UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING

File No. 3-15168

In the Matter of	
JOHN J. AESOPH, CPA, and DARREN M. BENNETT, CPA	
Respondents.	

RESPONDENT JOHN J. AESOPH'S POST-HEARING REPLY BRIEF

December 19, 2013

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INTRODUCTION

Respondents previously demonstrated—both at the hearing and in their post-hearing briefs—that their audit of TierOne's 2008 financial statements and internal controls over financial reporting satisfied all professional standards; that the Division's charges are not supported by the evidence; and that, in critical respects, the Division's allegations are based upon a misapprehension of the governing accounting and auditing standards. In its post-hearing brief and proposed findings of fact and conclusions of law, the Division clings to its unsupported positions, confirming that it has failed to prove a Rule 102(e) violation by Mr. Aesoph.

Indeed, the Division's post-hearing brief advances theories and positions that not only are unsupportable but, if adopted by the Court, would have profound implications for the entire accounting profession. Specifically, the Division persists in its wrong-headed attempts to create new accounting and auditing standards by re-writing both the definition of fair value under FAS 157 and the audit approach under AU § 342.10. To do this, the Division ignores the pronouncement that the Commission's own Office of the Chief Accountant ("OCA") and the Staff of the Financial Accounting Standards Board ("FASB") jointly issued in real time at the height of the financial crisis and just months before year-end 2008; it ignores the testimony of its own audit expert at the hearing; and it relies on the discredited, non-expert testimony of an economist who admittedly ignored the relevant accounting standards in forming his opinions.

In this and other ways, the Division's post-hearing brief and proposed findings misstate the record, presenting an inaccurate and incomplete version of both the applicable standards and the audit work that Messrs. Aesoph and Bennett planned, performed, and documented. When measured under the *applicable* accounting and auditing standards, and when viewed in its

entirety, the evidence demonstrates that Respondents' audit was consistent with professional standards and that the Division has failed to meet its high burden under Rule 102(e).

II.
THE DIVISION'S CHARGES EITHER IGNORE OR ATTEMPT TO REWRITE THE CONCEPT OF FAIR VALUE UNDER FAS 157

The Division's post-hearing brief continues to embrace the erroneous approach to fair value that the Division pursued during the hearing in this case. In an attempt to square the accounting guidance with its theory of the case, the Division distorts the meaning of fair value and ignores the nature of a Level 3 fair value estimate as defined in GAAP. Even assuming the Division's interpretation of FAS 157 had some support in the record—and it does not, as the Division's audit expert was forced to concede—Rule 102(e) is not a vehicle for revising Generally Accepted Accounting Principles years after the fact. An accounting professional cannot be sanctioned for applying GAAP.

FAS 157 governed the Bank's FAS 114 loan loss estimates. (J.P.F. ¶ 54.) This cannot be disputed. TierOne's 2008 10-K expressly disclosed that the Bank estimated the fair value of collateral securing its impaired loans under FAS 157. (J.P.F. ¶¶ 118–19.)[1] Mr. Aesoph gave a presentation to TierOne's Audit Committee regarding the implementation of FAS 157 in 2008. (J.P.F. ¶ 119; Resp'ts Ex. 1, Work Paper A-5.2, KPMGTO 2416.) The 2008 management representation letter signed by TierOne management and provided to Mr. Aesoph and his team states that: "We are responsible for making the fair value measurements and disclosures

[1] Citations to "J.P.F." refer to paragraphs in the Respondents' Joint Proposed Findings of Fact and Conclusions of Law. Citations to "D.P.F." refer to paragraphs in the Division of Enforcement's Proposed Findings of Fact and Conclusions of Law.

included in the financial statements in accordance with SFAS No. 157 . . . ." (Resp'ts Ex. 3, work paper B-2, KPMGTO 3474; *see* J.P.F. ¶ 119.)

It is therefore remarkable that the Division nonetheless persists in describing FAS 157 as a "red herring," arguing that Mr. Aesoph did not consider FAS 157 in connection with his procedures over TierOne's ALLL. (Div. Op. Br. at 52.) The evidence demonstrates otherwise. The Division devotes not one word of its 66-page brief to TierOne's 10-K disclosure, Mr. Aesoph's presentation to the Audit Committee regarding FAS 157's implementation, or the signed management representation letter. Nor does the Division address its own audit expert's concession that FAS 157 is so central to the idea of fair value that an accountant cannot even *mention* the word "fair value" without implicating that piece of guidance. (Aesoph Op. Br. at 2; J.P.F. ¶ 56 n.97.)[2] As. Mr. Aesoph testified, FAS 157 was "baked into our thinking." (J.P.F. ¶ 376 (Tr. 1778:22–79:7 (Aesoph)).) FAS 157 applied to TierOne's impaired loan loss estimates in 2008, and Mr. Aesoph and his team recognized that fact; the Division's arguments to the contrary are simply wrong.

Even while making the "red herring" argument, the Division's post-hearing brief proceeds to offer an interpretation of fair value that, while fitting its allegations, is inconsistent

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[2] The Division argues that because Mr. Aesoph did not refer to FAS 157 by name in his investigative testimony, he must have invented his reliance on it solely for purposes of the hearing. (Div. Op. Br. at 31–32, 52.) But the Division's failure to grasp the significance of FAS 157 in the course of its investigation is no fault of Mr. Aesoph. During his testimony, Mr. Aesoph responded to the Division's specific questions, and not one question referred to FAS 157 by name. Indeed, at the hearing, the Court paused the proceedings to allow the Division to designate portions of the investigative transcript demonstrating that Mr. Aesoph failed to invoke FAS 157 during his testimony in response to a specific question. The Division could not produce a single excerpt. (Tr. 1486:11–89:6 (Division).) The transcript does show, however, that Messrs. Aesoph and Bennett referred to the concept of fair value during their 14 days of investigative testimony *hundreds of times*. (J.P.F. ¶¶ 61 n.106, 119.) FAS 157 defines fair value, and, as Mr. Barron agreed, any reference to fair value accounting is, in fact, a reference to FAS 157. (J.P.F. ¶¶ 56 n.97, 471.)

with GAAP. According to the Division, the only relevant consideration under fair value is "the price a seller could receive *in the current market*." (Div. Op. Br. at 53–54 (emphasis in original).) Again, the Division is wrong.

The only witness who supported the Division's "market forces" interpretation of fair value was economist Anjan Thakor. The Division did not offer, and the Court did not accept, Professor Thakor as an accounting expert (Aesoph Op. Br. at 55.) Indeed, *no court* has accepted testimony from him in that capacity because he is unqualified to offer opinions about the meaning of accounting standards. (J.P.F. ¶ 509.) And while there is only minimal mention of the Division's *accounting* expert, John Barron, in the Division's post-hearing brief, Mr. Barron did, in fact, testify about the definition of fair value. He explained that under FAS 157, "distressed sales *really should be excluded* in trying to determine comparable sales for the determination of fair market value." (J.P.F. ¶ 56 (Tr. 1236:16–21 (Barron)) (emphasis added).)[3]

In that regard, Mr. Barron recognized the OCA's September 2008 guidance, released jointly with the FASB at the height of the financial crisis and just three months before year-end 2008, that "[d]istressed or forced liquidation sales are not orderly transactions," and "[t]he results of disorderly transactions are not determinative when measuring fair value." (J.P.F. ¶ 59 (Resp'ts Ex. 66, SEC Release No. 2008-234); *see* J.P.F. ¶¶ 479–80.) The OCA and FASB issued this guidance because "[t]he current environment" had "made questions surrounding the determination of fair value particularly challenging" (J.P.F. ¶ 58 (Resp'ts Ex. 66, SEC Release

[3] The portion of the Division's proposed findings devoted to Mr. Barron's testimony spans five pages and 57 separate paragraphs. Only one of those paragraphs even mentions FAS 157. (D.P.F. ¶ 420.) That paragraph fails to cite Mr. Barron's testimony acknowledging that under FAS 157, disorderly transactions "really should be excluded" in determining fair value. (J.P.F. ¶ 56 (Tr. 1236:16–21 (Barron)); J.P.F. ¶ 478.) Indeed, neither that paragraph, nor *any* other paragraph in the Division's proposed findings, provides a definition of fair value under FAS 157 or mentions the OCA and FASB's own guidance on the subject issued in 2008.

No. 2008-234))—not because, as the Division argues, the only relevant consideration is "the price a seller could receive *in the current market*." (Div. Op. Br. at 53–54 (emphasis in original).) In other words, the Division's own accounting expert made clear that Professor Thakor's opinions—including his "market forces" theory of fair value on which the Division's case depends—were fundamentally wrong and contravene the OCA and FASB's accounting guidance that applied to the year-end 2008 TierOne audit. (Aesoph Op. Br. at 56.)

Mr. Aesoph's analysis and judgment, on the other hand, were entirely consistent with GAAP and the September 2008 guidance. As documented in the L-30A memo, TierOne recorded significant losses on its Nevada loans throughout 2008 and decided that many of its year-end collateral value estimates need not be further adjusted because it believed then-current (year-end) comparable sales data was permeated by foreclosures and therefore not determinative of fair value under FAS 157. (J.P.F. ¶¶ 369, 371.) As Ms. Johnigan testified, the L-30A memo was "absolutely" a "recognition of the provisions of FAS 157"; that is why it included information about the level of disruption in the real estate markets and the fact that appraisals in Nevada reflected "liquidation" prices rather than fair value. (J.P.F. ¶ 376 (Tr. 2061:11–62:11 (Johnigan)).) This reasonably demonstrated to Mr. Aesoph and his engagement team that, far from ignoring the Nevada market price declines, TierOne made a judgment that those declines were not determinative of fair value. (J.P.F. ¶¶ 374–76.) Following the Division's arguments to their logical conclusion, the Division essentially proposes a sanction against Mr. Aesoph for permitting the audit client to follow GAAP. That is no basis for a Rule 102(e) sanction.

III.
THE DIVISION IGNORES CRITICAL ELEMENTS OF TIERONE'S ESTIMATION PROCESS AND THE AUDIT PROCEDURES APPLIED TO THAT PROCESS

In the course of the audit, Mr. Aesoph and his team focused specifically on TierOne's estimation process and tested the reasonableness of the ALLL estimate using the accepted method, under AU § 342.10. That standard sets forth three approaches to evaluating the reasonableness of an accounting estimate, and there was no dispute at the hearing that Mr. Aesoph and his team elected the approach most commonly used in evaluating ALLL: they tested the process. However, while Mr. Barron readily endorsed that approach, noting that it "made the most sense" (J.P.F. ¶ 83), the Division omits any reference to either Mr. Barron's testimony or the relevant standard.

Indeed, the Division attempts to characterize the procedures performed under AU § 342 as something they were not: audits of each individual loan loss estimate. According to the Division, "the only way for the auditors to get reasonable assurance that the estimates were adequate was to *audit individual loans* on a loan-by-loan basis." (Div. Op. Br. at 7 (emphasis added).) We can only assume that the Division attempts this position in order to shoehorn the auditor's estimation procedures into the language of the first negligence prong of Rule 102(e). However, the PCAOB standards that governed the year-end 2008 audit are directly to the contrary. AU § 342.04 states that auditors are "responsible for evaluating the reasonableness of accounting estimates made by management *in the context of the financial statements taken as a whole*." (J.P.F. ¶ 78 (Resp'ts Ex. 61, AU § 342.04) (emphasis added).) And, critically, that standard provides the auditors the option of "[r]eview[ing] and test[ing] the *process used by management* to develop the estimate." (J.P.F. ¶ 80 (Resp'ts Ex. 61, AU § 342.10 (emphasis added).)

Because it cannot support its "audit individual loans" argument with reference to the PCAOB standards that governed the audit, the Division grossly misstates the record in asserting that Messrs. Aesoph and Bennett "conceded that the FAS 114 loans must be audited on a loan-by-loan basis." (Div. Op. Br. at 56.) That is not what Messrs. Aesoph and Bennett testified, and in conflating "audit" with "evaluate" it confuses the critical distinction between the audit objective (evaluating the reasonableness of the ALLL estimate in the context of the financial statements as a whole) and the evidential matter obtained during the audit (which included evidence obtained from loan-by-loan procedures to evaluate a part of TierOne's multifaceted estimation process). As Mr. Aesoph explained, "We're not opining on individual loans. We're not opining on Clearwater Estates. . . . [I]t's our responsibility to come to a conclusion as to whether we believe those financial statements are materially correct or not." (Tr. 866:14–22 (Aesoph).) Similarly, Mr. Bennett testified, "we had to evaluate the loans on a loan-by-loan basis. But at the end of the day, we had to take a step back and evaluate the allowance for loan loss in the context of the financial statement[s] taken as a whole, based on considering charge-offs for the year, provisions for the year, remaining allowances for the year on impaired loans, coupling that with the work that we did around the FAS 5 loss factors." (Tr. 556:23–57:6 (Bennett).)

There is thus no basis under the standards or in the record for the Division to claim that Mr. Aesoph's responsibility extended to forming opinions on individual loan loss reserves. Nor may the Division support its claim by misstating the record or rewriting AU § 342 under the auspices of a Rule 102(e) enforcement proceeding. (Aesoph Op. Br. at 63–64.)

IV.
CONTRARY TO THE DIVISION'S CONTENTIONS, CHARGE-OFFS YIELDED MORE THAN SIMPLY A BALANCE SHEET RECLASSIFICATION

After testing the process itself, the auditors determined that TierOne's estimation process yielded a reasonable result—including the recognition of 30% losses on Nevada impaired loans with collateral deficiencies. The estimation process reviewed and tested by Mr. Aesoph and his engagement team resulted in a provision for losses that was then immediately classified on the balance sheet as either ALLL or charge-offs. While the Division characterizes charge-offs as "simply a balance-sheet reclassification" (Div. Op. Br. at 6 n.2), the fact remains that charge-offs are an intrinsic part of the picture. As Mr. Barron conceded, any charge-offs would "reduce the amount of ALLL that's required at the balance sheet date." (J.P.F. ¶ 476 (Tr. 1031:24–32:8 (Barron)).) Ms. Johnigan confirmed the importance of considering charge-offs: "unless you understand the charge-offs, you don't understand what's happening with the loans. You don't understand what the composition of the [loan loss] provision is and whether or not it affects the current year." (J.P.F. ¶ 476 (Tr. 1923:25–24:5 (Johnigan)).)

In fact, by dismissing charge-offs—and erroneously claiming that "ALLL would be required *regardless* of the prior period charge-offs" (Div. Op. Br. at 56 (emphasis added))—the Division ignores two-thirds of the total losses TierOne booked on its impaired loans in 2008 (Aesoph Op. Br. at 18).[4] Neither TierOne's estimation process nor the year-end 2008 audit can be properly understood if the largest portion of the outcome is ignored.

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[4] The Division also ignored the uncontroverted testimony that the loan loss provision for the relevant charge-offs and ALLL was recorded in 2008: in other words, these losses reduced income on the income statement in 2008. (J.P.F. ¶¶ 43, 232–33, 363, 372, 379–80, 391.)

As a final step in their test work over the ALLL estimation process at TierOne, the auditors evaluated the entirety of the outcome of that process—the recorded impaired loan loss—on both a quarter-to-quarter and market-by-market basis. Mr. Aesoph and his team saw, for example, that TierOne recorded approximately 30% in losses on Nevada impaired loans. (J.P.F. ¶¶ 363, 373.) They considered whether this outcome appeared reasonable in light of the evidence obtained, including Case-Shiller and other indices. And Mr. Aesoph concluded that the losses TierOne recognized on impaired loans in Nevada were not inconsistent with overall market pricing trends in that region. That, as Ms. Johnigan testified, is what auditors do. (J.P.F. ¶¶ 412–13.)

The chart admitted into evidence as Respondents' Exhibit 259, and attached to Mr. Aesoph's post-hearing brief as Exhibit C, illustrates this point: it shows two lines, one depicting quarter-to-quarter losses on TierOne's impaired Nevada loans with collateral deficiencies and one depicting the declines in the Case-Shiller index. The loan losses are not inconsistent with even this unadjusted market price index.[5] Not a single witness testified that this chart was inaccurate. Yet the Division's post-hearing brief seeks to complicate a simple picture, arguing that there are "serious disparities between TierOne's estimates [of impaired loan losses in Nevada] and the publicly-available market data." (Div. Op. Br. at 20 n.16.) This is wrong for a number of reasons.

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[5] The Division asserts that Mr. Aesoph's defense rests on the notion that "collateral values had held steady over the course of the worst real estate crisis since the Great Depression." (Div. Op. Br. at 51–52.) The 30% losses on Nevada impaired loans with collateral deficiencies, as depicted in the chart discussed above—as well as the 22% overall losses on *all* impaired loans—were certainly not based on the assumption that collateral fair values "held steady"; they were based on the assumption that the fair value of TierOne's real estate collateral fell significantly in 2008, leading to losses of tens of millions of dollars.

First, the Division argues that the timing of TierOne's impaired loan losses—with more losses recognized in the first half of the year than in the second—was problematic. (Div. Op. Br. at 29–30.) But there was a reason for that pattern. Markets in the second half of the year not only continued to decline, they entered such a distressed state that the vast majority of real estate transactions in areas such as Nevada and Arizona were no longer determinative of fair value under GAAP. (*E.g.*, J.P.F. ¶ 150.)[6]

Second, the Division claims that losses booked in the second half of 2008 on two significant newly impaired loans—MME and Valley Heights—don't count. By excluding them, the Division asserts that "TierOne's loss recognition on its Nevada loan portfolio in the second half of 2008 was only about 1%." (Div. Op. Br. at 29.) But the Division and its expert never criticized the timing of when any loan was designated as impaired and, as it must admit, FAS 114 losses were "not required to be recognized until the loans were formally designated impaired." (Div. Op. Br. at 55.) The Division cannot disregard these significant, large loan losses—which were reflected on the year-end financial statements that are the subject of this proceeding—because they contradict its allegations.

Third, the Division asserts that the 2008 losses TierOne recognized on impaired loans in Nevada amounted to 26%, rather than 30%. (Div. Op. Br. at 54.) But the 26% percent figure includes so-called "Bucket 2" loans—loans that "had no losses taken on them and had *excess*

[6] This is another reason why the Division's failure to mention the OCA's joint guidance with the FASB is a critical error. (*See* Resp'ts Ex. 66, SEC Release No. 2008-234.) That guidance, reiterating that distressed sales are not determinative of fair value, was issued in September 2008, precisely the time during which the Division characterizes TierOne's decline in recorded impaired loan losses to be a red flag. (Div. Op. Br. at 30.)

collateral." (Tr. 1937:7–8 (Johnigan) (emphasis added).)[7] The fair value of most of those loans could decline substantially—in one case, by 50%—before *any* losses would be recognized under FAS 114. (Resp'ts Ex. 42, Johnigan Rep. at 64, 84, 101 (Stratton Group).) As Ms. Johnigan explained, failing to exclude these "Bucket 2" loans distorts the true loss percentage recorded in 2008. (Aesoph Op. Br. at 25 n.8 (*citing* Tr. 1937:7–8 (Johnigan)).) But even if 26% were a fair characterization, it too is not inconsistent with relevant market information. The Bank's impaired loan losses were estimates, subject to a reasonable range. (J.P.F. ¶ 45 & n.75.) And as Level 3 estimates, that range was necessarily broad. (J.P.F. ¶ 63 & n.110, ¶ 90.) Compared to a market price index decline of 33%, a figure the auditors knew overstated the decline in fair value as defined by GAAP, 26% is entirely within reason. (*See* J.P.F. ¶ 376.)

Fourth, the Division claims that losses booked on loans in Arizona and Nebraska were also "wholly inconsistent with the market data," which, the Division argues, "casts significant doubt on the reliability of this purported audit evidence." (Div. Op. Br. at 57.) As an initial matter, these two markets accounted for a much smaller portion of TierOne's impaired loan portfolio than did Nevada.[8] Nevada presented the most significant risk: over *half* of the Bank's impaired loans originated there. (J.P.F. ¶¶ 362–63.) This is why the losses TierOne recorded on the Nevada impaired loans were of particular significance to the auditors. Moreover, the losses in Nebraska, as the Division acknowledges, were at the high end of the range: around 20%.[9]

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[7] The Division does not dispute that these loans had excess collateral. (Div. Op. Br. at 20 ("[A]ll of these loans had some excess collateral.").)

[8] Nebraska accounted for 15.5% of the Bank's delinquent loans; Arizona accounted for only 5.4%. (J.P.F. ¶ 363.)

[9] At trial, the Division repeatedly attempted to prove that TierOne's estimation process was "biased" and produced loan loss estimates that were too low. (*See* Aesoph Op. Br. at 31–33.) The 20% loss booked on Nebraska impaired loans is one more data point, among the many

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(Div. Op. Br. at 30.) And the approximately 15% loss rate in Arizona did not demonstrate that TierOne ignored or dismissed reasonably available market information in its estimation process. Mr. Aesoph and his team did not expect the losses TierOne booked to mimic unadjusted, broad-based market price indices.[10] He expected, and the audit evidence demonstrated, that TierOne would consider the facts and circumstances of each loan and make loan-by-loan estimates using all reasonably available information. (J.P.F. ¶ 224.) As Ms. Johnigan explained, the auditors appropriately evaluated evidence relating to impaired loans in *every* market, and this evidence supported the conclusion that management's estimation process was appropriate and yielded a reasonable ALLL estimate. (J.P.F. ¶ 356.)

Finally, the Division argues that "the most direct indictment" of the auditors' consultation of market data was that Mr. Aesoph and his team "made no effort to adjust [the data] for distressed sales." (Div. Op. Br. at 53.) But as Mr. Aesoph's post-hearing brief explains, no professional standard suggests that the auditors were required to perform that procedure. (Aesoph Op. Br. at 29–30.) The market data was nothing more or less than what Mr. Aesoph described it to be in his testimony: an additional data point corroborating the results of the extensive audit procedures he and his team employed to test TierOne's estimation process. (Tr. 1785:23–25 (Aesoph); *cf.* J.P.F. ¶ 382.)

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described in Mr. Aesoph's post-hearing brief, refuting the Division's bias arguments. (Aesoph Op. Br. at 31–33.) The Division's post-hearing brief abandons the bias argument.

[10] Further, the Arizona market, like the Nevada market, was subject to a wave of distressed sales in late 2008, meaning that declines in unadjusted sales price indices greatly overstated declines in fair values. (J.P.F. ¶¶ 157, 505.)

V.
THE DIVISION OMITS OR MISCHARACTERIZES THE AUDIT EVIDENCE GATHERED BY THE AUDITORS IN THEIR ASSESSMENT OF TIERONE'S ALLL ESTIMATION PROCESS

The Division, in its post-hearing brief as well as in the hearing in this matter, faced the challenge of confronting the audit procedures performed, the audit evidence gathered, and the relevant accounting and audit literature. The Division fails on all three fronts. Perhaps nowhere is its lapse more evident than in its failure to address the 200 instances in the work papers where the auditors expressly reference their review of loan files. (J.P.F. ¶ 451.) But the Division's failure even to acknowledge the inherent limitations in evaluating a Level 3 estimate comes close.

TierOne's impaired loan loss estimates were subject to Level 3 inputs, the least precise and most judgment-laden level on the fair value estimate hierarchy. (J.P.F. ¶ 63.) As Mr. Aesoph, Mr. Bennett, Ms. Johnigan, and even Mr. Barron testified, the fact that TierOne's impaired loan losses were based on Level 3 inputs was highly significant in evaluating the sufficiency of the audit evidence. (J.P.F. ¶¶ 63–66, 118.) The inputs were not "observable"—they were "assumptions about assumptions" that market participants might use to value each of the unique properties securing TierOne's impaired loans. (J.P.F. ¶ 118.) This meant that the evidence available was limited and the range of reasonableness for TierOne's estimated losses was broader than it would have been if "observable" (Level 1 or Level 2) inputs had been available. (J.P.F. ¶ 90.)

Given this context, the audit team obtained and reviewed the type of information that was relevant to TierOne's estimation process: appraisals; the FAS 114 templates themselves; the OTS's loan-by-loan findings; management's "assumptions about assumptions," including assumptions about the change in fair value between the appraisal date and the financial statement

date; and information from TierOne's loan files, including interim and final credit analyses, borrower-supplied financial statements, and other information. (Aesoph Op. Br. at 22–24; J.P.F. ¶¶ 321–22, 335–40, 361.) As Ms. Johnigan testified, the kind of evidence Mr. Aesoph and his team obtained and reviewed is the kind of evidence a reasonable auditor would obtain, and it provided a sufficient basis to conclude that management's process was working and led to a reasonable result. (J.P.F. ¶ 361; Aesoph Op. Br. at 40.)

Rather than address the evidence and the nature of the estimate, the Division resorts to the argument that while more "loan-specific evidence supporting the collateral values" was available, the audit team ignored that evidence. (Div. Op. Br. at 32–37.) The Division has not identified any "loan-specific evidence" that the auditors overlooked.[11] Nor does it explain how this supposedly absent evidence would have affected the auditors' conclusion that the Bank's estimation process was reasonable. Indeed, the Division did not examine the relevant body of information: it did not provide its audit expert, Mr. Barron, the loan files, and he did not review them—or even ask for them—before drafting his report and testifying at the hearing. (J.P.F. ¶ 483.)

The Division argues that the loan files "sat unopened" during the hearing—"gestured toward but never revealed"—and that "Respondents did not once point to the evidence from the loan files that purportedly corroborated management's representations." (Div. Op. Br. at 51.) This assertion is false. Portions of the loan files were in fact introduced into evidence—the Division's audit expert, after being shown materials from the loan files on cross examination,

[11] Instead, the Division alleges that the auditors failed properly to consider *market-wide* declines in unadjusted real estate sales prices. As explained above in Section IV, the auditors did, in fact, consider these price declines. And they considered the fact that price declines in distressed markets did not reflect commensurate declines in the fair value of TierOne's loan collateral.

admitted he was mistaken about opinions included in his report. (J.P.F. ¶ 484.) He also admitted that the loan files corroborated TierOne's loan loss estimates—something he would have known had he reviewed them before forming his opinions. (*Id.*)

The entirety of the loan files themselves—which amounted to 49 bankers' boxes full of documents[12]—was not admitted into evidence for the same reason it was not included in the work papers: to do so would have been impractical, as Mr. Barron conceded. (J.P.F. ¶ 434 (Tr. 1224:9–17, 1330:5–6 (Barron)).) The HDB loan, described below, is a good example: the file for that loan was massive, amounting to more than 26,000 pages.[13]

Even Mr. Barron had "no doubt that the auditors, Mr. Aesoph and Mr. Bennett, reviewed the loan files" in evaluating the Bank's ALLL estimation process. (J.P.F. ¶ 482 (Tr. 1326:16–18 (Barron)).) Indeed, that was their sworn testimony. (J.P.F. ¶ 335 (Tr. 1327:19–28:2 (Barron)); J.P.F. ¶ 337.) And that testimony was confirmed by the work papers, which document approximately 200 instances in which the audit team reviewed TierOne's loan files, including as part of the FAS 114 procedures. (J.P.F. ¶ 451.)[14] For example, the auditors reviewed loan files as part of their walkthrough procedures (work paper LA); as part of their test work over TierOne's collateral support control (work paper L-7, including L-7.1); as part of their test work over TierOne's appraisal review process (work paper L-8, including L-8.1); as part of their detailed

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[12] Because of the Division's incomplete investigation, the 49 bankers' boxes amounted to only a fraction of the files for the loans at issue in this case. (J.P.F. ¶ 453.)

[13] *See* Resp'ts Ex. 131. Rather than introduce the entire 26,000-page HDB loan file into the record, counsel for Mr. Aesoph offered, and the Court admitted, a subset of the HDB loan file, which comprises 223 pages. (Resp'ts Ex. 89.)

[14] In the face of this testimony and documentation, the Division claims that the auditors did not in fact review "the full loan files, but rather the specific appraisals they needed to review." (Div. Op. Br. at 27 n.19.) This is another mischaracterization. The Division's point rests on a single e-mail from a member of the audit staff, brushing aside sworn testimony and unambiguous audit documentation. (J.P.F. ¶¶ 335, 337, 451.)

review of TierOne's risk rating and impairment decision process (L-22 series of work papers); and, most importantly, as part of their review of individual impaired loans (L-32 series of work papers). (J.P.F. ¶ 451.)

Rather than opine on the reasonableness of individual loan loss estimates and reserves, the auditors selected and tested individual impaired loan loss estimates in order to test management's process. (J.P.F. ¶¶ 229, 317–18, 388, 462.c.) In doing so, the auditors obtained evidence showing that management's estimation process was reasonable. (J.P.F. ¶ 462.c.) The Division attempts a loan-by-loan criticism in its post-hearing brief, yet fails to note the extensive information obtained and considered by the auditors, including information regarding some of the largest Nevada impaired loans, which provided assurance that management's estimation process was operating as it should, including in the second half of 2008. Three examples suffice:

- **HDB**: Both Messrs. Aesoph and Bennett reviewed the loan file for HDB, a complex lending relationship totaling $19.2 million for property in Nevada, and the auditors evaluated the HDB loan at several points during 2008. (J.P.F. ¶¶ 338, 348.) In the first quarter of 2008, the auditors reviewed a FAS 114 template for HDB that reflected a $7 million estimated loss. (Resp'ts Ex. 42, Johnigan Rep. at 97.) In the second quarter, TierOne received a new appraisal proving TierOne's prior fair value estimate to be conservative—the new appraisal indicated a higher valuation for the collateral that could have supported a *reduction* in loan loss reserves. (J.P.F. ¶ 403.a.) But, as the work papers reflect, management maintained the prior (higher) reserves. (*Id.*) At year-end, the auditors again reviewed the HDB loan, observing that TierOne continued to use the lower appraised value—which amounted to a significant discount to the second-quarter appraisal—and also continued to apply an additional 19% reduction in that lower appraised value for present valuing because of the loan's particular risk characteristics (*i.e.*, the foreclosure process would be complicated by bankruptcy and the participation of other banks in the loan and would therefore take up to three years to complete). (J.P.F. ¶ 386.a; Resp'ts Ex. 42, Johnigan Rep. at 97–98.)

- **Valley Heights**: This loan, also for property in Nevada, was first impaired in the last quarter of 2008, resulting in a $6 million loan loss provision. (J.P.F. ¶¶ 367, 386.b.) The audit team sub-tested the evaluation of this loan performed by TierOne's Internal Audit Department, which included a detailed collateral analysis resulting in an effective 50% discount to a prior appraised value. (J.P.F. ¶¶ 353–54; Resp'ts Ex. 42, Johnigan Rep. at 90.) Management performed its own separate analysis of this loan at year-end 2008, and

it not only accepted Internal Audit's recommendation to deem the loan impaired but also recorded a FAS 114 reserve *higher* than the reserve recommended by Internal Audit. (J.P.F. ¶ 403.b.)

- **Celebrate 50**: The audit team reviewed this Nevada loan at each quarter in 2008, observing TierOne continue to discount the loan's collateral value and recognize losses throughout the year. TierOne identified the loan as impaired in the first quarter of 2008 and recognized losses of $3.87 million; the Bank then adjusted the estimated fair value of the collateral at each quarter, resulting in additional losses of over $500,000 by year-end, or approximately 47% of the original loan balance. (J.P.F. ¶ 422; Resp'ts Ex. 42, Johnigan Rep. at 101–03.) The losses were based on the specific circumstances of the loan—including changes in the development plans of the borrower—and the "deteriorating real estate markets in Las Vegas." (Resp'ts Ex. 42, Johnigan Rep. at 102.)

In her expert report, Ms. Johnigan discusses each of the 55 lending relationships implicated by the Division's allegations. She demonstrates that the auditors' evaluation of these loans, in the context of TierOne's estimation process, was reasonable. (Resp'ts Ex. 42, Johnigan Rep. at Exhibits B and C.) The work papers document evidence providing assurance that TierOne considered each loan individually, in recognition of each loan's unique circumstances. (J.P.F. ¶ 322.) As Ms. Johnigan explains, the Division's "broad assertions of alleged deficiencies in the engagement team's substantive testing of TierOne's FAS 114 analyses do not hold up when the engagement team's work is assessed in detail." (Resp'ts Ex. 42, Johnigan Rep. at 51.)

The Division ignores this entire body of evidence, focusing largely on a single consideration: whether or not the appraisal for a particular piece of real estate collateral was, in the Division's view, "stale." (Div. Op. Br. at 47–48.) Yet the Division is still unable to point to any professional guidance defining the term "stale appraisal." As Mr. Barron conceded, "I don't believe that 'stale' is [a] term you'll find in the professional literature." (J.P.F. ¶ 96 (Tr. 1240:17–21 (Barron)).)

In fact, the work papers tell a very different story than the Division urges. Of thirteen impaired loans located in Nevada at year-end 2008—including five Nevada loans that were newly impaired during the last half of the year—the auditors observed that nine had appraisals dated in 2008. (J.P.F. ¶¶ 366, 386.b.) As Ms. Johnigan testified, the 2008 appraisals obtained and reviewed by Mr. Aesoph and his team were competent audit evidence regarding the fair value of collateral at December 31, 2008. (J.P.F. ¶ 462.c–d (Tr. 1968:2–69:19 (Johnigan)).) But Mr. Aesoph and his team did not stop there. They obtained evidence demonstrating that the Bank's process included obtaining and evaluating market information at year-end, such as listing prices, sales prices, and construction progress, and that the Bank's loan-by-loan evaluation process continued through year-end. (J.P.F. ¶¶ 344–45; Resp'ts Ex. 42, Johnigan Rep. at 63, 92, 97–98, 105, 110–12, 122.) Mr. Aesoph and his team observed that the Bank, in the second half of 2008, obtained approximately *twenty* new appraisals, all but one of which were for loans in markets other than Nevada. (J.P.F. ¶ 386.) For loans with older appraisals, the Bank applied new or additional discounts in the second half of 2008 to account for the individual circumstances of the loans; these discounts on Nevada loans ranged from 34% to 55%. (J.P.F. ¶¶ 366, 386.) The result was additional impaired loan losses of $17 million in the second half of 2008 (J.P.F. ¶ 386), and overall losses that, as explained above in Section IV, were consistent with market data, properly understood under FAS 157.

VI.
THE DIVISION'S ARGUMENTS REGARDING MR. AESOPH'S TESTING OF INTERNAL CONTROLS SUFFER FROM THE SAME DEFECT OF MISINTERPRETING OR IGNORING THE EVIDENCE

As with the engagement team's substantive audit procedures, the Division misinterprets the evidence regarding the engagement team's testing of internal controls over financial reporting. The Division continues to insist that only one control at TierOne—"appraisal

review"—addressed the risk of "collateral overvaluation." (*E.g.*, D.P.F. ¶¶ 141, 303, 391.) It ignores two other key controls that were specifically identified to address the risk of *ALLL undervaluation*, the ACC's and the Controller's reviews of the impaired loan loss estimates. (*See* J.P.F. ¶¶ 238, 273–75, 277–304, 462.b.)

The Division distorts the facts when it asserts that the auditors identified only the "appraisal review" control as key in addressing the risk that impaired loan loss estimates would be improperly valued. The Division's proposed findings rely on a distinction without a difference: it claims that "appraisal review" is relevant because the risk addressed by it was described as "collateral overvaluation," while two other controls are irrelevant because they were described as addressing the risk of "improper[] valu[ation]" of the ALLL. (*See* D.P.F. ¶ 303 (Div. Ex. 120, at KPMGTO 5188).) In doing so, the Division invites the Court to adopt its proposed findings based on nothing more than semantics. As the Division acknowledges elsewhere in its post-hearing brief, the risk of collateral overvaluation and the risk of ALLL undervaluation are two sides of the same coin: overvaluation of collateral would *lead* to undervaluation of the ALLL. (Div. Op. Br. at 23 (describing "the critical risk of overvaluation of collateral, *and thus understatement of losses*" (emphasis added)); *see also* J.P.F. ¶¶ 280–81.) And as Ms. Johnigan explained, the Controller and ACC review of impaired loans and the ALLL, together with appraisal review and other complimentary controls, properly addressed the valuation risk. (J.P.F. ¶ 303; *see generally* J.P.F. ¶¶ 270–304.)

As it did at trial, the Division still ignores the role of TierOne's Controller, David Kellogg, in the control environment despite Mr. Barron's concession that "review of the supporting documentation by someone other than the group that actually did the estimation" would have been an effective control. (J.P.F. ¶ 280 (Tr. 1095:9–12 (Barron)).) Neither the

Division's proposed findings nor its post-hearing brief once mention Mr. Kellogg's name in the context of internal controls. The role Mr. Kellogg played, however, was precisely the "effective control" described by Mr. Barron: Mr. Kellogg was charged with independently reviewing and approving each of TierOne's individual FAS 114 estimates, which were prepared by Credit Administration personnel in the first instance. (J.P.F. ¶ 279.) He therefore saw "all the information that was used, and concur[red] on the method that was used and the amounts that were arrived at." (J.P.F. ¶ 280 (Tr. 2022:13–17 (Johnigan)).)

The Division also continues to mischaracterize the ACC, whose review of the ALLL, including TierOne's impaired loans, was another key control. (J.P.F. ¶¶ 245, 250, 277.) In describing the procedures performed to test this control, the Division asserts that the ACC reviewed only "high-level reports" (Div. Op. Br. at 38) and did not review "*any* information about the underlying collateral value, the appraisal date, or discounts taken on stale appraisals." (D.P.F. ¶¶ 145–46 (emphasis added).) The testimony at the hearing, and the documentary evidence, demonstrate that the Division is wrong. The ACC reviewed detailed reports that included information about individual impaired loans, including property locations, appraisal dates, collateral values, loss estimates, and narrative and statistical discussion of recommendations for non-accrual (*i.e.*, impairment) and the amount of specific reserves. (J.P.F. ¶ 290.) Moreover, Mr. Kellogg was a member of the ACC, and he contributed his knowledge and expertise to the ACC's review of this detailed information. (J.P.F. ¶ 287.) As the work papers document, his role provided assurance that "the Asset Classification Meetings have become more focused on what is happening within the loan portfolios," including "FAS 114 impairments." (J.P.F. ¶ 285 (Resp'ts Ex. 7, work paper L-6, KPMGTO 5076).)

The Division's effort to ignore Controller David Kellogg's critical role in the control environment does not make him disappear. Nor does it undo Mr. Barron's concession regarding the importance of Mr. Kellogg's independent review. (*See* J.P.F. ¶ 280.) The auditors appropriately identified and tested each key control, including Mr. Kellogg's review of impaired loans and approval of the ALLL, in context. The work papers demonstrate that Mr. Aesoph and his team complied with professional standards in identifying and testing controls at TierOne sufficient to address the risk that estimated FAS 114 losses would be too low. (J.P.F. ¶¶ 238, 245, 277, 300.)

The Division spends a considerable portion of its post-hearing brief on the high-risk nature of the ALLL estimate and what it calls the "damning 2008 examination by TierOne's federal regulator, the Office of Thrift Supervision." (Div. Op. Br. at 1.) But there is no dispute that the auditors appropriately identified the ALLL estimate as subject to high risk of misstatement. (*See* J.P.F. ¶¶ 179, 473.) And there is no dispute that the OTS report was critical of TierOne and was a significant event during 2008. Mr. Aesoph and his team recognized the significance of each of the OTS's actions, including the heightened capital ratios the OTS imposed on the Bank. That topic was specifically discussed as part of the auditors' consideration of fraud risks, and it was evaluated with the help of forensics experts. (J.P.F. ¶¶ 173-74.) Even the Division concedes that "the audit team was very aware of the increased capital levels." (Div. Op. Br. at 13.)

There is also no dispute that Mr. Aesoph and his team went to extensive lengths to understand the OTS's criticisms and track TierOne's remediation efforts. What the Division neglects to mention is Mr. Barron's concession that *each procedure* Mr. Aesoph and his team

applied in response to the OTS's findings and actions demonstrated due care. (Aesoph Op. Br. at 12–13.)[15]

VII.
THE AUDIT RECORD AS WELL AS THE RECORD DEVELOPED IN THE HEARING DEMONSTRATE THAT MR. AESOPH AND HIS TEAM COMPLIED WITH AS NO. 3

Mr. Aesoph and his team documented their procedures over TierOne's ALLL, including the FAS 114 portion, in hundreds of pages of work papers. (Aesoph Op. Br. at 19–26.) But the Division argues that because the auditors supposedly did not document various audit procedures under AS No. 3, Messrs. Aesoph and Bennett must be guilty of offering "self-serving testimony" about procedures that were never performed. (Div. Op. Br. at 3.) These allegations are all accusation; they are disproven by the record. Not a shred of *evidence* supports the Division's assertion that Messrs. Aesoph and Bennett are lying. Indeed, the evidence introduced at the hearing demonstrates their credibility. (*See* Aesoph Op. Br. at Section II.C.3.)

The Division claims, based on a single two-page work paper, that the auditors performed only "five basic procedures" over the FAS 114 portion of the ALLL. (Div. Op. Br. at 23.) As explained in detail in Mr. Aesoph's post-hearing brief, that assertion is untrue. It ignores over

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[15] The Division also selectively describes the OTS report and the OTS's actions, neglecting to mention, among other things, the OTS's recognition that: the Bank "filled the chief credit officer position and the newly created senior credit officer position with experienced candidates"; "[m]anagement further enhanced the credit administration department by expanding the special assets and loan recovery department"; 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"; and "[m]anagement developed an appropriate template in 2008 to measure quarterly impairment loss on impaired loans pursuant to SFAS No. 114." (J.P.F. ¶ 212.) The Division also neglects to mention that the OTS (1) did not require TierOne to restate any previously filed TFR; (2) did not require TierOne to order a new appraisal for any given loan; and (3) did not take action to remove from office any member of Bank management, including those later charged with fraud. (J.P.F. ¶ 211.)

two binders full of audit documentation reflecting procedures testing each portion of the ALLL estimation process, including the portion accounted for under FAS 114. (Aesoph Op. Br. at 19–26.) The audit cannot be understood unless *all* of that documentation, and all of the work it reflects, is considered. Because the Division adopts such a limited view, it mischaracterizes the procedures it discusses in its post-hearing brief.

For example, the Division claims the auditors did not, in fact, "review[ ] credit files, interim credit reviews, and third party data" because those procedures are not specifically documented "*in the* [two-page] *memo*." (Div. Op. Br. at 26 (emphasis added).) Yet the auditors documented their review of the loan files in approximately 200 locations in the work papers, including in the individual FAS 114 templates that are attached to the two-page memorandum. (*See supra* Section V.) Ms. Johnigan testified that "you can't . . . appropriately review the work without reviewing all of it." (J.P.F. ¶ 111 (Tr. 2042:10–22 (Johnigan)).)[16] The Division's myopic focus on a single two-page work paper demonstrates exactly what Ms. Johnigan meant. The procedures performed and evidence obtained were far more expansive than the Division claims. And, considered as a whole, the procedures and the evidence satisfied all professional standards.

The Division also mischaracterizes the professional guidance on audit documentation. While AS No. 3 makes clear that audit procedures must be documented, just what level of detail

[16] The Division's proposed findings mischaracterize the evidence presented at the hearing regarding the engagement team's substantive testing of TierOne's FAS 114 procedures, and its documentation of the same. For example, Ms. Johnigan did *not* agree, as the Division asserts, that "she did not see any evidence in the work papers that the auditors did the same analyses" that she did. (*See* D.P.F. ¶ 494.) On the contrary, in the very portion of the transcript that the Division cites for this proposition, she says, "No," disagreeing with the Division's suggested response. (Tr. 2172:19–73:2 (Johnigan).) She further explains: "I discussed what I found in the work papers, how I saw *the same information* and understood it from the work papers." (*Id.* (emphasis added).)

the documentation should include is left to the professional judgment of the auditors themselves. (Aesoph Op. Br. at 39–40.) The Division, however, wishes to expunge professional judgment from AS No. 3, attempting to transform it from an *audit* standard into a *legal* standard to serve its purposes in this Rule 102(e) proceeding. According to the Division, if a series of specific questions, in the form of allegations, are posed years *after* an audit, and the answers to those questions are not specifically documented in the work papers in a form the Division prefers, any attempt by Messrs. Aesoph or Bennett to address those questions is not credible and any relevant evidence must be ignored.

One example of this is Mr. Bennett's practice of providing detailed comments and questions on TierOne's FAS 114 templates. Those comments and questions were expressed by e-mail and often directed to Ms. Burke, a member of the audit staff, for follow-up. Mr. Bennett described this process in his testimony, explaining that he was "looking at the work papers and seeing things that [I was] either questioning, or it could indicate further procedures that [I] or [the] partners [*i.e.*, Messrs. Aesoph or Kenney] would like the staff to perform." (Tr. 1556:22–57:1.).[17] The Division does not mention this "review comment" process; indeed, the Division apparently denies that the FAS 114 work Mr. Bennett requested from Ms. Burke was done. In its post-hearing brief, the Division cites the same two-page work paper as support for its claim that the audit team "passed over the tens of millions of dollars in loans, particularly in Nevada, with appraisals between six months old and a year." (Div. Op. Br. at 25.) Mr. Bennett's review comments directly contradict this claim.

[17] Mr. Aesoph engaged in a similar "review comment" process with Mr. Bennett, which included Mr. Aesoph sitting side-by-side with Mr. Bennett to review and discuss the Bank's FAS 114 loan loss estimates. (J.P.F. ¶¶ 324, 347.)

Those review comments, which the Court admitted into evidence, demonstrate that Mr. Bennett inquired about numerous impaired loans with appraisals less than a year old—including Carolina Concrete, Passailaigue Homes, Leman Development, Jerry Dannenberg, Inca, and HDB—and directed Ms. Burke to perform additional procedures over them. (J.P.F. ¶¶ 325–29.) He specifically asked Ms. Burke to perform procedures to corroborate the Bank's fair value estimates on these loans, despite the recent appraisals. He asked her to evaluate whether particular fair values were based on "appraisals or estimates"; whether the state of completion of a construction project created a "[v]aluation issue"; and whether a particular fair value estimate was appropriate, "based on management's plan for [a particular] loan." (J.P.F. ¶ 325.) The Division cannot deny that this work was performed simply because—in the judgment of the auditors—some of the documentation reflecting it did not need to be included in the work papers.[18]

The Division's repeated references to KPMG's prior internal quality performance reviews of Mr. Aesoph are similarly unavailing. The referenced internal quality control review finding—made in 2006—did not find a violation of AS No. 3 and had nothing to do with audit procedures regarding ALLL or impaired loans. (*See* Div. Ex. 109 at 5–7.) Notably, the Division does not mention Mr. Aesoph's subsequent satisfactory reviews by KPMG. (*See generally* D.P.F. ¶¶ 272–369.) If any KPMG internal review is relevant to the charges in this case, it is the review that occurred on the very audit at issue. KPMG selected the TierOne 2008 audit for an "in-flight" review that focused precisely on the adequacy of audit documentation relating to the

[18] Furthermore, documentation *included* in the work papers demonstrates that this work was, in fact, performed. (Aesoph Op. Br. at 42.)

ALLL estimate. (J.P.F. ¶ 440.) The in-flight reviewer concluded that the very documentation criticized by the Division was appropriate and in compliance with internal firm standards. (*Id.*)

VIII.
THE DIVISION FAILED TO PROVE A VIOLATION OF AU § 561

The Division's charge under AU § 561 appears to assume that the auditors ignored the new appraisals TierOne received in 2009. The work papers, however, address the very appraisals on which the Division's charge rests. The work papers also address another 2009 appraisal that the Division continues to ignore and fails to mention in its post-hearing brief—an appraisal showing a $1.5 million *increase* in appraised value. (J.P.F. ¶ 419.)

The Division begins by resorting once again to a distortion of the professional guidance. The Division asserts that *any* new piece of information that comes to an auditor's attention must be examined under AU § 561, and "[i]t is only *after* that AU 561 analysis that an auditor can reach what [Ms.] Johnigan assumes is the threshold test: whether the audit report and financial statements 'would have been affected.'" (Div. Op. Br. at 61 (emphasis added).) Thus, in the Division's view, if newly discovered information might have existed at the time of the audit report, auditors must always perform extensive look-back procedures under AU § 561—professional judgment is irrelevant and an audit can never be closed.

But that is not what the guidance says. Instead, AU § 561 states that look-back procedures are warranted only "if the nature and effect of the matter are such that . . . [the auditor's] report *would have been affected.*" (J.P.F. ¶ 415 (Resp'ts Ex. 63, AU § 561.05) (emphasis added).) It further states that "[a]fter the date of the report, the auditor has no obligation to make any further or continuing inquiry or perform any other auditing procedures with respect to the audited financial statements covered by that report, unless new information which may affect the report comes to his or her attention." (Resp'ts Ex. 63, AU § 561.03.)

Mr. Barron declined to support the Division's theory that the audit report "would have been affected" by $4.2 million in losses booked as a result of (a) two appraisals showing a decline in appraised value and (b) one appraisal showing a large *increase* in appraised value, in the context of TierOne's multi-billion dollar loan portfolio. (J.P.F. ¶ 424 (Tr. 1159:8–9 (Barron)).) The Division, however, proceeds to rely on an argument never raised in testimony: that the relevant metric to trigger AU § 561 is the $2.9 million of net interest income TierOne reported in 2008. (Div. Op. Br. at 61 n.38.) The Division fails to explain why a reasonable investor would focus only on $2.9 million of net interest income while entirely ignoring the $93 million pre-tax loss TierOne booked in 2008 (a figure the Division's post-hearing brief never mentions). Neither Mr. Barron nor Ms. Johnigan suggested anything of the kind during their testimony. (*See* J.P.F. ¶ 424.) The Division's AU § 561 argument therefore lacks foundation in both the guidance and the evidence.

IX.
CONCLUSION

Rule 102(e) requires a full and fair evaluation of the audit—the entire audit—and given the gravity of a Rule 102(e) sanction, Mr. Aesoph deserves nothing less. *Checkosky v. SEC*, 23 F.3d 452, 479 (D.C. Cir. 1994). Hindsight can play no role in the evaluation of his conduct. Evidence and audit documentation cannot be ignored. And applicable auditing and accounting guidance cannot be creatively interpreted to achieve the Division's desired result.

The judgment of this Court should be based on what Mr. Aesoph did: on the entirety of the audit procedures performed, risks recognized, evidence obtained, and professional judgments made, with due consideration of all relevant accounting principles and applicable auditing standards. As Mr. Aesoph's post-hearing brief demonstrates, the record evidence shows that Mr. Aesoph was devoted to the 2008 audit; that he took seriously his responsibilities under the

auditing standards and abided by them. He involved specialists, dug into the detailed loan files, continuously engaged with and challenged management, and demanded of his team the same rigor. Mr. Aesoph is no threat to the Commission, and the charges against him must be dismissed.

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