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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No. 3-15168

Carol Fox Foelak
Administrative Law Judge

In the Matter of

JOHN J. AESOPH, CPA, and
DARREN M. BENNETT, CPA

Respondents.

RESPONDENT DARREN M. BENNETT'S POST-HEARING REPLY BRIEF

December 19, 2013

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INTRODUCTION

As set forth in his opening papers, the testimony and documentary evidence demonstrate that Darren Bennett met professional standards as the senior manager on the 2008 TierOne integrated audit. Along with Respondent John Aesoph, the engagement partner, Mr. Bennett appropriately assessed financial statement risks, identified the inherently subjective allowance for loan and lease losses ("ALLL") as a significant account, considered regulatory actions, and considered the risk of management bias. Focusing on TierOne's estimation process, he and the engagement team appropriately identified and tested key controls and performed enhanced substantive procedures regarding the reasonableness of the ALLL. Notwithstanding the Division's stubborn assertion to the contrary, Mr. Bennett and the engagement team obtained numerous forms of corroborating evidence, and they observed that annual loan losses recorded were not inconsistent with third-party market data. Significantly in the context of his role as the senior manager, each of his professional judgments challenged in this proceeding was reviewed and approved by multiple KPMG partners.

Mr. Bennett and the engagement team were not required to engage a credit risk specialist to assist in evaluating the reasonableness of the ALLL, but they did so here in an exercise of due professional care. They were not required to perform procedures on every FAS 114 loan in evaluating the reasonableness of the ALLL, but, again, they did so here in an exercise of due professional care. Among others, these enhanced procedures, designed to address risks appropriately identified, are among the reasons *why* a Rule 102(e) sanction is not warranted. That the Division attempts to use these enhanced procedures as a basis to second-guess Mr. Bennett's professional judgments is particularly dispiriting.

Mischaracterizing the record and misstating applicable professional standards, the Division insists in its post-hearing papers that Mr. Bennett committed both a "highly unreasonable" act and "repeated instances" of unreasonable acts. The Division's position hinges on a fundamental misunderstanding of the job of a public auditor. According to the Division, "[j]ust as TierOne prepared the FAS 114 loan loss estimates on a loan-by-loan basis, Respondents *audited* the FAS 114 loan loss estimates on a loan-by-loan basis." (Div. Br. 7 (emphasis added).) That assertion is wrong, contravening professional standards and the evidence. Auditors do not "audit" the fair value of the collateral supporting each FAS 114 loan, nor do they issue an opinion regarding any loan. Rather, they consider the reasonableness of the ALLL, including with respect to FAS 114 reserves, in the context of opining on the financial statements taken as a whole.

Unable to refute that risks were appropriately identified and substantial work was done, the Division struggles to impugn the credibility of Mr. Bennett. It claims that Mr. Bennett testified about an audit that was not documented and argues, consequently, that he ought not to receive credit for doing the work. The un-rebutted evidence is that the work about which Messrs. Bennett and Aesoph testified was performed. Any argument that the audit documentation is deficient ignores the role that judgment plays as contemplated by the applicable professional standards. And the Division's quibbling aside, the testimony at the hearing was *not* inconsistent with the workpapers.

The Division has a heavy burden under Rule 102(e) and failed to meet it. Conspicuously, the Division's own auditing expert, John Barron, did not conclude that Mr. Bennett's actions were "highly unreasonable" or repeatedly unreasonable—or "perfunctory", or "egregious", or any kind of threat to the Commission's processes. Rather, he opined half-heartedly that he would have made different professional judgments. Yet Mr. Barron has never audited a bank. And he did not read all of the workpapers here, nor look at a single loan file (among the limited loan files the Division saw fit to collect in its incomplete investigation). His hindsight opinion, contrary to that of all the KPMG auditors in the field and of Sandra Johnigan, a genuinely experienced bank auditor, cannot form the basis of a Rule 102(e) sanction. And issuing a sanction in these circumstances cannot be the message the Commission wants to send to the profession.

As demonstrated through days of earnest and credible testimony, Mr. Bennett is a careful, knowledgeable and hard working professional. He is a competent public auditor and poses no threat to the Commission's processes. The Order Instituting Public Administrative Proceedings ("OIP") against him should be dismissed.

I. THE DIVISION REPEATEDLY MISCHARACTERIZES THE RECORD.

Mischaracterizing the evidence is no basis for a Rule 102(e) sanction. In its post-hearing papers, however, the Division does it over and again.[1] For example, the Division argues throughout that the engagement team failed to obtain corroborating evidence in the course of evaluating TierOne's FAS 114 reserve estimates. As a predicate, it proposes as a finding of fact: "The FAS 114 template for the Jerry Dannenberg loan documents only that the auditors ticked and tied calculations, obtained the original, March 2008 appraisal and agreed the amount to the template, and noted that the loan was undergoing a workout plan." (DF ¶ 210.) The proposed finding is entirely misleading, as the record shows the engagement team corroborated information regarding the fair value estimate for the Jerry Dannenberg loan along with many

[1] Throughout this Post-Hearing Reply Brief, Mr. Bennett addresses many, though not all, of the Division's Proposed Findings of Fact (referenced herein as "DF") that are not substantiated by the record. The fact that a given DF is not addressed herein should not be construed as an agreement by Mr. Bennett that it is substantiated by the record. (*See generally* Respondents' Joint Proposed Findings of Fact ¶¶ 1-522 (cited herein as "JPF ¶ __").)

others loans. For example, the Division ignores that the Jerry Dannenberg FAS 114 template contains a variety of loan-specific information pertinent to a fair value assessment, including that the collateral was a "4 bdr [bedroom], 2.5 baths SFR [single-family residence] located in Fountain Hills, AZ," that the appraised value was $2,550,000, and that this was an "as completed" value as of March 12, 2008. (Resp. Ex. 8M, L-32 Series at L-32.1 FAS 114 - Impaired Reserves, KPMGTO0005485-5520, at 5503.) Further, the appraisal in the loan file, which was obtained by the engagement team as indicated in the workpapers (*see id.*), corroborated that the loan in process (LIP) reflected in the FAS 114 template was sufficient to cover the cost of completion. (Hr'g Tr. 1358:8-1362:10 (Barron); JPF ¶ 343.) These are precisely the types of facts and circumstances that the engagement team considered in evaluating the reasonableness of management's fair value estimates. (*See* Bennett Br. 21-24; JPF ¶¶ 321-24.) In fact, Jerry Dannenberg is one of the loans that, when Mr. Barron was confronted at the hearing with documentation from the loan files, he was forced to admit his report wrongly asserted that information in the FAS 114 templates was "uncorroborated".[2] (JPF ¶¶ 482-84; *see also id.* 343-44.)

[2] Similarly, the Division proposes as a predicate fact: "The FAS 114 template for the Streamline Construction loans documents only that the auditors ticked and tied the calculations and 'noted, based on current information TierOne did not think it was necessary to discount this appraisal. KPMG recommended that management order a new appraisal in order to assess future reserves, if necessary.'" (DF ¶ 223.) The Division ignores that the Streamline Construction FAS 114 template also documents that the engagement team agreed the fair value estimates for several of the Streamline Construction loans to appraisals in a prior quarter (indicated by the "t" tick mark next to the fair value estimates). (Resp. Ex. 8M, L-32 Series at L-32.1 FAS 114 - Impaired Reserves, KPMGTO0005485-5520, at 5497; *see also* JPF ¶¶ 343-44.) The engagement team agreed the fair values to the appraisals during interim review work in the third quarter 2008, as documented on the third quarter 2008 Streamline Construction FAS 114 template. (Resp'ts Ex. 15, Q3 2008 Work Paper Binder (1/2) at QC-2.3A, KPMGTO0001780-1802, at 1797.) The year-end FAS 114 template also documents that the engagement team verified that the estimated number of months to sales had not changed since the prior quarter (as indicated by the "t" tick mark next to the estimated number of months to sales). (Resp. Ex. 8M, L-32 Series at L-32.1 FAS 114 - Impaired Reserves, KPMGTO0005485-5520, at 5497; *see also* JPF ¶¶ 343-44.) Notably, Streamline Construction is another loan that, when confronted with corroborating documentation from the loan files that the auditors had obtained, Mr. Barron was forced to admit his report wrongly asserted that information in the FAS 114 templates was "uncorroborated". (JPF ¶¶ 482-84; *see also id.* 343-44.)

In another example, the Division contends bluntly that the OTS was *not* being aggressive in its ALLL analysis in the Report of Examination ("ROE") completed in August 2008. (*See* Div. Br. 10; DF ¶ 436.) It does so, presumably, in an attempt to suggest that at year-end TierOne should have further increased the ALLL (beyond the increases it otherwise recorded since the ROE). The Division refuses even to acknowledge a contemporaneous memorandum dated July 30/31, 2008 from Kirk Teters, the OTS Field Examiner who conducted the 2008 TierOne full-scope examination, in which he stated directly that the OTS's ALLL analysis "was based on *aggressive* classifications." (JPF ¶ 214 (emphasis added).) The Division then proceeds to ignore each and every positive action taken by TierOne management after June 2008 to improve its credit administration practices, which the OTS itself acknowledged in the ROE and which Douglas Pittman, the OTS Field Manager in charge of the TierOne examinations, confirmed in his testimony at the hearing. These include:

- "In the March 2008 quarter, management filled the chief credit officer position and the newly created senior credit officer position with experienced candidates." (JPF ¶ 212.a.)

- "Management also contracted with a special assets consultant to assist in managing the Las Vegas portfolio." (JPF ¶ 212.b.)

- "Management further enhanced the credit administration department by expanding the special assets and loan recovery department, and hired an experienced loan workout specialist in August 2008." (JPF ¶ 212.c.)

- The Executive Vice President/Director of Lending "provided numerous management reports to the examiners that stratified the loan portfolio for analysis, and credit administration reports demonstrating active oversight." (JPF ¶ 212.d.)

- "Management developed an appropriate template in 2008 to measure quarterly impairment loss on impaired loans pursuant to SFAS No. 114." (JPF ¶ 212.e.)

- "Credit administration personnel prepare reports listing income property loans meriting attention based upon the following: at least one late payment during the past two years, insufficient cash flow to service the debt, a vacancy rate above 15 percent, borrowers who have not provided requested financials, and properties with adverse operating trends." (JPF ¶ 212.f.)
- "Similar reports for commercial, business, and agriculture loans are generated identifying loans with weak capital, liquidity, or collateral position." (JPF ¶ 212.g.)

The Division does not mention *any* of these facts in its post-hearing papers.[3]

In several instances at the hearing the Division attempted, unsuccessfully, to impeach Mr. Bennett with excerpts from his investigative testimony. In its post-hearing papers, the Division then recounts only snippets of those portions of the record, intently excising important context that firmly was established both at the hearing and in the investigative testimony. As just one example, the Division proposes as a finding of fact: "In his prior, sworn investigative testimony, Bennett testified KPMG tested the 10% discount [for HDB] by '*discussions with the client* about the status of the loan, status of the project, things of that nature.'" (DF ¶ 230 (emphasis added).) The Division ignores the portion of the record that immediately follows:

> "MR. BENDINGER: With all due respect, Your Honor, there's more than just simply looking at a line on a FAS 114 sheet and focusing on that and ignoring all of the work that was done to test this process. And in fairness to Mr. Bennett, you can't single out just a line that seems to fit their theory and ignore the other stuff that's inconsistent.
>
> JUDGE FOELAK: I agree. Let's move on."

(Hr'g Tr. 655:7-15.) Contrary to the Division's insinuation, the fact that the engagement team discussed the HDB appraisal discount with management does not suggest that inquiry of

[3] Likewise, the Division argues that Mr. Bennett wrote in an email to Mr. Aesoph that he wanted to keep forensics' involvement in the audit planning process to a "minimum." (Div. Br. 17 n.11; DF ¶ 92.) The Division ignores Mr. Bennett's explanation in the same email as well as at the hearing that the "minimum is appropriate" based on his experience with forensic professionals on other audits and that it was not appropriate under the circumstances to approach the 2008 TierOne integrated audit as "a forensic investigation of sorts". (JPF ¶ 174.)

management was the *only* audit evidence considered in evaluating the reasonableness of the HDB fair value estimate. Rather, the evidence demonstrates that the engagement team performed a variety of substantive procedures. (*E.g.*, Bennett Br. 21-24; JPF ¶¶ 305-98.) Indeed, as Mr. Bennett explained at the hearing, he "carried around" copies of materials from the HDB loan file during 2008 to help him "understand how that complex loan was being accounted for." (Hr'g Tr. 508:23-509:19 (Bennett); Bennett Br. 24; JPF ¶ 339.) And as the record shows, that loan file contained detailed Loan Analyses setting forth reasoned reserve analyses. (*E.g.*, JPF ¶ 344 (explaining with respect to the development project why management "expected that a number of the below market contracts will fall out due to the purchasers ability to procure financing, divorce, death, etc." and, consequently, that "[t]he contracts that fall out could be resold at higher market prices").) Far from suggesting that the engagement team relied *only* on management representations, the record confirms that management inquiry was just one part of the engagement team's detailed FAS 114 test work. (Bennett Br. 22-24; *e.g.*, JPF ¶¶ 241, 316, 322, 330-34, 349, 372-73.)

With similar guile, the Division attempts to undo Mr. Bennett's credibility by repeatedly prefacing descriptions of his hearing testimony with the term "claimed". The effort was not subtle—the Division used some variation of this term more than *sixty* times in its post-hearing papers. Such a ploy should not be credited. Mr. Bennett was on the witness stand for the better part of two full days. Under oath, he answered *every* question he was asked, directly and sincerely, regardless of whether posed by the Division, the Court, or his own counsel. He explained his actions and professional judgments accurately and in an appropriate context. He was well versed in the applicable professional standards. Even Mr. Barron admitted Mr. Bennett was technically competent and knowledgeable regarding both FAS 114 and FAS 157. (Bennett

Br. 39; JPF ¶¶ 20, 471). And in a telling admission by one of the Division's own witnesses, Mr. Pittman confirmed Mr. Bennett's credibility. Specifically, with respect to a workpaper Mr. Bennett prepared summarizing his February 2009 conversation with the OTS Field Manager, Mr. Pittman testified unequivocally that the document accurately reflected his statements to the auditors, including that "the OTS has been receiving the Company's responses to the OTS comments in a timely ma[nn]er and the submissions to date have been satisfactory," "the overall relationship between the OTS and the Company has been positive," and "the Company is working diligently to clear the issues noted by the OTS." (JPF ¶¶ 209-10.) Mr. Pittman testified further that, contrary to the Division's suggestion at the hearing, neither Mr. Bennett nor Mr. Aesoph asked the regulators for any assurance that TierOne had corrected all of its problems, or that the bank would not fail, and that neither Mr. Bennett nor Mr. Aesoph suggested the 2008 ROE was "not serious". (JPF ¶ 208.)

The Division could have called additional witnesses—from TierOne or KPMG, or both—in an effort to refute Mr. Bennett's testimony. It chose not to do so, and for good reason. Mr. Bennett was credible. He was knowledgeable. And he was sincere. Simply sneering at his testimony in post-hearing papers does not expunge it from the record.

II. THE DIVISION MISSTATES, OR SIMPLY MISUNDERSTANDS, THE AUDITORS' JOB.

Possibly the most significant disconnect in the Division's post-hearing papers is its contention regarding audit procedures around impaired loans. According to the Division, "[j]ust as TierOne prepared the FAS 114 loan loss estimates on a loan-by-loan basis, Respondents *audited* the FAS 114 loan loss estimates on a loan-by-loan basis." (Div. Br. 7 (emphasis added).) Rather than a mere gloss on words, the Division's contention ignores evidence of the engagement team's conduct and contravenes professional standards. To base a Rule 102(e) sanction on a misinterpretation of professional standards would be fundamentally unfair and a violation of basic due process.

Under professional standards, an auditor is not responsible for expressing an opinion regarding a company's individual accounting estimates, let alone one component of an accounting estimate such as the FAS 114 reserves within the overall ALLL. (Bennett Br. 8; JPF ¶¶ 78, 85.) To the contrary, the auditor expresses an opinion regarding the presentation of management's financial statements and its internal control over financial reporting ("ICOFR"). (*See* Bennett Br. 8; JPF ¶ 70.) In doing so, the auditor's objective is to obtain reasonable assurance that the financial statements are free of material misstatements and that no material weaknesses exist. (*See* Bennett Br. 8; JPF ¶ 71.) The auditor seeks appropriate evidential matter to provide a reasonable basis for the opinion. (*See* Bennett Br. 8; JPF ¶ 73.)

One aspect of that work, and with respect to an accounting estimate such as the ALLL in particular, the auditor's objective is to reach a conclusion regarding the reasonableness of the estimate in the context of the financial statements taken as a whole. The Division's expert Mr. Barron agrees. (JPF ¶¶ 78-79.) He also agrees that reaching this conclusion does not involve determining whether the financial statements contain the "right amount" for the ALLL (JPF ¶ 87), or even whether the financial statements contain the amount "best supported by the evidence." (JPF ¶ 87; *see also id.* ¶ 84.) Reasonableness should be evaluated in the context of a range rather than a precise point. (JPF ¶ 45 & n. 75.) In assessing the reasonableness of TierOne's ALLL at December 31, 2008, the engagement team did in fact review each FAS 114 template (JPF ¶ 322) and thereafter perform a variety of procedures with respect to each FAS 114 loan (JPF ¶¶ 305-98). But addressing each FAS 114 loan was an exercise of heightened skepticism and due care, not the manifestation of any obligation to "audit" the reserves recorded for each impaired loan on an individual basis, or to render an opinion on the fair value of the collateral supporting each impaired loan.

The Division's argument that KPMG was obligated to "audit" each FAS 114 reserve—and that Respondents admitted this obligation—is another exercise in mischaracterization. (*See* Div. Br. 20 n. 16.) In effect, the Division tethers together sound bites teased out of witnesses and ignores the full context of the record. For example, the Division relies in one instance on testimony from Mr. Bennett in which he agreed in response to a specific question that the fair value of a given impaired loan supported by a given appraisal is determined on an individual basis.[4] (*See* DF ¶ 150 (citing Hr'g Tr. 501:22-502:8 (Bennett)).) That does not amount to an admission that the engagement team audited each impaired loan reserve as if it were a stand-alone financial statement assertion. In another instance, the Division relies on testimony from Mr. Bennett in response to its question whether he "*reviewed* the loss estimates on the FAS 114 loans on a loan-by-loan basis," to which he answered, "Correct." (DF ¶ 149 (citing Hr'g Tr. 499:4-6 (Bennett)).)[5] Again, the Division did not ask whether the engagement team *audited* each impaired loan reserve. The Division attempts the same trick with Ms. Johnigan's testimony. (*See* Div. Br. 7, 56-57 (citing DF ¶ 490).) But the immediate context makes clear that the Division's questions, and Ms. Johnigan's responses, were focused on the nature of FAS 114 procedures *within* the context of testing the ALLL estimation process, not on any supposed obligation to audit each FAS 114 reserve:

[4] The Division also relies on, and misconstrues, a portion of Mr. Aesoph's testimony. (DF ¶ 327.) In that instance, Mr. Aesoph endeavored to explain the context of audit procedures regarding FAS 114 templates, which were part of "developing our understanding of the allowance for loan loss" (Hr'g Tr. 850:20-24 (Aesoph)), and that "our audit approach here was, was assessing management – management's process to developing this estimate … and I reviewed the FAS 114 templates – you know, I had a couple of things in mind …. How was this company valuing its impaired loan portfolio? What process were they going through? And that's why we looked at each one of these [FAS 114 templates] every quarter." (Hr'g Tr. 854:1-7, 13-25 (Aesoph).)

[5] For the same reasons, the Division's reference to Respondents' supposed "own admission that impaired loans must be audited on a loan-by-loan basis" has no support. (*See* Div. Br. 20 n. 16.)

Q. And it's fair to say that TierOne as part of that process created the FAS 114 templates, and those were done on a loan-by-loan basis?

A. Yes.

Q. And it's also fair to say that KPMG, when they were *testing the process*, as you stated, tested the process by looking at the FAS 114 templates on a loan-by-loan basis?

A. In the *reviewing and testing of the process*, they did look at all of those templates, yes.

Q. And that's because determining fair value is a loan-by-loan, case-by-case analysis, right?

A. Let me put that in two parts. The measurement of it on a loan-by-loan basis is management's responsibility. And testing it would then be testing that loan-by-loan analysis at some level. And here they got all of the templates and *they tested the templates*."

(Hr'g Tr. 2123:16-2124:8 (emphases added).) As Ms. Johnigan clearly delineated in this response, *management* is obligated to estimate FAS 114 reserves on a loan-by-loan basis—that does not mean the engagement team was obligated to *audit* each one or even to perform procedures regarding each one in reaching its conclusion that the ALLL was reasonable at December 31, 2008. The Division's mischaracterizations are particularly disingenuous given that Ms. Johnigan, and Messrs. Bennett and Aesoph, testified unequivocally at the hearing that the professional standards did not require KPMG to audit each FAS 114 reserve on a stand-alone basis. (Bennett Br. 8; JPF ¶¶ 78, 85 (citing testimony from Ms. Johnigan, Mr. Aesoph ("We're not opining on individual loans.") and Mr. Bennett).) The engagement team performed certain procedures on each FAS 114 loan to consider the reasonableness of those individual reserves in the context of considering the reasonableness of the overall ALLL. Penalizing auditors, though, for doing more work, *i.e.*, procedures on each impaired loan, is not the intended effect of Rule 102(e).

In the end, the Division's sole support for its contention that the engagement team was required to audit TierOne's FAS 114 reserves on a loan-by-loan basis is the testimony of the Division's expert, Mr. Barron, who is not a bank auditor. Even his opinions, though, are contradicted by his admissions elsewhere regarding the professional standards that are applicable here. (*See* Div. Br. 7 n. 4, 56 (citing DF ¶ 385).) What is clear is that the Division identified no professional standard requiring an auditor to render an opinion on the ALLL itself, let alone on each component FAS 114 reserve. No such standard exists. According to basic due process and fundamental fairness, no Rule 102(e) finding can be predicated on such a mischaracterization—or novel interpretation—of the professional standards. (*See* Bennett Br. 43-44; JPF ¶ 78 & n. 136 (if the Division were correct, the "standards would have to be rewritten" (Johnigan)).)

III. THE DIVISION CANNOT REFUTE THE UNDERLYING EVIDENCE ESTABLISHING THAT MR. BENNETT MET PROFESSIONAL STANDARDS.

The Division's effort to invent new standards must derive from an acknowledgment that Mr. Bennett and the engagement team met professional standards. They performed extensive audit procedures in evaluating the reasonableness of TierOne's ALLL at December 31, 2008, including with respect to the FAS 114 reserves. The procedures consisted of, *inter alia*, engaging a credit risk specialist to conduct loan reviews *three times* during the year[6]—when involving a specialist at all was not required—and performing various substantive procedures on *all* of the impaired loans—when that, too, was not required. (Bennett Br. 19-30; *e.g.*, JPF ¶¶ 180, 191, 200, 317-18, 322, 355-56.) The Division cannot refute the underlying facts, which are set forth in comprehensive detail in Respondents' Joint Proposed Findings of Fact (JPF ¶¶ 161-428) and addressed in Mr. Bennett's Post-Hearing Brief (Bennett Br. 9-35).

[6] The engagement team involved the credit risk specialist in October 2008 specifically in response to the 2008 ROE to assist in assessing whether any systemic issues existed with respect to the risk rating process. (Bennett Br. 14; JPF ¶ 200.)

A. Understanding and Testing the ALLL Process and Obtaining Corroborating Evidence through Substantive Procedures

There is no dispute that TierOne's ALLL estimation process, appropriately, was a central focus of the 2008 TierOne integrated audit. (*See* JPF ¶ 462.c; *see also id.* ¶¶ 218-31, 251, 303.) The Division's expert, Mr. Barron, conceded that the engagement team appropriately developed an understanding of that estimation process, which understanding was well-documented in the audit workpapers. (Bennett Br. 12; JPF ¶ 471; *see also id.* ¶¶ 218-221, 223-231.) He acknowledged that professional standards set forth three alternative approaches for testing the reasonableness of the ALLL. (JPF ¶¶ 80-83, 475; Resp'ts Ex. 61, AU § 342.10(a)-(c).) He also acknowledged that the approach Mr. Bennett and the engagement team selected—to review and test management's ALLL estimation process—was both appropriate and the one that "makes the most sense." (JPF ¶¶ 80-83, *id.* ¶¶ 306-07.) As the record further shows, the engagement team performed a variety of enhanced substantive procedures in testing management's estimation process.[7] (*See* Bennett Br. 21-30 (discussing, for example, credit review of loan files, review of the Reynolds Williams Group's work, FAS 114 loan procedures, state-by-state impaired loan trend analyses, and consideration of third-party market data); JPF ¶¶ 305-98.) And, as Ms. Johnigan explained, the audit evidence obtained, including third-party appraisals and other loan file documentation along with market data, provided competent and reliable audit evidence on which Mr. Bennett and the engagement team appropriately relied. (JPF ¶¶ 397, 462.a; *see also id.* ¶ 308.)

[7] The Division would have the Court believe that "ticking and tying" are, in effect, dirty words and *per se* evidence of a Rule 102(e) violation. (*See* Div. Br. 2, 3, 22-23, 26, 47 n.33; DF ¶ 154.) Ticking and tying are industry terms of art for auditing procedures fundamental to the execution of an assortment of control and substantive tests. Contrary to the Division's intimation, though, the evidence shows that the engagement team did a great deal more than ticking and tying when assessing the reasonableness of TierOne's ALLL and the component FAS 114 reserves. (JPF ¶¶ 218-413.) Likewise, the Division's accusatory pronouncement that "[m]anagement representations are never sufficient audit evidence" (Div. Br. 48) stubbornly ignores evidence of the many audit procedures performed.

In attacking the extensive substantive procedures performed to test management's ALLL estimation process, the Division's continued insinuation that the engagement team did not consult "the loan files for *any* purpose" (Div Br. 27 (emphasis added)) can only be described as denial.[8] (JPF ¶¶ 334-46.) The related insistence that the engagement team obtained appraisals—which themselves come from the loan files (JPF ¶ 336; *id.* ¶ 452)—by way only of discrete written requests and outside the context of the loan files (Div. Br. 27 n. 19) reflects a complete lack of understanding of bank audits. (JPF ¶¶ 336-38; *id.* ¶ 452 (based on Ms. Johnigan's experience, "when you review appraisals, you review them in the loan files").) Equally, the fact that the engagement team on occasion made discrete written requests for specific appraisals does not mean that those appraisals were delivered outside the context of the corresponding loan files. It also does not mean that the engagement team did not obtain loan files for other appraisals it reviewed, *i.e.*, other than the appraisals that were the subject of the discrete written request. Significantly, the Division chose not to call a single TierOne witness to refute Mr. Bennett's testimony on this issue, including at least one TierOne witness with whom the Division has a cooperation agreement. (JPF ¶¶ 125-27.)

The Division's assertion that Messrs. Bennett and Aesoph could not identify at the hearing "loan-specific evidence" to support management's FAS 114 reserve estimates ignores the evidence and the audit process. (Div. Br. 32-37.) Messrs. Bennett and Aesoph explained in detail their consideration of various forms of audit evidence regarding the reasonableness of the FAS 114 reserves. (Bennett Br. 21-24; *e.g.*, JPF ¶¶ 322-24.) In particular, they explained that the engagement team reviewed each FAS 114 template and, based on professional judgment,

[8] The Division's contention that Respondents "[t]ellingly ... did not introduce any loan files into evidence" is wrong. Respondents *as well as the Division* offered into evidence a variety of documents from the loan files. (JPF ¶ 338.) But they had prepared exhibit copies of the documents in advance and therefore did not need to physically open the loan file boxes arranged in the courtroom. (Bennett Br. 22 n.12.)

communicated with management to understand its rationale regarding various fair value estimates. (Bennett Br. 22; JPF ¶¶ 241, 316, 322, 330-34, 349, 372-73.) The engagement team then, again using professional judgment, corroborated management's representations, for example, by reviewing appraisals and other loan file documentation, considering market trends, and in some instances even viewing properties on Google Earth (notwithstanding the Division's reluctance to acknowledge the utility of the internet). (Bennett Br. 22-24; *e.g.*, JPF ¶¶ 310-12, 315, 323, 335-41, 343-46, 348, 372-74; Div. Br. 35.) Taking a step back they also considered whether annual loan losses recorded by TierOne during the period under audit were inconsistent with available market data. (*See infra* pp. 16-18, 24.) In order to better evaluate the significance of market trends, the engagement team also performed state-by-state analyses regarding TierOne's fair value estimates. (Bennett Br. 26-27; JPF ¶¶ 355-56, 362-64.)

Unable to refute that substantial audit work was performed in testing management's ALLL estimation process,[9] the Division leans heavily in its post-hearing papers on the misguided economic analysis of Dr. Anjan Thakor, an economist and *not* an auditor. Dr. Thakor's opinions were neither relevant nor helpful in evaluating Mr. Bennett's conduct with respect to the 2008 TierOne integrated audit. (*See* Bennett Br. 7 & n. 1; JPF ¶¶ 509-10, 522.) *First*, Dr. Thakor's purported calculations of what the ALLL "would have been if the market-discounted collateral had been used in TierOne's FAS 114 calculation" is irrelevant. (*See* Div. Br. 19-20; DF ¶¶ 2, 23; *see also* DF ¶¶ 26, 28, 30.) In estimating individual impaired loan reserves in accordance with GAAP, TierOne could *not* simply adopt an impairment measurement based on market indices. (*See* JPF ¶¶ 66, 152-55, 158, 374, 518; Div. Br. 19 & n. 14; DF ¶ 26 (citing Hr'g Tr. 171:1-3

[9] In parsing the specific FAS 114 procedures summarized in the two-page L-32 workpaper, the Division curiously describes as "only seven" the number of loans reviewed by the KPMG credit specialist that were impaired at year-end 2008. (Div. Br. 24.) The Division offered no evidence, or expert opinion, that the credit risk specialist should have reviewed more than seven such loans. Rather, Mr. Barron conceded that involving a credit risk specialist *at all* was a "good example of due care." (Bennett Br. 14; JPF ¶¶ 191, 200.)

(Thakor) (acknowledging, "[e]xactly what the magnitude of [any appraisal] adjustments should be has to be determined based on a case-by-case analysis")); JPF ¶ 515 (Barron) (Mr. Barron did not rely on Dr. Thakor's opinions, explaining that estimating fair value is "not simply a matter of applying a housing price index".).) Presumably, this is why Dr. Thakor made clear up front and in no uncertain terms that he was not "computing the required ALLL". (DF ¶ 23 (citing Hr'g Tr. 166:10-20 (Thakor)); *see also* Div. Br. 19 n. 14; JPF ¶¶ 66, 374, 515, 522.) Neither was he offering any opinions regarding TierOne's fair value estimates or the reasonableness of TierOne's ALLL. (JPF ¶¶ 515, 522; *see also id.* ¶¶ 510-11, 513.)[10]

Second, Dr. Thakor's opinion that TierOne's appraisals and appraisal discounts were inconsistent with market data is entirely flawed. (Div. Br. 18-19; DF ¶¶ 24, 26, 35.) Dr. Thakor relies solely on market indices that include distressed sales and foreclosures, as well as other misleading market information. (JPF ¶¶ 503-05, 512, 514, 517, 522; *see also id.* ¶ 522 (addressing Dr. Thakor's improper reliance on data from Lincoln Institute of Land Policy).) He also ignores that volatile real estate conditions and the level of distressed sales in the latter half of 2008 impacted the reliability of appraisals. (JPF ¶¶ 147-160, 506.)

Third, it is absurd to suggest that the economic analysis performed by Dr. Thakor—who is not an auditor—and his team of analysts at Navigant Consulting—who also are not auditors—was a required audit procedure. (*See* Div. Br. 17, 49-50; *see also* Hr'g Tr. 307:12-308:21 (Thakor).) As Mr. Bennett explained, the engagement team's consideration of market data was focused on "taking a [step] back" after evaluating information specific to each of TierOne's FAS 114 loans in order to gain an understanding of "what is happening at the macro level" and

[10] Based on his flawed economic analysis, Dr. Thakor did opine that there was a discrepancy between the market decline and the appraised value of the Celebrate 50 loan. (DF ¶ 42.) He ignored entirely that TierOne recorded substantial reserves for this loan *after* applying an appraisal discount of 50-55% during 2008. (JPF ¶¶ 366 n. 645, 368 n. 648, 386.a & n. 686.)

whether the fair value estimates were "inconsistent with what the company had actually recorded in their financial statements." (*See* Hr'g Tr. 536:3-537:24 (Bennett).) That is just what is contemplated by applicable auditing standards. (Resp'ts Ex. 60, AU § 328.26, .29.)[11]

Ironically, the Division argues that Mr. Bennett must be sanctioned both for not "auditing" each FAS 114 reserve on an individual basis and, at the same time, for not uniformly applying a macro-economic price decline to assess the fair value of each FAS 114 loan. Neither is warranted. Recognizing that the Case-Shiller index reflected an approximately 33% decline in 2008 for Nevada—the portion of TierOne's portfolio that is under the Division's microscope—and that the Case-Shiller index included distressed and disorderly sales that skewed the decline in excess of actual declines in fair value under FAS 157,[12] Mr. Bennett reasonably concluded that this data was not inconsistent with the approximately 30% loan losses recorded by TierOne in 2008 on its Nevada impaired loans. (*See* Bennett Br. 17, 25-26, 34.)

[11] Dr. Thakor has no basis to opine that Nevada, Arizona and Florida appraisals older than six months were "stale" and overstated property values at December 31, 2008. (*See* Div. Br. 14, 16, 48; DF ¶¶ 31, 33, 36, 38, 39.) Setting aside for the moment the flaws in his economic analysis discussed above, applicable accounting principles do not define "stale" appraisal nor was TierOne required to obtain "current" appraisals. (JPF ¶¶ 69, 96.) Moreover, as a non-auditor, Dr. Thakor is not qualified, nor was he accepted as an expert to opine on the relevance or persuasiveness of audit evidence. (Hr'g Tr. 111:23-112:14 (offering Dr. Thakor as an expert only in "finance and economic analysis").) The auditors in the field, Messrs. Bennett and Aesoph, along with the only bank auditor accepted as an expert, Ms. Johnigan, concluded that six to nine month old appraisals remained reliable data points at December 31, 2008. (JPF ¶ 383.)

[12] The Division harps on Mr. Bennett's supposed lack of recollection at the hearing of a KPMG audit program discussing FAS 157's application to other aspects of TierOne's financial reporting but not referencing impaired loan reserves. (Div. Br. 31, 52; DF ¶¶ 264-65.) Enough is enough. There can be no legitimate dispute that FAS 157 is the applicable accounting principle with respect to estimating the fair value of collateral supporting TierOne's impaired loans. (JPF ¶¶ 61, 119, 479.) TierOne disclosed it as such in its 2008 Form 10-K, and the auditors reviewed and were thoroughly familiar with that accounting standard and TierOne's disclosure during the 2008 integrated audit. (Bennett Br. 8 n.2; JPF ¶¶ 118-19, 230.) The fact that Mr. Bennett did not specifically refer to FAS 157 by name in his investigative testimony—when the Division never asked him about FAS 157—changes nothing. (*See* Bennett Br. 8 n.2.) Lastly, during the Division's direct case, which commenced on October 7 and concluded after a two-week intermission on October 28, the Division had ample opportunity to identify and designate portions of Mr. Bennett's investigative testimony that supposedly contradicted his hearing testimony regarding FAS 157. Following a several-hour break taken on October 28 for the express purposes of giving the Division one last chance, the Division came up empty-handed. (*See* Hr'g Tr. 1471:24-1494:25.)

Finally, the Division insists—having engaged an expert who never audited a bank—that "it is simply not proper to audit the adequacy of the ALLL at the balance sheet date by looking at charge-offs during the year." (Div. Br. 55 ("charge-offs tell us nothing").) It then proceeds to dissect the fiscal period under audit into pieces and argue that TierOne's loan losses recorded throughout the second half of the year are not consistent with quarterly market trends. This is too much. KPMG did not conduct an audit of TierOne's quarterly financial statements, nor was it required or expected to do so. Also, the OIP takes issue only with conduct related to the year-end 2008 integrated audit.[13] And on that point, FAS 114 requires management to estimate the amount of impairment, or loan losses, if any, that are probable and inherent for a loan *as of the reporting period date*. (*See* Bennett Br. 28; JPF ¶¶ 51, 477.) As Ms. Johnigan explained from the perspective of an experienced bank auditor, auditors therefore must focus on whether losses are recorded in the period under audit. (JPF ¶ 477.) The annual losses recorded here were not inconsistent with the available market data.

Based on all of the audit procedures documented in the workpapers, Mr. Bennett exercised his professional judgment and concluded that the overall ALLL, which included the

[13] Even Dr. Thakor acknowledged that quarterly market data from one index to another differs significantly and that relative consistency in the data can only be gleaned at the annual level.

> Q: That's what we've got on the board, that's the subject of your study on this chart. More granular, less consistency. Aggregate and blend on an annual basis, you get to your 33 percent range, right?
>
> A: Right. What I'm saying is that that's an artifact of these numbers. It's not some general rule that I can generalize from looking at these numbers.
>
> Q: I'm right about this set of market indices, correct?
>
> A: These numbers are what they are. So I'm not disagreeing with the numbers. They're my numbers from my chart.

(Hr'g Tr. 324:11-24 (Thakor).) On a related point, the Division's effort to carve out of the second half of 2008 certain larger losses recorded on impaired loans to isolate certain smaller losses recorded on other impaired loans is nothing more than a dodge of the audit evidence. (Div. Br. 29, 55 (isolating a supposed 1% loss recorded on a portion of the Nevada portfolio in the second half of 2008 by eliminating much more substantial losses recorded on other newly impaired loans in the Nevada portfolio).)

FAS 114 components, was reasonable. (JPF ¶¶ 396-97.) At the time, Mr. Aesoph, the engagement partner, and Terence Kenney, the SEC concurring review partner—with decades of bank auditing experience between them—agreed. (*Id.*) After reviewing all the workpapers and listening to all the hearing testimony, Ms. Johnigan also agreed. (*Id.*) That leaves only Mr. Barron's judgment. (JPF ¶ 75 & n. 131 ("It's not, you know, a black-and-white hard line, but that's basically their judgment that they based their design of their procedures on.").)

B. Testing Key Controls

Just as the Division seemed unconvinced at the hearing by its internal control allegations, it devotes only a sliver of its post-hearing brief to argue KPMG failed to test controls in accordance with professional standards. Specifically, it asserts KPMG failed to identify and test any control regarding "a specific risk point that the collateral underlying the FAS 114 loans could be overvalued". (Div. Br. 58-59.) The argument ignores the evidence of appropriate control testing and instead continues to dwell on "stale" appraisals, without regard for applicable guidance regarding fair value. (Div. Br. 38 ("control did not address whether appraisals were still current at year-end").)

As an initial matter, the Division ignores the role of Mr. Kellogg, TierOne's Controller, in reviewing and approving each FAS 114 fair value estimate prepared by the Special Assets Executive (JPF ¶ 244) as well as the ALLL as a member of the Asset Classification Committee ("ACC"). As documented in the workpapers, Mr. Kellogg confirmed to the engagement team that the ACC discussed "recent trends, status changes within the loan portfolios, reserve modification, and *FAS 114 impairments*." (JPF ¶ 284 (emphasis added).) Given Mr. Barron's acknowledgement at the hearing that review by the Controller from "outside the process" of developing the FAS 114 estimates "sounds like it could be an effective control", there is not much the Division can do to refute the point now. (Hr'g Tr. 1248:8-1249:1 (Barron); *see also* Bennett Br. 20; JPF ¶¶ 277-84 & n. 469.)

Unable to refute the fact that Mr. Kellogg reviewed and approved each FAS 114 fair value estimate or that the engagement team performed a number of control tests focusing on the Controller's and the ACC's review and approval of the ALLL, the Division argues primarily that the ACC was a high-level control and, thus, insufficient to address the identified risks. More precisely, and in an apparent effort to obscure the weight of the evidence, the Division argues, first, that "there is no evidence that [the] committee reviewed the specific FAS 114 *templates*", and, second, that "the ALLL *schedule* contains no information about the FAS 114 loans' underlying collateral values, appraisal dates, or appraisal discounts." (Div. Br. 59 (emphases added).) Notwithstanding the Division's sleight of hand, what the evidence makes clear—and what the Division conspicuously ignores—is that the ACC meeting minutes confirm that the committee reviewed a variety of detailed reports and backup materials regarding individual impaired loans, and that the engagement team obtained and reviewed both the meeting minutes and the backup materials in the course of control testing. (*See* JPF ¶¶ 277-304; Bennett Br. 18-20.)

That corroborating audit evidence contained extensive information regarding individual impaired loans, including property locations, appraisal dates, estimates of collateral values, loss/reserve amounts, and narrative and statistical discussion of recommendations for non-accrual and specific reserves. (JPF ¶¶ 290-96.) As just one example among many, the Classification of Assets reports provided to the ACC detailed the loan balance, risk rating, appraised value, appraisal date, and any comments from TierOne personnel regarding individual impaired loans. (JPF ¶ 292.) In addition, the backup materials provided to the ACC included individual credit reviews with specific loan information regarding, among others, impaired loans. For example, with respect to the January 23, 2009 ACC meeting, the backup materials included credit reviews for the Lake Palmetto, Brother Sonny, Jericho Heights, Leman Development, Towne Vistas, and Pueblos Partners loans, each of which was evaluated for impairment at year-end 2008. (JPF ¶ 293.) Likewise, with respect to the October 29, 2008 ACC meeting, the materials included interim credit reviews for the Rodney Kush, Blake Home Builders, Double M Construction, Renar Development, Ashley Turner, Celebrate 45, Carlos Escapa (Commerce 81), Jerry Dannenberg, Denmark Construction, East Construction, and Gateway Homes loans, each of which was evaluated for impairment at September 30, 2008 (and at year-end 2008). (JPF ¶ 293.)

Based on these and other procedures performed, as documented in the workpapers, the engagement team appropriately concluded that TierOne had controls that were designed properly and operating effectively to address the risks that collateral could be overvalued and that the ALLL could be improperly valued. (*See* JPF ¶¶ 277-304; Bennett Br. 18-20.)

C. Due Consideration of Appraisals Received in 2009

The Division devotes similarly scant attention to its AU § 561 allegations. Unable to contend the auditors overlooked an error in the December 31, 2008 financial statements, the Division nevertheless insists that the auditors failed "to perform any inquiry" about the possibility of an error following TierOne's receipt of new appraisals in 2009. (Div. Br. 61.) This argument simultaneously rests on a misreading of AU § 561 and disregards the evidence.

The Division conflates, on the one hand, the manner in which an auditor must decide in the first instance whether AU § 561 applies to given facts and circumstances with, on the other hand, the procedures that an auditor performs once he or she has determined that AU § 561, in fact, applies. Stepping back for a moment from this confusion about the cart and the horse, the evidence shows that Mr. Bennett focused throughout the engagement on whether TierOne was reporting financial information, including loan losses, in the right fiscal period. (JPF ¶ 418.) The evidence also shows that he and Mr. Aesoph appropriately considered the impact of the new appraisals received in 2009, fully aware that the net result was approximately $4.2 million in additional charge-offs. (Bennett Br. 31; JPF ¶¶ 419, 421-22.) Considering that information in light of the specific impaired loans at issue—including the consistent trend with prior charge-offs recorded on those loans—they concluded it was *not* evidence of any error in the December 31, 2008 financial statements, *i.e.*, the new losses properly were recorded in 2009 (Bennett Br. 30-31; JPF ¶¶ 419-424.) Mr. Barron made very clear that he was not opining to the contrary. (Hr'g Tr. 1158:19-21 (Barron) ("My point here was not that this would have resulted in a restatement of the financial statements. I wasn't making that judgment."); JPF ¶ 424 & n. 750.) According to Ms. Johnigan from the perspective of an experienced bank auditor, these facts and circumstances do not suggest the auditors failed to perform an "inquiry" required by AU § 561. (JPF ¶ 423.) Rather, they were aware of the new appraisals received, they considered whether the resulting loan losses recorded might indicate an error in the prior financial statements, and they concluded that the losses did not.

D. Sufficient Audit Documentation

With respect to its fallback argument regarding audit documentation, the Division again distorts the record. In an appalling mischaracterization, it proposes the following categorical finding of fact: "Bennett testified that the audit staff's practice was to put a 'tick mark' on a FAS 114 template *if they had performed a procedure or corroborated something*." (DF ¶ 243 (emphasis added).) The testimony on which the Division relies, however, is a response to the following question: "And it was your practice to make that sort of notation if it was something that *you checked on these FAS 114 worksheets*?" (Hr'g Tr. 597:15-17 (emphasis added).) Mr. Bennett explained in response, "[u]sually it was the audit staff that did that level of work", *i.e.*, put tick marks on workpapers, and he in the "normal practice" of his supervision of their work would "look[] over their shoulder [to] understand[] what they were looking at." (Hr'g Tr. 597:18-21 (Bennett).) In other words, Mr. Bennett was explaining *who* on the engagement team made the tick marks and what his process was with respect to reviewing and understanding the tick marks. He was not suggesting—as the Division most certainly understood—that *every* procedure the engagement team performed relating to FAS 114 loans resulted in a tick mark on the FAS 114 templates themselves.

Still, the Division contends that Messrs. Aesoph and Bennett described at the hearing an audit that was not documented in the workpapers. (Div. Br. 3, 26, 50-51.) Without refuting that the work described was in fact performed, the Division urges the Court to sanction Mr. Bennett for failing sufficiently to document the work. This contingency argument ignores the judgment that unquestionably is involved in documenting audit work pursuant to AS No. 3. (JPF ¶ 108 (citing Resp'ts Ex. 49, AS No. 3); *id.* ¶ 433.) It also ignores the workpapers as a whole. The Division focuses myopically on a *single* workpaper, the FAS 114 Procedures memo (Div. Br. 22-23), and ignores almost every other workpaper pertaining to the ALLL. As Ms. Johnigan explained, it is inappropriate "to focus on one work paper and ignore all other documentation regarding the financial statement assertion". (JPF ¶ 439; *see also id.* ¶ 431 & n. 759 (workpapers "are of a whole ... you can't, in my view, appropriately review the work without reviewing all of it").) Indeed, these other workpapers bear directly on the auditors' conclusions with respect to the reasonableness of the ALLL, many of which are cross-referenced with and tied to the individual FAS 114 templates, *e.g.*, the L-30 ALLL Memo, L-30A Allowance for Credit Losses Discussion of 4th Quarter 2008 Adequacy Analysis, L-35 Impaired Loans Memo, L-35A Impaired Loan Listing, and L-37 Loan Analyses by State. (*See* Bennett Br. 34-35; *e.g.*, JPF ¶¶ 310-14, 321, 351-58, 388-94, 436-37.) And there certainly is no requirement to document all work relating to a particular account, or one component of one account, in a single omnibus workpaper. (JPF ¶ 432.)

Moreover, the Division attempts to create a disconnect where none exists. The testimony at the hearing is *not* inconsistent with the audit documentation. With respect to the much-scrutinized conversation with Mr. Kellogg about 30% losses recorded on Nevada loans (Div. Br. 28), the workpapers contain a variety of references to communications with management, including Mr. Kellogg, regarding loan loss trends. (*See* JPF ¶¶ 284, 373; Resp'ts Ex. 8, Year-End 2008 Work Paper Binder (8/12) at L-30 ALLL Memo, KPMGTO0005424-31, at 5425, 5427; Resp'ts Ex. 7, Year-End 2008 Work Paper Binder (7/12) at L-6 Test of Design and Operating Effectiveness Template - Integrated - Management Review of Impaired Loans, TDR's, and Non Performing Loans, KPMGTO0005074-77, at 5075-77.) And the fact that the two-page FAS 114 Procedures memo indicates the engagement team inquired about discounts on impaired loans that did not have "appraisals within the past twelve months" (Div. Br. 24-25) does not mean the engagement team made no such inquiries about discounts on impaired loans that did have appraisals within the last twelve months. Contemporaneous documents prepared in the course of the audit prove that the engagement team did just that. (JPF ¶¶ 327-28; Resp'ts Ex. 192, 2/4/09 Excerpt from Manager Review Comments - TONE 2008.xls, KPMGTO-E-00074555-59, at 4557-58.)

Ms. Johnigan, the only experienced bank auditor unconnected to this audit who reviewed *all* of the 2008 audit workpapers, found that the engagement team's documentation satisfied AS No. 3. Specifically, she opined that she understood "the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached." (JPF ¶ 438; *see also id.* ¶¶ 430-31.) The fact that Mr. Barron half-heartedly concluded otherwise (Bennett Br. 34 ("I would expect to see some sort of notation, like *maybe* in the margin, showing that the calculation equals 30 percent." (emphasis added)))—after reviewing just a portion of the workpapers—should be of little moment. In any event, there is no precedent on this record for a Rule 102(e) sanction based on such quibbling about documentation where the evidence demonstrates the work was performed. (Bennett Br. 32 n. 18.)

IV. THE DIVISION MISUNDERSTANDS ITS HEAVY BURDEN UNDER RULE 102(e) AND PLAINLY HAS NOT MET IT.

Based on hindsight and a persistent mischaracterization of the evidence, the Division blithely contends that professional judgments made by Mr. Bennett (and Mr. Aesoph) were "egregious". [14] (Div. Br. 57, 65.) That contention is entirely incongruous with the record. Regardless of whether Mr. Bennett fell short of some aspect of professional standards—which the evidence shows he did not—the Division has not met its heavy burden under Rule 102(e). (*See* Bennett Br. 36-41.)

No one disputes that Mr. Bennett was highly qualified and well-prepared to serve as the senior manager on the 2008 TierOne integrated audit. (JPF ¶¶ 20, 471.) No one disputes that he was diligent, reviewing all of the 2008 audit workpapers (JPF ¶¶ 31, 436) and closely

[14] The Division's attempt to delineate in its post-hearing brief *for the first time* the supposed "repeated instances of unreasonable conduct" allegedly committed by Mr. Bennett (Div. Br. 63-64) violates his right to fair notice. *See* Mr. Bennett's Second Affirmative Defense. Regardless, the acts identified do not individually or in the aggregate constitute the egregious conduct necessary for a Rule 102(e) sanction.

supervising junior professionals on the team by, among other things, providing hundreds of detailed review comments (JPF ¶¶ 30, 35, 324-25, 327-29). No one disputes that he worked tirelessly, increasing his hours on the 2008 engagement by approximately 90% compared to the prior year. (JPF ¶ 182.) No one disputes that he appropriately shared audit evidence with the engagement partner or that each of his professional judgments was reviewed and approved by multiple KPMG partners who had decades of bank auditing experience between them. (JPF ¶¶ 32-34.) To this day, Mr. Bennett is considered by his superiors to be a "great" senior manager. (JPF ¶ 24.) And, Ms. Johnigan, a member of the Auditing Standards Board and opining from the perspective of an experienced bank auditor, testified that she would have wanted Mr. Bennett as the senior manager on her audit engagements. (JPF ¶ 462.f.) This is not the picture of an incompetent professional who poses a threat to the Commission's processes.[15]

Any comparison by the Division to *In re Pascale*, Release No. 51393, 2005 WL 636868 (Mar. 18, 2005), is misplaced. (*See* Div. Br. 62.) *Pascale* involved three successive audits of a development-stage company with no operations or revenues from operations, and with projected revenue based on a patent for a product the audit client had no ability to manufacture, or contracts to sell. *Id.* at *5-*10. Among a variety of transgressions, the respondent audit partner valued the patent himself, utilizing a method that was the "invention of one of [his] partners'" rather than the fair value method required by applicable audit standards.[16] *Id.* at *2-*5

[15] The Division reveals in its post-hearing brief the proposed sanction against Mr. Bennett that it seeks—a two-year suspension. (Div. Br. 66.) Even assuming the Division had met its heavy burden, which it did not, a two-year suspension would be entirely unwarranted. This proceeding and the antecedent investigation already have turned Mr. Bennett's career, indeed his life, upside down for *years* now. (*See* Hr'g Tr. 1673:20-1675:6 (Bennett).) For Mr. Bennett, that is beyond sufficient deterrence. (*See* Div. Br. 64.) No remedial action is necessary to impress upon him the importance of adhering to professional standards, especially given his thorough knowledge of the applicable standards—during the 2008 audit and now—as exemplified at the hearing. (*See, e.g.*, Hr'g Tr. 1216:1-8 ("I gathered from the testimony that they understood the professional standards.") (Barron).)

[16] With respect to projections from joint venture agreements, the respondent in *Pascale* also accepted the company's unsubstantiated one-page revenue projections without reading the joint venture agreements or contacting the joint venturers. *Id.* at *8, 12. The following year, the auditor chose to calculate his own projections based on the joint

(observing that, "[a]s an initial matter, an auditor should review financial statements prepared by a company's management, not make those determinations for management"). Further, the respondent accepted the founder's representation that he would supply sufficient working capital to allow the company to continue to operate without bothering to review any evidence regarding whether the founder had the wherewithal to do so.[17] *Id.* at *9. This does not reflect, in any sense, the kind of auditor that Darren Bennett is. Nor do the few precedents in which non-partner auditors were sanctioned under Rule 102(e). (*See* Bennett Br. 37.)

Mr. Bennett's otherwise exemplary career has been put on hold by this proceeding. It should not be derailed by a sanction predicated on second-guessing in the stark light of hindsight.[18] *See* Amendment to Rule 102(e), Exchange Act Release No. 33-7593, 63 Fed. Reg. 57,164, at 57,168 (Oct. 26, 1998). It certainly should not be derailed based on an incomplete investigation (Bennett Br. 42-43) or by the Division's insistence on disregarding applicable professional standards or crafting novel standards of which Mr. Bennett was deprived notice. (*Id.* at 43-44 (addressing basic due process).) The Division has not proven a violation of professional standards, let alone conduct so egregious as to meet its heavy burden under Rule 102(e).

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venture agreements and, in doing so, neglected to review any detailed documentation such as business plans. *Id.* at *9, 12.

[17] The Division's reliance on *In re McCurdy*, Exchange Act Release No. 49182, 2004 WL 210606 (Feb. 4, 2004) is also misplaced. There, the Commission's imposition of sanctions was based in part on a finding that the respondent auditor acted recklessly in failing to perform *any* of the procedures set forth by GAAS to evaluate a material uncollected balance in a related party transaction. *Id.* at *5-*6 (noting that auditor failed to obtain any information about the related party's financial capability, relying only on management representations). Further, in rejecting the auditor's good faith defense, the Commission in *McCurdy* noted that his attitude was "essentially one of indifference" as to a key audit issue. *Id.* at *8 n.22.

[18] Unable to view the matter through the lens of the auditors in the field, the Division explicitly relies on post-March 2009 information, including TierOne's third quarter 2009 disclosure of loan losses, KPMG's April 2010 withdrawal of its 2008 audit opinions—in which Mr. Bennett had no involvement (*See* JPF ¶ 449)—and the July 12, 2011 Office of the Inspector General Audit Report regarding TierOne's eventual failure. (*See* Div. Br. 40.) This is unquestionably improper. (Bennett Br. 40-41.)

CONCLUSION

For the foregoing reasons, this public administrative proceeding against Mr. Bennett should be dismissed.

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