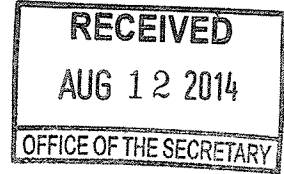


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UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING  
File No. 3-15168

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In the Matter of :

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

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**DIVISION OF ENFORCEMENT'S PETITION FOR REVIEW  
OF THE INITIAL DECISION**

Nicholas P. Heinke  
Gregory A. Kasper  
Byron G. Rogers Federal Building  
1961 Stout Street, Suite 1700  
Denver, CO 80294-1961  
(303) 844-1071 (Heinke)  
(303) 844-1026 (Kasper)  
HeinkeN@sec.gov  
KasperG@sec.gov

*COUNSEL FOR THE DIVISION  
OF ENFORCEMENT*

August 11, 2014

The Division of Enforcement, pursuant to Rule 410(a) of the Commission's Rules of Practice, hereby petitions the Commission for review of the sanctions ordered in the Initial Decision in this matter. The Initial Decision, issued by Administrative Law Judge Carol Fox Foelak on June 27, 2014, properly concluded that Respondents engaged in highly unreasonable conduct in connection with their audit work over a critical, high-risk account: the Allowance for Loan and Lease Losses ("ALLL") account of TierOne Corporation, a holding company for TierOne Bank. More specifically, the law judge correctly found that Respondents violated audit standards, and engaged in improper professional conduct, in three areas: their audit of internal control over financial reporting related to the ALLL account, their substantive audit of the ALLL account, and their response to subsequently-discovered facts related to the ALLL account. The law judge also properly rejected Respondents' core defense, which was based on their uncorroborated testimony that they had performed additional, important audit procedures that were wholly undocumented in the audit work papers.

The Division seeks review of the scope of the remedies imposed by the law judge in the Initial Decision. The law judge denied Respondent Aesoph the privilege of practicing or appearing before the Commission for one year, and denied Respondent Bennett that privilege for six months. While the law judge properly imposed a bar as a sanction, in light of the well-reasoned findings and conclusions regarding Respondents' highly unreasonable audit conduct, the Division respectfully submits the lengths of the bars ordered were too short.

## **I. Background**

Respondents Aesoph and Bennett were the engagement partner and senior manager, respectively, on the audit of TierOne's 2008 financial statements. *See* Initial Decision at 6. Although TierOne was a regional bank that had historically focused on its primary market area

of Nebraska, Iowa, and Kansas, in the mid-2000's TierOne aggressively expanded its lending activities by opening loan production offices ("LPOs") in then-booming markets like Nevada, Arizona, and Florida. *See id.* at 4. The primary purpose of the LPOs was to originate loans for large construction and land-development projects. *See id.* The promise of the LPOs faded as the Great Recession set in and many LPO markets saw record real estate value declines. *See id.* at 14. As the real estate markets plummeted, TierOne closed its LPOs, but was left with a significant amount of these high-risk loans on its books. *See id.* at 4.

Losses on these high-risk loans were recorded through TierOne's ALLL. The ALLL is a balance-sheet reserve account intended to cover known and inherent losses in a bank's loan portfolio. *See id.* at 7. The ALLL has essentially two components: losses related to impaired loans evaluated under Statement of Financial Accounting Standards ("FAS") 114; and losses related to unimpaired loans evaluated under FAS 5. *See id.* At issue in this matter are the FAS 114 impaired loan losses. *See id.*

TierOne's FAS 114 loans included many of the high-risk loans generated by the LPOs. *See id.* at 14. These FAS 114 loans were collateral-dependent, meaning that repayment was expected from the eventual sale of the underlying collateral, *e.g.*, the construction or land development project that the loan was intended to fund. *See id.* at 9. Losses on the FAS 114 loans were calculated by comparing the estimated fair value of the underlying collateral (with some adjustments for cost and time to sell) to the book value of the loan, meaning that if the collateral value fell below the book value, losses would result. *See id.* at 8. Put simply, collateral values drove losses on the FAS 114 loans. *See id.* at 9, 13. TierOne almost always used appraisals to determine the estimated fair value of the collateral. *See id.* at 8. Thus, if the appraisals overvalued the collateral, losses on the loans risked being understated. Even so, at

year-end 2008, TierOne determined the fair value of the collateral on many of its FAS 114 loans using stale appraisals (*i.e.*, appraisals that had become outdated due to changes in market conditions or the underlying collateral) that were not discounted to account for the precipitous market declines. *See, e.g., id.* at 30.

Further underscoring the risks in TierOne's ALLL account, shortly before the 2008 audit, TierOne's primary federal regulator, the Office of Thrift Supervision ("OTS"), issued a scathing examination report. *See id.* at 4, 9-10. In that report, the OTS criticized the bank's management generally and its loan practices specifically, downgraded the bank from its highest rating to its second-lowest, and found the bank had collateral-dependent loans with either stale or unsupported appraisals or, in some cases, no appraisals at all. *See id.* at 4. As a result of these deficiencies, the OTS increased TierOne's regulatory capital ratio requirements, breach of which could lead to significant enforcement action. *See id.* at 10. These ratios were directly impacted by TierOne's loan losses: additional losses would drive the ratios down. At year-end 2008 – the time of the audit – the bank stood just tenths of a percentage point above the required ratios. *See id.*

Although Respondents were acutely aware of the risks related to the FAS 114 portion of the ALLL, as well as the OTS report, they signed off on an unqualified opinion of TierOne's 2008 consolidated financial statements and the effectiveness of its internal control over financial reporting. *See id.* at 5, 11. However, just a few months later, when TierOne finally obtained updated appraisals, it disclosed a staggering \$120 million in loan losses. *See id.* at 5. In June 2010, the OTS closed TierOne. *See id.* KPMG also withdrew its unqualified audit opinion, finding that TierOne's year-end 2008 financial statements contained material misstatements

related to the bank's loan loss reserves, and that TierOne had a material weakness in its internal controls. *See id.*

In January 2013, the Commission entered an Order Instituting Public Administrative Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice ("OIP") to determine whether Respondents engaged in improper professional conduct within the meaning of Rule 102(e)(1)(ii) of the Commission's Rules of Practice. In October 2013, the law judge held nine days of hearings, during which she heard from numerous fact and expert witnesses. In June 2014, the law judge issued her Initial Decision sanctioning Respondents for their highly unreasonable conduct.

## **II. The Law Judge Properly Found That Respondents Engaged in Highly Unreasonable Conduct.**

The law judge properly found that Respondents engaged in a single instance of highly unreasonable conduct in circumstances in which heightened scrutiny was warranted, and, in the alternative, repeated instances of unreasonable conduct that indicate a lack of competence to practice before the Commission. *See, e.g.,* Initial Decision at 22, 36; *see also* 17 C.F.R. § 201.102(e)(1)(iv)(B). To start, it is undisputed that the FAS 114 portion of the ALLL was a high-risk, individually-material audit area, meaning that Respondents had a heightened responsibility to "exercise professional skepticism, corroborate management's representations, and perform extensive audit procedures and obtain persuasive evidence to support their audit judgments." Initial Decision at 26; *see generally id.* at 11-12.

The law judge also properly found that, faced with this high-risk, material audit area, Respondents violated professional standards in three distinct areas related to the FAS 114 portion of the ALLL: their audit of internal control over financial reporting; their substantive audit test

work over the account; and their post-audit procedures following the discovery of new appraisals that existed at the time of the audit report.

As for the audit of TierOne's internal control over financial reporting, the law judge properly found that, although Respondents had identified collateral overvaluation as a risk with respect to FAS 114 loans, the control the auditors selected for testing simply did not address that risk. *See id.* at 13, 28. The purpose of the identified control was to assess whether TierOne obtained and reviewed appraisals when a loan was originated, not whether those appraised values were still accurate at year-end. *See id.* As a result, Respondents did not have a reasonable basis to conclude that no material weaknesses existed, nor did they have a basis to issue an unqualified audit opinion regarding the effectiveness of TierOne's internal controls. *See id.* at 28.

The law judge also properly found that Respondents had violated professional standards in their substantive evaluation of the FAS 114 portion of the ALLL. *See id.* at 13-17, 29-34. Notwithstanding the precipitous market declines that continued – and accelerated – as 2008 went on, TierOne valued the collateral for numerous FAS 114 loans using undiscounted appraisals from early 2008 or before. *See id.* at 30. Even so, Respondents' audit work papers categorically deemed any appraisal that was a year old or less to be "current," and for appraisals older than a year, the work papers noted that Respondents simply "inquired" of management about the discount (or lack thereof). *See id.* at 31. As the law judge properly noted, these procedures fell short of professional standards: Respondents "failed to obtain sufficient competent evidence to support their audit judgments," and failed to use "the due care and professional skepticism required of this high risk and material area of the audit." *See id.*

Further, the law judge correctly found that Respondents failed to take appropriate action upon learning of facts after the audit that might have affected the audit report. *See id.* at 20, 34-

35. Shortly after the audit report was issued, Respondents learned of earlier appraisals on two FAS 114 loans that revealed massive declines in the collateral values used at year-end 2008, and resulted in millions of dollars in new losses. *Id.* Despite this, the auditors performed no evaluation under AU § 561, which requires some action when an auditor discovers facts that existed at the time of an audit report and that “might have affected” that report. *Id.* As the law judge properly concluded, that failure to perform any further inquiry violated professional standards. *Id.* at 35.

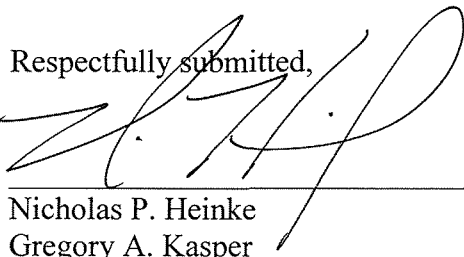
Finally, the law judge properly rejected Respondents core defense, which was their uncorroborated testimony that the audit work papers were wrong and that they in fact performed additional, but undocumented, audit procedures. *See id.* at 18-20, 32-33. As a threshold matter, the law judge properly recognized that any assertion of undocumented audit procedures is dubious on its face, as professional standards plainly require auditors to “document the procedures performed, evidence obtained, and conclusions reached.” AS No. 3 ¶ 6; *see also* Initial Decision at 25. Indeed, Respondents’ repeated attempts to contradict the audit work they had documented at the time, and instead to rely on claimed undocumented procedures, “underscore[d] the deficiency of the procedures as documented.” Initial Decision at 31. What’s more, the law judge correctly found that none of these procedures would have saved the deficient audit. *See id.* at 32-33. In sum, the law judge properly rejected Respondents’ claim that the purported undocumented procedures excused their highly unreasonable conduct.

**III. Given the Law Judge’s Significant Factual Findings, a More Significant Sanction is Warranted.**

In light of the law judge’s well-supported findings of fact and well-reasoned conclusions of law regarding Respondents’ improper professional conduct, the Division takes exception to the sanction imposed in the Initial Decision. The law judge assessed the sanctions using the

*Steadman* factors, and appropriately concluded that a suspension was warranted for both Respondents. However, the law judge imposed only a one-year suspension on Respondent Aesoph, and a six-month suspension on Respondent Bennett. In light of the fact that Respondents violated professional standards and engaged in improper conduct in three distinct areas of a high-risk, highly-material account, Commission precedent counsels for a more significant sanction. *Cf. Gregory M. Dearlove*, 92 S.E.C. Docket 1427, 2008 WL 281105, \*30-31 (Opinion of the Commission, Jan. 31, 2008) (suspending auditor for four years where his unreasonable conduct occurred in four audit areas). For this reason, the Division respectfully requests the Commission review the length of the suspension imposed.

Dated: August 11, 2014

Respectfully submitted,  


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Nicholas P. Heinke  
Gregory A. Kasper  
Byron G. Rogers Federal Building  
1961 Stout Street, Suite 1700  
Denver, CO 80294-1961  
(303) 844-1071 (Heinke)  
(303) 844-1026 (Kasper)  
HeinkeN@sec.gov  
KasperG@sec.gov

*Counsel for the Division of Enforcement*