not commit securities violations in connection with an audit.¹¹⁰

Fifty-seven percent of the decisions referred to related actions against the audit client or officers thereof. In an additional 21%, an action against another auditor or the respondent's audit firm was brought separately. These statistics demonstrate the pervasiveness of the wrongful activity—within both the accounting firm and the audited company—in many Rule 2(e) cases.

5. Most Frequently Alleged Violations¹¹¹

Virtually all of the cases surveyed included a description of violations of GAAS and departures from GAAP in the audited financial statements.¹¹² The SEC most frequently alleged failure to gather sufficient competent evidential matter and lack of due care¹¹³—in 83% and 64% of the cases, respectively. Other frequently alleged GAAS violations included (1) relying on management without gathering sufficient corroborating evidence—alleged in 45% of the cases; (2) failure to maintain the proper level of professional skepticism—36%; (3) failure to plan the audit adequately or to consider risk—33%; (4) failure to follow reporting standards—25%; (5) failure to recognize or audit related party transactions adequately—23%; (6) failure to rec-

109. See *infra* part IV (setting forth reasonable auditor standard).

110. Of course, related actions cannot be the only basis for a Rule 2(e)(1)(ii) violation—otherwise the violation would fall under Rule 2(e)(1)(iii).

111. Symbols *f1-y1* in the Appendix represent GAAS Standards that allegedly were not complied with in the cases surveyed.

112. In the few cases where the Commission merely alleged that the auditor had violated GAAS and the audited financial statements did not comport with GAAP, without detailing which specific GAAS standards were violated, the auditor previously had consented to violations of the securities laws. See *In re Briggs*, 50 S.E.C. 984, 985 (May 6, 1992); *In re Haney*, Securities Act Release No. 6687, 37 SEC Dock. 663, 663 (Jan. 28, 1987).

113. Lack of due professional care appeared to be a "catch-all" provision in some cases. See, e.g., *In re Shook*, Exchange Act Release No. 34,096, 56 SEC Dock. 2056, 2059 (May 23, 1994) (noting that the auditor failed to exercise due professional care by putting the audit report on false and misleading letterhead and failing to: (1) read the client's Form 8-K filing with the SEC, (2) contact the predecessor auditor, and (3) obtain sufficient competent evidential matter); *In re Schiemann*, Exchange Act Release No. 32,983, 55 SEC Dock. 225, 228-29 (Sept. 29, 1993) (noting that the auditor failed to exercise due professional care by failing to: (1) properly plan the audits and consider risk, (2) obtain sufficient competent evidential matter, (3) disclaim the opinion on the financial statements, (4) adequately consider documentary evidence, and (5) maintain in the workpapers representation letters that the auditor claimed to have obtained during the course of the audit). In a separate opinion in *Checkosky v. SEC*, one judge claimed that "stating that an auditor violated this generally accepted auditing standard [due professional care] is the same as stating that the auditor acted negligently." 23 F.3d 452, 480-81 (D.C. Cir. 1994) (Randolph, J.).

ognize or react properly to "red flags"¹¹⁴—19%; and (7) inadequate supervision—17%. Interestingly, lack of independence, which former Commissioner Karmel argues is the only proper ground for sanctioning a professional under Rule 2(e),¹¹⁵ was alleged in only 13% of the surveyed cases.

The SEC rarely referred to an auditor's judgment,¹¹⁶ yet, the role of professional judgment is crucial in most GAAS violations. Indeed, where the auditor does not act willfully, errors in judgment are the cause of GAAS violations. To determine whether conduct constitutes improper professional conduct, the SEC must consider whether the auditor's professional judgment was clearly erroneous, taking into account the auditor's permissible range of professional judgment for each alleged violation.

6. Sanctions Under Rule 2(e)¹¹⁷

In 21% of the orders, the SEC permanently denied the auditor the privilege of practicing or appearing before it. In these cases, the auditor could apply, probably unsuccessfully,¹¹⁸ for reinstatement at any time.¹¹⁹ In 55% of the cases, the SEC permanently denied the auditor's privileges, but provided the auditor with an opportunity to reapply after a specific amount of time.¹²⁰ The amount of time specified before reapplication ranged from six months to five years. In 28% of the orders, the SEC issued a temporary suspension, ranging from sixty days to five years; the average temporary suspension lasted 2.05 years. When the SEC issued a temporary suspension or permanent denial

114. For example, in *In re Gaede*, the Commission provided examples of "circumstances creating 'red flags' that may lead an auditor to question whether material errors or possible irregularities exist." 50 S.E.C. 371, 381 (Sept. 26, 1990). These circumstances included: "differences between a control account and its supporting subsidiary records; the completion of unusual transactions at or near year-end; and transactions not supported by proper documentation." *Id.* (citing AU § 327.08).

115. See Karmel, *supra* note 52, at 3.

116. Auditor judgment refers to the limited flexibility, based on work performed and professional experience, that the auditor has in making a conclusion. See *infra* part IV.A.1.

117. Symbols a2-12 in the Appendix represent sanctions against auditors in the cases surveyed.

118. See *infra* note 120.

119. Pursuant to Rule 2(e)(4)(i), "An application for reinstatement of a person permanently suspended or disqualified" under Rule 2(e)(1)(ii) for improper professional conduct "may be made at any time, and the applicant may, in the Commission's discretion, be afforded a hearing; however, the suspension or disqualification shall continue unless and until the applicant has been reinstated by the Commission for good cause shown." 17 C.F.R. § 201.2(e)(4)(i) (1994).

120. Because the Commission can use its discretion in affording an auditor a hearing, one could argue that specifying an amount of time before an auditor can reapply is a stricter sanction than mere permanent denial. On the other hand, it would seem that the Commission likely would afford an auditor a hearing soon after the expiration of this specified time period, where, if an auditor was permanently denied privileges, the SEC might never grant that auditor a hearing.

qualified by a period of time before reapplication, the order often specified standards that the auditor would be required to meet before privileges would be reinstated.¹²¹ Finally, in 23% of the cases, the Commission censured¹²² the auditor. Some censures were combined with a suspension.¹²³

B. *Correlation Between Respondent Criteria, Violations and Sanctions*

Among the Rule 2(e) cases, the survey compares (1) sanctions based on respondent criteria and (2) the number and type of GAAS violations occurring at each degree of sanction. Standing alone, the numbers and trends shown in this survey should not be considered dispositive. The severity of alleged GAAS violations varies in each case. Accordingly, the egregiousness and pervasiveness of each violation must be considered on a case-by-case basis in judicial and administrative orders of sanctions.

It appears that the Commission focuses on the level of culpability at the sanctions stage of the proceedings, that is, only *after* independently determining that a violation of Rule 2(e) has occurred. When there is a clear violation of GAAS or a departure from GAAP, a negligent level of culpability—at a minimum—is implicit in finding a violation.¹²⁴ When an auditor's decision, however, is not clearly erroneous due to the deference allowed for the auditor's range of professional judgment, the Commission bluntly states that GAAS and

121. See *supra* note 38.

122. A censure is defined as "an official reprimand." Black's Law Dictionary 224 (6th ed. 1990). As a practical matter, the SEC will consider the sanction in any subsequent action(s) against the auditor, and the censure will remain a "black mark" on the auditor's employment record.

123. The percentages total more than 100% because in some cases, the auditor was only censured, while in others, the auditor was sanctioned in addition to being censured. Further, in some cases, more than one auditor was included in the action, with each auditor receiving different sanctions.

124. For example, under AU § 331.12:

When the independent auditor has not satisfied himself as to inventories in the possession of the client through the procedures described . . . [in other areas of this auditing standard], tests of the accounting records alone will *not* be sufficient for him to become satisfied as to quantities; it will *always* be necessary for the auditor to make, or observe, some physical counts of the inventory and apply appropriate tests of intervening transactions. This should be coupled with inspection of the records of any client's counts and procedures relating to the physical inventory on which the balance-sheet inventory is based.

AICPA, *supra* note 18, AU § 331.12 (emphasis added). If, under these circumstances, the auditor does not make any physical counts of inventory, the decision to forego counts will be clearly erroneous, and therefore outside the protected range of judgment under the proposed reasonable auditor standard. The auditor's decision to act in direct contradiction of this standard, or failure to recognize that the standard applies to him or her, is, at a minimum, negligent.

GAAP violations exist without reviewing the auditor's mental state.¹²⁵ Instead, the culpability determination is made later, when ascertaining sanctions.¹²⁶

1. Comparison of Sanctions Imposed on Auditors According to the Size of the Audit Firm

The Commission appears to impose lighter sentences on Big Six firms as compared to solo practitioners and small- or medium-sized firms. In 53% of the cases involving Big Six firms, the order called for a censure.¹²⁷ Seventy-one percent of the orders to Big Six firms issued temporary suspensions, averaging 2.6 years. The SEC permanently denied Big Six auditors their privileges in 24% of these cases and gave auditors permission to reapply for privileges after an average of 2.65 years. To date, in Rule 2(e)(1)(ii) cases, the SEC has never permanently denied an auditor working in a Big Six firm privileges without also giving permission to reapply after a specified period of time.

In comparison, the Commission never censured or temporarily suspended solo practitioners. Solo practitioners were permanently denied privileges of practicing or appearing before the Commission in 43% of these cases. These auditors were permanently denied privileges in 57% of the cases, but were given a specific amount of time before reapplying for their privileges. The amount of time before reapplication was permitted averaged 3.4 years.

Finally, 23% of the surveyed Rule 2(e) decisions regarding small- and medium-sized firms called for censures; 37% issued temporary suspensions, averaging 1.4 years; 77% ordered permanent denials with an average of 3.2 years before reapplication; and 13% issued permanent denials.¹²⁸

These figures do not necessarily indicate that the SEC affords preferential treatment to Big Six firms. National firms tend to devote substantial sums of money to training their employees.¹²⁹ Furthermore, they often have inter-office reviews and peer reviews by outside firms

125. See *In re Lamirato*, Exchange Act Release No. 33,660, 56 SEC Dock. 294 (Feb. 23, 1994); *In re Lehman*, 50 S.E.C. 389 (Sept. 28, 1990); *In re Mercer*, 50 S.E.C. 8 (Apr. 13, 1989).

126. The effect of this process on the reasonable auditor standard proposed herein is discussed in part IV.A. This Note proposes that the culpability inquiry should be made initially, when determining whether a violation occurred, and then should be referred to a second time when ascertaining appropriate sanctions. See *infra* part IV.A.

127. Two cases provided for a censure alone. The remaining 15 cases provided for a censure in addition to another sanction. See Appendix.

128. If each auditor or firm in the orders is counted as a separate case, the statistics are altered as follows: the SEC issued censures in 18% of the cases, temporary suspensions in 28%, permanent denials with permission to reapply after a specified period in 59%, and permanent denials in 10%.

129. Easton, *supra* note 102, at 1 (citing Victor M. Earle III, general counsel of Peat, Marwick, Mitchell & Co.).

that protect against misconduct by employees. Many small firms and solo practitioners do not participate in such reviews.¹³⁰

Due to limited training and review, small firms' and solo practitioners' violations tend to be more serious. Other factors also contribute to the egregiousness of these violations. Primarily, these firms and practitioners can face greater economic pressures because each audit client most likely represents a substantial portion of their income.¹³¹ Furthermore, small firms and solo practitioners can choose to sacrifice their reputations as "strict, by the book" auditors in return for gaining or maintaining more clients. These statistics support the proposition that additional training and review, coupled with a desire to preserve or gain a favorable reputation, make findings of improper professional conduct less likely.

2. Comparisons of Violations by Degree of Sanction

Few trends emerged from a comparison of the severity of sanctions¹³² with the behavior sufficient to constitute improper professional conduct. The egregiousness of the offense and the circumstances surrounding the audit, rather than the particular auditing standard that was violated, properly appeared to be the primary factors in determining appropriate Rule 2(e) sanctions. Thus, the number and types of violations forming the basis for the degree of sanctions imposed were similar.

One trend did become evident, however, where the SEC held that the auditor lacked independence. In these cases, the *minimum* sanction imposed was a temporary suspension of ten years from appearing or practicing before the Commission as an independent auditor and five years as a preparer or reviewer of financial statements required to be filed with the Commission.¹³³ More often, the SEC permanently denied these auditors their privileges to appear before the Commission.¹³⁴ These cases demonstrate the Commission's concern with the independence of auditors.¹³⁵

130. *Id.*

131. *Id.*

132. See *supra* note 33 for a listing of the degrees of sanctions.

133. See *In re Iommazzo*, Exchange Act Release No. 31,726, 53 SEC Dock. 473 (Jan. 12, 1993) (suspending accountant as an auditor for 10 years and as a preparer of financial statements for five years).

134. See, e.g., *In re Goldstein*, Exchange Act Release No. 34,641, 57 SEC Dock. 1419, 1421 (Sept. 6, 1994) (ordering permanent denial without specific amount of time to reapply); *In re Rider*, Exchange Act Release No. 33,982, 56 SEC Dock. 1594, 1597 (Apr. 29, 1994) (same); *In re Woodside*, 50 S.E.C. 76, 83 (Aug. 21, 1989) (ordering permanent denial with permission to reapply after three years).

135. The Supreme Court has addressed the importance of an auditor's independence:

By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a *public* responsibility transcending any employment relationship with the client. The independent

C. *The Survey Results Indicate the Need for a Reasonable Auditor Standard*

The survey results evidence the need for a more precise explanation of Rule 2(e)'s improper professional conduct standard. In determining whether a Rule 2(e) violation has occurred, the SEC must consider factors such as the auditor's level of experience, the number of audits involved, the client's type of business, specific GAAS violations, and departures from GAAP. The reasonable auditor standard proposed herein considers each of these factors.

III. EXAMPLES OF EXCESSIVE AGGRESSION BY THE COMMISSION

Many critics have accused the Commission of being too aggressive in bringing Rule 2(e) proceedings.¹³⁶ Use of the proposed reasonable auditor standard would help alleviate unduly aggressive enforcement of Rule 2(e).¹³⁷

A. *Auditors Are Justifiably Concerned About Rule 2(e) Liability*

One administrative law judge asserted that auditors who "merely made an error of judgment or had been careless" are unlikely targets for professional discipline.¹³⁸ The Commission, however, has occasionally subjected auditors to professional discipline for such questionable behavior. In fact, "there appears to be an increasing aggressiveness by the [SEC] staff in instituting" Rule 2(e) cases against accountants who err in professional judgment.¹³⁹ Even the SEC's Chairman, Arthur Levitt, agrees that the accounting profession

public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.

United States v. Arthur Young & Co., 465 U.S. 805, 817-18 (1984). This Court also recognized that it is "not enough that financial statements be accurate; the public must also *perceive* them as being accurate." *Id.* at 819 n.15.

In March 1994, the SEC prepared a report for Congress regarding auditor independence, where its Office of the Chief Accountant declined to recommend additional legislation or Commission rules regarding auditor independence. Office of the Chief Accountant, Staff Report on Auditor Independence 1 (March 1994) (on file with the *Fordham Law Review*). The Commission determined that existing Commission rules, interpretations, and enforcement efforts adequately protect investors against auditors who lack independence. *Id.*

136. See *infra* notes 139-42 and accompanying text.

137. See *infra* part IV (proposing a reasonable auditor standard).

138. *In re Potts*, Initial Decision Release No. 48, 56 SEC Dock. 1980, 2000 (May 19, 1994).

139. Karmel, *supra* note 52, at 3. While there were only 5 Rule 2(e) decisions regarding improper professional conduct in the SEC's fiscal year 1990 (October 1, 1989, through September 30, 1990) and 4 in fiscal 1991, there were 10 decisions in fiscal 1992, 11 in fiscal 1993, and 17 in fiscal 1994. See Appendix.

is “*justifiably* concerned about increased litigation and unlimited liability.”¹⁴⁰

Many auditors settle cases rather than endure lengthy, expensive trials before administrative law judges, where they likely will lose. One author reasons:

The combined effect of vague standards of culpability, favorable legal standards of [the SEC's] own adoption, and the power to deprive professionals temporarily or permanently of what to many is the most vital part of their professional activity and livelihood, is a clear enough explanation of why accountants have been willing to negotiate consent settlements on terms that appear questionable in terms of the SEC's authority.¹⁴¹

Thus, because of the grave effect Rule 2(e) liability can have on an auditor's career, the Rule has a chilling effect—detering auditors from appearing before the Commission.¹⁴² The proposed reasonable auditor standard provides an auditor with comfort that his or her actions will not be looked upon too harshly.

B. *Examples of Overzealous Enforcement of Rule 2(e)*

In *In re Seidman & Seidman*,¹⁴³ an accounting firm's audit of Chronar Corporation, a research and development firm, resulted in Rule 2(e) proceedings.¹⁴⁴ The firm consented to a censure in an “Order Imposing Remedial Sanctions” without admitting or denying the SEC's allegations that Chronar's improper recognition of revenue on two transactions rendered its financial statements false and misleading.¹⁴⁵

In one of the transactions, Chronar agreed to sell equipment, machinery, and technology to Interplastica, S.A., a Swiss engineering and trading concern.¹⁴⁶ Chronar recognized \$1.8 million in revenue after

140. *SEC Chairman Promises More Investor Protection*, J. Acct., Dec. 1994, at 11 (emphasis added) (speaking at the Financial Executives Institute's 63rd annual conference). The Chairman continued, “While I am sympathetic to [the accounting profession's] concerns, I believe the interests of investors must be balanced against the interests of accountants who have engaged in irresponsible and sometimes fraudulent behavior.” *Id.*

141. Gormley, *supra* note 30, ¶ 13.04[1][b], at 13-41 to 13-42.

142. Accounting literature has cautioned auditors “to practice with one eye on Rule 2(e) decisions, [because] . . . the SEC and its staff relish the role of ‘Monday morning quarterback’ in determining compliance with GAAS and GAAP.” Quinton F. Seamons, *Elusive Meaning of SEC Rule Debated in Coopers Case; Securities and Exchange Commission, Coopers & Lybrand versus Savin Corp.*, Acct. Today, Oct. 24, 1994, at 13.

143. 48 S.E.C. 310 (Oct. 10, 1985).

144. *Id.*; see also Haft, *supra* note 1, § 8.03, at 8-19 to 8-20 (also describing *Seidman & Seidman* as an example of a “settled Rule 2(e) proceeding[] that involved . . . close (and honest) professional judgment[] by the accountants”).

145. 48 S.E.C. at 310, 332.

146. *Id.* at 312-13.

delivering technical materials to Interplastica.¹⁴⁷ The SEC questioned the recognition of this amount during the period between the signing of the agreement on March 26, 1983, and the final payment under the agreement on July 5, 1984. In issuing an opinion on Chronar's financial statements for the fiscal year ended March 31, 1983, and consenting to the reissuance of its unqualified opinion on February 17, 1984, the auditors reviewed the following support for this revenue: (1) the Buy/Sell Agreement;¹⁴⁸ (2) a representation from Chronar's outside (United States) law firm that the transaction would be valid under United States law;¹⁴⁹ (3) an oral representation from Interplastica's director that the \$1.8 million payment was related to the transfer of technology alone;¹⁵⁰ (4) a telex from Interplastica's Swiss attorney confirming that the payment was for the "delivery of technical know how" and the performance bond was independent of such payment;¹⁵¹ (5) a letter from Interplastica including the information set forth in their attorney's telex;¹⁵² (6) a \$500,000 wire payment from Interplastica;¹⁵³ (7) reports prepared by a government agency and Chronar's internal engineers supporting that "Chronar had the ability to meet the contract's performance criteria on an overall production basis;"¹⁵⁴ and (8) a modified Interplastica agreement which specifically set forth the portion of the agreement pertaining to the technology transfer for \$1.8 million (but added a provision regarding collection of the \$1.3 million not yet paid to Chronar).¹⁵⁵ Despite the overwhelming evidence gathered, the SEC claimed that Seidman should not have allowed Chronar to recognize the revenue.¹⁵⁶

In *Seidman & Seidman*, the SEC did not respect adequately the auditors' professional judgment that they had gathered a sufficient amount of evidence. Rather, the Commission weakly concluded that "the firm, while exercising its judgment, failed to adequately reconcile conflicting evidence which was available to it and which was contained in the documents obtained by it."¹⁵⁷ In doing so, the SEC failed to acknowledge Statements on Auditing Standards ("AU") Section 326.20, which provides that "[i]n the great majority of cases, the audi-

147. *Id.* at 315.

148. *Id.* at 317.

149. *Id.* at 318.

150. *Id.* at 318 n.11.

151. *Id.* at 318.

152. *Id.* at 320.

153. *Id.*

154. *Id.*

155. *Id.* at 321.

156. The SEC believed that (1) it was uncertain that Chronar could meet its obligations under the performance bond; (2) it was unclear that the obligations of Chronar under the performance bond were independent of the technology transfer; and (3) it was not certain that the \$1.8 million was for the transfer of technology alone. *Id.* at 325-28.

157. *Id.* at 329.

tor finds it necessary to rely on evidence that is persuasive rather than convincing,"¹⁵⁸ and AU Section 326.21, which recognizes the possible impact of time and cost constraints.¹⁵⁹ The evidence gathered here was persuasive by all reasonable standards. Under a reasonable auditor standard, greater weight would have been placed on the auditors' professional judgment—which was not clearly erroneous¹⁶⁰ here. Because reasonable auditors could differ, the auditors in this case would have been given the benefit of the doubt, and their conduct would not have been considered improper.

The Commission also determined that Seidman & Seidman failed to document completely its reconsideration of the transaction during subsequent events procedures,¹⁶¹ thereby violating the firm's guidelines regarding documentation.¹⁶² An auditor's failure to follow his or her firm's auditing guidelines, however, should not necessarily be equated with improper professional conduct.¹⁶³

In *In re Coopers & Lybrand and Cohen*,¹⁶⁴ auditors consented to perhaps the most unsupported Rule 2(e) settlement. The action related to the firm's audit of Digilog, a public company that developed, manufactured, and sold electronic equipment.¹⁶⁵ During the years for which audited financial statements were under scrutiny, Digilog had entered into an agreement with another company, DBS, whereby DBS would market microcomputer systems containing Digilog

158. AICPA, *supra* note 18, AU § 326.20.

159. *Id.* AU § 326.21. In full, this section provides:

An auditor typically works within economic limits; his opinion, to be economically useful, must be formed within a reasonable length of time and at reasonable costs. The auditor must decide, again exercising professional judgment, whether the evidential matter available to him within the limits of time and cost is sufficient to justify expression of an opinion.

Id. AU § 326.22 continues discussing this principle, noting, "As a guiding rule, there should be a rational relationship between the cost of obtaining evidence and the usefulness of the information obtained." Alone, the "difficulty and expense involved in testing a particular item is not . . . a valid basis for omitting the test." *Id.* AU § 326.22

160. Clearly erroneous auditing refers to audit conclusions that are "unsupported by substantial evidence, or contrary to [the] clear weight of evidence, or induced by an erroneous view" of the applicable auditing and/or accounting standards. See Black's Law Dictionary 251 (6th ed. 1990).

161. "An independent auditor's report ordinarily is issued in connection with historical financial statements that purport to present financial position at a stated date and results of operations and cash flows for a period ended on that date." AICPA, *supra* note 18, AU § 560.01. Subsequent events procedures refer to testing done on "events or transactions [that] occur subsequent to the balance[]sheet date, but prior to the issuance of the financial statements and auditor's report, [and] have a material effect on the financial statements and therefore require adjustment or disclosure in the statements." *Id.*

162. *In re Seidman & Seidman*, 48 S.E.C. 310, 330 & n.18. (Oct. 10, 1985).

163. See *infra* note 218 and accompanying text.

164. 48 S.E.C. 49 (Nov. 27, 1984).

165. *Id.* at 49-50.

microcomputers.¹⁶⁶ The auditors opined that consolidation of Digilog and DBS financial statements was not required.¹⁶⁷

Curiously, the SEC found neither a violation of GAAS nor any accounting that did not comply with GAAP. More curiously, the settlement neither sanctioned the firm or engagement partner nor mandated any corrective action.¹⁶⁸ Rather, the Commission opined that "in order to make the most meaningful presentation, Digilog's financial statements . . . should have been consolidated with those of DBS."¹⁶⁹ The following year, an attorney at the Annual Securities Regulation Institute claimed that the Commission was only reciting " 'what anyone would know from reading the financial statements' " and giving its view that it would have preferred that Digilog's financial statements had been consolidated.¹⁷⁰ Some considered this case evidence of the SEC's desire to police accounting firms strictly, but contended that the timing of the settlement indicated that the Commission's case was not very strong.¹⁷¹ Under a reasonable auditor standard, the auditor's range of judgment regarding financial statement presentation would have been given greater consideration, and these auditors probably would not have been subject to a Rule 2(e) action.

IV. PROPOSAL: THE REASONABLE AUDITOR STANDARD

The results of the survey and the examples of aggressive SEC enforcement of Rule 2(e) indicate the need for a reasonable auditor standard. Notably:

"The fundamental and primary responsibility for the accuracy of information filed with the Commission and disseminated among the investors rests upon [the audited company's] management. Management does not discharge its obligations in this respect by the employment of independent public accountants, however reputable. Accountants' certificates are required not as a substitute for management's accounting of its stewardship, but as a check upon the accounting."¹⁷²

166. *Id.* at 51.

167. *Id.* at 53.

168. *SEC, C&L Settle Consolidation Dispute; No Sanctions Imposed on Firm, Partner*, 16 Sec. Reg. & L. Rep. (BNA) No. 48, at 1936 (Dec. 7, 1984). The settlement was particularly unusual because it "neither sanction[ed] the respondents nor mandate[d] any corrective action." *Id.*

169. *In re Coopers & Lybrand*, 48 S.E.C. 49, 57 (Nov. 27, 1984).

170. *SEC Enforcement, Financial Services, Accounting Issues Dominate SRI Meeting*, 17 Sec. Reg. & L. Rep. (BNA) No. 5, at 210 (Feb. 1, 1985) (quoting Arthur F. Mathews, attorney at Wilmer, Cutler & Pickering in Washington, D.C.).

171. Easton, *supra* note 102, at 1.

172. AICPA, *supra* note 18, AU § 711.01 (quoting *In re Interstate Hosiery Mills, Inc.*, 4 S.E.C. 721 (Mar. 18, 1939)).

Management's primary responsibility for the accuracy of information filed with the SEC, however, does not eliminate an auditor's responsibilities.¹⁷³ Although a client may have misled or defrauded its auditor, the client's conduct will not shield the auditor from responsibility where the audit is materially defective.¹⁷⁴ Competent and ethical auditors are a crucial requirement in ensuring the reliability of the disclosure process.¹⁷⁵ Thus, it is imperative that the Commission adopt a specific standard to police auditing conduct and to lend predictability to the Rule 2(e) process.

A. *Considerations to be Reflected in the Proposed Standard*

The Commission must apply a reasonable auditor standard that requires, at a minimum, proof that the auditor violated GAAS or misinterpreted GAAP in the course of the audit to find improper professional conduct under Rule 2(e).¹⁷⁶ The Ninth Circuit has explicitly approved the Commission's holding that violations of GAAS and misinterpretations of GAAP constitute improper professional conduct.¹⁷⁷ Administrative decisions support the same conclusion.¹⁷⁸

As previously discussed, the Commission rarely discusses the level of culpability in determining whether an auditor has violated Rule 2(e).¹⁷⁹ Instead, the Commission appears to focus on culpability only after liability has been determined and sanctions are at issue. There are two possible explanations for the SEC's decision to delay consid-

173. "The auditor has an overriding duty to the investing public not to represent that a financial statement is presented in conformity with [GAAP] if it is not." *Checkosky v. SEC*, 23 F.3d 452, 495 (D.C. Cir. 1994) (Reynolds, J., concurring in part, dissenting in part) (citing Code of Professional Conduct, Rules 202, 203, 301).

174. *In re Smith*, Exchange Act Release No. 33,963, 56 SEC Dock. 1514, 1524 (Apr. 26, 1994); *In re Touche Ross & Co.*, Accounting Series Release No. 153, [1937-82 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,175, at 62,356-57 (Feb. 25, 1974). See also *In re Ernst & Whinney*, Initial Decision Release No. 5, 47 SEC Dock. 93, 123 (June 28, 1990) (noting that "fact that auditors are deliberately deceived by management may be viewed as a mitigating factor, particularly in assessing a sanction").

175. *Touche Ross & Co. v. SEC*, 609 F.2d 570, 581 (2d. Cir. 1979). The Second Circuit noted, "Breaches of professional responsibility jeopardize the achievement of the objectives of the securities laws and can inflict great damage on public investors." *Id.*

176. *Checkosky*, 23 F.3d at 456 (Silberman, J.) (noting that on remand, "at minimum, the Commission must establish that petitioners misinterpreted GAAP and violated GAAS in the course of their audits").

177. *Davy v. SEC*, 792 F.2d 1418, 1422 (9th Cir. 1986).

178. *In re Haskins and Sells*, Accounting Series Release No. 73, [1937-82 Transfer Binder] ¶ 72,092, at 62,197 (Oct. 30, 1952). More recent settlements confirm this view. See *In re Huss*, Exchange Act Release No. 34,414, 57 SEC Dock. 519, 520-22 (July 21, 1994); *In re Venezia*, Exchange Act Release No. 33,961, 56 SEC Dock. 1505, 1507 (Apr. 25, 1994); *In re Jenson*, Exchange Act Release No. 33,696, 56 SEC Dock. 386, 389 (Mar. 1, 1994). But see *Downing & Miller*, *supra* note 55, at 784 n.43 ("In certain 2(e) proceedings it is questionable whether the Commission's contentions that an accountant was negligent would pass muster under judicial standards of due diligence and reasonable care.").

179. See *supra* introduction to part II.

eration of the auditor's culpability until sanctions are being determined. First, it is possible that the SEC is concerned only with ineffective audits and, thus, does not inquire into the process that led to the failed results or the judgments involved therein.¹⁸⁰ Under this view, the Commission can determine, for example, that ABC Company's income was materially overstated and, thus, ABC's auditor failed to fulfill his or her responsibilities. The mental state of the auditor who performed the ineffective audit would be irrelevant. Under the second, more plausible, view, a finding of negligence, at a minimum, is implicit in the Commission's finding of a GAAS or GAAP violation. This Note asserts that a finding of negligence, whether implicit or explicit, gross, or willful, must be considered both in determining whether Rule 2(e) has been violated *and* in ascertaining the appropriate sanction for the misconduct. This Note suggests further considerations in determining a standard that will adequately describe improper professional conduct.

1. Professional Judgment Underlies GAAS Requirements

The two most often-cited GAAS violations in Rule 2(e) proceedings, lack of due care and lack of sufficient evidential matter,¹⁸¹ both refer to the auditor's judgment. The due care standard, AU Section 230, requires that auditors exercise proper judgment.¹⁸² AU Section 326, which pertains to evidential matter, acknowledges that "[t]he amount and kinds of evidential matter required to support an informed opinion are matters for the auditor to determine in the exercise of his professional judgment after a careful study of the circumstances in the particular case."¹⁸³ Furthermore, AU Section 326 allows the auditor to use professional judgment to determine "whether the evidential matter available to him within the limits of time and cost is sufficient to justify expression of an opinion."¹⁸⁴

Because GAAS frequently refers to the role that professional judgment plays in an auditor's performance, Rule 2(e)'s standard of improper professional conduct likewise should consider professional

180. In its brief on remand in *Checkosky*, the SEC contends that a "mental state need not be specified in an order for proceedings" under Rule 2(e)(1)(ii), pursuant to Rule 6(a) of the Commission's Rules of Practice, 17 C.F.R. § 201.6(a) (1994), and § 5(b) of the Administrative Procedures Act, 5 U.S.C. § 554(b) (Supp. 1993). Brief of the Office of the Chief Accountant on Remand at 22, *In re Checkosky*, Admin. Proc. File No. 3-6776 (Jan. 13, 1995) (on file with the *Fordham Law Review*). Instead the SEC argues that "the degree of intent and the egregiousness of the violations determine the sanction." *Id.* It appears that the auditor's mental state, which encompasses his or her range of judgment, would be most important in determining whether an auditor meets the improper professional conduct standard.

181. See *supra* part II.A.5. (most frequently alleged violations).

182. AICPA, *supra* note 18, AU § 230.02.

183. *Id.* AU § 326.20.

184. *Id.* AU § 326.21.

judgment.¹⁸⁵ Despite GAAS' treatment of professional judgment, the decisions in this area infrequently refer to the importance of professional discretion. One decision, *In re Schulzetenberg*,¹⁸⁶ however, did discuss the deference due to professional judgment. In discussing the respondent's audit treatment of an inadequate receivable allowance, the SEC noted that the auditor has "an obligation to assure that sufficient information [is] obtained in order to make a reasonable judgment [W]hile an auditor's conclusions about the reasonableness of accounting estimates inevitably involve[] the exercise of judgment, those judgments must be based on valid, carefully evaluated competent evidential matter."¹⁸⁷ In clarifying Rule 2(e)'s standard of improper professional conduct, the SEC should return to its reasoning in *Schulzetenberg*.

2. Does a Single Violation Constitute Improper Professional Conduct?

A single error by an auditor should not necessarily be actionable under Rule 2(e). A "single" occurrence can be defined as all errors occurring in one audit, or each error within an audit can be counted separately. Regardless of the definition used, the proposed reasonable auditor standard must take into account how many GAAS and GAAP violations occurred; while one error in judgment may be reasonable, several such errors may not be reasonable. The facts and circumstances surrounding a single error in judgment must be considered in determining whether that error meets the reasonable auditor standard.

Auditors and commentators have argued that a single finding of improper professional conduct does not "demonstrate a reasonable likelihood of future misconduct and therefore . . . a professional bar [would not further] . . . the legitimate purpose of protecting the integrity of the Commission's own processes."¹⁸⁸ The courts have not determined whether the SEC must show "how an isolated incident of alleged negligence presents any future threat to the public or the

185. Some within the Commission see Rule 2(e) as a method of engaging in professional standard setting. See *supra* text accompanying note 5. Additionally, courts look to GAAS in determining whether an auditor has engaged in improper professional conduct. See *supra* notes 176-78 and accompanying text.

186. 49 S.E.C. 916 (Sept. 23, 1988).

187. *Id.* at 946-47. The SEC further noted:

To the extent that [the auditor] makes judgments and forms his "opinion" on the basis of adequate evidence, he acts rationally by following a systematic or methodical procedure; to the extent that he fails to gather "sufficient competent evidential matter" and fails to evaluate it effectively, he acts irrationally and his judgments can have little standing.

Id. at 947 n.32 (quoting R.K. Mautz & R.A. Sharaf, *The Philosophy of Auditing*, American Accounting Association Monograph No. 6, at 68 (1961)).

188. *Danna v. SEC*, No. C-93-4158 CW, 1994 U.S. Dist. LEXIS 7256, at *9 (N.D. Cal. Feb. 8, 1994).

Commission processes."¹⁸⁹ The failure to place this burden on the SEC when determining misconduct seems appropriate because a possibility of future misconduct is relevant in sanctioning an auditor—not in determining misconduct.¹⁹⁰

3. What Level of Oversight is Necessary to Protect the Commission's Processes?

The Commission's use of Rule 2(e) to protect its internal processes is well-established.¹⁹¹ One issue, however, remains unclear: What minimum level of conduct harms the SEC? Several courts have considered this issue.

In *Checkosky v. SEC*,¹⁹² the petitioners argued that the Commission's authority did not extend to disciplining professionals for negligence.¹⁹³ They reasoned:

If the purpose of Rule 2(e) is to protect the integrity of administrative processes, then sanctions for improper professional conduct under 2(e)(1)(ii) are permissible only to the extent that they pre-

189. *Id.* at *10. Similar arguments are raised when the SEC seeks injunctions for securities violations. Before awarding injunctive relief, courts consider the totality of the circumstances; one relevant factor included in this "whole picture" is the isolated or repeated nature of the violations. *SEC v. Youmans*, 729 F.2d 413, 415 (6th Cir.), *cert. denied*, 469 U.S. 1034 (1984). Other relevant factors include the egregiousness of the violations; the degree of culpability; the sincerity of the defendant's assurances, if any, against future violations; the defendant's recognition of the wrongfulness of his conduct; the likelihood that the defendant's occupation will present opportunities for future violations; and the defendant's age or health. *Id.* To adequately protect the public, the court must determine whether the infraction is likely to recur. *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979).

190. Therefore, when ascertaining the appropriate sanction, the SEC should have the burden of proving whether an auditor would threaten the securities market in the future.

191. See *supra* part I.B.1. The administrative courts have recognized this as well. In *In re Ernst & Whinney*, the administrative law judge expounded:

The Commission relies very heavily on the competence and integrity of the independent auditors who practice before it in order to fulfill its statutory responsibilities. This reliance is in recognition of the unique responsibility independent auditors have and their role in preserving the integrity of the securities markets. The independent auditor assumes a public responsibility transcending any employment relationship with the client, and breaches of professional responsibility jeopardize the achievement of the objectives of the securities laws and can inflict great damage on public investors.

Initial Decision Release No. 5, 47 SEC Dock. 93, 126 (June 28, 1990) (citations omitted). Further, in *In re Arthur Andersen & Co.*, the Commission declared:

The objectives of the securities laws can only be achieved when those professionals who practice before the Commission . . . act in a manner consistent with their responsibilities. Professionals involved in the disclosure process are . . . representatives of the investing public served by the Commission, and, [thus] . . . their dealings with the Commission . . . must be permeated with candor and full disclosure.

45 S.E.C. 601, 609 (July 8, 1974).

192. 23 F.3d 452 (D.C. Cir. 1994) (per curiam).

193. *Id.* at 456 (Silberman, J.).

vent the disruption of proceedings. Punishment for mere negligence . . . extends beyond this realm of protective discipline into general regulatory authority over a professional's work.¹⁹⁴

Although the Commission did not clearly present the standard that it had applied to the auditors in the *Checkosky* case, two judges filing separate opinions urged that negligence was the proper standard,¹⁹⁵ while the third judge determined that the question regarding the minimum level of mental culpability was not properly presented and, accordingly, did not address the issue.¹⁹⁶

In *Danna & Dentinger v. SEC*,¹⁹⁷ a Rule 2(e) action against two Big Six auditors, a federal district court suggested that negligence was the threshold level of culpability that harms the SEC's processes.¹⁹⁸ The court determined that bad faith is not necessary to support a finding of improper professional conduct.¹⁹⁹ In addition, the court stated that the Commission's authority "extends to all situations in which [the alleged] improper professional conduct . . . may impair the integrity of the Commission's processes."²⁰⁰ The court noted that, in upholding the SEC's authority under Rule 2(e), the *Touche Ross*²⁰¹ court "did not distinguish between intentional misconduct and negligent misconduct and [its holding] was equally applicable to both."²⁰²

In a Commission decision, *In re Ernst & Whinney and Ferrante*,²⁰³ an administrative law judge held that auditors' conduct, "whether through negligence, good faith, incompetence or ignorance, may subject accountants to [Rule 2(e)] discipline . . . in order to preserve thereby the integrity of the Commission's processes."²⁰⁴ In support of its conclusion, the court quoted *In re Carter and Johnson*:

"[W]e perceive no unfairness whatsoever in holding those professionals who practice before [the Commission] to generally recognized norms of professional conduct, whether or not such norms had previously been explicitly adopted or endorsed by the Commis-

194. *Id.*

195. *Id.* at 480 (Randolph, J.); *id.* at 494 (Reynolds, J., concurring in part, dissenting in part).

196. *Id.* at 480 (Randolph, J.); *id.* at 494 (Reynolds, J., concurring in part, dissenting in part).

197. No. C-93-4158 CW, 1994 U.S. Dist. LEXIS 7256 (N.D. Cal. Feb. 8, 1994) (ruling tentatively on defendant's motion to dismiss and plaintiff's injunction).

198. *See id.* at *3.

199. *Id.* at *11. This court partially relied on *In re Checkosky*, 50 S.E.C. 1180 (Aug. 26, 1992), which was later appealed and then remanded. *See supra* text accompanying notes 10-14.

200. *Danna*, 1994 U.S. Dist. LEXIS 7256, at *3-4.

201. *Touche Ross & Co. v. SEC*, 609 F.2d 570 (2d Cir. 1979).

202. *Danna v. SEC*, No. C-93-4158 CW, 1994 U.S. Dist. LEXIS 7256, at *4 (N.D. Cal. Feb. 8, 1994).

203. Initial Decision Release No. 5, 47 SEC Dock. 93 (June 28, 1990).

204. *Id.* at 123.

sion. To do so upsets no justifiable expectations, since the professional is already subject to those norms."²⁰⁵

The proposed reasonable auditor standard takes these "generally recognized norms of professional conduct" into account.²⁰⁶

B. *Proposed Standard: The Reasonable Auditor*

This Note urges the Commission to adopt and apply consistently a reasonable auditor standard in Rule 2(e) proceedings. The proposed standard reflects the results of the survey in part II and accounts for the auditor's range of professional judgment, the circumstances under which a single error should constitute improper professional conduct, and the SEC's desire to protect the integrity of its processes. While the Commission must protect its processes and the investing public, the Commission and the public should not infringe arbitrarily upon the right of the practicing auditor to pursue his or her livelihood. To address these concerns, the SEC must apply the proposed reasonable auditor standard,²⁰⁷ which clearly establishes the boundaries of improper professional conduct and provides a fair warning to practicing auditors.²⁰⁸ As a starting point in flushing out this standard for the auditing community, the Commission can defer to specific auditing standards and authoritative literature.²⁰⁹ Specifically, the Commission

205. *Id.* (quoting *In re Carter*, 47 S.E.C. 471, 508 (Feb. 28, 1981)).

206. *Id.*

207. The Commission has used a reasonable auditor standard only sporadically, but, when doing so, has adequately addressed the concerns of all affected by the proceeding. In *In re Schoemer*, for example, the reasonable auditor standard was applied to determine that a reasonable auditor would have verified the cost of investments, verified that the investments existed at the balance sheet date, compared confirmation requests to underlying broker advices, and tested that all securities that should have been recorded in fact were recorded in the investment accounts—procedures that this auditor did not perform. 50 S.E.C. 921, 926-29 (Mar. 31, 1992). The court also referred to several AU standards in determining what conduct was reasonable. *Id.*; see also *In re Ford*, 50 S.E.C. 585, 588 (June 17, 1991) (applying the reasonable auditor standard to determine that a reasonable auditor would have reviewed board of directors minutes and recognized red flags that would have alerted the auditor to substantial questions concerning management integrity—procedures which this auditor did not perform).

208. This Note recognizes the difficulty in drafting and implementing a clear, consistent standard that could be applied in every Rule 2(e)(1)(ii) case. The facts of each case vary significantly, and thus the situation each auditor faces likewise differs. The present wording of the standard has been considered unconstitutionally vague, *Crane, supra* note 40, at 359-64, but it is difficult to propose a detailed flexible standard that could be applied reasonably and sensibly to the facts and circumstances of every, or even most, situations, considering how each differs. At the same time, the Commission would not want to set an overly restrictive standard because then auditors might find a way to evade the standard. Thus, supplementing the proposed standard with an interpretive release is recommended.

209. For example, the Commission, could refer to Financial Accounting Standards Board Statements and Interpretations, relevant publications of the AICPA, accounting textbooks, and articles. See *Checkosky v. SEC*, 23 F.3d 452, 472-73 & n.7 (D.C. Cir. 1994) (Randolph, J.) (discussing what materials constitute GAAP).

must describe the limitations on the auditor's realm of professional judgment.²¹⁰ Obviously, clearly erroneous violations of GAAS and GAAP are outside this range of discretion.

The proposed reasonable auditor standard protects the auditor when his or her professional conclusions are reasonable according to a reasonable practitioner under the circumstances of the audit. Primarily, the SEC must determine the extent to which the auditor complied with GAAS and GAAP standards.²¹¹ In determining the reasonableness of audit conclusions, the Commission must then consider the auditor's level of experience²¹² by inquiring into the auditor's general educational and work experience, as well as the auditor's experience with the particular client whose audit is being questioned. Further, under the proposed standard, the SEC must consider the level of supervision given or received (which will depend upon the seniority of the auditor in question).²¹³ Additionally, the SEC must determine the complexity of the audit issues, based upon the client's type of business and the general business conditions facing the client at the time of the audit.²¹⁴ While a scheme to defraud the auditor must not preclude a finding of improper professional conduct, it must be a factor in considering the reasonableness of auditor's conduct.²¹⁵

This reasonable auditor standard allows the Commission to proceed against negligent behavior,²¹⁶ especially where the behavior is pervasive.²¹⁷ While good faith should be a consideration to mitigate an au-

210. In adopting the proposed reasonable auditor standard, the SEC should specify materiality limits to which auditors could refer when deciding whether or not to test or disclose an item, or whether or not to propose a change thereto.

211. The reasonable auditor standard encompasses GAAS and GAAP standards. Under the pending Dodd bill, the SEC may acquire "express statutory authority to adopt, amend or abrogate rules pertaining to GAAS and GAAP requirements." See Seamons, *supra* note 142, at 13.

212. See *infra* part II.A.1. (respondent criteria).

213. See *supra* notes 92-97 and accompanying text.

214. See *supra* part II.A.3. (audit client).

215. See *supra* note 174 and accompanying text.

216. Negligence alone could constitute improper professional conduct. But as one judge in the *Checkosky* case noted:

If the Commission were to determine that an accountant's negligence is a *per se* violation of Rule 2(e), it would have to consider not only the administrative burden such a position would entail but also whether it would constitute a *de facto* substantive regulation of the profession and thus raise questions as to the legitimacy of Rule 2(e)(1)(ii)—or at least its scope.

Checkosky v. SEC, 23 F.3d 452, 459 (D.C. Cir. 1994) (Silberman, J.). On remand in *Checkosky*, the SEC argues that negligent failure to comply with GAAS or construe GAAP properly constitutes improper professional conduct. Brief of the Office of the Chief Accountant on Remand at 5-9, *In re Checkosky*, Admin. Proc. File No. 3-6776 (Jan. 13, 1995) (on file with the *Fordham Law Review*). The SEC supports its negligence standard by relying on Commission precedent and state law (many states provide that a certified public accountant may be disciplined for negligent acts), as well as findings that Rule 2(e) promotes investor confidence. *Id.*

217. While the standard includes one-time incorrect conclusions that are egregious, it focuses primarily upon a pattern of negligent behavior during the audit or a series

ditor's sanction, bad faith must not be determinative of misconduct. Furthermore, under the proposed standard, an auditor's failure to follow his or her firm's auditing guidelines must not be a *per se* indication of improper professional conduct.²¹⁸

Under the reasonable auditor standard, a conclusion within the auditor's range of professional judgment²¹⁹ must be given particular deference when determining whether the auditor has violated GAAS. Professional judgment will be an issue in many GAAS violations because, as previously discussed, GAAS standards do not always provide clear rules. Professional judgment "must be based on valid, carefully evaluated competent evidential matter."²²⁰ In addition, the Commission must recognize that "[a]ccounting principles must be interpreted" and "[j]udgments must be made about specific transactions."²²¹ Accordingly, "reasonable preparers of financial statements and auditors can disagree about those interpretations and judgments."²²²

An SEC interpretive release is an appropriate means to disseminate the details of the SEC's definition of improper professional conduct.²²³ The SEC's release must provide the auditing profession with examples of situations in which errors in professional judgment would constitute improper professional conduct. Examples easily could be drawn from previous Rule 2(e) proceedings as well as from particularly difficult issues addressed by the Office of the Chief Accountant and the Corporate Finance Division in matters not necessarily related to Rule 2(e) actions.²²⁴

of incorrect decisions made barely within the auditor's range of professional judgment. The range of protection partially depends upon the GAAS standard at issue.

218. The Commission has used an auditor's failure to follow his or her firm's guidelines as a factor in determining improper professional conduct. *In re Potts*, Initial Decision Release No. 5, 56 SEC Dock. 1980, 2000 (May 19, 1994) (holding that "concurring review partners must follow all professional and firm guidelines to avoid charges of improper professional conduct under Rule 2(e)"); *In re Childers*, Exchange Act Release No. 32,505, 54 SEC Dock. 759, 761 n.3 (June 24, 1993). It appears, however, to be an irrelevant and unfair measure of the auditor's performance, unless the firm's standard is held to be the same or less stringent than that of the Statements on Auditing Standards. Rather than referring to a particular firm's standards, the decisions must compare a respondent's behavior directly with applicable auditing standards.

219. This range is defined according to the standards of a reasonable practitioner.

220. *In re Schulzetenberg*, 49 S.E.C. 916, 946-47 (Sept. 23, 1988); see *supra* note 187 and accompanying text.

221. *Checkosky v. SEC*, 23 F.3d 452, 479 (D.C. Cir. 1994) (Randolph, J.).

222. *Id.* (quoting Jerry Sullivan et al., *Montgomery's Auditing* 19 (10th ed. 1985)).

223. This Note does not attempt to reach the administrative law issue of the appropriate means of promulgating SEC rules.

224. For example, the SEC sanctioned auditors for their interpretations of Accounting for Sales of Real Estate, Statement of Financial Accounting Standards No. 66 (Fin. Accounting Standards Bd. 1982) in *In re Lamirato*, Exchange Act Release No. 33,660, 56 SEC Dock. 294, 295 (Feb. 23, 1994), and *In re Burton*, Exchange Act Release No. 32,566, 54 SEC Dock. 949, 951-52 (July 1, 1993). These particularly com-

Alternatively, after announcing a reasonable auditor standard and providing general assertions regarding the auditor's range of judgment, the Commission can decide to apply the reasonable auditor standard on a case-by-case basis (starting with the *Checkosky* remand). The Commission should follow this course only if it determines that an interpretive release would flush out the standard in a restrictive manner. The underlying rationale of this approach is that an overly specific standard invariably omits conduct that should be considered a violation. Thus, an excessively restrictive standard inadvertently can allow would-be violators to "beat the system."

CONCLUSION

The Commission must enunciate a clear definition of improper professional conduct either in an interpretive release or on remand in *Checkosky*.²²⁵ This interpretation must set forth a reasonable auditor standard that delineates the boundaries of an auditor's judgment, defines conduct that is clearly erroneous, and includes detailed examples to which an auditor can refer. Of course, the SEC will be unable to address all possible situations where an auditor's judgment is crucial to fair audit conclusions. The Commission, however, is able to refer to its experience and provide guidance in areas where an auditor is most likely to err. A precise uniform standard will make future accusations of overzealousness by the Commission staff in Rule 2(e) proceedings less likely and will balance the interests of the auditing profession, the Commission, and the investing public.

plex standards could be reviewed by the Office of the Chief Accountant and the Corporate Finance Division in unrelated matters. Nevertheless, the SEC can draw upon those experiences in describing the reasonable auditor standard for specific audit circumstances.

225. See *supra* part IV.B.

APPENDIX

CASES USED IN THE SURVEY IN PART TWO OF THIS NOTE

LEGEND OF SYMBOLS

Respondent Criteria

- a* Engagement Partner
- b* Concurring Partner
- c* Reviewing Partner
- d* Audit Manager
- e* Separate action against firm
- f* Big Six Firm
- g* Small- or Mid-Sized Firm
- h* Solo Practitioner
- i* Staff Accountant

Type of Business That Audited Company Practiced

- j* Broker/Dealer
- k* Business Development Company
- l* Communications
- m* Construction
- n* Holding Company
- o* Hotel
- p* Manufacturer
- q* Mining
- r* Natural Resources
- s* Sales
- t* Service
- u* Other or Unidentified

Related Action

- v* Against Audited Company
- w* Against Other Accountant or Accounting Firm in Separate Action

Other Violations by Respondent

- x* Rule 2(e)(1)(i)
- y* Rule 2(e)(1)(iii)
- z* Rule 2(e)(3)
- al* Other Securities Violations

Number of Audits Addressed by Rule 2(e) Action

- b1* One
- c1* Two
- d1* Three
- e1* More Than Three

GAAS Standards That Allegedly Were NOT Complied With

- f1* Broker/Dealer Related Procedures
- g1* Due Care
- h1* Errors and Irregularities
- i1* Expired CPA License
- j1* GAAS and GAAP Violations Alone Alleged, Without Any Specific Violations
- k1* Independence
- l1* Internal Control Procedures
- m1* Perform Audit Procedures
- n1* Plan Audit and Consider Risk
- o1* Professional Skepticism
- p1* Red Flags
- q1* Related Party Transactions
- r1* Rely on Management Without Corroboration
- s1* Reporting Standards
- t1* Representation Letter
- u1* Successor Audit Procedures
- v1* Sufficient Competent Evidence
- w1* Supervision
- x1* Training
- y1* Other

Sanction

- a2* Censure
- b2* Temporary Suspension—Six months or less
- c2* Temporary Suspension—Greater than six months, but less than or equal to one year
- d2* Temporary Suspension—Greater than one year, but less than or equal to two years
- e2* Temporary Suspension—Three years or more
- f2* Permanent Denial With Specified Amount of Time to Reapply—Less than or equal to one year
- g2* Permanent Denial With Specified Amount of Time to Reapply—Greater than one year, but less than or equal to two years
- h2* Permanent Denial With Specified Amount of Time to Reapply—Greater than two years, but less than or equal to three years
- i2* Permanent Denial With Specified Amount of Time to Reapply—Four years
- j2* Permanent Denial With Specified Amount of Time to Reapply—Five years
- k2* Specific Standards to be Met Upon Reapplication or When Ability to Practice is Reinstated
- l2* Permanent Denial

CASES

Davy v. SEC, 792 F.2d 1418 (9th Cir. 1986).

h, r, a1, b1, p1, r1, s1, v1, l2

In re Fox, Exchange Act Release No. 34,740, 57 SEC Dock. 1746 (Sept. 28, 1994).

d, g, u, w, z, a1, b1, g1, q1, v1, l2

In re Halpern, Exchange Act Release No. 34,727, 57 SEC Dock. 1719 (Sept. 27, 1994).

a, g, l, w, b1, g1, m1, q1, v1, y1, h2, k2

In re Goldstein, Exchange Act Release No. 34,641, 57 SEC Dock. 1419 (Sept. 6, 1994).

h, j, x, e1, i1, k1, l2

(involved audits of more than one company)

In re Silvestain, Greenberg, Silvestain, and Wenner, Silvestain & Co., Exchange Act Release No. 34,631, 57 SEC Dock. 1398 (Sept. 2, 1994).

a, b, c, g, p, s, v, b1, g1, m1, n1, q1, s1, t1, v1, y1, a2, b2, g2, k2

In re Withers, Exchange Act Release No. 34,537, 57 SEC Dock. 1048 (Aug. 17, 1994).

a, f, n, v, e1, g1, o1, v1, y1, e2, k2

In re Huss and Moellenberg, Exchange Act Release No. 34,414, 57 SEC Dock. 519 (July 21, 1994).

h, m, a1, b1, n1, s1, t1, v1, w1, l2

In re Sologuren, Exchange Act Release No. 34,402, 57 SEC Dock. 494 (July 19, 1994).

h, j, e1, f1, g1, l1, n1, q1, v1, l2

In re Shook, Exchange Act Release No. 34,096, 56 SEC Dock. 2056 (May 23, 1994).

h, u, b1, g1, u1, v1, y1, l2

In re Potts, Initial Decision Release No. 48, 56 SEC Dock. 1980 (May 19, 1994).

b, f, o, v, w, c1, g1, p1, r1, v1, d2

In re Rider, Exchange Act Release No. 33,982, 56 SEC Dock. 1594 (Apr. 29, 1994).

h, p, e1, g1, k1, o1, r1, v1, l2

In re Smith and Reed, Exchange Act Release No. 33,963, 56 SEC Dock. 1514 (Apr. 26, 1994).

a, d, f, m, v, c1, g1, n1, p1, r1, v1, f2, k2

In re Venezia, Exchange Act Release No. 33,961, 56 SEC Dock. 1505 (Apr. 25, 1994).

a, g, l, b1, g1, v1, y1, j2, k2

In re Kappel, Exchange Act Release No. 33,955, 56 SEC Dock. 1478 (Apr. 22, 1994).

a, g, p, v, d1, g1, n1, q1, u1, v1, w1, y1, l2

In re Gotthilf, Exchange Act Release No. 33,949, 56 SEC Dock. 1398 (Apr. 21, 1994).

h, k, v, w, b1, g1, n1, o1, s1, v1, x1, h2, k2

In re Jenson, Exchange Act Release No. 33,696, 56 SEC Dock. 386 (Mar. 1, 1994).

h, l, dl, gl, ll, rl, vl, yl, i2, k2

In re Lamirato, Exchange Act Release No. 33,660, 56 SEC Dock. 294 (Feb. 23, 1994).

a, g, l, dl, gl, yl, f2, k2

In re Dellinger and Henson, Exchange Act Release No. 33,296, 55 SEC Dock. 1618 (Dec. 7, 1993).

a, d, e, g, n, bl, gl, nl, ol, vl, g2, k2

In re Schiemann, Exchange Act Release No. 32,983, 55 SEC Dock. 225 (Sept. 29, 1993).

h, u, v, z, al, cl, gl, nl, ol, rl, sl, vl, j2, k2

In re Burnes and Hemming Morse, Inc., Exchange Act Release No. 32,980, 55 SEC Dock. 217 (Sept. 28, 1993).

a, e, g, k, bl, gl, ol, rl, vl, a2, g2, k2

In re Gotthilf and Haft, Exchange Act Release No. 32,969, 55 SEC Dock. 201 (Sept. 28, 1993).

h, k, v, w, bl, gl, nl, ol, rl, sl, vl, wl, l2

In re Melsen, Exchange Act Release No. 32,917, 55 SEC Dock. 35 (Sept. 17, 1993).

a, f, o, v, w, cl, gl, ml, sl, vl, yl, c2

In re Tarnowsky, Exchange Act Release No. 32,635, 54 SEC Dock. 1168 (July 15, 1993).

h, n, v, bl, kl, vl, yl, g2, k2

In re Berti, Exchange Act Release No. 32,620, 54 SEC Dock. 1134 (July 13, 1993).

a, g, u, v, bl, gl, hl, nl, ol, ql, vl, a2, j2, k2

In re Burton, Exchange Act Release No. 32,566, 54 SEC Dock. 949 (July 1, 1993).

a, f, n, v, bl, gl, ol, ql, vl, yl, a2

In re Curtin and Lukenda, Exchange Act Release No. 32,519, 54 SEC Dock. 859 (June 28, 1993).

a, d, f, n, v, bl, gl, hl, rl, vl, wl, a2

In re Childers and Argy, Exchange Act Release No. 32,505, 54 SEC Dock. 759 (June 24, 1993).

a, d, f, p, bl, gl, ol, vl, yl, g2, j2, k2

In re Hinkle and Konrath, Exchange Act Release No. 32,453, 54 SEC Dock. 649 (June 11, 1993).

a, d, g, j, v, cl, fl, ll, ml, nl, rl, wl, yl, h2, k2

In re Iommazzo, Exchange Act Release No. 31,726, 53 SEC Dock. 473 (Jan. 12, 1993).

b, f, u, dl, kl, sl, e2

In re Andrus, Exchange Act Release No. 31,267, 52 SEC Dock. 1718 (Sept. 30, 1992).

h, u, v, bl, nl, rl, tl, vl, wl, h2, k2

In re Taylor, Exchange Act Release No. 31,244, 52 SEC Dock. 1667 (Sept. 28, 1992).

h, r, dl, gl, ol, rl, vl, yl, l2

In re Baker, Exchange Act Release No. 31,184, 52 SEC Dock. 1443 (Sept. 16, 1992).

h, t, v, w, y, cl, gl, nl, rl, sl, ul, vl, yl, l2

In re Domingues and Brimhall, 50 S.E.C. 1091 (July 30, 1992).

a, d, f, u, v, b1, nl, ol, rl, sl, tl, vl, yl, a2, c2, f2, k2

In re Epstein, Exchange Act Release No. 30,731, 51 SEC Dock. 757 (May 21, 1992).

a, g, j, w, b1, fl, gl, hl, ll, ol, ql, rl, sl, tl, vl, yl, a2, e2, h2, k2

In re Briggs, 50 S.E.C. 984 (May 6, 1992).

h, u, w, al, cl, jl, l2

In re Dougan, 50 S.E.C. 987 (May 6, 1992).

h, u, w, al, b1, jl, l2

In re Nilson, 50 S.E.C. 914 (Mar. 31, 1992).

h, r, v, b1, k1, ol, rl, vl, j2, k2

(involved audits of more than one company)

In re Schoemer and Denkensohn, 50 S.E.C. 921 (Mar. 31, 1992).

a, d, f, v, b1, gl, m1, nl, vl, a2, c2, k2

In re Frederick S. Todman & Co. and Marchioni, 50 S.E.C. 770 (Nov. 4, 1991).

a, e, g, j, w, b1, fl, gl, hl, ll, ol, ql, rl, sl, tl, vl, a2, b2, k2

In re Wahl, 50 S.E.C. 742 (Sept. 30, 1991).

h, j, v, y, al, cl, il, k1, g2, k2

In re Anchel, 50 S.E.C. 686 (Aug. 29, 1991).

a, g, u, v, e1, gl, hl, pl, vl, yl, i2, k2

(involved audits of more than one company)

In re Greenspan, 50 S.E.C. 672 (Aug. 26, 1991).

a, g, t, v, w, y, al, cl, gl, k1, nl, pl, ul, vl, l2

In re Ford, 50 S.E.C. 585 (June 17, 1991).

h, u, v, b1, k1, ll, nl, pl, si, i2, k2

In re Lehman, 50 S.E.C. 389 (Sept. 28, 1990).

a, g, r, b1, gl, vl, yl, g2, k2

In re Gaede and Richards, 50 S.E.C. 371 (Sept. 26, 1990).

a, f, u, v, b1, gl, m1, ol, pl, rl, vl, a2, b2

In re McCarley and Keenan, 50 S.E.C. 272 (Aug. 1, 1990).

a, d, g, j, v, y, al, cl, fl, m1, nl, w1, yl, h2, k2

In re Ernst & Whinney and Ferrante, Initial Decision Release No. 5, 47 SEC Dock. 93 (June 28, 1990).

a, e, f, u, w, cl, gl, nl, ol, pl, rl, vl, a2, b2

In re Hochberg and Webber, 50 S.E.C. 181 (Jan. 11, 1990).

a, d, g, s, v, b1, rl, vl, yl, a2

In re Rodriguez Santos, 50 S.E.C. 99 (Sept. 1, 1989).

h, u, v, y, al, dl, k1, ql, vl, xl, j2, k2

In re Woodside, 50 S.E.C. 76 (Aug. 21, 1989).

h, u, y, al, cl, k1, yl, h2, k2

In re Portney, 50 S.E.C. 68 (Aug. 21, 1989).

h, p, v, b1, gl, nl, vl, w1, h2, k2

- In re Clark*, 50 S.E.C. 57 (Aug. 11, 1989).
a, f, r, v, b1, g1, m1, r1, v1, w1, y1, a2, c2
- In re Mercer*, 50 S.E.C. 8 (Apr. 13, 1989).
a, g, r, e1, g1, s1, y1, h2, k2
- In re Franke and Richard P. Franke & Co.*, 49 S.E.C. 1112 (Mar. 24, 1989).
e, h, u, b1, g1, h1, n1, q1, v1, l2
- In re Morrison*, 49 S.E.C. 1074 (Feb. 23, 1989).
a, g, s, v, d1, m1, o1, p1, s1, v1, i2, k2
- In re Van Horn*, 49 S.E.C. 982 (Nov. 1, 1988).
h, u, v, y, a1, c1, g1, il, ll, n1, q1, r1, v1, x1, y1, j2, k2
- In re Schulzetenberg*, 49 S.E.C. 916 (Sept. 23, 1988).
a, f, u, v, c1, g1, n1, o1, r1, v1, w1, y1, a2, c2
- In re Abrams, Laskey, and Bunyan*, 49 S.E.C. 753 (Feb. 12, 1988).
a, d, g, i, u, v, c1, m1, n1, o1, p1, r1, v1, w1, c2, e2, k2
- In re Rasmussen*, Exchange Act Release No. 24,961, 39 SEC Dock. 335 (Sept. 30, 1987).
h, r, v, y, b1, g1, p1, q1, r1, s1, v1, h2, k2
- In re Gilman and Van Son*, 49 S.E.C. 720 (Sept. 29, 1987).
a, g, i, p, s, d1, o1, q1, r1, v1, f2, k2
- In re Berryman*, 49 S.E.C. 697 (Sept. 9, 1987).
h, u, e1, m1, q1, t1, v1, y1, g2, k2
(involved audits of more than one company)
- In re KMG Main Hurdman*, 49 S.E.C. 668 (Mar. 25, 1987).
e, f, u, v, b1, c1, g1, o1, q1, r1, v1, y1, a2, k2
(involved audits of more than one company)
- In re Kutz*, 49 S.E.C. 642 (Jan. 28, 1987).
a, g, p, v, e1, g1, o1, p1, r1, v1, y1, d2, k2
- In re Haney*, Securities Act Release No. 6687, 37 SEC Dock. 663 (Jan. 28, 1987).
a, g, a1, b1, z1, h2, k2
- In re Huber, Erickson & Butler and Erickson*, 48 S.E.C. 585 (Oct. 10, 1986).
a, e, g, u, b1, q1, r1, s1, v1, g2, k2
- In re Jacobs*, Exchange Act Release No. 23,644, 36 SEC Dock. 768 (Sept. 24, 1986).
h, u, v, c1, g1, v1, y1, h2, k2
- In re Nilssen and Oliver*, 48 S.E.C. 570 (Sept. 11, 1986).
a, d, f, u, v, c1, o1, p1, q1, r1, s1, v1, b2, c2, k2
(involved audits of more than one company)
- In re Rogovin and Debiccari*, Exchange Act Release No. 22,956, 35 SEC Dock. 147 (Feb. 27, 1986).
a, g, p, s, v, w, a1, c1, h1, p1, r1, v1, h2, k2
- In re Frantz, Warrick, Strack & Assoc. and Becker*, Exchange Act Release No. 22,885, 35 SEC Dock. 42 (Feb. 10, 1986).
d, e, g, u, b1, g1, r1, u1, v1, w1, y1, e2, j2, k2
- In re Harrington and Arnott*, 48 S.E.C. 340 (Dec. 5, 1985).
a, d, g, u, v, w, c1, ll, m1, n1, o1, r1, v1, y1, c2, j2, k2

In re Seidman & Seidman, 48 S.E.C. 310 (Oct. 10, 1985).

e, g, u, v, cl, ol, sl, vl, yl, a2, k2

In re Schoenfeld & Mendelsohn and Mendelsohn, 48 S.E.C. 295 (Sept. 26, 1985).

a, e, g, p, s, el, gl, ll, ml, tl, vl, yl, a2, d2, k2

In re Rogers, 48 S.E.C. 233 (Aug. 12, 1985).

h, u, v, cl, gl, ol, rl, vl, xl, yl, h2

In re Markman, 48 S.E.C. 216 (July 11, 1985).

a, g, s, v, w, el, ll, ml, ql, vl, wl, yl, g2, k2

In re Coopers & Lybrand and Cohen, 48 S.E.C. 49 (Nov. 27, 1984).

a, e, f, p, s, cl, yl

(no sanctions given, yet settlement; *see supra* part III.B.)

Note: Because *Checkosky v. SEC*, 23 F.3d 452 (D.C. Cir. 1994) (*per curiam*) has been remanded, it was not included in the survey.