



Ontario  
Securities  
Commission

Commission des  
valeurs mobilières  
de l'Ontario

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**IN THE MATTER OF THE *SECURITIES ACT*,  
R.S.O. 1990, c. S.5, as amended**

**-and -**

**IN THE MATTER OF ERNST & YOUNG LLP**

**-and-**

**IN THE MATTER OF ERNST & YOUNG LLP  
(AUDITS OF ZUNGUI HAIXI CORPORATION)**

**Hearing:** September 30, 2014

**Panel:** James E. A. Turner -Vice-Chair

**Appearances:** Yvonne Chisholm -For Staff of the Commission

Linda Fuerst -For Ernst & Young LLP

## ORAL RULING AND REASONS

*The following ruling and reasons have been prepared for the purpose of publication in the Ontario Securities Commission Bulletin and are based on portions of the transcript of the hearing. The excerpts from the transcript have been edited and supplemented and the text has been approved by the Chair of the Panel for the purpose of providing a public record of the decision and reasons.*

[1] Staff of the Commission (“**Staff**”) and Ernst & Young LLP (“**Ernst & Young**” or the “**Respondent**”) have agreed to a settlement of the proceeding initiated in respect of Ernst & Young by Notice of Hearing dated December 3, 2012 relating to its audits of the financial statements of Sino-Forest Corporation (“**Sino-Forest**”), and of the proceeding initiated in respect of Ernst & Young by Notice of Hearing dated June 24, 2013 relating to its audits of the financial statements of Zungui Haixi Corporation (“**Zungui**”) on the basis of the terms and conditions set forth in a settlement agreement dated September 15, 2014 (the “**Settlement Agreement**”).

[2] This was a hearing to consider and approve the Settlement Agreement between Staff and the Respondent.

[3] The facts and circumstances relating to Staff’s investigations and conclusions are set forth in the Settlement Agreement and will not be repeated here.

[4] This is a very important settlement for the Commission for the reasons I will refer to below.

[5] First, I note that the Settlement Agreement was submitted to me for my consideration in a confidential settlement conference on September 18, 2014. I reviewed the terms of the settlement at that time, heard the submissions of the parties and indicated that I was prepared to approve the settlement as being in the public interest.

[6] The Settlement Agreement is the result of a negotiation between Staff and the Respondent and in considering the approval of the Settlement Agreement, I must give significant deference to the recommendations of Staff given their knowledge of the investigations and all of the surrounding circumstances. Staff has recommended approval of this settlement as being in the public interest.

[7] The question I must determine is not whether I would impose the sanctions set forth in the Settlement Agreement after a contested hearing. My role is to determine whether the terms of the settlement as a whole are fair and reasonable in the circumstances. In making that determination, I must rely only on the facts and the conclusions reached by Staff as set out in the Settlement Agreement.

[8] In considering this matter, I note that the Commission's objective under the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "Act") is not to punish a respondent but to ensure the integrity of our capital markets and that investors and our capital markets are protected, to the extent reasonably possible, from similar misconduct. Accordingly, specific and general deterrence is a very important factor in considering the terms and conditions of the Settlement Agreement.

[9] An auditor plays a crucial gatekeeper role in ensuring the integrity of the financial information and statements upon which investors rely. Accordingly, auditors play a vital role in the effective functioning of our capital markets. That is why the Commission views Ernst & Young's failures in these matters as so serious.

[10] I am satisfied that the voluntary payment of \$8 million to the Commission under the Settlement Agreement, together with the other terms of settlement, will send a very clear message that the Commission expects that auditors of reporting issuers will fully comply with auditing standards and will exercise an appropriate level of scrutiny, professional skepticism and diligence in the performance of their audits. The settlement also demonstrates that Staff will not hesitate to initiate proceedings against an auditor where appropriate audit standards have not been met.

[11] In considering whether the terms of the Settlement Agreement are fair and reasonable, I note the following:

(a) Ernst & Young has settled class action lawsuits relating to the circumstances described in the Settlement Agreement by paying \$119 million to shareholders and noteholders of Sino-Forest and Zungui. I understand that those settlements were found by the relevant courts to be fair and reasonable. It is appropriate in these circumstances for me to acknowledge and take into consideration the making of those payments in assessing the overall terms of this settlement;

(b) in addition, Ernst & Young will make a voluntary payment to the Commission of \$8 million. The \$8 million amount was agreed to by Staff and Ernst & Young after what was described as "intense" negotiations. It is likely that amount exceeds any administrative penalty or penalties that could have been imposed on Ernst & Young under the Act after contested hearings in these matters. As noted by Staff, \$2.1 million of the \$8 million payment will be applied to the Commission's substantial costs in these matters and will substantially defray those costs. I am prepared to accept the voluntary payment of \$8 million as being reasonable in the circumstances and proportionate to Ernst & Young's conduct in these matters;

(c) Staff does not allege, and has found no evidence of, dishonest conduct by Ernst & Young. There is no suggestion that Ernst & Young engaged in abusive, fraudulent or criminal conduct; to the contrary, these matters address appropriate auditing standards and the failures of an auditor as a gatekeeper. I note that

allegations of fraud have been made against certain officers and directors of Sino-Forest in a separate proceeding before the Commission;

(d) Ernst & Young co-operated with Staff in connection with this matter and self-reported auditing issues related to the Zungui matter;

(e) Ernst & Young has taken significant remedial action with respect to its policies and procedures for auditing reporting issuers with significant operations in emerging markets. That means that the auditing deficiencies in these matters are unlikely to occur again;

(f) Ernst & Young has agreed to co-operate with Staff in its ongoing investigation of the affairs of Sino-Forest and will make its officers and employees available to testify at the hearing before the Commission with respect to that matter. That co-operation may be a substantial benefit to Staff; and

(g) it is important to recognize that this settlement avoids two complex, lengthy and expensive hearings addressing the interpretation and application of auditing standards and the exercise by auditors of an appropriate level of scrutiny, professional skepticism and diligence. I understand that those hearings would have involved expert reports from multiple expert witnesses and were anticipated to take at least 100 hearing days before the Commission. There is significant uncertainty and substantial risks to both sides as to the potential outcomes of those hearings. The settlement avoids those uncertainties and risks and brings these proceedings to an appropriate conclusion. These are important factors in considering this settlement.

[12] I have reviewed the cases referred to me as relevant to this matter, including some cases settled by the United States Securities and Exchange Commission (the “SEC”) on a no-contest basis. The terms of this settlement are unprecedented in Canada in these circumstances and the voluntary payment in this matter is consistent with the level of payments imposed by the SEC in some similar matters.

[13] Staff is recommending this settlement on a no-contest basis. The Settlement Agreement provides that Ernst & Young “neither admits nor denies the accuracy of the facts stated by Staff or the conclusions of Staff set out in the Settlement Agreement”. However, Staff asserts that the facts set out in the Settlement Agreement are based on the investigations carried out by Staff and are supported by the evidence, and that Staff’s conclusions set forth in the Settlement Agreement are reasonable.

[14] Under the Settlement Agreement, Ernst & Young has agreed not to make any public statement that is inconsistent with the Settlement Agreement or state that there is no factual basis for this settlement. Ernst & Young is not, however, restricted by this settlement in meeting its testimonial obligations or in taking any legal or factual positions in other investigations or proceedings.

[15] This is the first no-contest settlement since the Commission's decision that it would consider such settlements in appropriate circumstances. In my view, these matters are entirely appropriate for a no-contest settlement for the following reasons:

- (a) first, the Settlement Agreement includes detailed facts and conclusions asserted by Staff. That means that I have an appropriate record before me to consider and assess the terms of settlement and that market participants will have a clear understanding as to the audit deficiencies involved in these matters and of Staff's views with respect to those deficiencies. Accordingly, hearings on the merits in these matters would provide little further guidance or benefit to the market;
- (b) as noted above, Staff does not allege, and has found no evidence of, dishonest conduct by Ernst & Young;
- (c) there is no doubt that investors suffered severe financial losses as a result of the collapse of Sino-Forest. Ernst & Young has, however, paid an aggregate of \$119 million in settlement of class action lawsuits brought by security holders of Sino-Forest and Zungui; \$117 million of that amount was paid in respect of the Sino-Forest matter. Those are unprecedented payments and the courts involved have approved them. These payments have, to at least some extent, mitigated the harm to investors and must be taken into account in assessing the overall terms of this settlement;
- (d) Ernst & Young co-operated with Staff in connection with this matter and self-reported auditing issues related to the Zungui matter; and
- (e) Ernst & Young has taken the remedial actions described in paragraph 11(e) above and has agreed to the on-going co-operation with Staff referred to in paragraph 11(f) above.

[16] Further, it appears to me that, but for the no-contest nature of this settlement, it is unlikely that a settlement of these matters would have been reached.

[17] In recommending that the Commission approve this settlement, Staff has considered the factors set forth in OSC *Staff Notice 15-702 – Revised Credit for Co-Operation Program*, and Staff submits that this settlement meets those criteria. I agree with that submission.

[18] Accordingly, the Commission is through the terms of this settlement accomplishing on a timely basis the important regulatory objectives referred to above and is avoiding the risks inherent in the outcomes of contested hearings.

[19] Ultimately it is a matter for my discretion, to be exercised in the public interest, whether I am prepared to approve this settlement on the terms presented. In the circumstances, I find that the terms of the Settlement Agreement are fair and reasonable and provide an appropriate basis for settlement of these matters.

[20] I therefore conclude that it is in the public interest to approve the Settlement Agreement in the form submitted to me. I will issue an order approving the settlement in the form set out in Schedule A to this ruling.

Approved this 3<sup>rd</sup> day of October, 2014.

*“James E. A. Turner”*

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James E. A. Turner

## Schedule A



Ontario  
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Commission des  
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22<sup>nd</sup> Floor  
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**IN THE MATTER OF THE *SECURITIES ACT*,  
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**IN THE MATTER OF ERNST & YOUNG LLP  
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**IN THE MATTER OF A  
SETTLEMENT AGREEMENT  
BETWEEN STAFF OF THE ONTARIO SECURITIES COMMISSION  
AND ERNST & YOUNG LLP**

**ORDER  
(Sections 127 and 127.1)**

**WHEREAS** on December 3, 2012, the Ontario Securities Commission (the “Commission”) issued a Notice of Hearing pursuant to sections 127 and 127.1 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the “*Securities Act*”) in respect of Ernst & Young LLP (“Ernst & Young”). That Notice of Hearing was issued in connection with the allegations set out in the Statement of Allegations of Staff of the Commission (“Staff”) dated December 3, 2012 relating to Ernst & Young’s audits of the financial statements of Sino-Forest Corporation (the “Sino-Forest Proceeding”);

**AND WHEREAS** on June 24, 2013, the Commission issued a second Notice of Hearing pursuant to sections 127 and 127.1 of the *Securities Act* in respect of Ernst & Young. That

Notice of Hearing was issued in connection with the allegations set out in the Statement of Allegations of Staff dated June 24, 2013 relating to Ernst & Young's audits of the financial statements of Zungui Haixi Corporation (the "Zungui Proceeding");

**AND WHEREAS** Ernst & Young entered into a Settlement Agreement with Staff dated September 23, 2014 (the "Settlement Agreement") in which Ernst & Young agreed to a proposed settlement of the Sino-Forest Proceeding and the Zungui Proceeding, subject to the approval of the Commission;

**AND WHEREAS** on September 19, 2014, the Commission issued a Notice of Hearing pursuant to section 127 of the *Securities Act* to announce that it proposed to hold a hearing to consider whether it is in the public interest to approve the Settlement Agreement;

**AND UPON** reviewing the Settlement Agreement, the Notices of Hearing, and the Statements of Allegations of Staff in the Sino-Forest Proceeding and the Zungui Proceeding, and upon hearing submissions from counsel for Ernst & Young and from Staff;

**AND WHEREAS** Ernst & Young has undertaken in the Settlement Agreement to cooperate with Staff regarding its ongoing investigation into the affairs of Sino-Forest Corporation and any resulting hearing before the Commission. Ernst & Young has further undertaken to make its current partners and employees available to testify at any resulting hearing if requested by Staff and make best efforts to cause its former partners and employees to do so;

**AND WHEREAS** the Commission is of the opinion that it is in the public interest to make this Order;

**IT IS HEREBY ORDERED THAT:**

- (a) the Settlement Agreement is approved;
- (b) Ernst & Young shall make a voluntary payment to the Commission in the amount of \$8 million in total, to be allocated as follows:

- (i) \$6.5 million for the Sino-Forest Proceeding, of which \$1.5 million shall be allocated to the Commission's costs of the investigation, and the balance shall be designated for allocation or for use by the Commission in accordance with subsections 3.4(2)(b)(i) or (ii) of the *Securities Act*; and
- (ii) \$1.5 million for the Zungui Proceeding, of which \$600,000 shall be allocated to the Commission's costs of the investigation, and the balance shall be designated for allocation or for use by the Commission in accordance with subsections 3.4(2)(b)(i) or (ii) of the *Securities Act*.

**DATED** at Toronto, this 30<sup>th</sup> day of September, 2014.

*"James E. A. Turner"*

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James E. A. Turner