

Via Email

April 9, 2020

William D. Duhnke III
Chairman
PCAOB
1666 K Street NW
Washington, DC 20006

Re: Luckin Coffee Inc. & Ernst & Young Hua Ming LLP

Dear Mr. Chairman:

I am writing regarding Public Company Accounting Oversight Board (PCAOB or Board)-registered firm Ernst & Young Hua Ming LLP.¹

The Council of Institutional Investors (CII) is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately \$4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true “Main Street” investors through their pension funds. Our associate members include non-U.S. asset owners with about \$4 trillion in assets, and a range of asset managers with more than \$35 trillion in assets under management.²

As the leading U.S. voice for effective corporate governance and strong shareholder rights, CII believes that accurate and reliable audited financial statements are critical to investors in making informed decisions, and vital to the overall well-being of our capital markets.³ Consistent with our policies, we first shared with you our concerns about PCAOB-registered firms located in China in September 2018 in our comment letter in response to PCAOB Draft Strategic Plan 2018-2022.⁴ At the time, we respectfully requested that “that the PCAOB consider examining

¹ PCAOB, Registration, Annual and Special Reporting, Firm Summary, Ernst & Young Hua Ming LLP (1408) (last visited Apr. 7, 2020),

<https://rasr.pcaobus.org/Firms/FirmSummaryPublic.aspx?FirmID=7F42AF1786DA878DD7EAC2AFA2A74C03>.

² For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at <http://www.cii.org>.

³ CII, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (updated Mar. 1, 2017), http://www.cii.org/policies_other_issues#indep_acct_audit_standards.

⁴ Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Office of the Secretary, PCAOB 6 (Sept. 6, 2018), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/September%206.%202018%20PCAOB%20Strategic%20Plan.pdf (“We are particularly concerned about PCAOB-registered firms located in China for at least four

whether some or all of the PCAOB-registered firms located in China (and perhaps other jurisdictions) should be deregistered.”⁵ Since that time, we appreciate your efforts working with Securities and Exchange Commission (SEC) Chairman Jay Clayton and members of the SEC staff to discuss with representatives of the largest U.S. audit firms audit quality issues relevant to PCAOB-registered firms located in China.⁶

In that regard, we have read with concern the recent press coverage of the alleged accounting fraud at Luckin Coffee Inc.⁷ As a result of the allegations the company valuation has taken a very large hit.⁸ As one financial expert on China has reported: “It marks the worst crisis in confidence for China Inc. since a decade ago when Muddy Waters began exposing frauds.”⁹

As you are aware, the auditor of Luckin Coffee Inc. is Ernst & Young Hua Ming LLP.¹⁰ Ernst & Young Hua Ming LLP has been a PCAOB-registered firm since 2004, but has never been subject to a Board inspection.¹¹

We acknowledge there is nothing in the press coverage to-date to suggest that Ernst & Young Hua Ming LLP has any responsibility for the Luckin Coffee Inc. alleged accounting fraud, except perhaps in its uncovering following the release of a short-selling report.¹² We, however,

reasons: (1) since 2010 the PCAOB has actively sought without success inspections of China-based audit firms and the mainland affiliates of the Big Four accountancies - Deloitte, KPMG, PricewaterhouseCoopers and EY; (2) many of the China-based audit firms do significant work on audits of major U.S. companies doing business in China; (3) the recent surge in the number of Chinese companies listed on U.S. stock exchanges; and (4) most of the Chinese companies listed on U.S. stock exchanges in recent years have a variable interest entity structure that is highly complex and might include risks that some investors and auditors may not fully understand or appreciate.”)

⁵ *Id.*

⁶ See Press Release, *SEC Chairman Clayton, PCAOB Chairman Duhnke, and Members of SEC Staff Meet With Auditing Firm Representatives to Discuss Audit Quality in Emerging Economies and Markets* (Nov. 4, 2019), available at <https://www.sec.gov/news/press-release/2019-228>; SEC Chairman Jay Clayton, SEC Division of Corporation Finance Director Bill Hinman, SEC Chief Accountant Sagar Teotia, and PCAOB Chairman William D. Duhnke III, *Statement on Continued Dialogue with Audit Firm Representatives on Audit Quality in China and Other Emerging Markets; Coronavirus — Reporting Considerations and Potential Relief* (Feb. 19, 2020), available at <https://www.sec.gov/news/public-statement/statement-audit-quality-china-2020-02-19>.

⁷ Jeanny Yu et al., *Luckin Coffee Scandal Deals New Blow to Corporate China*, Bloomberg (Apr. 3, 2020), available at <https://finance.yahoo.com/news/luckin-coffee-scandal-deals-blow-094716448.html>; Quentin Webb & Joanne Chiu, *Ernst & Young Says It First Found Accounting Issues at Luckin*, Wall St. J. (Apr. 3, 2020), <https://www.wsj.com/articles/ernst-young-says-it-first-found-accounting-issues-at-luckin-11585927403>; Bob Pisani, *Luckin Coffee is a painful reminder of ‘the extreme fraud risk’ of some China-based companies*, CNBC (Apr. 3, 2020), <https://www.cnbc.com/2020/04/03/luckin-coffee-debacle-is-a-painful-reminder-of-fraud-risk.html>.

⁸ See, e.g., Jeanny Yu et al., *Luckin Coffee Scandal Deals New Blow to Corporate China*, Bloomberg (“Luckin Coffee shares plunged as much as 81% in U.S. trading and CAR Inc., a rental company founded by Luckin Coffee’s chairman, sank 54% in Hong Kong.”).

⁹ Ye Xie, *Who Will Be Next Luckin Coffee Is the Talk of Town: China Today*, Bloomberg (Apr. 8, 2020) (on file with CII).

¹⁰ See, e.g., Quentin Webb & Joanne Chiu, *Ernst & Young Says It First Found Accounting Issues at Luckin*, Wall St. J. (“Ernst & Young Hua Ming LLP is the entity in China that audits Luckin.”).

¹¹ See PCAOB, Registration, Annual and Special Reporting, Firm Summary, Ernst & Young Hua Ming LLP (1408) (Registration date: 07/08/2004).

¹² See Zhang Lihua, *Auditor’s Anti-fraud Team Led to Luckin’s Confession, Sources Say*, YiCai Global (Apr. 3, 2020), <https://www.yicai.com/news/exclusive-auditor-anti-fraud-team-led-to-luckin-confession-sources-say> (“Short seller Muddy Waters’ anonymous short-selling report on Luckin Coffee early this year immediately alerted

would respectfully request that the PCAOB investigate the matter to the extent possible and determine whether it is appropriate and in the interest of U.S. investors that Ernst & Young Hua Ming LLP remain a PCAOB-registered firm.¹³ Confidence in the auditor of Luckin Coffee Inc. will be even more critical in light of apparent control failures at the company, and it is not clear to us that the PCAOB can have confidence in processes of firms that it has not been permitted to inspect for more than a decade.

As you know, in 2010 the PCAOB stopped allowing firms to register from jurisdictions in which it cannot oversee their activities.¹⁴ Firms, like Ernst & Young Hua Ming LLP, that registered before 2010, however, were grandfathered and remain registered with the PCAOB and therefore eligible to serve as lead auditor on the audits of U.S.-listed companies. The PCAOB has stressed, in the past, that such firms remain responsible under the Sarbanes-Oxley Act of 2002 to cooperate with Board investigations. In fact, the PCAOB has taken enforcement action, including deregistration, against firms that failed to cooperate in Board investigations of their audit work, despite the fact that the firm claimed legal issues prevented it from providing the PCAOB with necessary information.¹⁵

While we understand that PCAOB investigations are non-public, please confirm that the Board remains committed to exercising its enforcement authority over all registered firms, even those located in jurisdictions where it cannot inspect, and will insist on timely cooperation in its investigations of all registered firms in the interest of protecting U.S. investors.

EY, a person with close ties to EY China's management said, adding that the auditor then sent over an anti-fraud team of more than 10 members.”); Quentin Webb & Joanne Chiu, *Ernst & Young Says It First Found Accounting Issues at Luckin*, Wall St. J. (“While auditing Luckin’s financials for 2019, the accounting firm said it found some ‘management personnel engaged in fabricated transactions which led to the inflation of the Company’s income, costs and expenses’ from the second quarter to the fourth quarter.”).

¹³ See Bob Pisani, *Luckin Coffee is a painful reminder of ‘the extreme fraud risk’ of some China-based companies*, CNBC (Commenting that “[o]ne possible next step: The PCAOB could deregister the auditors [and] [b]ecause the companies need to have an auditor that is listed with the board, the SEC or the exchanges could then delist the company.”).

¹⁴ See Consideration of Registration Applications from Public Accounting Firms in Non-U.S. Jurisdictions Where There are Unresolved Obstacles to PCAOB Inspections, PCAOB Rel. No. 2010-007 at 3 (Oct. 7, 2010), https://pcaobus.org/International/Inspections/Documents/Registration_of_Non-US_Firms.pdf (“In light of the length of time that has elapsed without successful resolution of the obstacles, and the continuing inability of the Board to inspect PCAOB-registered firms in some jurisdictions, the Board has re-evaluated its approach to new registration applications from firms in those jurisdictions.”).

¹⁵ See In the Matter of PKF, PCAOB Rel. No. 105-2016-001 at 3-4 (Jan.12, 2016), <https://pcaobus.org/Enforcement/Decisions/Documents/105-2016-001-PKF.pdf> (“Respondent declared that it would not provide an associated person of the Firm to provide the required testimony about the audits of Issuer A asserting that: (1) the Division was required to make a request for assistance under the May 2013 Memorandum of Understanding . . . on Enforcement Cooperation between the Board, the China Securities Regulatory Commission . . . (“CSRC”) and the PRC Ministry of Finance (“MOF”) in order to obtain the testimony and (2) the testimony could not proceed without first obtaining the approval of the CSRC or the MOF.”).

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We appreciate your consideration of this request. Please let me know if you have any questions.

Sincerely,

A handwritten signature in cursive script that reads "Jeff Mahoney". The signature is written in black ink and is positioned above the typed name.

Jeffrey P. Mahoney
General Counsel