PCAOB
Public Company Accounting Oversight Board

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

In the Matter of Michael Freddy, Respondent	PCAOB File No. 105-2017-001 **ORDER SUMMARILY AFFIRMING INITIAL DECISION** November 2, 2017

The Board is in receipt of a several-paragraph letter, dated October 15, 2017 and transmitted by email, from Respondent Michael Freddy, personally, in response to the September 26, 2017 initial decision by default in this disciplinary proceeding. After not previously participating in the proceeding, Freddy now urges "the Board to reconsider to cancel the civil money penalty" ordered by the initial decision because it is "beyond my ability" to pay. Freddy's letter does not contest any other aspect of the initial decision. Construing and accepting, in our discretion, Freddy's letter as a petition for Board review, we hold that it raises no issue warranting further consideration by the Board and summarily affirm the initial decision pursuant to PCAOB Rule 5460.

I. Background

The initial decision (I.D.) was based on the allegations in the Order Instituting Disciplinary Proceedings (OIP) and evidentiary materials submitted by the Division of Enforcement and Investigations in support of its motion for default. The initial decision found that Freddy was an accountant formerly employed by KAP Purwantono, Sungkroro & Surja (the Firm), the Indonesia affiliate of the Ernst & Young global network, and, as such, was an associated person of a registered public accounting firm as defined in Section 2(a)(9) of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 7201(9), and PCAOB rules. The decision further found that Freddy refused to cooperate with a PCAOB investigation, conduct for which the Board is authorized to impose sanctions pursuant to Sarbanes-Oxley Act Section 105(b)(3), 15 U.S.C. 7215(b)(3), and PCAOB Rule 5300. Specifically, the decision determined that Freddy refused to comply with two Accounting Board Demands (ABDs) issued by the Division for him to appear for testimony related to possible violations of PCAOB rules and auditing standards in connection with certain audits and reviews of an issuer, as defined by Section 2(a)(7) of the Act, 15 U.S.C. 7201(7), including a 2011 audit on which Freddy served as engagement manager. In addition to the ABDs, the first of which was served on

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Freddy, through his attorney at the time, in November 2014 and the second of which was served on Freddy personally in October 2015, the decision pointed out numerous other communications by the Division to Freddy, to which he did not respond, informing him that he had been directed to appear for testimony and that he might be subject to sanctions should he refuse to cooperate with the investigation, including three emails and two letters.[1/] The decision also noted that, when Division staff traveled to Indonesia in January 2015 to take testimony of various members of the engagement team for the 2011 audit and repeatedly tried to reach Freddy by telephone, Freddy did not answer or hung up. Further, the decision discussed February 2016 investigative testimony in the record from one of those audit team members who stated, among other things, that Freddy and another team member had asked her to alter work papers for the 2011 audit for the purpose of misleading PCAOB inspectors. Additionally, the decision noted documentation in the record of text messages from Freddy to that witness showing that, while the Division was trying to contact Freddy, he was well aware of the Division's various communications, was deliberately ignoring them, fully expected to be sanctioned for his noncooperation, and advised her to avoid contact with the Division.[2/]

The Board issued the OIP on February 14, 2017. After a lengthy period in which Freddy failed to participate in the proceedings, the hearing officer entered the initial decision by default pursuant to PCAOB Rule 5409(a)(2). Despite having been personally served with the OIP in June 2017, Freddy never answered the OIP nor appeared for any of the prehearing conferences held by the hearing officer. Such failures prompted the hearing officer to issue an order in July 2017 that Freddy show cause why he should not be held in default. When Freddy failed to respond to that order, the Division filed a motion for issuance of a default decision in mid-August 2017, attaching exhibits and accompanying affidavits. As with the previously described communications dating back to November 2014, Freddy again chose not to respond.

The initial decision found that Freddy's refusal to cooperate with the PCAOB investigation was "serious misconduct warranting strong sanctions." In determining appropriate sanctions, the decision noted that Freddy prevented the Division from questioning him about potential deficiencies in the audit procedures performed during the 2011 audit, as to which, as audit manager, Freddy was "well-situated to provide potentially valuable information." The decision also considered "aggravating" evidence that Freddy's noncooperation was intentional, that after commencement of the

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1/ The record reflects that the Division sent the emails to the same email address Freddy used in sending his October 15, 2017 communication about the initial decision.

2/ The initial decision stated that shortly after issuance of the first ABD, the Firm informed the Division that Freddy had resigned "in lieu of termination." I.D. 5.

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investigation Freddy had "sent a text message to the former colleague recommending that she, too, avoid talking to the Division staff when they tried to contact her," and that Freddy had "impeded the Division's efforts to investigate the scope of the document alteration scheme, including identifying those who directed those efforts as well as those who participated in them." I.D. 11. For Freddy's misconduct, the decision ordered that, "consistent with prior rulings in adjudicated noncooperation cases," Freddy be censured, be permanently barred from associating with any registered public accounting firm, and pay a $50,000 civil money penalty. I.D. 12.

II. Summary Affirmance

The Board "may summarily affirm an initial decision based upon the petition for review, without further briefing, if it finds that no issue raised in the petition for review warrants further consideration by the Board." PCAOB Rule 5460(e); *see* PCAOB Rule 5469 ("[t]he Board may, in its discretion, act summarily on the basis of [a] petition"). Under an analogous rule, the Securities and Exchange Commission (Commission or SEC) has stated that summary affirmance is particularly appropriate where, as here, "the relevant facts are undisputed and the initial decision does not embody an important question of law or policy warranting further review." *See, e.g., Eric S. Butler*, SEC Rel. No. 64204, 2011 WL 3792730, at *1 n.2 (Aug. 26, 2011); *see also, e.g., Groendyke Transport, Inc. v. Davis*, 406 F.2d 1158, 1162 (5th Cir. 1969). We have summarily affirmed initial decisions under similar circumstances. *See Kabani & Co.*, SEC Rel. No. 34-80201, 2017 WL 947229, *8 (Mar. 10, 2017), *appeal filed*, No. 17-70786 (9th Cir. Mar. 20, 2017); *Ron Freund, CPA,* PCAOB File No. 105-2009-007 (Jan 26, 2015).

Freddy's petition for review raises no issue warranting further consideration by the Board. He contests none of the evidentiary materials underlying the initial decision and none of the facts found by the decision. Nor does he challenge any of the decision's analysis or legal conclusions based on those facts or raise any procedural objection to the decision. *See* PCAOB Rule 5460(a) (petitions for Board review must "set[] forth specific findings and conclusions of the initial decision as to which exception is taken, together with the supporting reasons for each exception") & (d) (review limited to "the issues specified in the petition for review" unless, with notice, Board broadens review). Based on our *de novo* review of the record, we conclude that the hearing officer's determinations are amply supported by the record. *See* PCAOB Rules 5460(c), 5465; *Kabani*, 2017 WL 947229, *8.

Freddy's conduct stands, as found by the initial decision, as a deliberate, complete refusal to cooperate with a PCAOB investigation, aggravated by an attempt to improperly influence a potential witness and thwart the efforts to investigate Freddy's and others' involvement in the work paper alteration scheme to which Freddy's former colleague testified and other potential violations of PCAOB rules and standards in

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connection with the 2011 audit. Noncooperation with an investigation is fundamentally serious misconduct that "impairs the Division's ability to investigate, which in turn impairs the Board's ability to identify violations and sanction violators" and "deprives investors of an important protection that the [Sarbanes-Oxley] Act was intended to provide." *R.E. Bassie & Co.*, SEC Rel. No. AE-3354, 2012 WL 90269, *11-*12 & n.38 (Jan. 10, 2012) ("failure to cooperate in an investigation is very serious misconduct"); *see vFinance Investments, Inc.*, SEC Rel. No. 34-62448, 2010 WL 2674858, *15 & n.46 (July 2, 2010); *cf. Brogan v. United States,* 522 U.S. 398, 402 (1998) ("[S]ince it is the very *purpose* of an investigation to uncover the truth, any falsehood relating to the subject of the investigation perverts that function."); *Geoffrey Ortiz*, SEC Rel. No. 58416, 2008 WL 3891311, *9 (Aug. 22,2008) (providing false information to NASD in an investigation "'subvert[s]' NASD's ability to perform its regulatory function and protect the public interest") (quoting *Michael A. Rooms*, SEC Rel. No. 34-51467, 2005 WL 742738, *5 (Apr. 1, 2005), *aff'd*, 444 F.3d 1208 (10th Cir. 2006)). Investigations "play a crucial role in furthering the Board's goals of investor protection and the preparation of informative, accurate, and independent audit reports." *Bassie*, 2012 WL 90269, *11. Freddy has shown no recognition of the wrongful nature of his conduct, the record provides no assurance that he would respond differently if faced with similar circumstances in the future, and absent sanctions, nothing prevents him from continuing to audit public companies. Freddy's especially egregious misconduct amply demonstrates his unfitness to audit issuers within the regulatory framework established by the Sarbanes-Oxley Act and shows the urgent need for strong disciplinary action to prevent him and others from engaging in and benefitting from such harmful conduct.

Freddy's only assignment of error in the initial decision is the $50,000 civil money penalty, which he asserts, without any detail or corroboration, is "beyond [his] ability" to pay based on his "current financial condition" and "income." As the Commission has held, the Sarbanes-Oxley Act "does not recognize ability to pay as a factor to consider in determining whether to impose a civil money penalty." *Bassie*, 2012 WL 90269, *14 n.53. Our decision in that same case indicated that even if we have discretion to consider whether ability to pay is relevant to penalty considerations in any particular case, "evidence concerning Respondents' ability to pay a penalty would be irrelevant to our determination of whether to impose a penalty" because of "the egregiousness of Respondents' noncooperation[] and the need to protect investors and advance the public interest by deterring such noncooperation." *R.E. Bassie & Co.*, PCAOB File No. 105-2009-001 at 18 (Oct. 6, 2010). The SEC agreed. *Bassie*, 2012 WL 90269, *14 n.53 (citing *Thomas C. Bridge*, SEC Rel. No. 34-60736, 2009 WL 3100582, *25 (Sept. 29, 2009) ("when conduct is 'sufficiently egregious,' the Commission may impose a sanction despite a demonstrated inability to pay"), *petition denied sub nom.*, *Robles v. SEC*, 2010 WL 5479603 (D.C. Cir. Dec. 30, 2010)). The same analysis applies here, given the severity of Freddy's misconduct, discussed above. Furthermore, we note the general principle that where a person claims that ability to pay should be considered in

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imposing a monetary sanction, he or she bears the burden of proving inability to pay. *See, e.g.*, *Keith D. Geary*, SEC Rel. No. 34-80322, 2017 WL 1150793, *12 (Mar. 28, 2017). The lack of support for Freddy's claim of inability to pay a civil money penalty, despite ample opportunity to raise it before, would be a separate and independent ground for rejecting his claim.

III. Conclusion

After *de novo* review of the record, we therefore summarily affirm the initial decision's findings of violations and order of sanctions.

Accordingly, it is ORDERED that:

Michael Freddy is censured;

Michael Freddy is barred from associating with any registered public accounting firm; and

Michael Freddy shall pay a civil money penalty in the amount of $50,000 by (a) United States postal money order, certified check, bank cashier's check, or bank money order, (b) made payable to the Public Company Accounting Oversight Board, (c) delivered to the Controller, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, D.C. 20006 within 30 days after the effective date, described below, and (d) submitted under a cover letter which identifies Michael Freddy as a respondent in these proceedings, sets forth the title and PCAOB File Number of these proceedings, and states that payment is made pursuant to this Order, a copy of which cover letter and money order or check shall be sent to Office of the Secretary, Attention: Phoebe W. Brown, Secretary, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington, D.C. 20006.

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Effective Date of Sanctions: If Respondent does not file an application for review by the Securities and Exchange Commission and the Commission does not order review of the sanction on its own motion, the effective date of the sanction shall be the later of the expiration of the time period for filing an application for Commission review or the expiration of the time period for the Commission to order review. If Respondent files an application for review by the Commission or the Commission orders review of the sanction, the effective date of the sanction shall be the date the Commission lifts the stay imposed by Sarbanes-Oxley Act Section 105(e), 15 U.S.C. 7215(e).

By the Board

Phoebe W. Brown
Secretary

November 2, 2017