Ernst & Young Hit Hard in PeopleSoft Case

It would be barred from taking new business for six months under a judge's recommendation.

BY MATTHEW GOLDSTEIN
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Ernst & Young should pay the government $1.7 million and be barred from taking new auditing clients for six months for breaching a **Securities and Exchange Commission** conflict-of-interest regulation, an administrative law judge recommended Friday.

The proposed penalty stems from a joint marketing agreement the accounting firm had in the 1990s with **PeopleSoft** (**PSFT**), a former client. The judge found that the pact violated SEC rules that forbid auditors from having anything more than a "consumer" relationship with businesses whose books they review.

No wrongdoing was alleged in its bookkeeping work for the software company.

Ernst & Young issued a statement late Friday saying the judge's order "will not impair our ability to continue to serve our existing public company audit clients, accept new audit work from privately held companies, or to accept non-audit work from public companies we do not audit." The statement did not say whether the firm would appeal to the SEC.

The issue of auditor independence has been a hot one in the wake of **Enron's** collapse in December 2001. Efforts to strictly define an accountant's role with corporate clients were stepped up after revelations came to light that **Arthur**

Andersen was a willing conspirator in the fraudulent accounting that laid the energy trader low.

The SEC brought a proceeding against Ernst & Young in May 2003 after determining the firm collected huge royalties under a marketing agreement with PeopleSoft. PeopleSoft wasn't charged.

In a 69-page ruling, Chief Administrative Law Judge Brenda Murray found that Ernst "engaged in improper professional conduct because it violated applicable professional standards for auditors by conduct that was both reckless and negligent."

The judge, who presided over an 11-day hearing last spring, said she found "overwhelming evidence" that Ernst's "day-to-day operations were profit-driven and ignored consideration of auditor independence in business relationships with PeopleSoft."

She also ordered the audit firm to hire an independent consultant to monitor its activities, and said that punitive measures were necessary because the evidence suggests that without them, Ernst "will likely commit future violations" of the auditor independence rule.

Judge Murray said it did not matter that Ernst has since sold its consulting business because the firm has displayed "an utter disdain for the commission's rules and regulations of auditor independence."

This is the second time in the past two years that the SEC has brought a major enforcement action against a Big Four accounting firm. Last year the SEC charged KPMG with fraud in connection with its past audits of **Xerox**. Regulators also charged four of the firm's partners in that case, which KPMG is challenging.

In the aftermath of Enron's collapse, federal prosecutors won an obstruction of justice conviction against Arthur Andersen, a victory that effectively shut down the firm.

Last September, former Ernst partner Thomas Trauger was charged by federal authorities with obstruction of justice for allegedly destroying audit working papers stemming from the firm's work for NextCard, a credit card company.

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