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PCAOB Announces Settled Disciplinary Order for Audit Failures Against Ernst & Young and Four of its Partners

Ernst & Young to Pay $2 Million to Settle Charges

Washington, DC, Feb. 8, 2012 -- The Public Company Accounting Oversight Board today announced a settled disciplinary order censuring Ernst & Young LLP, imposing a $2 million civil money penalty against the firm, and sanctioning four of its current and former partners for violating PCAOB rules and standards.

The $2 million civil money penalty against the firm is the Board's largest civil money penalty to date.

The order related to three E&Y audits of Medicis Pharmaceutical Corporation, and a consultation stemming from an internal E&Y audit quality review of one of the audits. The respondents agreed to settle without admitting or denying the Board's findings.

"These audit partners and Ernst & Young — the company's outside auditor for more than 20 years — failed to fulfill their bedrock responsibility," said James R. Doty, PCAOB Chairman. "The auditor's job is to exercise professional skepticism in evaluating a public company's accounting and in conducting its audit to ensure that investors receive reliable information, which did not happen in this case."

In the audits of Medicis's Dec. 31, 2005, 2006 and 2007 financial statements, the Board found that E&Y and its partners failed to properly evaluate a material component of the company's financial statements — its sales returns reserve.

In connection with a 2008 inspection of E&Y's audits of Medicis, the PCAOB Division of Registration and Inspections staff questioned E&Y's acceptance of the company's accounting for its sales returns reserve. E&Y ultimately concluded that Medicis's reserving for its sales returns was not in conformity with U.S generally accepted accounting principles (GAAP).

The company corrected its accounting for its sales returns reserve and filed restated financial statements with the Securities and Exchange Commission as a result.

The Board found that during the audit periods in question, E&Y and its responsible partners failed to comply with PCAOB standards in evaluating Medicis's practice of reserving for most of its estimated product returns at the cost of replacing the product, instead of at gross sales price.

The Board also found that, in auditing the company's Dec. 31, 2005 financial statements, E&Y and its responsible partners violated PCAOB standards by accepting the company's basis for reserving at replacement cost when the auditors knew, or should have known, that it was not supported by the audit evidence.

The Board further found that, two months later, during an internal audit quality review of the Dec. 31, 2005 audit, E&Y personnel who were not associated with the audit identified the rationale as conflicting with both GAAP and E&Y's internal accounting guidance that specifically addressed revenue recognition for sales with rights of return. Rather than appropriately addressing this material departure from GAAP, E&Y and its personnel wrongly decided in an internal consultation that another flawed accounting rationale supported the company's existing practice of reserving for most of its product returns at replacement cost.

The Board also found that E&Y and its responsible partners violated PCAOB standards in auditing the company's new methodology for calculating its year-end product returns reserve estimates for 2006 and 2007. The Board found that they failed to sufficiently audit key assumptions and placed undue reliance on management's representation that those assumptions were reasonable.

"Accounting firms and their personnel must continually evaluate their clients' accounting and related disclosures, putting themselves in investors' shoes. The audit standard violations outlined in the Board's order are particularly troubling because, when the firm identified the problem itself in 2006, through its internal inspection program, it failed appropriately to address a material departure from GAAP regarding the company sales returns reserve," said Claudius B. Modesti, Director of the PCAOB Division of Enforcement and Investigations.

The Board initiated this proceeding on March 8, 2011, and, as required by the Sarbanes-Oxley Act, the proceeding was nonpublic. Although the Board found good cause to make the hearing in the proceeding public, and the Division of Enforcement and Investigations consented to a public proceeding, none of the respondents provided their consent. Consistent with the requirements of the Act,the proceeding therefore remained nonpublic.

In addition to the censure and fine of E&Y, the Board barred E&Y partner Jeffrey S. Anderson from associating with a PCAOB-registered accounting firm, with the right to petition to remove the bar after two years, and imposed a $50,000 civil money penalty against him. Anderson was the lead partner for the Dec. 31, 2005 and 2007 audits, and participated in the audit quality review and the consultation.

The Board barred former E&Y partner Robert H. Thibault from associating with a PCAOB-registered accounting firm, with the right to petition to remove the bar after one year, and imposed a $25,000 civil money penalty against him. Thibault was the independent review partner for the Dec. 31, 2005 and 2006 audits, and participated in the consultation in a National Office role as a member of E&Y's Professional Practice Group.

The Board censured E&Y partner Ronald Butler, Jr., and imposed a $25,000 civil money penalty against him. Butler was the second partner, supervised by Anderson, on the Dec. 31, 2005 audit, he led the Dec. 31, 2006 audit, and concurred with the consultation conclusion.

The Board also censured E&Y partner Thomas A. Christie, who was the second partner, supervised by Anderson, on the Dec. 31, 2007 audit.

The PCAOB investigation and litigation were conducted by PCAOB Enforcement staff members Mark Adler, Richard Jacobus, John Abell, Raphael Larson, Bernard McDonough, Michael Plotnick, Pamela Woodward, and Tima Hawes.

Today’s Order: In the matter of Ernst & Young LLP, Jeffrey S. Anderson, CPA, Ronald Butler, Jr., CPA, Thomas A. Christie, CPA, and Robert H. Thibault, CPA (Feb. 8, 2012)

The PCAOB is a nonprofit corporation established by Congress. Its mission is to oversee the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.