SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
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Admin. Proc. File No. 3-17758

In the Matter of the Application of

CYNTHIA C. REINHART, CPA

For Review of Action Taken by the

PCAOB

OPINION OF THE COMMISSION

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD -- REVIEW OF DISCIPLINARY PROCEEDINGS

Person associated with registered public accounting firm was not shown to have engaged in repeated instances of negligent conduct during the audit of a company's financial statements. *Held*, the disciplinary sanctions imposed are *cancelled*.

APPEARANCES:

George A. Salter and *Ira M. Feinberg*, of *Hogan Lovells US LLP*, for Applicant.

J. Gordon Seymour, *Luis de la Torre*, and *Jerome P. Sisul* for the PCAOB.

Appeal filed: December 29, 2016
Last brief received: January 16, 2018

Cynthia C. Reinhart, who was a partner at KPMG LLP, a registered public accounting firm, appeals disciplinary action by the Public Company Accounting Oversight Board ("PCAOB"), which found that Reinhart violated PCAOB Rules 3100[1] and 3200T[2] by not adhering to professional auditing standards during the audit of a public company's 2007 financial statements. The PCAOB further found that those violations constituted "repeated instances of negligent conduct," which supported the imposition of a bar from Reinhart's associating with a registered public accounting firm (with leave to petition to associate after two years) and, if permitted to associate again with a registered public accounting firm, a bar from serving in certain senior roles and exercising certain oversight authority for an additional year.[3] We base our findings on an independent review of the record and apply the preponderance of the evidence standard.[4]

We hold that the record does not support the PCAOB's finding that Reinhart engaged in repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard, a finding of which is necessary under Sarbanes-Oxley Section 105(c)(5) to support the sanctions imposed by the PCAOB.[5]

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1 PCAOB Rule 3100 requires registered public accounting firms and their associated persons, which includes partners of such firms, to comply with the PCAOB's "auditing and related professional practice standards" in connection with the preparation or issuance of any audit report for an issuer, as defined in the Sarbanes-Oxley Act of 2002. Rule 1001(a)(viii) defines the term "auditing and related professional practice standards" to mean "the auditing standards, related attestation standards, quality control standards, ethical standards, and independence standards (including any rules implementing Title II of Sarbanes-Oxley), and any other professional standards, that are established or adopted by the [PCAOB] under Section 103 of the [Sarbanes-Oxley] Act."

2 In April 2003, the PCAOB adopted certain preexisting standards as its interim standards. PCAOB Rule 3200T states that, "[i]n connection with the preparation or issuance of any audit report, a registered public accounting firm, and its associated persons, shall comply with generally accepted auditing standards ("GAAS"), as described in the AICPA Auditing Standards Board's Statement of Auditing Standards No. 95, as in existence on April 16, 2003 (Codification of Statements on Auditing Standards, AU § 150 (AICPA 2002)), to the extent not superseded or amended by the [PCAOB]." The interim standards are cited as "AU §__."

3 Final Decision, *Cynthia C. Reinhart, CPA*, PCAOB File No. 105-2012-003 (Nov. 18, 2016).

4 *S.W. Hatfield*, Exchange Act Release No. 69930, 2013 WL 3339647, at *1 (July 3, 2013).

5 15 U.S.C. § 7215(c)(5) (stating that a temporary or permanent suspension or bar of a person from further association with any registered public accounting firm, and temporary or permanent limitations on the person's activities, shall only be imposed when there is (A) either intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or (B) repeated instances of negligent

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The PCAOB found that Reinhart engaged in repeated instances of negligent conduct on two alternate bases. First, the PCAOB found that there were repeated instances of negligence because Reinhart's alleged auditing failures concerned "two [audit] areas . . . not just one financial statement account," with those two audit areas being (1) whether there was substantial doubt about Thornburg Mortgage, Inc.'s ("Thornburg") ability to continue as a going-concern for a reasonable period of time[6] and (2) whether Thornburg had the intent and ability to retain its investments for a period of time sufficient to allow for any anticipated recovery in market value.[7] Second, the PCAOB alternatively found that, "even if these two audit areas were treated as one," Reinhart's handling of certain additional audit tasks underlying her going-concern and ability-to-hold inquiries also resulted in independent instances of negligent conduct.

We find, concerning the first basis of the PCAOB's sanction, that the PCAOB has not established on the record here that the fact that two audit areas were affected by Reinhart's allegedly negligent conduct necessarily means that repeated instances of negligent conduct occurred. As to the PCAOB's alternate finding that Reinhart's decisions regarding certain audit steps independently constituted repeated instances of negligent conduct, we find that the record does not support the PCAOB's finding that Reinhart engaged in the conduct that the PCAOB found her to have engaged in regarding those audit steps or, to the extent that she engaged in that conduct, that it constituted repeated instances of negligent conduct in the context of the overall audit work Reinhart did.

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conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard).

6 AU § 341.02 (requiring an auditor to evaluate whether there was "substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited . . . based on his or her knowledge of relevant conditions and events that exist at or have occurred prior to the completion of fieldwork.").

7 AU § 332.47 (providing guidance and example factors for determining whether "an impairment loss for a decline in fair value . . . is other than temporary"); AU § 332.48 (stating that the "auditor should evaluate (*a*) whether management has considered relevant information in determining whether factors such as those listed in paragraph [AU §332].47 exist and (*b*) management's conclusions about the need to recognize an impairment loss"); *SEC Staff Accounting Bulletin No. 59* ("*SAB 59*"), 17 C.F.R. § 211(5)(M) (explaining that an issuer need not recognize a security's unrealized losses against income if the issuer possessed both "the ability and intent to hold" the impaired security until maturity or the recovery of its fair value). As we have previously observed, however, "expressions of views offered to the public by the Commission's staff . . . do not necessarily reflect the views of the Commission [and] do not have the force of law." *Allen Douglas Sec., Inc.*, Exchange Act Release No. 50513, 2004 WL 2297414, at *4 n.31 (Oct. 12, 2004) (quotation marks omitted).

We accordingly conclude that the record does not support the PCAOB's finding that Reinhart engaged in repeated instances of negligent conduct as required by Sarbanes-Oxley to support the sanctions PCAOB imposed, and we cancel the PCAOB's sanctions on that basis.

I. Background

Reinhart, now retired, was the lead engagement partner on KPMG's audit of Thornburg's financial statements for the fiscal year ending December 31, 2007. Reinhart also served as engagement partner for KPMG's audit of Thornburg's 2006 financial statements. KPMG's 2007 audit engagement team included a senior manager, another manager, a senior associate, and two staff accountants, the three most senior of whom had worked on Thornburg's 2006 audit. Reinhart also consulted with three senior KPMG audit partners: an in-depth review partner (the "In-Depth Review Partner"), an SEC review partner (the "SEC Review Partner")—both of whom also assisted on the 2006 audit—and a business unit professional practice partner (the "BUPP Partner").[8] Near the end of the 2007 audit, the engagement team members, including Reinhart, were at Thornburg's headquarters in Santa Fe, New Mexico, almost daily conducting fieldwork. The team spent approximately 7,000 hours on the audit, with Reinhart logging more than 300 hours.

The PCAOB's findings related to certain financial events that occurred after Thornburg's 2007 year-end, but before KPMG issued its audit report in late February 2008 (the "Subsequent Period"). The specific financial events related to two audit areas: (1) whether there was substantial doubt about Thornburg's ability to continue as a going concern for a reasonable period of time[9] and (2) whether Thornburg had the intent and ability to hold certain securities that had decreased in value until their fair value recovered or whether Thornburg needed to recognize in earnings the unrealized losses on those assets as an other than temporary impairment ("OTTI").[10] The facts surrounding Reinhart's audit, unless otherwise noted, are undisputed.

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8 The SEC Review Partner was an auditor with 40 years of audit experience; who had worked on the audit of Thornburg's 2006 financial statements; and who reviewed certain significant audit areas of the 2007 Thornburg audit, including the "going-concern" and "other than temporary impairment" ("OTTI") analyses and disclosures in the financial statements and footnotes. The In-Depth Review Partner testified that he conducted a deeper dive into the work papers than the SEC Review Partner and consulted with Reinhart on her going-concern and OTTI analyses. He had 32 years of audit experience, including experience with real estate investment trusts and mortgage-backed securities. The BUPP Partner, with whom Reinhart also consulted on her going-concern analysis, had been involved with more than 30 going-concern analyses.

9 AU § 341.02.

10 AU § 332.47; SAB 59.

A. Thornburg's mortgage-backed securities business.

Thornburg was a residential mortgage lender that originated, acquired, and retained investments in adjustable rate mortgage assets ("ARM Assets"). Thornburg's two main categories of ARM Assets were "ARM Loans" and, more relevant here, "Purchased ARM Assets," which were mortgage-backed securities, representing pools of ARM loans that were publically traded and issued by third-party lenders. Within those Purchased ARM Assets, Thornburg specialized in originating Alt-A mortgage loans and securitizing them as mortgage-backed securities.[11] Thornburg generated income primarily from the difference between the interest income it earned on its ARM Assets and its cost of borrowing.

Thornburg classified its Purchased ARM Assets as "available for sale" securities, which under FAS No. 115 the company carried at fair value on its balance sheet and reported any unrealized gains and losses as a component of shareholders' equity.[12] Under FAS No. 115 periodic fluctuations in the market value of available-for-sale securities were generally not recognized in earnings until the securities' sale or maturity. However, if Thornburg were to determine that any decline in the securities' market value was an OTTI, the company would have to recognize the decline as an income statement loss.

1. Reverse Repurchase Agreements.

Thornburg was classified as a real estate investment trust (or "REIT"), which meant that it was not required to pay corporate income taxes so long as it distributed substantially all of its taxable income to investors.[13] This required Thornburg to continually raise capital primarily through financing activities, rather than through operations, which Thornburg generally did by entering into reverse repurchase agreements, issuing commercial paper debt, issuing collateralized mortgage debt ("CMD") securitizations,[14] and issuing its own equity.[15] The

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[11] The parties stipulated that "Alt-A" mortgage loans, as described by the U.S. Federal Reserve Bank of San Francisco, are loans "in which the borrowers 'generally have higher credit ratings than subprime borrowers, but the loans are viewed as nonprime because of some specific feature of the loan arrangement.'" Stipulation Regarding the Definition of "Alt-A Mortgage," PCAOB 047321–047322 (Apr. 3, 2014) (quoting Fed. Reserve Bank of San Francisco, 2007 Annual Report at 6–7).

[12] Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. FAS 115 has since been codified as Topic 320 in the Financial Accounting Standards Board Accounting Standards Codification. *See* FASB ASC 320-10-65.

[13] *See* 26 U.S.C. § 857(a)(1) (describing income distribution requirements for REITs).

[14] Thornburg's CMD securitizations were asset-backed securities, which are created by originating and buying loans and then bundling them—such as, in this case, residential mortgage loans—and creating securities backed by those assets, which are then sold to investors.

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company primarily relied on reverse repurchase agreements ("Reverse Repos") during the relevant time here—under which Thornburg would sell Purchased ARM Assets to a lender and later repurchase them at a higher price.

Thornburg's repurchase obligations were secured by its Purchased ARM Assets. The Reverse Repo lenders required Thornburg to maintain a margin (or "cushion") of 7% between the amount the company borrowed and the current value of the pledged Purchased ARM Assets. If the asset's value dropped below the borrowed amount plus 7%, the counterparty could make a margin call, which required Thornburg either to pay down the amount borrowed or to pledge additional collateral. If Thornburg did not have enough readily available assets to do so, the Reverse Repo lender could declare Thornburg in default and liquidate Thornburg's pledged Purchased ARM Assets to satisfy the debt. Defaulting under one Reverse Repo could trigger cross-defaults in other agreements, which happened in August 2007.

2. Thornburg's August 2007 financial difficulties.

Investor confidence in mortgage-backed securities ("MBS") began to deteriorate by mid-2007, and in August 2007, their prices, including those of Thornburg's Purchased ARM Assets, suddenly declined. Thornburg was required to meet margin calls quickly by providing its counterparties with cash or additional collateral as commercial paper debt, another major source of Thornburg's financing, was no longer available. Several Reverse Repo lenders also left the mortgage financing business altogether, while others increased their margin requirements. These factors forced Thornburg to meet margin calls in August 2007 by selling its Purchased ARM Assets into what it described as a "panicked market"—causing asset prices to decline further, triggering even more margin calls.[16] Thornburg ultimately liquidated approximately $21.9 billion in assets to meet the margin calls, at an aggregate estimated loss of $1.1 billion (collectively, the "August 2007 events").

Thornburg reported a profit for its fourth quarter ended December 31, 2007, but the company warned in its 2007 Form 10-K, filed February 28, 2008, that there were no assurances that the adverse conditions in the mortgage industry and the difficulties the company faced in pricing and financing its mortgage assets had stabilized or that they would not worsen.

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Thornburg issued six CMD securitizations throughout 2007 and into 2008, including an approximately $1 billion CMD securitization on March 3, 2008.

15 Thornburg raised $691 million through the sale of its own equity in Q3 and Q4 of 2007 and $282 million in January 2008 through a common stock offering, a preferred stock offering, and a dividend reinvestment stock purchase plan. The company planned to raise another $300–$500 million through another equity sale as soon as the 2007 10-K was filed.

16 Thornburg Mortg., Inc., Form 10-Q, at *26 (Nov. 9, 2007).

B. Reinhart's Audit.

1. Planning and Initial Steps.

Reinhart, who had been the lead audit engagement partner for Thornburg's 2006 audit, began planning the company's 2007 audit in March 2007. The August 2007 events caused her to ask Thornburg's management to assess the company's ability to continue as a going concern. Thornburg's management responded with an August 24, 2007 memorandum, which described the August 2007 events, addressed their effect on Thornburg's business, and concluded that they did not create a risk that Thornburg would be unable to continue as a going concern.

KPMG's audit team took steps to confirm the factual assertions in Thornburg's memorandum, and observed in their audit work papers that, while it was never management's intent to sell its assets, the company had lost the ability to hold those assets in order to meet margin calls in August 2007. Reinhart accordingly identified Thornburg's liquidity and margin calls as fraud risks and the company's ability to continue as a going concern and ability to hold its impaired assets, particularly the Purchased ARM Assets, as critical, high-risk audit areas.

These concerns led Reinhart to increase KPMG's budgeted audit hours and to defer her consideration of the going-concern and OTTI issues until near the audit completion date, which was at the end of the Subsequent Period, in late February 2008. She did this, she testified, to have the greatest amount of information available regarding the state of the market for market-backed securities and Thornburg's liquidity. The PCAOB does not challenge her initial determinations about how to approach the 2007 audit, but rather challenges Reinhart's later efforts during the Subsequent Period regarding the going-concern and OTTI issues.

2. Reinhart's audit steps during the Subsequent Period regarding the going-concern and OTTI issues.

Reinhart's analysis of the going-concern and OTTI issues was primarily, but not exclusively, reflected in three work papers: (1) a memorandum prepared by Thornburg management that updated and expanded on their earlier August 2007 memorandum, which was subject to audit and addressed the company's ability to continue as a going concern and intent and ability to hold assets; (2) a KPMG memorandum that Reinhart directed the senior manager to prepare that evaluated Thornburg's assertions in its memorandum; and (3) an Audit Completion Document, which Reinhart and her team used to evaluate and document the audit's significant findings and issues (including going-concern and OTTI), the actions taken to address them, and the basis for the audit team's conclusions.

a. Reinhart's assessment of Thornburg's ability to continue as a going concern.

Reinhart's assessment of Thornburg's ability to continue as a going concern involved examining management's memorandum, which incorporated comments by Reinhart, the In-Depth Review Partner, senior manager and other KPMG personnel and was finalized on February 24, 2008. Thornburg management's memorandum began by describing the disruptions in the mortgage-backed securities market, including that the company was still experiencing declines in the market value of its securities to levels at or below levels experienced in August 2007, and incurred additional margin calls as a result of the decline in securities prices and an increase in certain margin requirements. The memorandum also observed, however, that the company returned to profitability during the fourth quarter and successfully continued to meet all margin calls. The Thornburg memorandum then analyzed twelve criteria that management believed needed to be evaluated regarding the company's ability to continue as a going concern,[17] and concluded that there was "no substantial doubt" about Thornburg's ability to continue as a going concern through January 1, 2009.

Reinhart's audit team finalized its own memorandum on February 27, 2008. Its stated purpose was to document the audit team's consideration of Thornburg management's key assumptions and the testwork performed by KPMG to validate the financial data used by management in reaching its conclusions. KPMG's memorandum, which included comments from the In-Depth Review Partner, SEC Review Partner, and BUPP Partner, concluded that substantial doubt did not exist about Thornburg's ability to continue as a going concern. In doing so, KPMG's memorandum summarized the audit procedures it used to test the underlying assumptions and data supporting Thornburg management's conclusions regarding the going-concern issue, which generally involved assessing Thornburg's ability to maintain sufficient liquidity and assessing Thornburg's asset values and its ability to withstand certain stress events.

i. Thornburg's ability to maintain sufficient liquidity.

KPMG's memorandum identified Thornburg's ability to manage liquidity as the primary risk to the company's ability to continue as a going concern. In describing the audit team's assessment of this issue, the KPMG memorandum explained that, because Thornburg needed to distribute substantially all of its taxable income to maintain its REIT status, Thornburg's cash flows were generally not relied upon to repay unanticipated debt repayment or margin calls. Thornburg's liquidity risk, the memorandum further explained, was not linked to cash flows from operations, as is commonly the focus in a going-concern analysis, but rather on the company's ability to repay or roll over existing short-term debt through its financing activities and on whether the company could survive high margin calls similar to those in August 2007. Reinhart testified that she and her team therefore did not test Thornburg's ability to manage its liquidity by conducting a specific number calculation, but rather by reviewing Thornburg's cash and overnight investments, access to financing, access to capital, and ability to securitize assets. The senior manager further explained at the hearing that, in the context of a business like Thornburg's, understanding the company's liquidity involved assessing how it managed its

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[17] These criteria were key financial ratios and operating activities; sources and availability of short-term financing; monitoring liquidity; long-term financing; senior and sub-debt financing and covenant maintenance; warehouse lines of credit and covenant maintenance; REIT qualification; equity capital raises; investment quality; lending activities; legal proceedings; and financial projections.

resources. Reinhart's auditing expert similarly described how, in his experience, assessing the liquidity of a company like Thornburg involved more than looking at its cash position; it required weighing all of its sources and uses of funds, which, for Thornburg, included the company's "point-in-time cash balance," available equity and debt financings (*i.e.*, securitizations), sales of unimpaired assets, and results of operations (*i.e.*, positive cash flows from earnings).

a) Thornburg's ability to roll over debt.

KPMG concluded that Thornburg had proven its ability to continue to roll its Reverse Repo debt over, given that approximately half of such debt that had been outstanding as of September 30, 2007 had matured and been rolled into new Reverse Repo agreements. Reinhart and the engagement team tested this by obtaining a schedule of Reverse Repo debt and a schedule of assets collateralizing that debt, along with third-party confirmations from Reverse Repo lenders about the amount of short-term debt as of December 31, 2007. These confirmations, combined with the audit team's alternative procedures on unreturned confirmations, showed that more than half of Thornburg's short-term debt had matured and had been refinanced or rolled over between September 30, 2007 and the 2007 year-end. The memorandum also noted that 69% of the Reverse Repo debt had been rolled over since December 31, 2007, and that another 19% was longer-term debt. The memorandum further noted that the audit team had obtained a list of all Reverse Repo balances as of February 20, 2008, which showed that the company had continued to roll over the new Reverse Repo balances and added additional Reverse Repo debt of approximately $400 million for a security purchased in January 2008. Reinhart testified that the fact lenders continued to roll over Thornburg's short-term debt was a significant indication that Thornburg had been meeting its margin calls and that lenders believed that the company's assets provided sufficient collateral value.

The audit team also confirmed during the Subsequent Period that Thornburg had $400 million in commercial paper debt outstanding as of December 31, 2007. The memorandum explained, however, that the commercial paper market remained unavailable and that, to address this, the company had been successful in rolling that commercial paper debt into repurchase agreements as the commercial paper debt came due. Specifically, the memorandum noted that the company had reduced its balance of commercial paper debt from $1 billion as of September 30, 2007 to $400 million as of year-end, and the commercial paper debt was expected to be eliminated by the beginning of March 2008. While the Company continued to face liquidity challenges, the memorandum continued, the quantity of short-term borrowings was significantly less. Reinhart concluded that this audit evidence was sufficient to support the reasonableness of management's assertion that Thornburg would be able to roll over its short-term debt for a reasonable period.

KPMG further observed that the company had also shown that it could survive events like those in August 2007 without changing its basic operating model or structure for an extended period. The memorandum further noted that, although there had been very little MBS securitization activity in the market after the August 2007 events, Thornburg had been able to close securitizations of its new loan originations in the Fall of 2007 and had another securitization that was expected to close at the end of February 2008.

b) Thornburg's ability to maintain a sufficient liquidity cushion.

As part of their liquidity analysis, Reinhart and her audit team also examined Thornburg's liquidity cushion. At 2007 year-end, Thornburg held $12.8 billion in securities as collateral for $11.9 billion in debt, plus an additional $587.2 million in available cash and unpledged securities—a total amount that exceeded its debt and collateral obligations by 4.5%.

In the Subsequent Period, Thornburg raised an additional $282 million in equity offerings and, as KPMG's memorandum explained, expected to close another equity offering shortly after the 10-K was filed and had access to other cash sources, including monthly principal and interest payments. KPMG's Audit Completion Document further noted that Thornburg could access additional liquidity by refinancing non-Purchased ARM Assets that were serving as collateral in other financing transactions. The company had generated approximately $200 million in liquidity through such re-financings as of February 27, 2008.

KPMG's memorandum nevertheless stated that, by the last week of the Subsequent Period, Thornburg's cash balance had become "relatively tight," at approximately $45.5 million, due to a security purchased under a mandatory auction call on January 25, 2008 and margin calls in early February. The memorandum also noted that the company had received around $250 million in margin calls in the last week or so, which Thornburg covered by the recent equity offerings. The memorandum further described the short-term money markets as dislocated and noted that the company's projected cash balance through April 10, 2008 was $377 million—although the memorandum stated that this cash projection was for informational purposes only and that KPMG was not relying on the projections as audit evidence.

c) Thornburg's cash liquidity reports and margin call schedules.

As part of their analysis of Thornburg's liquidity, Reinhart and her team also began reviewing the company's "Cash Liquidity Reports" in late January 2008. Reinhart testified the reports provided an estimate of the company's available cash and cash equivalents, and included management's rolling 45-day cash projections. KPMG's audit team, however, did not regard these projections as reliable "beyond a week or so."

The first such report that the audit team appears to have received, dated January 29, 2008, listed the company as having a cash balance of $213 million. Subsequent reports showed a fluctuating, but generally declining daily cash balance, reaching a low on February 20, 2008, when the daily report indicated that the company's cash balance had dropped to $1.8 million—down from a reported $5 million the day before. That February 20 report projected an even lower cash balance of $476,000 for the next day, February 21.

The senior audit manager testified that she and Reinhart identified this projection as a potential red flag that they needed to look into further. The senior manager and Reinhart spoke with Thornburg management, who informed the auditors that the low cash level was caused by an "unusual, abnormal, and large" amount of more than $300 million in margin calls caused by the decline in the value of the company's Alt-A securities that Thornburg began receiving around February 14, 2008. Upon learning this, Reinhart directed the senior manager to obtain a list from Thornburg showing all margin calls by counterparty that the company had received since year-end. Management responded that the company did not track margin call activity by counterparty, and Reinhart decided the information was not necessary for their going-concern and OTTI analyses and thus did not require follow up.

Reinhart received another liquidity report on February 22, which showed that the company's cash balance had risen to $10.5 million and projected it increasing to $219.5 million on February 26 and to $284.9 million on February 27. Although this was the last Cash Liquidity Report that she read, Reinhart directed the senior manager to continue monitoring them. The senior manager recalled reviewing and discussing the subsequent reports with Reinhart on an approximately daily basis. These included the Cash Liquidity Report for February 26, which showed that the company had a cash balance of $61 million, and the February 27 report, which showed a cash balance of $27 million. Thornburg's management also emailed Reinhart's team on February 26, informing them that the company's total readily available liquidity level of cash and unpledged securities was about $150 million—an amount the company characterized as historically low and substantially reduced from its 2007 year-end balance of $587.2 million.

ii. Reinhart's assessment of Thornburg's asset values and its ability to withstand certain stress events.

Reinhart's audit team also assessed the company's asset values and analyzed the impact of possible future declines in those values. Reinhart and her team, for example, assessed Thornburg's methodology for valuing its mortgage-backed securities and the credit worthiness of the company's collateral, including its Purchased ARM Assets. In doing so, the audit team consulted with KPMG's structured finance group, which examined Thornburg's valuation methodologies, relevant credit ratings, and quality of the underlying collateral. The group concluded that the fair value prices of Thornburg's securities appeared reasonable and that the company's methodology and procedures for valuing its securities appeared reasonable and consistent with the approach taken by other market participants who hold these types of assets. The group warned that the current MBS market was extremely turbulent, but concluded that Thornburg's securities have maintained relatively strong credit performance and do not appear to be in immediate danger of credit downgrades and/or default.

As described in KPMG's memorandum, Reinhart's audit team examined the impact of possible future declines in the company's securities values by performing a stress test of Thornburg's ability to continue as a going concern under hypothetical scenarios in which the company was forced to sell assets. As the senior manager testified, the stress tests attempted to lay out three scenarios: "probable" (the Base Scenario), "worst case" (Scenario 1), and "complete devastation" (Scenario 2).

Base Scenario. KPMG's Base Scenario described Thornburg as holding pledged collateral valued at 107% of existing debt and also having cash and unpledged securities of $587 million. These holdings provided Thornburg with additional protection against margin calls for changes in fair value of the securities up to a 4.5% decrease in the market price of the pledged securities.[18] The memorandum's Base Scenario stated further that management concluded that the likelihood of the company's collateral values decreasing by more than another 2% to 3% was "remote."

Reinhart believed this position was supported by the audit team's conversations with Thornburg management about the market and audit confirmation of the underlying quality of Thornburg's assets, as well as Reinhart's own knowledge of the value of Thornburg's collateral. The Base Scenario explained that Thornburg's pledged asset values were primarily related to the underlying performance of individual borrowers and that delinquencies continued to be lower than those generally observed in the market. KPMG tested these delinquencies and concluded that they supported management's conclusion that security values would not decline to a level that would force the sale of all the company's pledged and unpledged securities. As the In-Depth Review Partner also testified, management's representation that the market had "started to level off" was consistent with information that he learned during his audit of another client, whose capital markets group also predicted that markets had leveled off. The In-Depth Review Partner also wrote in a summary of his review that, in connection with KPMG's audit of the going-concern issue, he was satisfied about the reasonableness of management's judgments.

KPMG's memorandum noted further that management represented to the audit team that the decline in the company's asset values during the Subsequent Period was concentrated in Alt-A securities, which represented only about 20% of Thornburg's assets. Management further believed that the fair values for these securities were at or approaching bottom, as evidenced by recent purchases of similar securities by outside investors at these prices.[19]

Based on these considerations, KPMG determined under the Base Scenario that Thornburg had sufficient assets to repay the current level of short-term debt.

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18 The Base Scenario also stated that Thornburg held 7% in pledged collateral, plus another 4.5% in cash and liquid, unpledged investments. The memorandum's Base Scenario then incorrectly stated that, "[t]hus, a decline in fair value of available cash and securities greater than 11.5% would require the Company to either raise more capital or sell assets to satisfy lenders (because they could not satisfy margin calls)." Reinhart admitted that the 7% margin requirement was not an amount Thornburg could use to meet margin calls without taking some other action, and that the sentence should have stated that, as of year-end, a decline greater than 4.5% (not 11.5%) would require the company to raise more capital or sell assets. But the work papers elsewhere describe Thornburg's cushion correctly, including on the same page as this error, and the record does not provide other sufficient evidence to establish that KPMG's audit relied on this mistake in its assessment of Thornburg's liquidity.

19 The record is not clear whether KPMG tested these recent purchases, but the PCAOB did not cite this issue as a basis for imposing sanctions.

__Scenario 1__. In Scenario 1, the memorandum again noted management's belief that another 2%–3% decline in the company's collateral values was "remote," while considering a scenario of Thornburg's being forced to sell assets if the Reverse Repo counterparties became unwilling or unable to provide Thornburg with financing (*i.e.*, similar to what occurred in August 2007). Using 2007 year-end securities values and operating expenses for 2006 and 2007, KPMG concluded in Scenario 1 that a forced sale of the company's assets would generate sufficient cash to meet Thornburg's collateral obligations and allow Thornburg to continue profitably "for multiple years," while recognizing that declines in the value of the securities would decrease the amount of net cash inflow.

__Scenario 2__. In Scenario 2, KPMG considered what would happen in the "severely extreme scenario" in which a forced sale of Thornburg's assets did not produce a cash flow beyond meeting its collateral obligations and in which the company lost its ability to originate new loans. The memorandum concluded that, although Thornburg would have to make severe cuts in its operations, the yields on the remaining CMD securities should be sufficient to support a reduced staff until operations could resume, which could be more than a year.

b. Reinhart's assessment of Thornburg's intent and ability to hold assets.

Reinhart's audit also addressed whether the company's Purchased ARM Assets were other-than-temporarily impaired at year-end for purposes of FAS No. 115. In the company's memorandum, Thornburg management concluded that Thornburg had the ability and intent to hold these securities until recovery based on the company's on-going profitability, liquidity position, and ability to continue to make margin calls. Reinhart testified that, because the Thornburg memorandum based its ability-to-hold conclusion on the same factors discussed in its going-concern assessment, Reinhart pulled her underlying analyses of both inquiries into the KPMG memorandum. KPMG's memorandum did not specifically reference the OTTI issue. However, its Audit Completion Document described how the audit team used the underlying going-concern analysis in its OTTI assessment, explaining that, consistent with the going-concern analysis performed by the company, Thornburg appeared to have the intent and ability to hold the securities to maturity or recovery.[20] In doing so, the Audit Completion Document stated that, although the August 2007 events forced it to sell a large portion of its available for sale assets that were pledged against short-term debt, the company "performed a thorough analysis of its liquidity position as of yearend [sic] and subsequently to conclude that it has the intent and ability to hold the securities based on their over collateralized position (107% collateralization) and continued ability to raise equity." The Audit Completion Document further observed that Thornburg had closed an equity offering in January 2008 for more than $250 million and was preparing another offering for shortly after its 10-K was filed. The Audit

[20] The auditors similarly observed in another work paper (describing test work performed on the unrealized gains and losses on Thornburg's ARM securities and purchased ARM loans) that "[t]he Company does believe that it has the intent and ability to hold all their securities to maturity as discussed in the going concern analysis . . . ."

Completion Document concluded that the audit team had reviewed management's assessment, audited the underlying assumptions, and agreed with management's assessment of its intent and ability to hold.

C. KPMG issues, and then withdraws, an unqualified audit opinion.

KPMG issued an unqualified audit opinion on February 27, 2008, and Thornburg filed its 2007 Form 10-K, including the audit opinion, on February 28, 2008. The same day it filed its Form 10-K, the company received more than $150 million in margin calls. Although Thornburg had represented that it had $150 million in available liquidity two days earlier, Thornburg was able to meet only $31.6 million in calls on February 28. It is not clear from the record why this was the case but, regardless, this led to a notice of default and additional cross-defaults. The company received an additional $125 million in margin calls on February 29—the next day—and was able to meet only $15.7 million of them.

Reinhart learned of these post-audit margin calls and defaults on Sunday, March 2, 2008. After consulting with others at KPMG, interviewing management, and reviewing emails and other documents, Reinhart and her team concluded that Thornburg's financial statements contained material misstatements related to whether losses to the company's ARM Assets were other than temporary and therefore needed to be recognized in the company's income statement. Reinhart sent Thornburg's audit committee a letter on March 4, 2008, notifying the committee that KPMG's audit opinion of February 27 should no longer be relied upon, that Thornburg's financial statements contained material misstatements, and that the audit report "should have contained an explanatory paragraph indicating that substantial doubt exists relative to the Company's ability to continue as a going concern for a reasonable period of time."

On March 5, Thornburg's board of directors concluded that Thornburg needed to restate its financial statements and, on March 11, the company filed an amended Form 10-K in which it restated portions of its 2007 financial statements. Unlike in its original Form 10-K, Thornburg concluded that a more than $400 million decline in its Purchased ARM Assets was an OTTI because the company may not be able to hold those securities for the foreseeable future and may need to sell them to satisfy margin calls from lenders or to otherwise manage its liquidity position. This caused Thornburg to include in its net loss for 2007 roughly $427.8 million in previously unrealized losses in its Purchased ARM Assets, which, along with certain other charges not at issue, increased the company's losses by more than 75%—from $875 million to $1.546 billion.

Thornburg's amended Form 10-K also included KPMG's revised audit report. The report explained that the company did not have the financial resources as of March 6, 2008 to satisfy approximately $610 million in margin calls associated with its reverse repurchase agreements and other financial instruments and that failure to satisfy those margin calls was an event of default under the reverse repurchase agreements. These events, the report explained, provided lenders the discretion to declare the entire unpaid amounts due and payable on demand and to force liquidation of the company's assets to satisfy those obligations. The report concluded that these matters raised substantial doubt about the company's ability to continue as a going concern.

By early March, Thornburg had received post-audit margin calls totaling more than $1 billion. The company eventually reached agreements with its lenders that allowed its business to continue until early 2009, when it filed for bankruptcy.

II. Procedural History

On July 27, 2012, the PCAOB issued an order instituting proceedings alleging that Reinhart violated its rules by failing to exercise professional skepticism,[21] failing to obtain sufficient competent evidential matter,[22] and inappropriately relying on management representations[23] during her audit of both (1) whether there was substantial doubt about Thornburg's ability to continue as a going concern for a reasonable period of time[24] and (2) whether a decrease in the value of certain Thornburg assets was an OTTI.[25]

A PCAOB hearing officer issued an initial decision on May 1, 2014, finding that the PCAOB's Division of Enforcement had proven by a preponderance of the evidence some, but not all, of its allegations. Specifically, the initial decision found that the Division had established that Reinhart did not properly evaluate the going-concern and OTTI issues and that, because of those two failures, Reinhart failed to exercise due care and improperly authorized an unqualified audit opinion. The initial decision also concluded, however, that the Division had not proven that Reinhart failed to obtain sufficient competent evidential matter or exercise professional skepticism, or that she inappropriately relied on management representations.[26] The initial

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[21] AU § 230.

[22] AU § 150.

[23] AU § 333.

[24] AU § 341.02 (requiring an auditor to evaluate whether there was "substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited . . . based on his or her knowledge of relevant conditions and events that exist at or have occurred prior to the completion of fieldwork.").

[25] AU § 332.47.

[26] Specifically, the initial decision found that Reinhart failed to comply with AU § 332 (going concern) and § 341 (OTTI), which it concluded in both cases reflected a failure to exercise due professional care, contrary to AU § 150 and AU § 230 and, because she did not fully comply with those PCAOB auditing standards, violated AU § 508.07 by authorizing an unqualified audit report on the 2007 Audit. The decision found that the Division had shown neither that Reinhart violated AU §§ 230.07, .09 (professional skepticism), § 326 (evidential matter), and § 333 (management representations), nor that she violated the disclosure-related charges under AU § 431 and AS No. 3.

decision further held that Reinhart's violations did not constitute reckless conduct, but did constitute repeated instances of negligent conduct and ordered that Reinhart be suspended from association with a registered public accounting firm for one year and limited her from serving as an engagement partner for any issuer audit for an additional two years if she became re-associated.

Reinhart and the Division both appealed. On November 18, 2016, the PCAOB issued a final decision, which found that Reinhart violated PCAOB rules and auditing standards by failing to evaluate adequately the going-concern and OTTI issues. The PCAOB also found that, in failing to adequately consider these issues, Reinhart violated the requirement to exercise due professional care and, unlike the initial decision, also found that she violated the requirements to exercise professional skepticism, to obtain and evaluate sufficient audit evidence, and to not improperly rely on management representations.

The PCAOB further concluded, as discussed more below, that Reinhart had engaged in repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standards. On this basis, the PCAOB barred Reinhart from associating with a registered public accounting firm, with leave to petition the PCAOB to associate after two years, and limited her from serving in certain roles and exercising certain authority as to any issuer audit for an additional year. One board member dissented from the sanctions imposed, finding that the majority had not adequately articulated how Reinhart's conduct amounted to repeated instances of negligent conduct.

III. Analysis

On appeal, we review the record to determine if a preponderance of the evidence supports the PCAOB's findings that (1) Reinhart engaged in the conduct in which the PCAOB found her to have engaged, or failed to engage; (2) Reinhart's conduct violated PCAOB rules; and (3) those rules are, and were applied in a manner, consistent with the purposes of Sarbanes-Oxley.[27] Only if we find that the record supports all three prongs, can we affirm or otherwise modify the sanction; if we find any of those prongs to be unsupported, we must cancel the sanction.[28] At issue here are the PCAOB's two alternate findings that Reinhart engaged in "repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or

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[27] *See* 15 U.S.C. § 7217(c)(2); *S.W. Hatfield*, 2013 WL 3339647, at *1 (applying preponderance of evidence standard in PCAOB disciplinary proceeding).

[28] 15 U.S.C. § 7217(c) (2) (incorporating the Exchange Act review standard that the Commission may affirm or modify a sanction only if it first finds the necessary predicates); *id.* §7217(c)(3) (setting forth the standard for when the Commission may "enhance, modify, cancel, reduce, or require the remission of a sanction imposed by the [PCAOB]").

professional standard," which underlie the PCAOB's bar on Reinhart and its limitation of her serving in certain roles and exercising certain authority.[29]

We have not previously specified what constitutes "repeated instances" of negligent conduct under Sarbanes-Oxley,[30] but we have analyzed a similar provision in the Commission's analogous Rule of Practice 102(e).[31]

Rule of Practice 102(e) uses largely the same language as in Sarbanes-Oxley Section 105(c)(5) in allowing the Commission to suspend an accountant from appearing before it if that accountant is found to have engaged in "[r]epeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards . . . ."[32] We further explained when adopting Rule 102(e) that "repeated" can "encompass as few as two separate instances of unreasonable conduct occurring within one audit, or separate instances of unreasonable conduct within different audits."[33] Notably, we added that "a single error that results in an issuer's

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[29] 15 U.S.C. § 7215(c). The PCAOB could also have based these sanctions on a finding that Reinhart engaged in "reckless conduct," but the PCAOB expressly declined to make that finding. *See id.*

[30] In *Hatfield*, we affirmed the PCAOB's finding that applicants had engaged in reckless conduct, but in a footnote alternatively affirmed a finding that applicants had engaged in repeated instances of negligent conduct. We did so without explaining how the negligent conduct was "repeated" beyond stating that applicants' repeated failures to comply with multiple auditing standards during the audit of two unrelated companies' financial statements "clearly established that they engaged in repeated instances of conduct." 2013 WL 3339647, at *26 n.169.

[31] *See, e.g., Gately & Assocs., LLC*, Exchange Act Release No. 62656, 2010 WL 3071900, at *11 (Aug. 5, 2010) (stating that the Commission's "interpretations of the Rule 102(e) standards inform our analysis under Sarbanes-Oxley Section 105(c)(5)" because of the provisions' "similar formulations"). Although both provisions contain the same "repeated instances" language, Section 105(c)(5) does not include Rule 102(e)'s requirement that the Commission also find that the repeated instances "indicate a lack of competence to practice [as an auditor]." *See, e.g., John J. Aesoph, CPA*, Exchange Act Release No. 78490, 2016 WL 4176930, at *16 (Aug. 5, 2016) (explaining that, for Rule 102(e), the Commission must "'make a specific finding that the conduct indicates a lack of competence'" (quoting *Amendment to Rule 102(e) of the Commission's Rules of Practice*, Securities Act Release No. 7593, 1998 WL 729201, at *9 (Oct. 26, 1998)). This opinion, therefore, does not address this additional language in Rule 102(e) or its significance, if any, for purposes of Sarbanes-Oxley.

[32] 17 C.F.R. § 201.102(e)(iv)(B)(2). The only relevant difference here is that Sarbanes-Oxley Section 105(c)(5) uses "negligent" instead of "unreasonable," but we explained when adopting Rule 102(e), that "[t]he term 'unreasonable' . . . connotes an ordinary or simple negligence standard." *Amendment to Rule 102(e)*, 1998 WL 729201, at *9.

[33] *Amendment to Rule 102(e)*, 1998 WL 729201, at *9.

financial statements being misstated in more than one place would not, by itself, constitute [repeated instances of unreasonable conduct]."[34]

Negligence is the failure to exercise reasonable care or competence,[35] which we have described as an objective standard "measured by the degree of the departure from professional standards rather than the intent of the accountant."[36] Here, the PCAOB found that Reinhart engaged in repeated instances of negligent conduct under Sarbanes-Oxley Section 105(c)(5) on two, alternate bases: first, because Reinhart's alleged auditing failures encompassed two audit areas—going concern and OTTI/ability to hold—and not just one financial statement account; and, alternatively, because "even if these two audit areas were treated as one," Reinhart allegedly failed to take four auditing steps within her going-concern and OTTI inquiries and that each of these failures constituted an independent instance of negligence.

We find that the PCAOB has not established either basis for determining that Reinhart engaged in more than one instance of negligent conduct. As explained below, after the lengthy history of this matter, during which both parties had multiple opportunities to brief and argue the merits, the PCAOB has not established how Reinhart's alleged audit deficiencies constituted repeated instances of negligent conduct for purposes of Sarbanes-Oxley solely because they affected the two audit areas of going-concern and OTTI. Moreover, the preponderance of the evidence does not support the conclusion that Reinhart's decisions to take, or not take, four audit steps each constituted an instance of negligence. The record does not support the conclusion that Reinhart engaged in the conduct that the PCAOB found her to have engaged in regarding two of those audit steps. Regarding the two other steps, the record does not support the conclusion that Reinhart's conduct constituted repeated instances of negligent conduct in the context of her audit. Accordingly, there is not a sufficient basis to support the PCAOB's findings that Reinhart engaged in repeated instances of negligent conduct and we therefore cannot sustain the PCAOB's imposition of sanctions. We do not remand for further proceedings.

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[34] *Id.* Our opinion does not require resolving the differences in wording between Sarbanes-Oxley and Rule of Practice 102(e) or on establishing the precise meaning of "repeated instances." Our findings are limited to the narrow facts at issue here.

[35] *Hatfield*, 2013 WL 3339647, at *26 n.169 (quoting *Byron G. Borgardt*, Securities Act Release No. 8274, 2003 WL 22016313, at *10 (Aug. 25, 2003)).

[36] *Kevin Hall, CPA*, Exchange Act Release No. 61162, 2009 WL 4809215, at *7 (Dec. 14, 2009); *cf. Dearlove v. SEC*, 573 F.3d 801, 805 n.1 (D.C. Cir. 2009) (stating that the Commission's "Rule 102(e) does not require the SEC to hold that every violation of the GAAS amounts to improper professional conduct").

A. The record does not support the PCAOB's conclusion that Reinhart's alleged audit deficiencies constituted repeated instances of negligent conduct because they affected more than one audit area.

The PCAOB found that it "naturally follows that there were repeated instances of negligence" because Reinhart's auditing violations "concern[ed] audit work in two areas—going concern and OTTI/ability to hold—not just one financial statement account." But the PCAOB does not explain, and it is not clear on this record, how the PCAOB's conclusion follows.

Reinhart argues that her alleged misconduct consisted of only a "single set of facts" that affected Thornburg's ability to manage liquidity during the Subsequent Period. She cites our prior statement that "a single error that results in an issuer's financial statements being misstated in more than one place" does not, by itself, constitute repeated instances of misconduct.[37] The PCAOB's opinion rejects her contention by asserting that Reinhart could not "conflate the OTTI/ability to hold evaluation with the going concern evaluation for sanctions purposes." Although "[a]n auditor may encounter conditions and events that have implications for more than one aspect of an audit," the PCAOB reasoned, "Reinhart's attempt to make those circumstances the defining characteristic of the auditor's conduct ignores the different responsibilities the auditor may have in the various individual aspects of the audit." It added that going-concern and OTTI analyses are "distinct processes, governed by substantively different auditing standards, and related to separate financial statement reporting considerations."

Nevertheless, the PCAOB has failed to establish that Reinhart's audit decisions constituted more than one instance of negligent conduct based on the fact that they related to two audit areas. To the contrary, the PCAOB's analysis of Reinhart's conduct in the going-concern and OTTI audit areas are effectively indistinguishable. Although the PCAOB examines Reinhart's conduct in separate going-concern and OTTI sections of its opinion, both sections, in nearly identical language, examine Reinhart's evaluation of Thornburg's readily available liquidity, margin call activity, and securities values. Even the PCAOB's sanctions analysis recognizes that "information regarding Thornburg's liquidity, margin calls, and securities values was pertinent to both evaluations."[38] Given the record here, we cannot sustain the PCAOB's

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[37] *See supra* note 34 and accompanying text.

[38] For example, whether Thornburg's asset values fell sufficiently to trigger margin calls that the company could not meet with readily available liquidity could determine whether the company could hold its assets long enough for their value to recover. Such a scenario could, in turn, determine the company's ability to continue as a going concern. *See, e.g.*, AU § 341.06 (stating that examples of whether an issuer may be able to continue as a going concern include "indications of possible financial difficulties" such as a need to "dispose of substantial assets").

As evidence of her allegedly deficient evaluation and lack of due care in connection with how her going-concern and OTTI analyses overlapped, the PCAOB's opinion points to a supposed conflict in those two analyses between (1) the KPMG memorandum's stress test, which analyzed the likelihood of Thornburg's surviving as a going-concern under the hypothetical

(continued…)

finding that Reinhart's alleged auditing violations were repeated for sanctions purposes based only on the fact that they concerned both the going-concern and OTTI audit areas.

B. The record does not support the PCAOB's conclusion that Reinhart's decisions regarding certain audit steps constituted repeated instances of negligent conduct that resulted in a violation of the applicable standards.

The PCAOB alternatively found that, even if the going-concern and OTTI audit areas were treated as one, Reinhart performed individual audit tasks within those two analyses that represented "differentiated" instances of negligent conduct resulting in a violation of the applicable statutory, regulatory, or professional standard.[39] Specifically, the PCAOB identified four audit steps each of which allegedly constituted an instance of such negligent conduct: (1) Reinhart's alleged assumption that Thornburg had a 7% liquidity cushion against further margin calls; (2) her alleged failure to analyze the reasonably possible 2%–3% further drop in Thornburg's securities prices; (3) her allegedly uncritical acceptance of management's representation that Thornburg had about $150 million in readily available liquidity; and (4) her alleged failure to obtain or evaluate the company's margin call levels and cash reports. The record, however, does not support the factual bases underlying the first two findings, and the PCAOB has not established how, on this record, Reinhart's audit decisions regarding the PCAOB's second two findings evidenced negligent conduct within the meaning of the statute.

1. The record does not support the PCAOB's finding that Reinhart erroneously assumed that Thornburg had a 7% collateral cushion to meet future margin calls.

The PCAOB found that Reinhart erroneously assumed that Thornburg had a 7% liquidity cushion against further margin calls, which the PCAOB found to be such a "gross error" that it constituted a clear failure to exercise due professional care.[40] While the KPMG memorandum included the erroneous reference to Thornburg' liquidity cushion and its discussion of that cushion was not entirely consistent, the record does not support the PCAOB's finding. Rather, the record suggests that Reinhart and her team understood that the cushion was 4.5% and audited Thornburg's liquidity with that cushion in mind.

Reinhart admitted that the statement in the KPMG memorandum about Thornburg having a 7% liquidity cushion against further margin calls was incorrect. KPMG's work papers,

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(…continued)

scenario of being forced to sell assets and (2) Reinhart's OTTI conclusion that Thornburg had the ability and intent to hold its Purchased ARM Assets. But the PCAOB does not establish how Reinhart's examination of expressly alternative and hypothetical scenarios created an inconsistency that required further explanation in the work papers.

[39] 15 U.S.C. § 7215(c)(5)(A).

[40] *See supra* note 18 and accompanying text (discussing the 7% error).

however, correctly described the amount of available liquidity that the company had to meet future margin calls elsewhere, including on the same page of KPMG's memorandum as the one admitted error. And the record does not provide other evidence that establishes Reinhart failed to understand the amount of readily available liquidity that Thornburg could use to meet future margin calls. Thornburg's memorandum, which was reviewed and commented on by various members of KPMG engagement team, also described the amount of available liquidity correctly. We therefore cannot conclude on this record that Reinhart's consideration of Thornburg's readily available liquidity was negligent or resulted in a violation of the applicable statutory, regulatory, or professional standard for sanctions purposes.

2. The record does not support the PCAOB's finding that Reinhart negligently failed to analyze a "reasonably possible" 2%–3% further decline in Thornburg's asset values.

The PCAOB found that Reinhart failed to analyze a 2%–3% further drop in Thornburg's securities prices as another instance of negligent conduct.[41] In support, the PCAOB found that Thornburg's management told KPMG auditors that a 2%–3% decrease was "reasonably possible," but that Reinhart nevertheless conducted no audit testing of whether Thornburg could withstand even a 1% decrease in its securities values. Instead of addressing this information, the PCAOB held, Reinhart merely highlighted the remoteness of a more than 2%–3% decrease and obtained little, if any, evidence about how the company derived those particular percentages. The evidence, however, does not support these findings.

First, the record about what management told KPMG's audit team about the likelihood of a 2%–3% decline is, at best, ambiguous. The senior manager's contemporaneous notes from a meeting between Reinhart and Thornburg's chief operating officer indicate only that a "2–3% drop = maybe." The senior manager agreed during cross-examination that management believed it "a possibility" that the securities values could decline by 2%–3% "over the foreseeable future"—with no mention of it being "reasonably" possible. The senior manager further testified that management believed a decrease of more than 2%–3% was "unreasonable" and "remote." On this record, we find the evidence insufficient to support the PCAOB's conclusion that management told KPMG that such a decrease was "reasonably possible."

Second, the record shows that Reinhart and her team *did* take steps to corroborate the KPMG memorandum's characterization of a further 2%–3% drop in asset values as being "remote" and the company's ability to withstand such a drop. Reinhart discussed the likelihood of such a drop in conversations with Thornburg employees, and the memorandum's "remote"

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[41] The PCAOB cited AU § 150.02 (stating that "[d]ue professional care is to be exercised in the performance of the audit and the preparation of the report"), § 230.01 (reciting previous quote from AU § 150.02), and § 230.07 (stating that "[d]ue professional care requires the auditor to exercise professional skepticism," which "is an attitude that includes a questioning mind and a critical assessment of audit evidence").

characterization was consistent with other audit work that Reinhart's team had already performed that showed prices were bottoming out, including the team's evaluation that Thornburg's collateral was still of high quality with low delinquency rates, and that, at current market prices, Thornburg's securities would provide a large return to investors. The record further shows that Reinhart and her team analyzed the impact of Thornburg's assets falling by more than 3% through the stress tests, which concluded that the company could continue operating in such a "worst-case" scenario.

This record therefore does not support the PCAOB's finding about what management told Reinhart and her team about the possibility of a further 2%–3% drop; its finding that Reinhart failed to consider such a drop; or its finding that Reinhart's conduct in assessing such a drop represented an instance of negligence.

3. The record does not support the PCAOB's finding that Reinhart's consideration of Thornburg's representation about having $150 million cash liquidity constituted a negligent act resulting in a violation of applicable standards.

The PCAOB found that Reinhart's alleged acceptance of management's representation that Thornburg still had $150 million in readily available liquidity at the end of the Subsequent Period represented another instance of negligent conduct. Specifically, the PCAOB held that, "[a]t a minimum, [Reinhart] could have requested that management provide documentary support for its representation, but she failed to make even this most basic inquiry." The PCAOB, however, has not established why Reinhart's decision not to take these additional steps to test this particular snapshot of the company's finances at the end of the Subsequent Period constituted an instance of negligent conduct given Reinhart's overall approach to auditing the company's ability to manage its liquidity and the specific steps her team took in this regard.

Thornburg, as noted above, needed to distribute substantially all of its taxable income to maintain its REIT status, which meant that Thornburg generally used financing activities, rather than cash flows, to repay unanticipated debt repayment or margin calls. And as the senior manager explained, Thornburg's admission about having $150 million in liquidity at the end of the Subsequent Period was something the audit team understood. The senior manager added that they needed to determine the implications of this low cash balance, but the specific $150 million figure was not a number subject to their audit work that they would vouch for or confirm, because assessing the company's overall liquidity involved looking at more than just a particular day's cash balance. Rather, the audit team evaluated management's process for managing Thornburg's liquidity, which consisted of understanding that process and Thornburg's ability to manage its liquidity position going forward—which included the company's steps to reduce exposure to short-term debt and the company's ability to generate cash through operations, securitizations, and equity offerings. And while KPMG's memorandum did not cite the specific $150 million liquidity representation, the memorandum observed that Thornburg had an even lower cash balance of only $45.5 million as of February 22, and KPMG's Audit Completion document cited the $150 million amount when discussing "Subsequent Events."

The PCAOB's decision found that Reinhart's allegedly uncritical acceptance of Thornburg's $150 million liquidity representation was an instance of negligence for sanctions purposes. In doing so, however, the PCAOB has not shown why testing this particular representation was necessary for her audit, particularly given the other liquidity information that was available at the time. While the auditing standards require auditors to carefully evaluate management's representations,[42] they do not require auditors to independently corroborate every management statement and they permit discretion on whether to look beyond management representations.[43] And the record before us does not establish that Reinhart's decisions surrounding Thornburg's $150 million liquidity representation were negligent under the circumstances.

Management's admission about having only $150 million in readily available liquidity was also consistent with information that Reinhart knew about the company's diminished liquidity. Moreover, Thornburg's admission about having a low liquidity level on a particular day was not inconsistent with the company's historical ability to raise funds and manage liquidity—evidenced, for example, by Thornburg's paying nearly $1 billion dollars in margin calls during the Subsequent Period despite having only approximately $587.2 million dollars of readily available liquidity as of December 31, 2007.

Moreover, whether Reinhart's approach was correct or not, the PCAOB does not dispute that, in undertaking this approach, Reinhart and her team identified going-concern and ability-to-hold as significant audit issues, developed a plan to address them, documented what they believed to be the relevant considerations, and consulted with senior KPMG audit partners in assessing the going-concern and OTTI issues. And the PCAOB never establishes why, given this context, Reinhart's decision not to do more to confirm the $150 million snapshot of Thornburg's finances on a specific day was negligent. We therefore do not find sufficient

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42 *See, e.g.*, AU § 333.02 ("[R]epresentations from management are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit."); AU § 333.04 ("If a representation made by management is contradicted by other audit evidence, the auditor should investigate the circumstances and consider the reliability of the representation made."); *Hatfield*, 2013 WL 3339647, at *2 (stating that auditors cannot "defer[] to untested management representations . . . as an excuse not to undertake meaningful audit procedures").

43 *See, e.g.*, AU § 230.11 (providing that "[t]he nature of most evidence derives, in part, from the concept of selective testing of the data being audited, which involves judgment regarding both the areas to be tested and the nature, timing, and extent of the tests to be performed"); AU § 560.12(f) (stating that, during the subsequent period, "[t]he auditor generally should . . . [m]ake such additional inquiries or perform such procedures as he considers necessary and appropriate to dispose of questions that arise in carrying out the foregoing procedures, inquiries, and discussions").

evidence to conclude that, in this regard, Reinhart engaged in an act of negligence that resulted in a violation of applicable standards.

Our conclusion is not an endorsement of how Reinhart conducted her liquidity assessment. A closer examination of the company's liquidity management process might have addressed, for example, the PCAOB dissent's concern that, while "[i]t may not have been possible to evaluate [Thornburg]'s rapidly evolving situation in the time available, . . . Reinhart should have taken more time to evaluate the evidence, understand the implications and address the consequences of the situation before the audit report was issued." But even if, as the dissent concluded, Reinhart was "negligent in failing to adequately consider, in light of contrary evidence, whether the company had sufficient readily available liquidity to meet its financial obligations," that represents only a single instance of negligent conduct, which as we discussed above (and the dissent also concluded), does not support the sanctions imposed.

4. The record does not support the PCAOB's finding that Reinhart's decisions regarding Thornburg's margin call schedules and cash reports constituted negligent acts.

The PCAOB further found that Reinhart's alleged failure to obtain or evaluate important audit evidence, such as the margin call schedules and cash reports during the Subsequent Period, constituted another negligent act. The PCAOB's decision does not explain this finding further. In its briefs to the Commission, the PCAOB asserts that Reinhart violated the auditing requirements to obtain sufficient competent evidential matter[44] and to exercise professional skepticism[45] by not following-up on Thornburg's claim that it could not provide a list of margin calls that the company received and paid during the Subsequent Period. We find, however, that the PCAOB has not established how this decision in the context of her audit amounted to negligent conduct resulting in a violation of applicable standards.

As explained above, Reinhart focused her going-concern and OTTI analyses on how Thornburg broadly responded to increases in margin calls. Obtaining a particular snapshot of the company's margin calls, Reinhart and the senior manager concluded, was not critical to that inquiry. They still asked for such a list by counterparty, but when Thornburg informed the senior manager that the company did not keep track of its margin calls in that format, Reinhart decided the audit team's going-concern and OTTI analyses did not require follow up on this particular

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44 *See, e.g.*, AU § 150.02 (providing that "[s]ufficient appropriate evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit"); AU § 326.22 (stating "an independent auditor's objective is to obtain sufficient competent evidential matter to provide him or her with a reasonable basis for forming an opinion" and that "in the great majority of cases, the auditor has to rely on evidence that is persuasive rather than convincing").

45 *See, e.g.*, AU § 230.07 (defining professional skepticism as "an attitude that includes a questioning mind and a critical assessment of audit evidence").

issue. Reinhart's team, however, eventually did ask for (and obtain) margin call information, without specifying the particular format, when Reinhart decided such information had become relevant to a different auditing issue: Thornburg's inclusion of the amount of margin calls the company paid during the last two weeks of February in its Form 10-K Subsequent Events footnote.

The PCAOB found that Reinhart displayed a lack of professional skepticism in connection with accepting Thornburg's representation that it could not provide a margin call list in the format Reinhart had requested and then not following up when the company later provided margin call information in a different format. But Thornburg never represented that it could not provide margin call data, only that it could not do so in the format originally requested. Reinhart determined that this was a reasonable response and did not pursue it at that time. The subsequent last-minute receipt of margin information, in a different format than originally requested, was driven by Reinhart's learning about the company's 10-K footnote on a different audit topic. Based on this record, we see no red flag here.

Moreover, the margin call information received by the team was then reviewed by a KPMG staff accountant and manager, who confirmed that it supported the information in the footnote. Reinhart and her team also included margin call information in their going-concern and OTTI evaluations, as KPMG's memorandum discussed how Thornburg's margin call activity affected the company's ability to manage liquidity. KPMG's memorandum stated that, although Thornburg had recently incurred around $250 million in margin calls and the current value of its securities was lower than it was in August, the company had thus far been able to raise capital to meet the increased margin calls. The memorandum further explained that, while the company's liquidity risk could increase with continued market declines in mortgage-backed securities and future margin calls triggered by Reverse Repo debt, such future events were difficult, if not impossible, to predict.

The PCAOB's opinion also cites as an instance of negligent conduct Reinhart's not using the company's daily cash settlements and margin call schedules to corroborate Thornburg's assertion that it was meeting margin calls. Here again, however, the record does not establish that Reinhart's decisions surrounding Thornburg's daily cash settlements and margin call schedules were negligent in the context of her audit work. The PCAOB fails to establish, for example, why Reinhart needed to seek such additional corroboration. Rather, the evidence shows that Reinhart reviewed other evidential matter during the Subsequent Period related to the company's ability to meet margin calls. As KPMG's memorandum stated, Thornburg rolled over 69% of its Reverse Repo debt during the Subsequent Period (which, because lenders would have been unlikely to do so with a delinquent debtor, indicated that there were no outstanding margin calls). Reinhart also had third-party confirmations of lenders' continuing to provide Thornburg with financing through February 20, 2008, and KPMG received confirmations from Thornburg's outside counsel that did not show any outstanding claims by Reverse Repo counterparties.

The record before us does not provide sufficient evidence to support the PCAOB's finding that Reinhart's decision not to take additional steps regarding the company's margin call schedules or cash settlements negligently resulted in a violation of the applicable standards for sanctions purposes. Indeed, we note all four instances of alleged negligent conduct on which the PCAOB relies for sanctions purposes are specific alleged failures within Reinhart's broader audit work into Thornburg's ability to manage its liquidity; but the PCAOB has not established why those alleged failures were negligent in the context of Reinhart's audit work as shown in the record.

* * *

For these reasons, we find that the PCAOB has not established by a preponderance of the evidence that Reinhart engaged in repeated instances of negligent conduct as required by Sarbanes-Oxley. We accordingly cancel the PCAOB's imposition of sanctions.

An appropriate order will issue.

By the Commission (Chairman CLAYTON and Commissioners JACKSON, PEIRCE and ROISMAN).

Vanessa A. Countryman
Acting Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 85964 / May 29, 2019

Admin. Proc. File No. 3-17758

In the Matter of the Application of

CYNTHIA C. REINHART, CPA

For Review of Action Taken by the

PCAOB

ORDER CANCELLING DISCIPLINARY ACTION TAKEN BY PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

On the basis of the Commission's opinion issued this day, it is

ORDERED that the PCAOB's disciplinary sanctions imposed against Cynthia C. Reinhart, CPA, are hereby cancelled.

By the Commission.

Vanessa A. Countryman
Acting Secretary