

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 92382 / July 13, 2021**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 5773 / July 13, 2021**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 4226 / July 13, 2021**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-20395**

**In the Matter of**

**Stockman Kast Ryan & Co. LLP;**  
**Ellen S. Fisher, CPA; and**  
**David H. Kast, CPA**

**Respondents.**

**ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-  
AND-DESIST PROCEEDINGS  
PURSUANT TO SECTION 4C OF  
THE SECURITIES EXCHANGE  
ACT OF 1934, SECTION 203(k)  
OF THE INVESTMENT  
ADVISERS ACT OF 1940, AND  
RULE 102(e) OF THE  
COMMISSION'S RULES OF  
PRACTICE AND NOTICE OF  
HEARING**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Stockman Kast Ryan & Co. LLP. (“SKR”), Ellen S. Fisher (“Fisher”), and David H. Kast (“Kast”) (collectively, “Respondents”) pursuant to Section 4C<sup>1</sup> of the Securities Exchange Act of 1934

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<sup>1</sup> Section 4C provides, in relevant part, that: “The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct.”

(“Exchange Act”), Section 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) (cease-and-desist proceedings), and Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.<sup>2</sup>

## II.

After an investigation, the Division of Enforcement and the Office of the Chief Accountant allege that:

### SUMMARY

1. This proceeding arises from widespread audit failures in 12 audits of six private funds (collectively, the “Funds” or Funds 1-6) by audit firm SKR and audit partners Fisher and Kast. These audit failures were in connection with SKR’s engagement by an SEC-registered investment adviser (the “Adviser”), to audit funds so that the Adviser could comply with Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder (the “Custody Rule”).

2. Respondents engaged in improper professional conduct under Rule 102(e). Respondents’ audit reports stated that the audits were conducted in accordance with Public Company Accounting Oversight Board (“PCAOB”) auditing standards, but they were not. Specifically, Fisher, the audit partner, and SKR failed to obtain sufficient appropriate audit evidence regarding the valuation and existence of certain hard-to-value assets described herein as Level 3 assets.<sup>3</sup> Fisher and SKR knew that these assets were hard to value and acknowledged that they were high risk areas of the audit, but they failed to properly assess the risks associated with these complex assets and design and execute an audit response sufficient to address the risks. As such, Fisher and SKR failed to meet PCAOB auditing standards related to audit planning, evaluating audit results, audit documentation, exercising due professional care, and supervision and review.

3. In one particularly egregious example, Fisher and SKR failed to obtain sufficient evidence of the existence of certain stock valued at \$1,000,000 that made up 91% of one fund’s total assets. If they had obtained such evidence, they would have seen that this stock series owned by the fund had been cancelled in a recapitalization. The fund later restated its financial statements by removing this asset.

4. The engagement quality review conducted by Kast, who was required under PCAOB standards to evaluate significant judgments made by the engagement team and assess the engagement team’s response to significant risks, was deficient. Kast reviewed and approved work papers that failed to obtain sufficient appropriate audit evidence regarding the valuation

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<sup>2</sup> Rule 102(e)(1)(ii) provides, in pertinent part, that the “Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to a person who is found . . . to have engaged in unethical or improper professional conduct.”

<sup>3</sup> As described in greater detail below, Financial Accounting Standards Board (“FASB”) Accounting Standards Codification “ASC” 820 sets forth three categories of inputs for use in determining an asset’s fair value. Assets valued using Level 3 inputs are the most difficult to value because they have no readily available market information and are valued using unobservable inputs.

and existence of Level 3 assets and failed to review other required work papers on independence and completion.

5. As a result of their deficient conduct, Fisher and Kast did not act with due professional care, including professional skepticism.

6. The audit failures include multiple single instances, detailed below, of highly unreasonable conduct that resulted in a violation of applicable professional standards in circumstances in which Fisher, Kast, and SKR knew, or should have known, that heightened scrutiny was warranted.

7. The audit failures detailed below also demonstrate repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards that indicate a lack of competence to practice before the Commission.

8. Respondents also caused CGI to violate the Custody Rule under the Advisers Act. Among other things, the Custody Rule requires that advisory client assets be maintained with a qualified custodian, and requires client assets to be verified through an annual surprise examination by an independent public accountant. The Adviser, which had custody of investor assets, sought to use the audit exception to the Custody Rule, which required that the funds' financial statements be audited in accordance with U.S. Generally Accepted Auditing Standards ("GAAS") by an independent public accountant that is registered with and subject to regular inspection by the PCAOB.

9. As was stated in the Commission's final rule revising the Commission's Auditor Independence Requirements, Release Nos. 33-7919; 34-43602; 35-27279; IC-24744; IA-1911; FR-56, "It is the auditor's opinion that furnishes investors with critical assurance that the financial statements have been subjected to a rigorous examination by an objective, impartial, and skilled professional, and that investors, therefore, can rely on them." Similarly, AICPA's Statement on Auditing Standards (SAS) No. 1, has long emphasized that auditors "should not only be independent in fact; they should also avoid situations that may lead outsiders to doubt their independence."

10. SKR was not independent under the Commission's independence rules set forth in Regulation S-X, Rule 2-01.

11. SKR violated the SEC's independence rules when a tax partner at SKR served as the trustee or general partner for a number of trusts that invested in eight private funds audited by SKR (Funds 7-14). SKR also lacked independence because it provided bookkeeping services to one fund (Fund 2) for which it also audited the fund's financial statements. Both of these relationships violated the Commission's independence rules for accountants.

12. Because SKR lacked independence and because of common control of the Adviser's funds, SKR's lack of independence affected all 29 audits it conducted for the Adviser in 2015 and 2016.

13. Moreover, as described below, many of the audit failures demonstrate that Respondents failed to conduct the audits in accordance with PCAOB standards or GAAS.

14. Because SKR was not independent and did not conduct the audits of the funds in accordance with GAAS, the Adviser could not meet the audit exception and violated the Custody Rule.

**A. RESPONDENTS**

15. Stockman Kast Ryan & Co., LLP is a Colorado limited liability partnership and accounting firm registered with the PCAOB. SKR has one office headquartered in Colorado Springs, Colorado.

16. Ellen S. Fisher, CPA, age 51, is a resident of Elbert, Colorado. She began working at SKR in 1999 as a senior auditor and became a partner in 2012. She first served on audits of the Adviser's funds in 2011 as senior manager, then as the audit engagement partner from 2014 through at least 2019. She has been a licensed CPA in Colorado since 1998.

17. David H. Kast, CPA, age 69, is a resident of Colorado Springs, Colorado. He was one of the founding partners of SKR in 1995. Kast served as the audit engagement partner on audits of the Adviser's funds from at least 2010 through 2013 and then as the audit engagement quality review ("EQR") partner from 2014 through at least 2017. He has been a licensed CPA in Colorado since 1977.

**B. OTHER RELEVANT ENTITIES AND INDIVIDUALS**

18. Adviser is an SEC-registered investment adviser incorporated in Colorado that provides investment advisory, financial planning, and estate planning services to high-net-worth clients.

19. Individual 1, age 66, is a resident of Colorado Springs, Colorado. Individual 1 is a tax partner at SKR and was a trustee and general partner for seven trusts or partnerships that invested in eight funds also audited by SKR in 2015.

**C. BACKGROUND**

20. Between at least January 1, 2015 and December 31, 2016, the Adviser had custody of investor assets invested in the Funds and, as such, was required to comply with the Custody Rule.

21. Among other things, the Custody Rule requires that advisory client assets be maintained with a qualified custodian, and requires client assets to be verified through an annual surprise examination by an independent public accountant. *See* Advisers Act Rule 206(4)-2(a)(1) and (4). An adviser to a limited liability company or pooled investment vehicle, such as the Adviser, does not have to satisfy the annual surprise examination requirement if it distributes annual audited financial statements to each member or beneficial owner within 120 days of the end of each fund's fiscal year. *See* Rule 206(4)-2(b)(4) of the Advisers Act. The audit exception requires that the Funds' financial statements be prepared in accordance with generally accepted accounting principles ("GAAP") and that they be audited in accordance with GAAS for the purpose of expressing an opinion therein.

22. To comply with the audit exception to the Custody Rule, the Adviser engaged SKR to perform annual audits for the funds for the years ended December 31, 2015 and December 31, 2016, and then distributed audited financial statements to each investor in the Funds.

23. SKR's relationship with the Adviser dates back to approximately 1999 and SKR provides (or has provided) audit, tax, and bookkeeping services to the Adviser and/or affiliates of the Adviser. Between 2014 and 2016, SKR's revenues from the Adviser, the Adviser's employees, and related parties ranged between approximately 8-10% of SKR's total revenue.

24. In 2015, SKR audited a total of 20 Adviser funds, 11 of which were funds holding Level 3 assets.<sup>4</sup> In 2016, SKR audited a total of nine Adviser funds, seven of which held Level 3 assets. For each year, six of the funds that held Level 3 assets involved audit failures that are the subject of this proceeding. The 12 audits with audit failures at issue in this proceeding are referred to as the "Audits."

25. ASC 820 defines fair value for purposes of GAAP as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." ASC 820-10-35-36 states that the methods used to measure fair value "shall maximize the use of relevant observable inputs and minimize the use of unobservable inputs."

26. According to SKR's audit reports, the Audits were performed in accordance with PCAOB auditing standards.

27. Kast worked on the Adviser's audits as engagement partner from at least 2010 through 2013 and then as EQR beginning in 2014. Fisher worked on the Adviser's audits beginning in 2011 as senior manager, and then as engagement partner from 2014.

28. In 2015 and 2016, Fisher was the SKR engagement partner on all fund audits for the Adviser and was ultimately responsible for the funds' audit engagements and for SKR's audit reports.

29. Prior to the 2014 audits of the Adviser's private funds, Fisher could not recall whether she had ever audited valuations of Level 3 assets.

30. SKR audited six Adviser funds in 2014 holding 19 Level 3 assets totaling \$48 million. SKR's audit of Level 3 assets expanded to 11 funds in 2015 holding 78 Level 3 assets totaling \$103 million.

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<sup>4</sup> ASC 820 prioritizes inputs used to measure fair value into three levels based on the observability of the inputs. The highest, and generally most reliable, level of inputs – Level 1 – are "quoted prices (unadjusted) in active markets for identical assets or liabilities." ASC 820-10-35-40. Level 2 inputs are "inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly." ASC 820-10-35-47. Level 3 inputs are "unobservable inputs for the asset or liability." ASC 820-10-35-52. ASC 820-10-35-53 further notes as follows: "Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any market activity for the asset or liability at the measurement date."

31. Many of the Audits at issue here involved funds whose assets were entirely Level 3 assets, while Funds 2 and 3 (discussed in more detail below) included Level 3 assets accounting for between 57% and 71% of total assets.

32. Prior to the 2015 fund audits, Fisher could not recall any specific training in valuing Level 3 assets, which made up a large portion of the funds' assets that year and had increased significantly from 2014. Despite having little to no experience in auditing these types of assets, Fisher did not engage a valuation specialist or anyone trained and experienced in auditing these type of assets.

33. In 2015, the individual at the Adviser preparing the financial statements for the funds was doing so for the first time, and was not a CPA. He replaced a CPA who had left the firm, and for the 2016 financial statements a new CPA took over primary responsibility for preparing the financial statements.

34. Fisher knew that, in 2015, the individual at the Adviser who performed the Level 3 asset valuations that SKR audited was not an accountant and had minimal familiarity with GAAP, including ASC Topic 820 concerning the valuation of investments for financial reporting purposes.

35. Fisher also knew in 2015 that the audit senior (the most senior professional on the audit below Fisher) also had minimal audit experience auditing valuations of Level 3 assets.

36. As the EQR partner, Kast was responsible for reviewing the audit file and the Fund financial statements. Under the applicable PCAOB standards and GAAS, Kast was responsible for evaluating the significant judgments made by the engagement team, the conclusions reached by the engagement team, and approving the issuance of the audit report.

**RESPONDENTS FAILED TO CONDUCT THE AUDITS  
IN ACCORDANCE WITH PCAOB AND GAAS AUDITING STANDARDS**

37. Fisher, Kast, and SKR failed to conduct the Audits in accordance with PCAOB auditing standards and GAAS.

38. SKR and Fisher planned for the Fund audits collectively, but within the audit work papers there was a separate valuation work paper for each Fund's assets.

39. This section first describes conduct that impacted all of the Audits and failed to comply with the applicable auditing standards. This section then describes conduct that impacted the audit of specific funds and specific assets that failed to comply with the applicable auditing standards.

**A. PERVASIVE FAILURES THROUGHOUT THE AUDITS**

40. As detailed in this section, Fisher and SKR failed to do the following with respect to the Audits:

- (i) adequately plan the Audits and obtain sufficient appropriate audit evidence to provide a reasonable basis for SKR’s audit opinions;
- (ii) properly evaluate audit results;
- (iii) document audit procedures;
- (iv) adequately supervise the Audits; and
- (v) exercise due professional care, including professional skepticism.

41. In addition, Kast failed to comply with the requirements for EQRs and exercise due professional care and professional skepticism.

**i. SKR and Fisher Failed to Obtain Sufficient Appropriate Audit Evidence on Level 3 Assets**

**a. Insufficient Audit Response to the High Inherent Risk and Risk of Material Misstatement of Level 3 Assets**

42. Fisher and SKR failed to adequately assess the risks of the Audits and appropriately plan the Audits in response to the high risks of these Audits.

43. Fisher, Kast and other SKR employees admit the valuation of Level 3 assets in these Audits were high risk.

44. The valuation of Level 3 assets in these Audits were high risk.

45. AS 2110.59<sup>5</sup> states, among other things, that the auditor should “identify and assess the risks of material misstatement at the financial statement level and the assertion level” and “determine whether any of the identified risks and assessed risks of material misstatement are significant risks.”

46. AS 2301.05 states that “[t]he auditor should design and implement overall responses to address the assessed risks of material misstatement” including, but not limited to, evaluating whether the “company’s selection and application of significant accounting principles, particularly those related to subjective measurements and complex transactions, are indicative of bias that could lead to material misstatement of the financial statements.”

47. AS 1105.04 states that “the auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion.”

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<sup>5</sup> PCAOB Auditing Standards use the nomenclature “AS” and a numbering arrangement adopted when the standards were reorganized effective after December 30, 2016. The reorganized standards were in effect for SKR’s audits for the period ending December 31, 2016. The substance of the standards applicable to SKR’s 2015 and 2016 audits was not changed. As such, we cite the reorganized standards throughout this Order. *See* PCAOB Release No. 2015-002 (permitting referencing the reorganized standards before the effective date, as the amendments do not substantively change the standards’ requirements).

48. AS 1105.05 adds, among other things, that as the risk of the audit increases, “the amount of evidence that the auditor should obtain also increases.”

49. AS 2301.09 states, in relevant part, that “[i]n designing the audit procedures to be performed, the auditor should: a. obtain more persuasive audit evidence the higher the auditor’s assessment of risk [and] b. take into account the types of potential misstatements that could result from the identified risks and the likelihood and magnitude of potential misstatement.”

50. AU-C 200.08<sup>6</sup> provides that “GAAS requires that the auditor exercise professional judgment and maintain professional skepticism throughout the planning and performance of the audit and, among other things . . . obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.”

51. AU-C 240.A38 provides that “[d]etermining overall responses to address the assessed risks of material misstatement due to fraud generally includes the consideration of how the overall conduct of the audit can reflect increased professional skepticism through, for example, increased

- sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions.

- recognition of the need to corroborate management explanations or representations concerning material matters....”

52. AU-C 330.07(b) provides that in “designing the further audit procedures to be performed, the auditor should . . . obtain more persuasive audit evidence the higher the auditor’s assessment of risk.”

53. AU-C 330.18 states that “[i]rrespective of the assessed risks of material misstatement, the auditor should design and perform substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure.”

54. Level 3 assets can be difficult to value because they have no readily available market information and are estimated using unobservable inputs.

55. In 2015, SKR identified and assessed the risk of material misstatement and planned audit responses for all Adviser funds collectively. In 2016, SKR identified and assessed the risk of material misstatement and planned audit responses for all Funds holding Level 3 assets collectively (and separately from funds holding Level 1 and 2 assets). SKR did not perform separate risk identification, assessment, and response procedures for each individual fund and SKR failed to document the funds with Level 3 assets generally had a risk level above those that did not have Level 3 assets.

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<sup>6</sup> AU-C refers to the AICPA professional standards.



56. SKR's work papers for the 2015 Audit failed to identify these Level 3 assets as having a significant risk, including a fraud risk, despite Fisher's knowledge that valuation of Level 3 assets were a significant audit risk and a fraud risk. Kast similarly knew that valuation of Level 3 assets was "high risk in the audit" and was both a significant risk and a fraud risk.

57. SKR's work papers for the 2015 and 2016 Audits also failed to identify that the inherent risk of the Level 3 assets was high, despite Fisher's knowledge that inherent risk related to the valuation of Level 3 assets was high.

58. Accordingly, in both 2015 and 2016, the audit work papers incorrectly documented the risk of material misstatement as moderate, instead of high.

59. Fisher and SKR failed to design audit approaches and procedures to address the high risks they knew were associated with valuation of these Level 3 assets.

60. SKR's audit program also contained no specific procedures to be performed regarding evaluating the appropriateness of valuation models, testing Level 3 inputs, or obtaining and evaluating investment committee minutes and related documentation that included contemporaneous information regarding the valuation of Level 3 assets.

61. Because SKR and Fisher failed to properly plan and perform audit procedures for the risk of material misstatement associated with the valuation and existence of these Level 3 assets, they also failed to obtain sufficient appropriate audit evidence to provide a reasonable basis for SKR's audit reports.

b. Insufficient Audit Evidence of Existence of Level 3 Assets

62. In each of the Audits, SKR did not perform audit procedures to obtain sufficient appropriate audit evidence regarding the existence of Level 3 assets at year end. Fisher reviewed and approved audit work papers showing that SKR did not obtain sufficient appropriate audit evidence.

63. AS 1105.04 requires the auditor to, "plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion."

64. AS 1105.08 provides that, "evidence obtained from a knowledgeable source that is independent of the company is more reliable than evidence obtained only from internal company sources."

65. AS 2310.06 states that, "confirmation is undertaken to obtain evidence from third parties about financial statement assertions made by management."

66. AU-C 330.03 details that the "objective of the auditor is to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement through designing and implementing appropriate responses to those risks."

67. AU-C 330.18 discussed above, applies to both existence and valuation issues.

68. AU-C 330.19 states that the auditor “should use external confirmation procedures for accounts receivable.”

69. AU-C 500.06 provides that the “auditor should design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.”

70. AU-C 500.A8 provides that “[m]ore assurance is ordinarily obtained from consistent audit evidence obtained from different sources or of a different nature than from items of audit evidence considered individually. For example, corroborating information obtained from a source independent of the entity may increase the assurance that the auditor obtains from audit evidence that is generated internally, such as evidence existing within the accounting records, minutes of meetings, or a management representation.”

71. AU-C 505.02 notes that “audit evidence is more reliable when it is obtained from independent sources outside the entity.”

72. AU-C 505.03 provides that the “auditor is required to consider whether external confirmation procedures are to be performed as substantive audit procedures and is required to use external confirmation procedures for accounts receivable unless the overall account balance is immaterial, external confirmation procedures would be ineffective, or the auditor’s assessed level of risk of material misstatement at the relevant assertion level is low, and the other planned substantive procedures address the assessed risk.”

73. AU-C 505.03 also notes that “section 330 requires that the auditor obtain more persuasive audit evidence the higher the auditor’s assessment of risk. To do this, the auditor may increase the quantity of the evidence or obtain evidence that is more relevant or reliable, or both. For example, the auditor may place more emphasis on obtaining evidence directly from third parties or obtaining corroborating evidence from a number of independent sources. Section 330 also indicates that external confirmation procedures may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error.

74. AU-C 580.04 clarifies that “[a]lthough written representations provide necessary audit evidence, they complement other auditing procedures and do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, obtaining reliable written representations does not affect the nature or extent of other audit procedures that the auditor applies to obtain audit evidence about the fulfillment of management's responsibilities or about specific assertions.”

75. SKR’s audit program provided that the existence of Level 3 assets should be confirmed, *i.e.* that SKR should obtain sufficient appropriate evidence that those assets exist at the time of the audit. However, Fisher and SKR took no steps to confirm the existence of Level 3 assets or obtain other sufficient appropriate evidence.

76. SKR did not confirm the existence of *any* Level 3 assets held by any of the Funds or perform sufficient alternative procedures; instead, SKR relied predominantly on the Adviser’s representations (in valuation write ups, management representation letters, and made orally).

Fisher reviewed and approved the audit work papers showing these failures and Kast signed off on the Audits.

c. Insufficient Audit Evidence of Valuation of Level 3 Assets

77. In each of the Audits, SKR did not perform audit procedures to obtain sufficient appropriate audit evidence regarding the valuation of Level 3 assets. Fisher reviewed and approved audit work papers showing these failures.

78. AS 2502.03 requires, in relevant part, the auditor “to obtain sufficient appropriate audit evidence to provide reasonable assurance that fair value measurements and disclosures are in conformity with GAAP.”

79. AS 2805.02 states, among other things, that management representations, “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.”

80. AS 2810.03 states that, “[i]n forming an opinion on whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, the auditor should take into account all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements.”

81. AS 2502.47 provides that the “auditor should evaluate the sufficiency and competence of the audit evidence obtained from auditing fair value measurements and disclosures as well as the consistency of that evidence with other audit evidence obtained and evaluated during the audit. The auditor’s evaluation of whether the fair value measurements and disclosures in the financial statements are in conformity with GAAP is performed in the context of the financial statements taken as a whole (see AS 2810.12 through .18 and AS 2810.24 through .27).”

82. AS 2301.11 requires that “[f]or significant risks, the auditor should perform substantive procedures, including tests of details that are specifically responsive to the assessed risks.”

83. AU-C 330.03 and 500.06, discussed above, also apply to valuation issues.

84. AU-C 330.28 states that, “In forming a conclusion, the auditor should consider all relevant audit evidence, regardless of whether it appears to corroborate or contradict the assertions in the financial statements.”

85. AU-C 500.08 states that “[i]f information to be used as audit evidence has been prepared using the work of a management’s specialist, the auditor should, to the extent necessary, taking into account the significance of that specialist’s work for the auditor’s purposes, . . . a. evaluate the competence, capabilities, and objectivity of that specialist; . . . b. obtain an understanding of the work of that specialist; and . . . c. evaluate the appropriateness of the specialist’s work as audit evidence for the relevant assertion.” (citations omitted).

86. AU-C 500.09 provides that “when using information produced by the entity, the auditor should evaluate whether the information is sufficiently reliable for the auditor’s purposes, including, as necessary, in the following circumstances: a. Obtaining audit evidence about the accuracy and completeness of the information . . . [and] b. Evaluating whether the information is sufficiently precise and detailed for the auditor’s purposes. . . .”

87. AU-C 501.06 sets forth parameters for “investments in derivative instruments and securities measured or disclosed at fair value” noting the “auditor should a. determine whether the applicable financial reporting framework specifies the method to be used to determine the fair value of the entity’s derivative instruments and investments in securities and b. evaluate whether the determination of fair value is consistent with the specified valuation method.”

88. “If estimates of fair value of derivative instruments or securities are obtained from broker-dealers or other third-party sources based on valuation models, the auditor should understand the method used by the broker-dealer or other third-party source in developing the estimate and consider the applicability of section 500.1.” AU-C 501.07.

89. Further, “If derivative instruments or securities are valued by the entity using a valuation model, the auditor should obtain sufficient appropriate audit evidence supporting management's assertions about fair value determined using the model.” AU-C 501.08.

90. AU-C 540.06 provides that the “objective of the auditor is to obtain sufficient appropriate audit evidence about whether, in the context of the applicable financial reporting framework a. accounting estimates, including fair value accounting estimates, in the financial statements, whether recognized or disclosed, are reasonable and b. related disclosures in the financial statements are adequate.”

91. AU-C 540.12 requires that “[b]ased on the assessed risks of material misstatement, the auditor should determine . . . a. whether management has appropriately applied the requirements of the applicable financial reporting framework relevant to the accounting estimate and b. whether the methods for making the accounting estimates are appropriate and have been applied consistently and whether changes from the prior period, if any, in accounting estimates or the method for making them are appropriate in the circumstances.”

92. AU-C 540.13 states, in relevant part, that in “responding to the assessed risks of material misstatement, as required by section 330, the auditor should undertake one or more of the following, taking into account the nature of the accounting estimate: . . . [t]est how management made the accounting estimate and the data on which it is based. In doing so, the auditor should evaluate whether . . . i. the method of measurement used is appropriate in the circumstances.... ii. the assumptions used by management are reasonable in light of the measurement objectives of the applicable financial reporting framework, and . . . iii. the data on which the estimate is based is sufficiently reliable for the auditor’s purposes.”

93. AU-C 540.A33 explains that “In the case of fair value accounting estimates, assumptions reflect, or are consistent with, what knowledgeable, willing arm's length parties (sometimes referred to as market participants or equivalent) would use in determining fair value

when exchanging an asset or settling a liability. Specific assumptions also will vary with the characteristics of the asset or liability being valued; the valuation technique used (for example, a market approach or an income approach); and the requirements of the applicable financial reporting framework.”

94. AU-C 540.A69 elaborates on how the auditor may test how management made an accounting estimate and the data on which it is based by for example:

- “Testing the extent to which data on which the accounting estimate is based is accurate, complete, and relevant and whether the accounting estimate has been properly determined using such data and management assumptions[.]

- Considering the source, relevance, and reliability of external data or information, including that received from management's specialists, to assist in making an accounting estimate[.]

- Determining how management has taken into account the effect of events, transactions, and changes in circumstances occurring between the date that the estimate or inputs to the estimate were determined and the reporting date, if the estimate was not made as of a date that coincides with the reporting date (for example, a valuation by an independent appraiser may be as of a different date)[.]

- Recalculating the accounting estimate and reviewing, for internal consistency, information used to determine the estimate[.]

- Considering management's review and approval processes[.]”

95. AU-C 540.A84 elaborates on fair value accounting related to unobservable inputs, noting “when fair value accounting estimates are based on unobservable inputs, matters that the auditor may consider include, for example, how management supports

- the identification of the characteristics of market participants relevant to the accounting estimate.

- modifications it has made to its own assumptions to reflect its view of assumptions market participants would use.

- whether it has incorporated appropriate information.

- when applicable, how its assumptions take account of comparable transactions, assets, or liabilities.”

96. AU-C540.A84 continues on to state that if “there are unobservable inputs, it is more likely that the auditor's evaluation of the assumptions will need to be combined with other responses to assessed risks in paragraph [540.13 (see above)] in order to obtain sufficient appropriate audit evidence. In such cases, it may be necessary for the auditor to perform other audit procedures (for example, examining documentation supporting the review and approval of

the accounting estimate by appropriate levels of management and, when appropriate, those charged with governance).”

97. AU-C 580.04, discussed above, also applies to valuation issues.

98. SKR’s valuation procedures excessively relied on representations from the Adviser without obtaining sufficient corroborating audit evidence and sometimes ignored contradictory evidence inconsistent with the Adviser’s valuation determinations.

99. For example, SKR failed to identify that the valuation estimates were not prepared in accordance with GAAP and failed to obtain sufficient audit evidence corroborating management’s supporting valuation inputs and assumptions (e.g. at times the Adviser and SKR relied on stale appraisals, consulting reports that were up to nine years old, and unsigned sales agreements).

100. As further set forth below, these audit deficiencies contributed to Fisher’s and SKR’s failure to identify potential misstatements in financial statements for three funds in 2015 (pertaining to 9 separate Level 3 assets), and for two funds in 2016 (pertaining to four Level 3 assets).

## **ii. Fisher and SKR Failed to Evaluate Audit Results**

101. In several Audits, SKR did not evaluate management for possible bias and properly identify and evaluate misstatements in the financial statements.

102. AS 2401.64 requires a retrospective review of accounting estimates in significant accounts to provide the auditor with additional information, with the benefit of hindsight, about whether there may be a possible bias on the part of management.

103. AS 2810.03, also discussed above, requires auditors to take into account all relevant audit evidence in forming an opinion on the financial statements.

104. AS 2810.17 states, in relevant part, “[t]he auditor should evaluate whether uncorrected misstatements are material, individually or in combination with other misstatements.”

105. Importantly, AS 1215.12 states, among other things, that the auditor must document the identified “accumulated misstatements and evaluation of uncorrected misstatements, including the quantitative and qualitative factors the auditor considered to be relevant to the evaluation.”

106. AU-C 240.32b states that the auditor should design and perform audit procedures to “review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor should ... perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year. ”

107. AU-C 240.A52 explains that the “purpose of performing a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year is to determine whether an indication exists of a possible bias on the part of management. This review is not intended to call into question the auditor's professional judgments made in the prior year that were based on information available at the time.”

108. AU-C 240.A53 elaborates that a “retrospective review is also required by section 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures. That review is conducted as a risk assessment procedure to obtain information regarding the effectiveness of management's prior period estimation process, audit evidence about the outcome, or when applicable, the subsequent reestimation of prior period accounting estimates that is pertinent to making current period accounting estimates, and audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements. As a practical matter, the auditor's review of management judgments and assumptions for biases that could represent a risk of material misstatement due to fraud in accordance with this section may be carried out in conjunction with the review required by section 540.” (Internal footnotes omitted.)

109. AU-C 540.21 states, “The auditor should review the judgments and decisions made by management in the making of accounting estimates to identify whether indicators of possible management bias exist. Indicators of possible management bias do not, themselves, constitute misstatements for the purposes of drawing conclusions on the reasonableness of individual accounting estimates.”

110. AU-C 450.05 provides that the “auditor should accumulate misstatements identified during the audit, other than those that are clearly trivial.”

111. AU-C 450.11 provides that the “auditor should determine whether uncorrected misstatements are material, individually or in the aggregate.”

112. AU-C 560.15 provides that if “a subsequently discovered fact becomes known to the auditor after the report release date, the auditor should . . . a. discuss the matter with management and, when appropriate, those charged with governance. [and] b. determine whether the financial statements need revision and, if so, inquire how management intends to address the matter in the financial statements.”

113. Fisher reviewed and approved the SKR audit work papers that failed to perform a retrospective review and properly evaluate and document whether identified misstatements in Fund 2 in 2016 were material to fund financial statements.

114. For example, with respect to retrospective reviews, as detailed below in Funds 2 and 3, Asset 1, despite an 83% increase in the value of an asset within 5 months from the date of the 2015 financial statements, SKR failed to perform a retrospective review and address whether the Adviser's 2015 valuation contained bias or was materially in error.

115. SKR's failure to sufficiently document whether identified misstatements were material to the fund financial statements applies to Fund 2 and is discussed below in Section B.x.

116. During the Audits, SKR identified valuation discrepancies and concluded without adequate evaluation or documentation that these discrepancies were not errors and/or were immaterial to the financial statements.

117. These identified valuation discrepancies, which SKR concluded without adequate evaluation or documentation were not errors and/or were immaterial to the financial statements, included for example, SKR's failure to consider the effect of the ownership error discovered in 2016 for Asset 2 of Fund 2, in which, as discussed below, the Adviser discovered the ownership percentage for Fund 2 in 2016 was overstated by 29%, corresponding to a \$716,000 overstatement in the financials (SKR did not even quantify the overstatement for 2015 based on the ownership error).

### **iii. SKR's Audit Documentation Was Not in Accordance with Applicable Audit Standards**

118. In each of the Audits, SKR's audit work papers are replete with documentation deficiencies.

119. AS 1215.06 requires the auditor to document the procedures performed, evidence obtained, and conclusions reached and the audit documentation must clearly demonstrate that the work was in fact performed.

120. AS 1215.06 further requires that the audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement to a) understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached; and b) determine who performed the work and the date such work was completed as well as the person who reviewed the work and the date of such review.

121. AU-C 230.08 provides that the "auditor should prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit to understand. . . a. the nature, timing and extent of the audit procedures performed to comply with GAAS and applicable legal and regulatory requirements; b. the results of the audit procedures performed, and the audit evidence obtained; and c. significant findings or issues arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions."

122. SKR's work papers contain various documentation deficiencies that would prevent an experienced auditor from understanding the extent and results of the procedures performed, evidence obtained, and conclusions reached, and whether certain work was reviewed. For example:

- Fisher and Kast both reviewed and approved the 2015 audit work papers that did not identify the valuation of Level 3 assets as a significant risk, including a fraud risk, although Fisher knew that valuation of level three assets were a significant audit risk and a fraud risk and Kast knew that they were high risk, and both a significant risk and a fraud risk;



- Fisher and Kast both reviewed and approved the 2015 and 2016 audit work papers that incorrectly documented inherent risk and the risk of material misstatement as moderate instead of high; and
- The 2015 audit work papers did not identify that SKR provided bookkeeping services to a fund that it audited or evaluate whether the services impacted SKR's independence.

**iv. Fisher's Supervision and Review of the Audit Engagements was Inadequate**

123. It is the responsibility of the engagement partner to provide for proper supervision of the work of the engagement team and for compliance with PCAOB auditing standards. AS 1201.03.

124. The engagement partner is also responsible for evaluating that the audit work was performed and documented, the objectives of the audit procedures were achieved, and the results of the work support the conclusions reached. AS 1201.05.

125. AU-C 220.13 states that the "engagement partner should form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner should a. obtain relevant information from the firm and, when applicable, network firms to identify and evaluate circumstances and relationships that create threats to independence; b. evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and c. take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards or, if considered appropriate, to withdraw from the audit engagement when withdrawal is possible under applicable law or regulation. The engagement partner should promptly report to the firm any inability to resolve the matter so that the firm may take appropriate action."

126. AU-C 220.17 directs that the engagement partner "should take responsibility for the following: a. the direction, supervision, and performance of the audit engagement in compliance with professional standards, applicable legal and regulatory requirements, and the firm's policies and procedures...[and] b. The auditor's report being appropriate in the circumstances."

127. AU-C 220.19 requires that "on or before the date of the auditor's report, the engagement partner should, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued."

128. In each of the Audits, Fisher's supervision and review was inadequate because she reviewed and approved the audit work papers that did not meet PCAOB auditing standards or GAAS and did not support SKR's audit reports. This pervasive failure applies to all of the identified existence and valuation audit failures in this Order.

129. Most significantly, Fisher reviewed and approved the Audits that did not properly evaluate SKR's independence, document the risks of Level 3 assets, adequately respond to the identified risks of Level 3 assets, and obtain sufficient appropriate audit evidence. She also did not perform a retrospective review.

**v. Fisher Did Not Act with Due Professional Care, Including Professional Skepticism**

130. AS 1015 and AS 2301 required Fisher to act with due professional care, including professional skepticism in the planning and performance of the audit.

131. AS 2301.07 provides that due professional care includes, among other things, "obtaining sufficient appropriate evidence to corroborate management's explanations or representations concerning important matters, such as through third-party confirmation, use of a specialist engaged or employed by the auditor, or examination of documentation from independent sources."

132. AU-C 200.08, cited above, requires Fisher to maintain professional skepticism.

133. AU-C 200.17 provides that the "auditor should plan and perform an audit with professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated."

134. Professional skepticism, as defined by AU-C 200.A22, includes "being alert to," for example, "[a]udit evidence that contradicts other audit evidence obtained."

135. AU-C 200.A24 continues to explain that "[p]rofessional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in light of the circumstances; for example, in the case when fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount."

136. AU-C 240.08 states, in relevant part, that "[w]hen obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit."

137. AU-C 240.A9 explains that "[m]aintaining professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information to be used as audit evidence and the controls over its preparation and maintenance when relevant. Due to the characteristics of fraud, the auditor's professional skepticism is particularly important when considering the risks of material misstatement due to fraud."

138. AU-C 240.A20 notes that "[m]anagement is often in the best position to perpetrate fraud. Accordingly, when evaluating management's responses to inquiries with professional skepticism, the auditor may judge it necessary to corroborate responses to inquiries with other information."

139. AU-C 240.A38 provides, in part, that “[d]etermining overall responses to address the assessed risks of material misstatement due to fraud generally includes the consideration of how the overall conduct of the audit can reflect increased professional skepticism through, for example, increased [1] sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions[] [and] [2] recognition of the need to corroborate management explanations or representations concerning material matters.”

140. In each of the Audits, Fisher did not act with due professional care, including professional skepticism, because she did not plan and perform the audits in accordance with PCAOB auditing standards or GAAS, including not corroborating management representations, not obtaining sufficient appropriate audit evidence, and ignoring contradictory information. Again, this applies to all of the existence and valuation audit deficiencies identified in this Order.

141. In each of the Audits, Fisher’s deficient conduct caused SKR to issue unqualified audit opinions on the Funds’ financial statements for 2015 and 2016 when SKR was not independent and the SKR’s audits were not performed in accordance with PCAOB auditing standards and GAAS.

#### **vi. Kast’s EQR Failures**

142. For each of the Audits, Kast failed to conduct his engagement quality reviews in accordance with PCAOB auditing standards and GAAS.

143. AS 1220.09 states that an engagement quality reviewer should, among other things, “evaluate the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the engagement.”

144. AS 1220.10 adds that the engagement quality reviewer must evaluate the engagement team’s assessment of and response to significant risks, including fraud risks; evaluate the significant judgments made about the materiality and disposition of identified misstatements; and review the engagement team’s evaluation of the firm’s independence in relation to the engagement.

145. AU-C 220.22 states that “engagement quality control reviewer should perform an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the auditor's report. This evaluation should involve a. discussion of significant findings or issues with the engagement partner; b. reading the financial statements and the proposed auditor’s report; c. review of selected audit documentation relating to the significant judgments the engagement team made and the related conclusions it reached; and d. evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate.”

146. The engagement quality reviewer must evaluate whether the procedures performed by the engagement team responded appropriately to significant risks identified and supported the conclusions reached. The engagement quality review can provide concurring approval only if the engagement quality review was performed with due professional care and the reviewer is not aware of a significant engagement deficiency, including the engagement team failing to obtain sufficient appropriate evidence. *See* AS 1220.11 and .12.

147. Kast failed to perform a sufficient engagement quality review on the Audits.

148. Kast approved the 2015 audit risk work papers that did not document valuation of Level 3 assets as a significant risk, including a fraud risk, contrary to his knowledge about the risk level of the valuation of these assets.

149. In both 2015 and 2016, Kast also reviewed and approved the work papers that incorrectly documented the valuation of Level 3 assets as having only moderate inherent risk and risk of material misstatement, contrary to his testimony about the risk level.

150. In both 2015 and 2016, Kast reviewed and approved every investment valuation audit work paper and failed to recognize that SKR did not respond appropriately to the identified risks and did not obtain sufficient appropriate audit evidence supporting its conclusion that Level 3 assets existed and were properly valued.

151. For example, Kast reviewed and approved the deficient valuation work paper for a fund (Fund 1 described below) that had to restate its financial statements because its principal asset, which had been valued at \$1 million, actually did not exist at year-end 2015.

152. In another example, like Fisher, Kast reviewed and approved another work paper (for Fund 2 described below) that concluded, without any analysis, that an overstatement of Level 3 assets was immaterial.

153. Kast did not review the 2015 and 2016 work papers that contain the team's independence work.

154. Kast also did not review the 2015 and 2016 investment audit programs, which list the procedures that will be performed to obtain sufficient evidence in response to the identified risks.

155. Further, for each of the two biggest funds holding Level 3 assets Kast chose to review one 2016 work paper, the valuation work paper, yet he failed to document his review and approval of those work papers.

156. For each of the Audits, Kast's EQR audit failures demonstrate that he did not act with the required due professional care, including professional skepticism.

## **B. AUDIT FAILURES WITH RESPECT TO SPECIFIC FUNDS AND ASSETS**

### **i. Fund 1: Failure to Identify Non-Existence of Shares**

157. Fund 1 was a private fund created by and managed by an affiliate of the Adviser to hold an investment in an unrelated, third-party private technology company.

158. In 2014, Fund 1 purchased a series of shares in a private company for \$1,000,000. In August 2015, Fund 1 purchased another series of shares in that company for \$102,845 as part of a recapitalization.

159. As of year-end 2015, Fund 1's financial statements showed that it owned one series of shares worth \$1,000,000 (91% of assets) and another series of shares worth \$102,845 (9% of assets). The shares valued at \$1,000,000, however, did not exist at year-end 2015 because they had been cancelled in connection with a recapitalization earlier that year.

160. Fund 1 restated its 2015 financial statements in April 2017, writing off the entire value of the series of shares purchased in 2014 and writing down the value of the shares purchased in 2015 to \$1.

161. Fisher and SKR reviewed and approved the 2015 work papers showing SKR failed to obtain sufficient appropriate audit evidence of existence of Level 3 assets held by Fund 1.

162. The Adviser had an investment committee that received all documents associated with the recapitalization. The recapitalization documents and the Adviser's investment committee meeting minutes reflect that the private company had "suffered a business catastrophe," was having "severe inner turmoil," had "no sales," and its board advised liquidation was the "only alternative." Documents associated with the recapitalization made it clear that the shares purchased in 2014 were being cancelled and that there was no outstanding equity prior to issuance of the shares purchased in 2015. Documents associated with the purchase of the 2015 shares clearly set forth the steps of the recapitalization and noted that previously issued shares would be converted to common stock, the technology company would conduct a reverse stock split, and that "[a]fter effecting the reverse split, all Existing Shares will be effectively cancelled." (Emphasis in original.)

163. SKR and Fisher knew about the recapitalization but did not request or obtain all of the recapitalization documents. Fisher and SKR also knew about the existence of the Adviser's investment committee, but did not request any materials submitted to the investment committee, or the investment committee minutes regarding the investments in the technology company.

164. SKR did not take any steps to confirm the existence of either series of shares. Instead, SKR relied only on the Adviser's representations, and SKR's prior receipt of documentation evidencing the purchase of both series of shares of the technology company.

165. Additionally, Fisher received one of the recapitalization documents that stated there would be no outstanding stock of the technology company prior to issuance of the new security.

166. Fisher and SKR reviewed and approved work papers showing that SKR failed to obtain sufficient appropriate audit evidence of valuation of the Level 3 assets held by Fund 1.

167. Fisher reviewed and approved SKR's 2015 test work that failed to obtain sufficient appropriate audit evidence corroborating the representation that the value of the Fund's investment in its first series of shares of the technology company was unchanged from the prior year and should be valued at cost, or \$1,000,000.

168. Fisher and SKR knew based on the valuation write up provided by the Adviser that the Adviser did not conduct any type of valuation estimating the fair value of the shares.

169. Fisher and SKR learned information during the audit that contradicted the Adviser's position of leaving the fair value unchanged from the prior year. Specifically, during the 2015 audit, Fisher and SKR learned from the Adviser's employees and the Adviser's valuation write up that in 2015 the private company 1) was in financial trouble and had experienced a substantial drop in revenue and increased losses, 2) underwent a recapitalization resulting in the company's valuation declining from \$85 million in 2014 to \$8 million in 2015, and 3) failed to provide annual financial statements to the Adviser when requested. This information should have prompted Fisher and SKR to take additional audit steps to obtain evidence supporting the Adviser's valuation of these Level 3 assets.

170. In 2016, SKR similarly relied on the Adviser's representations and failed to confirm the existence of the series of shares of the technology company or perform sufficient other procedures.

171. In addition to the audit standards discussed above concerning sufficiency of evidence in general, AS 2810.08, in relevant part, states that "the auditor should obtain corroboration for management's explanations regarding significant unusual or unexpected transactions, events, amounts, or relationships."

172. In connection with Fund 1, in 2015 SKR and Fisher failed to comply with the following PCAOB audit standards: AS 1101, AS 1105, AS 1215, AS 2301, AS 2310, AS 2401, AS 2502, AS 2503, AS 2805, AS 2810, AS 3101, AS 1015, and AS 1201.

173. In connection with Fund 1, in 2015, SKR and Fisher failed to comply with the following GAAS: AU-C 330.03, AU-C 330.18, AU-C 330.19, AU-C 500.06, AU-C 505.02, AU-C 505.03; AU-C 330.28, AU-C 500.09, AU-C 501.06, AU-C 540.06, AU-C 540.12, AU-C 540.13, AU-C 540.A33.

174. In connection with Fund 1, in 2016, SKR and Fisher failed to comply with the following PCAOB audit standards: AS 1101, AS 1215, AS 2301, AS 2310, AS 2401, AS 2502, AS 2503, AS 2805, AS 3101, AS 1015, and AS 1201.

175. In connection with Fund 1, in 2016, SKR and Fisher failed to comply with the following GAAS: AU-C 330.03, AU-C 330.18, AU-C 330.19, AU-C 500.06, AU-C 505.02, AU-C 505.03, and AU-C 220.

176. In connection with Fund 1, in both 2015 and 2016, Kast failed to comply with AS 1220 and AU-C 220.

**ii. Funds 2 and 3 – Asset 1: Failure to obtain evidence about an appraisal and perform retrospective review**

177. Funds 2 and 3 are private funds that held significant Level 3 assets, including many of the same Level 3 assets.

178. Funds 2 and 3 each owned an interest in an LLC formed by the Adviser and managed by an affiliate of the adviser, “Asset 1,” which in turn owned undeveloped ranch land.

179. The LLC was formed and funded in 2005. It acquired land for development purposes. While it previously held a contract to develop the parcel, due to the economic downturn in 2008 that contract was cancelled.

180. In its valuation write up for the financial statements in 2015, the Adviser valued the ranch land owned by Asset 1 at \$14 million based on a stale appraisal from 2012, added cash held by the LLC, and calculated the valuation for Fund 2 and Fund 3’s interests based on each entity’s pro-rata ownership portion of the LLC that owned the land.

181. SKR failed to obtain sufficient evidence that the appraisal remained an accurate estimate of the fair value three years later at December 31, 2015. This failure violated PCAOB standards, including AS 2502.25. This failure violated GAAS, including AU-C 330.03, AU-C 330.28, AU-C 500.06, AU-C 500.08, AU-C 500.09, AU-C 501.06, AU-501.08, AU-C 505.03, AU-C 540.06, AU-C 540.12, AU-540.13, AU-C 540.13, AU-C 540.A33, and AU 540.A70.

182. SKR also ignored contradictory evidence in the work papers showing the value the ranch land had likely increased between 2012 and 2015 including that (1) the population in the area had increased and was expected to increase through 2019, which “will provide demand for the development of [the land],” (2) there was a decrease in vacant housing in 2014 which “will cause an increase in value,” and (3) listing prices for homes in the area increased 12% from 2013 to 2015. These failures violated PCAOB standards, including AS 2502.47. These failures violated GAAS, including AU-C 500.10.

183. In May 2016, the Adviser obtained a new appraisal that valued the land at \$25.6 million.

184. SKR did not evaluate the qualifications of the appraiser, or test any of the data inputs supporting the appraisal. These failures violated PCAOB standards, including AS 1210.08-12 and AS 2502.21. These failures violated GAAS, including AU-C 500.08.

185. Despite this 83% increase in value within 5 months from the date of the 2015 financial statements, SKR failed to perform a retrospective review in 2016 and address whether the Adviser’s 2015 valuation contained bias or was materially in error. This failure violated PCAOB standards, including AS 2401.64. This failure violated GAAS, including AU-C 240.32 and AU-C 540.21.

186. Further, Fisher and SKR failed to perform any audit procedures upon learning of the new appraisal to determine if the 2015 financial statements were materially misstated. This failure violated PCAOB standards, including AS 2905.04 and 2905.05. This failure violated GAAS, including AU-C 560.15.

187. SKR also did not consider that the Adviser valued the ranch land rather than Asset 1 (an LLC), which in turn owned the ranch land. SKR did not obtain sufficient audit evidence to determine whether or not there were any other assets or liabilities or if Asset 1 was just a pass through entity. In 2015, SKR acknowledged that the land was the “primary asset” held by the

LLC, but it did not consider whether there were other assets or liabilities. These failures violated PCAOB standards, including AS 2502.03. These failures violated GAAS, including AU-C 540.06.

**iii. Funds 2 and 3 – Asset 2: Failure to obtain evidence and perform a retrospective review**

188. Funds 2 and 3 each owned 50% of a promissory note that entitled them to \$1,000 for each lot sold in a parcel of undeveloped land (“Asset 2”).

189. In 2015, SKR did not obtain sufficient audit evidence supporting the Adviser’s \$800,000 valuation. This failure violated PCAOB standards, including AS 2502.03, AS 2805.02, and AS 2301.11. This failure violated GAAS, including AU-C 330.03, AU-C 330.28, AU-C 500.06, AU-C 500.08, AU-C 500.09, AU-C 501.06, AU-501.08, AU-C 505.03, AU-C 540.06, AU-C 540.12, AU-540.13, AU-C 540.13, AU-C 540.A33, and AU-C 540.A70.

190. During the 2016 audit, SKR did not perform a retrospective review after learning the Adviser received a May 2016 appraisal valuing this asset at \$2 million or 150% higher than the \$800,000 value at December 31, 2015. This failure violated PCAOB standards, including AS 2401.64. This failure violated GAAS, including AU-C 240.32 and AU-C 540.21.

191. Further, Fisher and SKR failed to perform any audit procedures upon learning of the new appraisal to determine if the 2015 financial statements were materially misstated. These failures violated PCAOB standards, including AS 2905.04 and 2905.05. These failures violated GAAS, including AU-C 560.15.

192. SKR also did not evaluate the qualifications of the appraiser, or test any of the data inputs supporting the appraisal. These failures violated PCAOB standards, including AS 1210.08-.12 and AS 2502.21. These failures violated GAAS, including AU-C 500.08.

193. In both 2015 and 2016, SKR failed to obtain evidence of the existence of Asset 2. This failure violated PCAOB standards, including AS 1105.08, and AS 2310.06. This failure violated GAAS, including AU-C 330.03, AU-C 330.18, AU-C 500.06, AU-C 505.02, AU-C 505.03, AU-C 580.04, and AU-C 240.A38.

**iv. Funds 2 and 3 – Asset 3: Failure to obtain evidence of existence of ownership interests and to audit valuation of interest**

194. Funds 2 and 3 both had an ownership interest in an LLC (“Asset 3”) that was managed by an affiliate of the Adviser, and which in turn had two wholly owned subsidiaries that owned land in Hawaii being developed for residential use.

195. In 2015 and 2016, SKR failed to obtain sufficient appropriate evidence of the existence of the funds’ ownership interests in Asset 3 and relied only upon management representations. This failure violated PCAOB standards, including AS 1105.08, and AS 2310.06. This failure violated GAAS, including AU-C 330.03, AU-C 330.18, AU-C 500.06, AU-C 505.02, AU-C 505.03, AU-C 580.04, and AU-C 240.A38.



196. According to the Adviser's records, Fund 2 had a 25.22% interest in Asset 3 in 2015 and a 19.525% interest in 2016; Fund 3 had a 24.0% interest in 2015 and a 23.9% interest in 2016.

197. In 2016, during fieldwork, the Adviser discovered the ownership percentage for Fund 2 in 2015 was overstated by 29%, corresponding to a \$716,000 overstatement in the 2015 value of Asset 3. SKR failed to identify and then evaluate this overstatement. These failures violated PCAOB standards, including AS 2401.64, AS 2810.17, AS 1215.12, AS 2905.04, and AS 2905.05. These failures violated GAAS, including AU-C 240.32, AU-C 540.21, and AU-C 560.15.

198. In 2015 and 2016, SKR did not obtain sufficient appropriate audit evidence supporting valuation. This failure violated PCAOB standards, including AS 2502.03, AS 2805.02, and AS 2301.11. This failure violated GAAS, including AU-C 330.03, AU-C 330.28, AU-C 500.06, AU-C 500.09, AU-C 501.06, AU-C 501.08, AU-C 505.03, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A33.

199. With respect to the valuation models used by the Adviser, SKR failed to (1) properly evaluate the appropriateness of the models that the Adviser used; (2) test model inputs; and (3) test the mathematical accuracy of the Adviser's models. These failures violated PCAOB standards, including AS 2502.03, AS 2502.26, AS 2502.38, AS 2502.39, and AS 2503.40. These failures violated GAAS, including AU-C 330.03, AU-C 540.06, AU-C 540.13, and AU-C 580.04.

200. In 2017, the Adviser determined the year-end 2016 fair value estimate of Asset 3 was overstated by approximately \$1.3 million, which corresponds to a \$316,000 or 16.9% overstatement of Asset 3 held by Fund 2 and a \$299,000 or 16.9% overstatement of Asset 3 held by Fund 3.

**v. Funds 2 and 3 – Asset 4: Failure to obtain evidence of value and to test existence and failure to perform retrospective review**

201. Funds 2 and 3 invested in an LLC ("Asset 4") formed by affiliates of the Adviser, which in turn invested in an LLC that owned an apartment complex and land in Arizona.

202. In 2015, SKR did not obtain sufficient audit evidence to support the value of this investment. This failure violated PCAOB standards, including AS 2502.03, AS 2805.02, and AS 2301.11. This failure violated GAAS, including AU-C 330.03, AU-C 330.28, AU-C 500.06, AU-C 500.09, AU-C 501.06, AU-C 501.08, AU-C 505.03, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A33.

203. SKR relied on a July 2015 email from Asset 4's property manager to the Adviser stating the fair value of the investment was estimated to be a 55-60% return of capital. SKR did not evaluate the qualifications of the manager to make this estimate, determine how the property manager estimated the fair value, or test any of the data inputs supporting the estimate. These failures violated PCAOB standards, including AS 1210.08-.12 and AS 2502.21. These failures violated GAAS, including AU-C 500.08.

204. SKR ignored other available information, which it could have used to calculate its own fair value estimate, or used to perform procedures to verify whether the Adviser complied with ASC 820 in the valuation of investments. This other available information included estimates of the per unit sale price. This failure violated PCAOB standards, including AS 2502.03. This failure violated GAAS, including AU-C AU 330.03, 330.28, AU-C 500.06, AU-C 500.09, AU-C 501.06, AU-C 501.08, AU-C 505.03, AU-C 540.06, and AU-C 540.12.

205. SKR did not test the existence or ownership of Fund 2 or 3's ownership in Asset 4 and relied on management representations. Consequently, SKR failed to identify that Fund 3 and 4's ownership and fair values were incorrect. This failure violated PCAOB standards, including AS 1105.08, and AS 2310.06. This failure violated GAAS, including AU-C 580.04 and AU-C 240.A38. These failures violated GAAS, including AU-C 330.03, AU-C 330.18, AU-C 330.19, AU-C 500.06, AU-C 505.02, and AU-C 505.03, AU-C 580.04 and AU-C 240.A38.

206. In 2016, SKR continued to rely on the July 2015 email and ignored inconsistent and contradictory information in the work papers showing that the apartment complex was now estimated to sell for \$210,000 per unit - an 18% increase over the prior year estimate of \$178,000 - suggesting the fair value of the investment may have increased. These failures violated PCAOB standards, including AS 2502.26, and AS 2502.29. These failures violated GAAS, including AU-C 500.10, AU-C 540.06, AU-C 540.13, AU-C 580.04, and AU-C 330.03.

207. The manager for Asset 4 had a broker price opinion from Q4 2016, estimating that the units could sell for \$220,000 per unit, a 23% increase over the estimate of \$178,000 for 2015.

208. SKR failed to conduct any retrospective analysis after learning during the 2016 audit that Fund 2's and Fund 3's capital contribution of \$7.5 million in 2015 was overstated by 20% and should have been \$6.25 million. SKR determined, without any analysis, the resulting 2015 valuation overstatement of \$158,000 for Fund 3 and \$143,000 for Fund 2 were immaterial. This failure violated PCAOB standards, including AS 2905.04, AS 2905.05, and AS 2401.64. This failure violated GAAS, AU-C 240.32 AU-C 540.21, and AU-C 560.15.

**vi. Funds 2 and 3 – Asset 5: Failure to obtain evidence of valuation in transactions with a related party**

209. Funds 2 and 3 each owned interests in an LLC ("Asset 5"), which was formed by affiliates of the Adviser in September 2015 and closed in December 2015. The LLC in turn purchased a two-thirds interest in a construction company located in Hawaii. An oral agreement concerning entering into a partnership with the construction company was reached on April 1, 2015, prior to execution of the formal documentation.

210. Since at least 2014, the construction company had been providing construction services to the president of the Adviser.

211. In 2015, Fund 3 made a capital contribution to the LLC of \$500,000.

212. In 2015, Fund 3 also loaned \$180,000 to the LLC for operating expenses under a promissory note due 12/22/2016 bearing a 5% interest rate.

213. In 2015, Fund 2 made a capital contribution of \$1,750,000 to the LLC.

214. In 2015, the Adviser valued Fund 2 and 3's ownership interest in Asset 5 at the amount Funds 2 and 3 contributed as capital. The Adviser determined that "the capital contributed to the LLC is a good measure of fair market value" because "the transaction occurred within a few weeks of the year end."

215. In 2015, the Adviser also valued Fund 3's promissory note at par value "because the transaction occurred within a few weeks of the year end."

216. SKR agreed stating that "due to the small amount of time between the date the note was made and year end and no paydowns on the note prior to year end – it is reasonable the note is valued at par value." SKR also considered the collectability of the note based on the borrower's ability to repay it.

217. SKR failed to consider that the capital contributed and the loan amount may not represent fair value because these transactions with the construction company may not have been at arms-length given the relationship between the president of the Adviser and the construction company. Consequently, SKR did not obtain sufficient evidence that contributed capital or the loan amount represented the fair value of the loan or the investment in the construction company. These failures violated PCAOB standards, including AS 2410.12, AS 2502.03, AS 2805.02, and AS 2301.11. These failures violated GAAS, including AU-C 330.03, AU-C 500.06, AU-C 330.28, AU-C 500.09, AU-C 501.06, AU-501.08, AU-C 505.03, AU-C 540.06, AU-C 540.12, AU-C 540.13, AU-C 540.A33, AU-C 550.03, and AU-C 550.05.

218. Fund 3's promissory note to the LLC was repaid in April 2016.

219. In 2016, the Adviser valued the fund's ownership interests in Asset 5 by performing a discounted cash flow ("DCF") analysis based on net operating income. SKR failed to obtain and sufficiently evaluate audit evidence for the valuation cash flows and assumptions supporting the valuation of Asset 5. These failures violated PCAOB standards, including AS 2502.03, AS 2805.02, and AS 2301.11. These failures violated GAAS, including AU-C 330.03, AU-C 500.06, AU-C 330.28, AU-C 500.09, AU-C 501.06, AU-C 501.08, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A33.

220. In both 2015 and 2016, SKR did not obtain sufficient evidence of the funds' ownership interest in the LLC. These failures violated PCAOB standards, including AS 1105.04, AS 1105.08, and AS 2310.06. These failures violated GAAS, including AU-C 330.03, AU-C 330.18, AU-C 500.06, AU-C 505.02, and AU-C 505.03, AU-C 580.04 and AU-C 240.A38.

**vii. Fund 3 – Asset 6: Failure to obtain evidence of valuation and existence**

221. Fund 3 owned an interest in an LLC formed by third-parties ("Asset 6") that in turn owned an interest in undeveloped land.

222. In 2015, the Adviser's valuation on its face valued the land and not the LLC whose fair value could be different from the land. SKR did not obtain sufficient audit evidence

to determine whether or not there were any other assets or liabilities or if Asset 6 was just a pass through entity. SKR failed to obtain sufficient appropriate audit evidence regarding the valuation of Asset 6 including (1) failing to consider that the Adviser valued the land and not the LLC whose fair value could be different from the land; (2) primarily relying on management representations and an undated purchase offer; and (3) ignoring information inconsistent with valuing the asset at the same amount as the prior year. These failures violated PCAOB standards, including AS 2502.03, AS 2502.26, AS 2502.29, AS 2805.02, and AS 2301.11. These failures violated GAAS, including AU-C 330.03, AU-C 500.06, AU-C 501.06, AU-C 330.28, AU-C 500.09, AU-C 501.06, AU-C 501.08, AU-C 505.03, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A33.

223. In 2016, the Adviser again valued the land and not the LLC whose fair value could be different from the land, and SKR did not obtain sufficient audit evidence to determine whether or not there were any other assets or liabilities or if Asset 6 was just a pass through entity. SKR failed to obtain sufficient appropriate audit evidence regarding the valuation of Asset 6 including (1) failing to consider that the Adviser valued the land and not the LLC whose fair value could be different from the land; (2) primarily relying on management and the same unsigned, undated potentially stale purchase offer used for the 2015 valuation; and (3) ignoring information inconsistent with the Adviser's valuation, including a recent sale of nearby land that sold for 56% above the Adviser's fair value. These failures violated PCAOB standards, including AS 2502.03, AS 2502.26, AS 2502.29, AS 2805.02, and AS 2301.11. These failures violated GAAS, including AU-C 330.03, AU-C 500.06, AU-C 330.28, AU-C 500.09, AU-C 501.06, AU-C 501.08, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A33.

224. In both 2015 and 2016, SKR failed to obtain sufficient appropriate evidence of the Fund's ownership percentage in Asset 6 and relied on management's representations regarding the ownership percentage. These failures violated PCAOB standards, including AS 1105.04 and 1105.08. These failures violated GAAS, including AU-C 330.03, AU-C 330.18, AU-C 500.06, and AU-C 505.02, AU-C 505.03, AU-C 580.04, and AU-C 240.A38.

**viii. Funds 2 and 3 – Asset 7: Failure to obtain evidence about existence and valuation; failure to perform retrospective review**

225. Funds 2 and 3 invested in a real estate fund formed by affiliates of the Adviser ("Asset 7"), which owned two apartment buildings (Buildings 1 and 2).

226. In 2015, the two buildings were valued by the Adviser at approximately \$5.3 million (Building 1) and \$3.7 million (Building 2).

227. The Adviser valued the buildings using a DCF model, which uses average capitalization rate as a significant input. The Adviser's valuation used the average capitalization rate for Class A and Class B properties,<sup>7</sup> without considering Building 1's characteristics. SKR

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<sup>7</sup> "Class A and Class B" properties are classifications of property used in real estate to communicate factors about the quality and rating of properties. Each property classification reflects a different risk and return as properties are graded on a variety of factors. Class A properties are typically the highest quality buildings in their market and area. Class B properties are a step down from Class A and generally older, tend to have lower income tenants, and may or

failed to evaluate the Class of building 1 and whether it was appropriate for the Adviser to use the average capitalization rate for Class A and Class B properties. These failures violated PCAOB standards, including AS 2502.03, AS 2805.02, and AS 2301.11. These failures violated GAAS, including AU-C 330.03, AU-C 500.06, AU-C 330.28, AU-C 500.09, AU-C 501.06, AU-C 501.08, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A33.

228. Fisher knew of Building 1's characteristics that likely made it a lower class of property, but did not question the Adviser's use of the average capitalization rate for Class A and B properties.

229. SKR did not obtain evidence showing these investments existed at December 31, 2015. This failure violated PCAOB standards, including AS 1105.08, and AS 2310.06. These failures violated GAAS, including AU-C 330.03, AU-C 330.18, AU-C 330.19, AU-C 500.06, AU-C 505.02, and AU-C 505.03, AU-C 580.04, and AU-C 240.A38.

230. The Adviser valued the property based upon an estimated fair market value ("FMV") using an appraisal of the building, plus assets, minus liabilities. In 2016, SKR failed to obtain sufficient appropriate evidence regarding the fair value of Building 2. This failure violated PCAOB standards, including AS 2502.03, AS 2502.23-42, AS 2503.38, AS 2503.40, AS 1210.08, AS 1210.09, and AS 1210.12. These failures violated GAAS, including AU-C 330.03, AU-C 500.06, AU-C 330.28, AU-C 500.09, AU-C 501.06, AU-C 501.07, AU-C 501.08, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A33.

231. SKR never saw the appraisal and its evidence of value was limited to an internal Adviser email where an employee of the Adviser said that a manager of Building 2 told him that the building manager had an appraisal of the building and the property had a mortgage. This failure violated PCAOB standards, including AS 1105.04 and AS 2502.03. This failure violated GAAS, including 500.08 and AU-C 501.07.

232. SKR and Fisher knew Building 1 sold in 2016 but failed to perform a retrospective review to evaluate if there was any bias in the Adviser's 2015 estimate or analyze the valuation difference. Information sent to SKR notes that Building 1 was sold in April 2016 for \$500,000 less than the Adviser's December 31, 2015 fair value estimate. This failure violated PCAOB standards, including AS 2401.64. This failure violated GAAS, including AU-C 240.32, AU-C 540.21, and AU-C 560.15.

233. SKR did not obtain evidence that the funds owned the real estate fund, or that the real estate fund owned Building 2. This failure violated PCAOB standards, including AS 1105.04, AS 1105.08 and AS 2310.06. These failures violated GAAS, including AU-C 330.03, AU-C 330.18, AU-C 500.06, and AU-C 505.02, AU-C 505.03, AU-C 580.04, and AU-C 240.A38.

**ix. Funds 2 and 3 – Asset 8: Failure to obtain evidence about valuation.**

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may not be professionally managed. Class C properties are typically more than 20 years old and located in less than desirable locations.

234. Fund 2 and Fund 3 each owned an interest in another real estate fund (“Asset 8”), which in turn owns apartments.

235. SKR failed to obtain sufficient appropriate audit evidence of valuation. The Adviser valued the investment based on a market value assessment provided by the manager for the apartments that noted that the manager had annual appraisals of the underlying assets, which provided reasonable FMV estimates. SKR did not evaluate the manager’s estimate or evaluate the underlying appraisal as required. SKR also did not check the mathematical accuracy of the Adviser’s calculation. This failure violated PCAOB standards, including AS 2502.03, AS 2805.02, and AS 2301.11. These failures violated GAAS, including AU-C 330.03, AU-C 500.06, AU-C 330.28, AU-C 500.09, AU-C 501.06, AU-C 501.07, AU-C 501.08, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A33.

236. SKR did not confirm existence or obtain sufficient evidence regarding Fund 2 and 3’s ownership interests. SKR tested the Adviser’s purchase of this asset but not whether the fund still held the investment at year-end. This failure violated PCAOB standards, including AS 1105.08 and AS 2310.06. These failures violated GAAS, including AU-C 330.03, AU-C 330.18, AU-C 500.06, AU-C 505.02, AU-C 505.03, AU-C 580.04, and AU-C 240.A38.

**x. Funds 2 and 3 – Asset 9: Failure to obtain evidence about valuation**

237. Fund 2 and Fund 3 each owned an interest in another real estate fund (“Asset 9”), which in turn owned an apartment.

238. SKR failed to obtain sufficient appropriate audit evidence of valuation. The Adviser valued the investment based on a market value assessment provided by the manager for the apartments. SKR noted in its 2015 and 2016 work papers that the estimated value is the manager’s “best estimates of current market values” but the work papers fail to mention that the manager also states the value is not based on an independent appraisal. SKR did not evaluate the manager’s estimate, including evaluating the underlying methodology or assumptions as required. SKR also did not check the mathematical accuracy of the Adviser’s calculation. This failure violated PCAOB standards, including AS 2502.03, AS 2805.02, and AS 2301.11. These failures violated GAAS, including AU-C 330.03, AU-C 500.06, AU-C 330.28, AU-C 500.09, AU-C 501.06, AU-C 501.07, AU-C 501.08, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A33.

239. SKR did not confirm existence or obtain sufficient evidence regarding Fund 2 and 3’s ownership interest. SKR tested the Adviser’s purchase of this asset but not whether the fund still held the investment at year-end. This failure violated PCAOB standards, including AS 1105.08 and AS 2310.06. These failures violated GAAS, including AU-C 330.03, AU-C 330.18, AU-C 330.19, AU-C 500.06, AU-C 505.02, AU-C 505.03, AU-C 580.04, and AU-C 240.A38.

**xi. Fund 2: Failure to Properly Evaluate Misstatements**

240. As discussed above, PCAOB standards and GAAS require SKR to document accumulated misstatements and evaluation of uncorrected misstatements, including the quantitative and qualitative factors the audit team considered to be relevant to the evaluation. AS 1215.12; AU-C 450.05.

241. For Fund 2's 2016 audit, SKR prepared a "Summary of Unadjusted Misstatements" that accumulated misstatements identified during the audit that had not been corrected by management, which totaled approximately \$483,000. SKR concluded that the \$483,000 "was immaterial individually and in the aggregate" without considering quantitative or qualitative factors regarding materiality. SKR did not document any evaluation or benchmark by which it evaluated audit differences. This failure violated PCAOB standards, including AS 2810.03, AS 2810.17, AS 1215.06 and AS 1215.12. This failure violates GAAS, including AU-C 450.11.

**xii. Summary of Audit Deficiencies for Fund 2 and Fund 3**

242. In sum, in connection with Funds 2 and 3, in 2015, SKR and Fisher failed to comply with the following PCAOB audit standards: AS 1101, AS 1105, AS 1215, AS 2301, 2310, AS 2401, AS 2410, AS 2502, AS 2503, AS 2805, AS 2810, AS 2905, AS 1015, and AS 1201.

243. In sum, in connection with Funds 2 and 3, in 2015, SKR and Fisher failed to comply with the following GAAS: AU-C 240, AU-C 330, AU-C 500, AU-C 501, AU-C 505, AU-C 540, AU-C 560, AU-C 580.

244. In sum, in connection with Funds 2 and 3, in 2016 SKR and Fisher failed to comply with the following audit standards: AS 1101, AS 1105, AS 1215, AS 2301, AS 2310, AS 2401, AS 2410, AS 2502, AS 2503, AS 2805, AS 2310, AS 2905, AS 1015, and AS 1201.

245. In sum, in connection with Funds 2 and 3, in 2016, SKR and Fisher failed to comply with the following GAAS: AU-C 240, AU-C 330, AU-C 500, AU-C 501, AU-C 505, AU-C 540, AU-C 560, AU-C 580.

246. In connection with Funds 2 and 3 – in 2015 and 2016, Kast failed to comply with AS 1220 and AU-C 220.22.

**xiii. Audit Deficiencies Related to Debt Funds (Funds 4, 5, and 6)**

247. SKR's audits for Funds 4, 5, and 6 also failed to meet PCAOB standards.

248. Funds 4, 5, and 6 are each debt funds holding a single Level 3 asset consisting of a credit facility to a single borrower that developed real estate.

249. Fund 4 was formed by affiliates of the Adviser and provides a letter of credit ("LOC") to the LLC discussed above as Funds 2 and 3, Asset 3. The executed letter of credit was dated February 28, 2014, although initial draws on the LOC were made on October 9, 2013 prior to execution of the agreement.

250. The loan balance on the LOC for Fund 4 was \$8,086,737 at an interest rate of 6% at 12/31/2015. The loan balance on the LOC for Fund 4 was \$18,297,314 at 12/31/2016 at an interest rate of 6.5%.

251. In 2015, the Adviser's valuation included a paragraph from the previous year describing the facility with a 2015 update that said "The loan is almost completely drawn up to the maximum line of \$25m. There was one sale by [the LLC that is Asset 5] in 2015 (P28) that resulted in a pay-down to the line of approximately \$3.3m. No conditions occurred during 2015 that would lead to a change in the valuation of the note."

252. The audit work papers for Fund 4 in 2015 noted that per discussion with an employee of the Adviser, the credit facility and Fund 4 were "established as the borrowers could not find other reasonable sources of financing. Due to the risk of the project, location, and the specific needs of the borrowers reasonable financing could not be found. The borrowers, who are also investors in various funds managed by [the Adviser], and [the Adviser] determined they could create a reasonable yield for investors and create a Fund to offer the credit facility."

253. Fund 5 was formed by Affiliates of the Adviser in 2015. It was funded by investors in September 2015. Its purpose was to provide a letter of credit to another construction company developing real estate in Hawaii.

254. The initial borrowing was made in October 2015. As of 12/31/2015, there was \$3,058,073 outstanding at an interest rate of 5.5%.

255. The audit work papers note that the credit facility and Fund 5 were established "as the borrowers could not find other reasonable sources of financing. Due to the risk of the project, location, and the specific needs of the borrowers reasonable financing could not be found." The work papers further noted that the "borrowers, who are also investors in various funds managed by [the Adviser], and [the Adviser] determined they could create a reasonable yield for investors and create a Fund to offer the credit facility."

256. Fund 6 was formed by affiliates of the Adviser in 2014. It again provided a loan for construction financing. As of 12/31/2015 the outstanding loan balance was \$8,087,737. The interest rate was 20% per year, with 8% paid quarterly and 12% added to the principal balance and paid quarterly.

257. The audit work papers note that the investment opportunity in Fund 6 was brought to the Adviser when an individual associated with the construction loan needed financing to pay off his previous lender and that Adviser was looking for alternative investments with appropriate yields.

258. In both years, SKR failed to test the existence of the credit facilities held by Funds 4, 5 and 6 as required by AS2310.06 and AU-C 330.19.

259. In 2015, the Adviser valued the investments at "cost basis for fair market value." This valuation method was not in accordance with GAAP, which defines fair value as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. This valuation methodology did not comply with GAAP.

260. In 2015, SKR failed to obtain sufficient audit evidence of fair value of Funds 4, 5, and 6. This failure violated PCAOB standards, including AS 2502.03, AS 2805.02, AS 2810.03, and AS 2301.11. These failures violated GAAS, including AU-C 330.03, AU-C 500.06, AU-C



330.28, AU-C 500.09, AU-C 501.08, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A33

261. In 2016, SKR failed to obtain sufficient appropriate evidence supporting the Adviser's DCF model, including failing to obtain sufficient evidence supporting the discount rate used. These failures violated PCAOB standards, including AS 2502.03, AS 2805.02, AS 2810.03, and AS 2301.11. These failures violated GAAS, including AU-C 330.03, AU-C 500.06, AU-C 330.28, AU-C 500.09, AU-C 501.06, AU-C 501.07, AU-C 501.08, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A33

262. In connection with the audits of Funds 4, 5, and 6, in 2015, SKR and Fisher failed to comply with the following PCAOB audit standards: AS 1101, AS 1105, AS 1215, AS 2301, AS 2310, AS 2401, AS 2502, AS 2503, AS 2805, AS 3101, AS 1015, and AS 1201.

263. In connection with the audits of Funds 4, 5, and 6, in 2015, SKR and Fisher failed to comply with the following GAAS: AU-C 330.03, AU-C 330.19, AU-C 500.06, AU-C 330.28, AU-C 500.09, AU-C 501.08, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A33.

264. In connection with the audits of Funds 4 and 5, in 2016, SKR and Fisher failed to comply with the following audit standards: AS 1101, AS 1105, AS 1215, AS 2301, AS 2310, AS 2401, AS 2502, AS 2503, AS 2805, AS 3101, AS 1015, and AS 1201.

265. In connection with the audits of Funds 4 and 5, in 2016, SKR and Fisher failed to comply with the following GAAS: AU-C 330.03, AU 330.20, AU-C 500.06, AU-C 330.28, AU-C 500.09, AU-C 501.06, AU-C 501.07, AU-C 501.08, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A3

266. In connection with the audits of Fund 6, in 2016, SKR and Fisher failed to comply with the following audit standards: AS 1101, AS 1215, AS 2301, AS 2310, AS 2401, AS 2805, AS 3101, AS 1015, and AS 1201.

267. In connection with the audits of Fund 6, in 2016, SKR and Fisher failed to comply with the following GAAS: AU-C 330.03, AU-C 330.19, AU-C 500.06, AU-C 330.28, AU-C 500.09, AU-C 501.06, AU-C 501.07, AU-C 501.08, AU-C 540.06, AU-C 540.12, AU-C 540.13, and AU-C 540.A33

268. In connection with Funds 4, 5, and 6, in 2015 and 2016, Kast failed to comply with AS 1220 and AU-C 220.22.

### **SKR WAS NOT INDEPENDENT**

269. The exception to the Custody Rule relied upon by the Adviser required that it receive and distribute an audit report prepared by an independent public accountant.

270. For purposes of assessing compliance with the Custody Rule, the Commission looks to whether an accountant is independent under the Commission's independence rules set forth in Regulation S-X, Rule 2-01.

271. SKR was not independent under these rules for the reasons described below and thus caused the Adviser to violate the Custody Rule.

272. PCAOB AS 1005 requires an auditor to maintain independence and notes that the SEC has also adopted independence rules.

273. PCAOB Rule 3520 requires that an auditor be independent of the audit client throughout the engagement period and note 1 specifies that “Under Rule 3520, a registered public accounting firm or associated person’s independence obligation with respect to an audit client encompasses not only an obligation to satisfy the independence criteria applicable to the engagement set out in the rules and standards of the PCAOB, but also an obligation to satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the Commission under the federal securities laws.”

274. PCAOB Rule 3526 provides, among other things, that a registered public accounting firm must, at least annually with respect to each of its audit clients: (1) describe in writing to the audit committee all relationships between the audit firm and the audit client that, as of the date of the communication, may reasonably be thought to bear on independence; (2) discuss with the audit committee the potential effects of those relationships on the independence of the audit firm; and (3) affirm to the audit committee in writing that, as of the date of the communication, the firm is independent in compliance with PCAOB Rule 3520, *Auditor Independence*.

275. PCAOB Rule 3501(a)(v) provides that “The term ‘audit committee’ means a committee (or equivalent body) established by and among the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of the entity and audits of the financial statements of the entity; if no such committee exists with respect to the entity, the entire board of directors of the entity. For audits of non-issuers, if no such committee or board of directors (or equivalent body) exists with respect to the entity, ‘audit committee’ means the person(s) who oversee(s) the accounting and financial reporting processes of the entity and audits of the financial statements of the entity.”

276. Adviser did not have an audit committee. Instead of communicating relationships and services that may reasonably be thought to bear on independence as required by PCAOB Rule 3526, SKR misrepresented to the Adviser that there were none in both 2015 and 2016. These failures constitute improper professional conduct.

#### **A. Trustee Relationship**

277. Individual 1, an SKR partner, served as a trustee to a number of trusts that were invested in Adviser funds audited by SKR. As a result, SKR was not independent under Regulation S-X, Rule 2-01(c).

278. Rule 2-01(c) sets forth non-exclusive circumstances where accountants are not considered independent. Rule 2-01(c)(1) provides that:

An accountant is not independent if, at any point during the audit and professional engagement period, the accountant has a direct financial interest or a material indirect financial

interest in the accountant's audit client such as (i) Investments in audit clients. An accountant is not independent when: ... (C) The accounting firm, **any covered person** in the firm, or any of his or her immediate family members, **serves as voting trustee of a trust, or executor of an estate, containing the securities of an audit client**, unless the accounting firm, covered person in the firm, or immediate family **member has no authority to make investment decisions for the trust or estate**. (Emphasis added.)

279. Rule 2-01(f)(11)(iv) defines a covered person in the firm to mean "the following principals, shareholders, and employees of an accounting firm: . . . (iv) any other partner, principal, or shareholder from an 'office' of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit."

280. Individual 1 was a "covered person" because he was a partner in the same office as Fisher, the lead engagement partner in charge of the audits for the Adviser funds. Individual 1 did not serve on the audit engagement team.

281. In 2015, Individual 1 was a trustee and/or a member of the management committee for seven trusts or partnerships that had invested in eight Adviser funds audited by SKR, including Funds 7-14.

282. As both a trustee and/or member of the management committee, Individual 1 had authority to make investment decisions for the trusts/partnerships.

283. Two of the trusts did not have a management committee and the trust documents provided that "**The Trustee shall have power . . . to invest and reinvest in real or personal property of any kind....**" (Emphasis added.)

284. Three of the trusts had similar language regarding the powers of the trustee to invest and reinvest the trust estate but simultaneously contain provisions under which the trustee would be bound by recommendations of the management committee.

285. The two LLLPs provided for broad powers to the general partner, but also provided for a management committee.

286. For all of the trusts and partnerships with a management committee, Individual 1 was trustee or general partner and a member of a three-person management committee, which had responsibility to, "monitor and review the performance of the Trustee and the Investment Advisors, (ii) oversee and direct the scope of services to be performed by the Investment Advisors, and (iii) select and terminate the Investment Advisors as provided in Section 10.5."

287. The management committees met quarterly beginning in 2015.

288. Individual 1's role as trustee for entities that invested in some of the Adviser funds impacted SKR's independence for the 2015 audits.

289. As the engagement partner, it was Fisher's responsibility to ensure that all such potential conflicts were identified and resolved for independence purposes.

290. The audit team performed no specific audit procedures to capture relevant relationships to analyze and confirm SKR's independence.

291. SKR held an annual meeting in which partners and certain employees of the firm who worked on matters for the Adviser discussed services the firm provided to the Adviser.

292. Fisher did not document the annual meeting or any information she learned from the meeting in the work papers. In fact, the 2015 work papers do not identify any relationships or services for evaluation that could impair independence.

293. During the 2015 audits, the audit team sent Individual 1, as trustee, a confirmation concerning certain contributions and distributions on behalf of the trusts he represented, which he received and returned as trustee to the trusts. This confirmation was included in the work papers.

294. The contributions and distributions confirmed by Individual 1 related to six of the seven trusts of which he was a trustee or member of the management committee.

295. Fisher reviewed the work paper that contained the confirmation returned by Individual 1.

296. Fisher should have been aware of Individual 1's role and a potential independence issue based on information in the work papers.

## **B. Bookkeeping Services**

297. SKR provided bookkeeping services to Fund 2 in 2015 and 2016 when Fund 2 was also audited by SKR in those years.

298. Rule 2-01(c)(4) provides that:

An accountant is not independent, if, at any point during the audit and professional engagement period, the accountant provides the following non-audit services to an audit client:

(i) *Bookkeeping or Other Services Related to the Accounting Records or Financial Statements of the Audit Client.* Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including: (A) Maintaining or preparing the audit client's accounting records; ... (C) Preparing or originating source data underlying the audit client's financial statements.

299. SKR's bookkeeping services provided to Fund 2 impaired SKR's independence.

300. SKR's accounting services department created and maintained the accounting records underlying the financial statements audited by SKR.

301. Specifically, SKR's accounting services department:

- entered transactions into QuickBooks based upon information provided by the Adviser or an accountant associated with Fund 2, including recording all investments into or out of the fund, interest or dividend income received by the fund, and expenses incurred by the fund;
- performed bank reconciliations by comparing the accounting transactions in QuickBooks to the activity reflected on the bank account statements; and
- sent the Adviser the year-end QuickBooks file and/or the general ledger exported from QuickBooks that the Adviser used to prepare the fund financial statements.

302. After receiving the QuickBooks file and/or the general ledger from SKR, the Adviser made journal entries to record the Level 3 assets at fair value. The Adviser then used that general ledger to prepare the fund financial statements, including the final balance sheet and income statements.

303. The audit engagement team then audited the final Fund 2 financial statements based in part on the general ledger prepared by SKR.

304. The Adviser paid SKR approximately \$200-\$670 per month for “bookkeeping services.”

305. It was Fisher’s responsibility to ensure that all such potential conflicts were identified and resolved for independence purposes.

306. The audit team performed no specific audit procedures to capture relevant relationships and services and to evaluate and confirm SKR’s independence.

307. Fisher was aware of SKR’s bookkeeping relationship in 2015.

308. In 2016, Fisher reviewed and approved a memo in the work papers concerning the bookkeeping that incorrectly concluded the bookkeeping relationship did not impair SKR’s independence.

309. PCAOB Rule 3526 required SKR to communicate to the Adviser all relationships and services that may reasonably be thought to bear on SKR’s independence. SKR told the Adviser there were none for the 2015 and 2016 audits.

## **VIOLATIONS**

310. As a result of the conduct described above, Respondents engaged in improper professional conduct within the meaning of Section 4C of the Exchange Act and Rule 102(e)(1)(ii) of the Commission’s Rules of Practice. Section 4C of the Exchange Act and Rule 102(e)(1)(ii) provide, in pertinent part, that the Commission may censure or deny, temporarily or permanently, the privilege of appearing or practicing before the Commission to any person who is found by the Commission to have engaged in improper professional conduct. Exchange Act 4C(b) and Rule 102(e)(1)(iv) define improper professional conduct with respect to persons licensed to practice as accountants.

311. Under Section 4C(b) and Rule 102(e)(1)(iv)(B), the term “improper professional conduct” means one of two types of negligent conduct: (1) a single instance of highly unreasonable conduct in circumstances for which heightened scrutiny is warranted; or (2) repeated instances of unreasonable conduct that indicate a lack of competence.

312. The audit failures of SKR, Fisher, and Kast constitute repeated instances of unreasonable conduct throughout the audits discussed above and also satisfy the single instance of highly unreasonable conduct standard as there were multiple single instances of highly unreasonable conduct since the audit of Level 3 assets warranted heightened scrutiny.

313. Further, questions regarding an auditor’s independence always warrant heightened scrutiny. *See* Final Rule: Amendment to Rule 102(e) of the Commission’s Rules of Practice, Release Nos. 33-7593; 34:40567; 35-26929; 39-2369; IA-1771; IC-23489; File No. S7-16-98) (“Because of the importance of an accountant’s independence to the integrity of the financial reporting system, the Commission has concluded that circumstances that raise questions about an accountant’s independence always merit heightened scrutiny.”).

314. As detailed above, the Adviser was required to comply with the Custody Rule or to satisfy its provisions by meeting an exception to it. During 2015 and 2016, the Adviser attempted to comply with this rule by relying on the audit exception. The Adviser failed to qualify for the Audit Exception because SKR did not conduct the Audits in accordance with GAAS auditing standards and was not independent. As a consequence, the Adviser violated the Custody Rule and the Respondents caused the Adviser’s violations of the Custody Rule.

### III.

In view of the allegations made by the Division of Enforcement and the Office of the Chief Accountant, the Commission deems it necessary and appropriate that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. Whether pursuant to Section 4C of the Exchange Act and Section 102(e) of the Commission’s Rules of Practice, Respondents should be censured or denied, temporarily or permanently, the privilege of appearing or practicing before the Commission as an accountant;

C. Whether, pursuant to Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, and whether Respondents should be ordered to pay a civil penalty pursuant to Section 203(i) of the Advisers Act.

#### IV.

IT IS ORDERED that a public hearing before the Commission for the purposes of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed by further order of the Commission, pursuant to Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.220(b).

IT IS FURTHER ORDERED that the Division of Enforcement and Respondents shall conduct a prehearing conference pursuant to Rule 221 of the Commission's Rules of Practice, 17 C.F.R. § 201.221, within fourteen (14) days of service of the Answer. The parties may meet in person or participate by telephone or other remote means; following the conference, they shall file a statement with the Office of the Secretary advising the Commission of any agreements reached at said conference. If a prehearing conference was not held, a statement shall be filed with the Office of the Secretary advising the Commission of that fact and of the efforts made to meet and confer.

If any Respondents fail to file the directed Answer, or fail to appear at a hearing or conference after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310.

This Order shall be served forthwith upon Respondents by any means permitted by the Commission's Rules of Practice.

The Commission finds that it would serve the interests of justice and not result in prejudice to any party to provide, pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), that notwithstanding any contrary reference in the Rules of Practice to service of paper copies, service to the Division of Enforcement of all opinions, orders, and decisions described in Rule 141, 17 C.F.R. § 201.141, and all papers described in Rule 150(a), 17 C.F.R. § 201.150(a), in these proceedings shall be by email to the attorneys who enter an appearance on behalf of the Division, and not by paper service.

Attention is called to Rule 151(a), (b) and (c) of the Commission's Rules of Practice, 17 C.F.R. § 201.151 (a), (b) and (c), providing that when, as here, a proceeding is set before the Commission, all papers (including those listed in the following paragraph) shall be filed electronically in administrative proceedings using the Commission's Electronic Filings in Administrative Proceedings (eFAP) system access through the Commission's website, [www.sec.gov](http://www.sec.gov), at <http://www.sec.gov/eFAP>. Respondents also must serve and accept service of documents electronically. All motions, objections, or applications will be decided by the Commission.

The Commission finds that it would serve the interests of justice and not result in prejudice to any party to provide, pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), that notwithstanding any contrary reference in the Rules of Practice to filing with or disposition by a hearing officer, all filings, including those under Rules 210, 221, 222, 230, 231, 232, 233, and 250 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.210, 221, 222, 230, 231, 232, 233, and 250, shall be directed to and, as appropriate, decided by the Commission. This proceeding shall be deemed to be one under the 120-day timeframe specified in Rule of Practice 360(a)(2)(i), 17 C.F.R. § 201.360(a)(2)(i), for the purposes of applying Rules of Practice 233 and 250, 17 C.F.R. §§ 201.233 and 250.

The Commission finds that it would serve the interests of justice and not result in prejudice to any party to provide, pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), that the Commission shall issue a decision on the basis of the record in this proceeding, which shall consist of the items listed at Rule 350(a) of the Commission's Rules of Practice, 17 C.F.R. § 201.350(a), and any other document or item filed with the Office of the Secretary and accepted into the record by the Commission. The provisions of Rule 351 of the Commission's Rules of Practice, 17 C.F.R. § 201.351, relating to preparation and certification of a record index by the Office of the Secretary or the hearing officer are not applicable to this proceeding.

The Commission will issue a final order resolving the proceeding after one of the following: (A) The completion of post-hearing briefing in a proceeding where the public hearing has been completed; (B) The completion of briefing on a motion for a ruling on the pleadings or a motion for summary disposition pursuant to Rule 250 of the Commission's Rules of Practice, 17 C.F.R. § 201.250, where the Commission has determined that no public hearing is necessary; or (C) The determination that a party is deemed to be in default under Rule 155 of the Commission's Rules of Practice, 17 C.F.R. § 201.155, and no public hearing is necessary.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Vanessa A. Countryman  
Secretary