HARD COPY

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

RECEIVED
JAN 26 2015
OFFICE OF THE SECRETARY

ADMINISTRATIVE PROCEEDING
File No. 3-15168

In the Matter of

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

DIVISION OF ENFORCEMENT'S REPLY BRIEF IN SUPPORT OF ITS PETITION FOR REVIEW

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

January 23, 2015

<u>**TABLE OF CONTENTS**</u>

I. INTRODUCTION 1

II. DISCUSSION 3

A. Respondents' Arguments That They Did Not Violate Rule 102(e) Are Outside the Scope of the Division's Appeal and Should be Disregarded 3

B. The Division Did Not Misconstrue the Initial Decision or the Record, Which Reveal Significant Audit Failures 4

C. Respondents' Failure to Recognize their Misconduct Justifies Sanctions 8

D. Respondents' Ultimate Resignation When They Later Learned of TierOne's Fraud Does Not Excuse Their Improper Audit Conduct 13

E. Respondents' Other Attempts to Mitigate their Misconduct Do Not Reduce the Need for Significant Sanctions 15

1. Respondents Cannot Take Credit for Recognizing Audit Risks 15

2. Respondents' Review of the 2008 OTS Report Further Highlighted the Need for Heightened Procedures 16

3. Respondents' Work in Other Audit Areas Does Not Mitigate Their Serious Failures in a Critical, High-Risk Account 16

4. Bennett's Role as a Senior Manager Does Not Insulate Him from Sanctions 17

5. Respondents' Recurrent Misconduct Is No Less Serious because it was Negligent 18

6. Respondents Have the Opportunity to Repeat their Misconduct 20

F. Respondents' Reliance on Undocumented Procedures Underscores Their Failure to Grasp Important Rules of Audit Conduct 21

III. CONCLUSION 22

TABLE OF AUTHORITIES

Cases

Barry C. Scutillo, Rel. No. 34-48238, 2003 WL 21738818 (July 28, 2003) 14

Conrad P. Seghers, Rel. No. IA-2656, 91 S.E.C. Docket 1945, 2007 WL 2790633 (Sept. 26, 2007) 9, 11

Geiger v. SEC, 363 F.3d 481 (D.C. Cir. 2004) 21

Gordon Brent Pierce, Rel. No. 34-71664, 2014 WL 896757 (March 7, 2014) 5

Gregory M. Dearlove, Rel. No. 34-57244, 2008 WL 281105 (Jan. 31, 2008) 15, 17, 18, 19

Harding Advisory LLC, Rel. No. 33-9561, 2014 WL 988532 (March 14, 2014) 11

John P. Flannery and James D. Hopkins, Rel. No. 34-73840, 2014 WL 7145625 (Dec. 15, 2014) 20

Kevin Hall, CPA and Rosemary Meyer, CPA, Rel. No. 34-61162, 2009 WL 4809215 (Dec. 14, 2009) 19

McCurdy v. SEC, 396 F.3d 1258 (D.C. Cir. 2005) 22

Michael C. Pattison, CPA, Rel. No. 34-67900, 2012 WL 4320146 (Sept. 20, 2012) 10

Michael C. Pattison, Rel. No. ID-434, 2011 WL 4540002 (Sept. 29, 2011) 10

Samuel H. Sloan, 45 S.E.C. 734, (1975) 11

SEC v. Holschuh, 694 F.2d 130, (7th Cir. 1982) 11

SEC v. Ingoldsby, Civ. A No. 88-1001, 1990 WL 120731 (D. Mass May 15, 1990) 20

SEC v. Lipson, 278 F.3d 656 (7th Cir. 2002) 1, 10, 11

SEC v. McNulty, 137 F.3d 732 (2d Cir. 1998) 11

SEC v. Seghers, 548 F.3d 129 (D.C. Cir. 2008) 10

Steadman v. SEC, 450 U.S. 91 (1981) 9

Steadman v. SEC, 603 F.2d 1126 (5th Cir. 1979) 9

Steven Altman, Esq., 99 S.E.C. Docket 2744, 2010 WL 5092725 (2010) 9, 20

Toby G. Scammell, Rel. No. IA-3961, 2014 WL 5493265 (Oct. 29, 2014) 9

Wendy McNeeley, CPA, Rel. No. 34-68431, 2012 WL 6457291 (Dec. 13, 2012) 9, 20, 21

Other Authorities

Amendment to Rule 102(e), 63 Fed. Reg. 57,164, (Oct. 26, 1998) 18, 19

AS No. 3 .... 3, 5, 22

AU 312 17

AU 561 3

Rule of Prac. 450(b) 3

TABLE OF RECORD CITATION ABBREVIATIONS

"ID __" Initial Decision, at page __.

"Tr. __" Hearing Transcript, at page __.

"DX __" Division's Exhibit, at page __.

"DF __" Division's Proposed Findings of Fact, fact number __ (filed Dec. 10, 2013).

"DB __" Division's Opening Brief, at page __ (filed Oct. 24, 2014).

"AB __" Opening Brief of Respondent John J. Aesoph, at page __ (filed Oct. 24, 2014).

"BB __" Opening Brief of Respondent Darren M. Bennett, at page __ (filed Oct. 24, 2014).

"DB Opp. __" Division's Opposition to Opening Briefs of Aesoph and Bennett, at page __ (filed Dec. 23, 2014).

"AB Opp. __" Respondent Aesoph's Brief in Opposition to the Division's Opening Brief, at page __ (filed Dec. 23, 2014).

"BB Opp. __" Respondent Bennett's Brief in Opposition to the Division's Opening Brief, at page __ (filed Dec. 23, 2014).

I. INTRODUCTION

In its opening brief, the Division detailed why Respondents' highly unreasonable audit conduct during the 2008 audit of TierOne Bank required significant sanctions. More specifically, the Division explained why, in light of the findings by the Administrative Law Judge of serious audit failings in an individually material, high-risk audit area (the FAS 114 portion of TierOne's Allowance for Loan and Lease Losses ("ALLL")), and in the face of Respondents' continued refusal to acknowledge any wrongdoing, but rather their insistence that they performed audit procedures that appear nowhere in the audit workpapers, sanctions were warranted beyond the one-year suspension imposed on Respondent Aesoph and the six-month suspension imposed on Respondent Bennett.

In response to the Division's brief, Respondents spend significant time arguing, not about the appropriate sanction, but about whether they committed any misconduct in the first instance. Not only do these arguments run afoul of Commission rules, which require opposition briefs to be responsive to the issues raised in the opening brief, they further demonstrate that Respondents do not and cannot recognize that they did anything wrong.

When Respondents do advance arguments about sanctions, they misapprehend the record in this case and relevant Commission law. Perhaps most notably, Respondents claim they are being punished – and their due process rights violated – for defending themselves rather than admitting wrongdoing. Respondents ignore the fact that the Commission routinely looks to acknowledgement of wrongdoing when assessing the appropriate sanction. More broadly, consideration of acceptance of responsibility is a "routine and unexceptionable feature" of both criminal and civil sanctions. SEC v. Lipson, 278 F.3d 656, 664 (7th Cir. 2002). It raises no due process concerns.

Respondents' other attempts to mitigate their misconduct fare no better. For example, Respondents insist the Division has embellished the ALJ's findings, and that the misconduct she identified was not as severe as the Division contends. But in fact, the ALJ found, among other things, that in auditing "one of TierOne's most critical accounts," and in the face of "[n]umerous red flags indicat[ing] that management was inept and had an incentive to understate losses," Respondents "failed to obtain sufficient competent evidence" or use "the due care and professional skepticism required of this high risk and material area of the audit"; that their claims of having performed certain purported but undocumented procedures were "belie[d]" by the record; and indeed that their attempts to distance themselves from the audit workpapers "underscore[d] the deficiency of the procedures as documented."[1] It is beyond dispute that the Initial Decision found significant audit failings.

Respondents also seek to claim credit for purportedly playing a role in investigating and prosecuting fraud by TierOne's management. These claims exaggerate the record. While it is true that Respondents ultimately resigned after learning of a previously concealed analysis of loan losses, the analysis was outed not by the auditors, but by the Office of Thrift Supervision examiners. Moreover, these events occurred in April 2010 – more than a year after the audit misconduct in question. Finally, Respondents were not voluntary cooperators in the investigation, as they claim, but rather only provided testimony and documents in response to formally-issued investigative subpoenas. Respondents' limited role in assessing management's fraud does not excuse their improper audit conduct. In short, none of Respondents' arguments change the fact that significant sanctions are needed, both to protect the investing public and to encourage more rigorous compliance with professional standards.

---

[1] ID 26, 31, 33, 36.

II. DISCUSSION

A. Respondents' Arguments That They Did Not Violate Rule 102(e) Are Outside the Scope of the Division's Appeal and Should be Disregarded.

The Initial Decision found that Respondents violated basic audit standards, and as a result suspended them from the privilege of practicing before the Commission. The Division appealed only one portion of the Decision: the length of the suspensions imposed. More specifically, the issue presented in the Division's appeal is whether, in light of the ALJ's findings of significant audit failures (and presuming those findings are correct), more significant sanctions are warranted. [DB 1, 5 n.4.] Despite the focused nature of the Division's appeal, Respondents spend a significant portion of their opposition briefs recycling – sometimes word-for-word – arguments made in their opening briefs that they committed no audit misconduct in the first place.[2] These arguments are beyond the scope of the Division's appeal and thus, under the Commission's rules, should be disregarded. See Rule of Prac. 450(b) ("Briefs shall be confined to the particular matters at issue."). In any event, they raise nothing new. The Division's opposition to Respondents' opening briefs responds at length to Respondents' flawed arguments that there was no audit misconduct; the Division does not repeat that response here.

---

[2] Compare BB Opp. 11-12 (arguing audit documentation standard does not provide a basis for disregarding undocumented procedures);12-17 (arguing internal control audit was adequate), 17-27 (arguing substantive audit procedures were adequate), 27-28 (arguing AU 561 analysis was adequate) with BB 17-20 (documentation); 20-26 (internal control), 26-37 (substantive procedures), 38-39 (AU 561); compare also AB Opp. 10-15 (arguing substantive procedures were adequate because all loans had "time value" discounts, that FAS 157 informed procedures, that workpaper statement that market conditions had not deteriorated should be ignored, and that auditors assessed annual 30% loan loss recognition through conversation with Kellogg), 16-19 (arguing internal control audit was adequate), 23-24 (arguing AS No. 3 is not an exclusionary rule of evidence) with AB 8 ("time value" discount), 12-20 (FAS 157), 18 (workpaper statement regarding market conditions not deteriorating), 20-24 (AS No. 3), 21-22 (Kellogg 30% loan loss recognition), 27-31 (internal control).

B. The Division Did Not Misconstrue the Initial Decision or the Record, Which Reveal Significant Audit Failures.

Respondents also argue that the Division has exaggerated the ALJ's findings and the record in arguing for increased sanctions. Respondents are wrong.

Bennett argues that the Division has "embellished" the Initial Decision, essentially claiming that the ALJ did not identify any serious audit misconduct. [See BB Opp. 1, 23 n.7, 32, 33.] In fact, the Initial Decision highlights significant failings. For example, when evaluating the substantive audit, the Initial Decision concluded: "Respondents' procedures ... fell short of professional standards.... [T]hey failed to obtain sufficient competent evidence to support their audit judgments regarding TierOne's estimates, and the work papers do not reflect the due care and professional skepticism required of this high risk and material area of the audit." [ID 31.] Similarly, when assessing Respondents' internal control procedures, the Initial Decision noted that "[g]iven the risks of error and fraud and that the FAS 114 portion of the ALLL was a significant estimate, the failure to obtain competent, persuasive evidence related to whether TierOne's internal controls addressed the risk of collateral overvaluation fell short of ... professional standards ...." [ID 28.] The Initial Decision went on to find that "Respondents did not have a reasonable basis to conclude that no material weaknesses existed and issue an unqualified opinion." [ID 28.] And when assessing Respondents' conduct after learning of appraisals showing significant new losses, the Initial Decision noted that Respondents "had no discussion with management, at any level, regarding whether additional losses should be recorded in 2008," that they "failed to adequately consider whether investors ... would attach importance to the new facts," and that "Respondents should have conducted further inquiry and investigation to appropriately determine whether the new appraisals would have affected their

report and the importance investors would have attached to the information before concluding that no additional steps were required." [ID 35.]

The Initial Decision was similarly critical of Respondents' supposed reliance on undocumented procedures.[3] In assessing Respondents' purported reliance on FAS 157, the Initial Decision concluded that "[t]he weight of the evidence casts doubt on Respondents' contention that either their or management's proffered interpretation of FAS 157 ... played any meaningful role in their assessment of TierOne's fair value estimates." [ID 18.] It later reiterated this point, noting that "[t]he record belies Respondents' assertion that, in evaluating TierOne's FAS 114 estimates, they conducted any sort of review consistent with their proffered interpretation of FAS 157." [ID 33.] Further, the Initial Decision observed that "[a]t the hearing, Respondents distanced themselves from the [FAS 114 procedures] memo, pointing to undocumented

---

[3] Bennett makes the incredible claim that the Division has waived its argument that Respondents' audit documentation was inadequate. [BB Opp. 2, 11-12 & n.4.] "Waiver is the intentional relinquishment or abandonment of a known right." Gordon Brent Pierce, Rel. No. 34-71664, 2014 WL 896757, *22 (March 7, 2014) (citations, quotations, alterations omitted). Here, the Division has repeatedly argued – at every stage of the proceeding – that Respondents should not be permitted to excuse their deficient audit by pointing to undocumented procedures. [See, e.g., Tr. 2279:13-23, 2306:13-2307:21 (closing argument); Div. Opening Br. in Support of Findings of Fact 3, 26-38 (filed Dec. 10, 2013); Div. Reply Br. in Support of Findings of Fact 1, 30-31 (filed Dec. 19, 2013); Div. Petition for Review of Initial Decision 1, 6 (filed Aug. 11, 2014); DB 1, 3, 16-19; DB Opp. 1, 2-3, 13-15, 22-33].

Nor is it true, as Bennett claims, that the Division did not ask the ALJ to make a finding that Respondents violated AS No. 3, the audit documentation standard. [BB Opp. 11 n.4.] The focus of the Division's argument is and has always been that Respondents' audit procedures violated basic audit standards requiring due care, professional skepticism, and competent evidence, and that Respondents should not be permitted to disavow the documented audit by resorting to undocumented procedures. Even so, the Division specifically noted that if the ALJ credited Respondents' testimony about undocumented procedures, "Respondents would still be liable for violations of the PCAOB's standards on audit documentation," and such violations, in this case, "would warrant sanctions under Rule 102(e)." [Div. Opening Br. in Support of Findings of Fact 57.]

considerations and procedures, which underscores the deficiency of the procedures as documented." [ID 31.]

The Initial Decision summarized Respondents failings as follows:

> They knew that heightened scrutiny was warranted over the ALLL in general and the FAS 114 portion in particular, collateral overvaluation was a specific risk point, and management continued to rely on older or undiscounted appraisals from the first half of 2008 or earlier at year-end 2008, despite contrary market information. Numerous red flags indicated that management was inept and had an incentive to understate losses. Yet, their procedures in testing TierOne's internal control over financial reporting and evaluating the FAS 114 estimates failed to sufficiently address these issues, and KPMG issued a clean audit opinion.

[ID 36.] Given these findings, Bennett's insistence that the Initial Decision did not identify significant audit failures is simply not credible.

Respondents also take issue with certain specific claims in the Division's opening brief. Aesoph claims the Division mischaracterized the record when it argued that "Respondents' audit workpapers deemed an appraisal 'current,' and did no further assessment of whether the appraisal's value was still reasonable, so long as the appraisal was dated some time during 2008." [AB Opp. 9-10.] In fact, that is precisely what the audit workpapers say:

> Using judgment, KPMG selected a sample of FAS 114 calculations and obtained the original appraisals ***to ensure the appraisal values used in the calculations*** were "as is" values and ***were current (within past 12 months). If appraisals were not within the past twelve months, KPMG inquired*** whether a discount was applied to the appraised value, and if not, KPMG inquired as to why TierOne didn't think it was necessary or appropriate.

[DX-120 at KPMGTO0005482 (emphasis added); see also ID 31.] As the workpapers make clear, so long as an appraisal was a year old or less, Respondents were satisfied that it was reasonable – an assumption that was contrary to every indicator of market value during 2008, in the depths of the Great Recession.

Aesoph also claims the Division "highly exaggerated" the record when arguing that TierOne "typically estimated collateral values" using stale appraisals that were not discounted. [AB Opp. 9-10.] But that practice was typical, particularly in the markets where the FAS 114 loans were concentrated and where market conditions were most troubled. For example, Nevada accounted for approximately half of TierOne's FAS 114 loans. [ID 14; DX-191 ¶102.] Of the thirty FAS 114 loans in Nevada, only two had collateral valued using arguably current appraisals from the second half of 2008. [DX-191 ¶104.] Further, and contrary to Aesoph's claim that Respondents "observed that TierOne continued to ... apply additional discounts to the most recent appraised values for loans in the Nevada portfolio" [AB Opp. 11], twenty-five of the thirty loans had appraisals with no discount, even though markets had declined twenty to forty percent since the dates of the appraisals.[4] [DX-191 ¶114.] A similar pattern followed in Arizona: all thirteen loans had collateral valued with appraisals older than the second-half of 2008, and only one of the appraisals was discounted, despite market declines of twenty to thirty percent since the dates of the appraisals. [DX-191 ¶181.] The evidence that TierOne frequently relied on stale, undiscounted appraisals is clear.

Bennett claims the Division misrepresented the ALJ's findings when arguing that Respondents' conduct was recurrent and represented a serious threat to the Commission's processes. [BB Opp. 32 (citing DB 22, 25-26).] But it is Bennett who is mischaracterizing. The Division did not claim that these were findings of the ALJ. Rather, these were arguments the Division made in explaining why the ALJ's sanctions were too light. In any event, while the

---

[4] As he did in his opening brief, Aesoph claims that there were no undiscounted appraisals because each appraisal carried a "time-value" discount for the time TierOne projected it would take to sell the collateral. [AB Opp. 10.] But as Respondents' own accounting expert conceded, this discount had nothing to do with adjusting for the age or staleness of the appraisal. [See DB Opp. 5 n.1.] The fact is that many appraisals were not discounted to reflect market realities since the dates of the appraisals.

Initial Decision did not use the same language used by the Division, the ALJ's findings do show recurrent conduct that is a threat to the Commission's processes. As described above, the ALJ found repeated failures in a high-risk audit area: in Respondents' audit of internal controls, in their substantive procedures, and in their assessment of new appraisals. Moreover, she found that Respondents relied heavily on undocumented procedures – including claims of procedures that were "belie[d]" by the record – and that their attempts to distance themselves from their workpapers "underscore[d] the deficiency of the procedures as documented." In short, the ALJ's findings demonstrate repeated failures to follow basic audit standards in a high risk audit area, and counsel for significant sanctions.

C. Respondents' Failure to Recognize their Misconduct Justifies Sanctions.

Respondents also take issue with the Division's – and the Decision's – reliance on Respondents' failure to recognize the wrongfulness of their conduct as a basis for sanctions, claiming that such consideration violates due process. [AB Opp. 5-9; BB Opp. 35-39.] Respondents' arguments misapprehend both the Division's theory and the applicable law.

The Division's argument for sanctions is not based merely on the fact that Respondents chose to mount a defense to the charges rather than admit wrongdoing. Rather, it is also based on the fact that their defense hinges on Respondents' insistence that they performed significant audit procedures that are simply not documented. [DB 27.] In other words, Respondents not only contest the Division's charges, they do so by resorting to arguments that are contrary to clear PCAOB guidance that auditors must document their work. [Id.] This goes well beyond mounting a defense, and reveals a fundamental misunderstanding of basic auditing standards and auditor responsibilties. As the Commission has noted in similar circumstances, such conduct underscores the need for sanctions. See Wendy McNeeley, CPA, Rel. No. 34-68431, 2012 WL 6457291, *18

(Dec. 13, 2012) ("Our concern that McNeeley will commit future violations is exacerbated by McNeeley's subsequent failure to recognize the wrongfulness of her conduct. McNeeley has consistently asserted that she conducted the audit appropriately. While a respondent has the right to present a vigorous defense, McNeeley's testimony and subsequent arguments on appeal reflect a continuing failure to grasp the role of an auditor."); cf. Conrad P. Seghers, Rel. No. IA-2656, 91 S.E.C. Docket 1945, 2007 WL 2790633, *8 (Sept. 26, 2007) ("Consistent with a vigorous defense of the District Court's injunction, [respondent] denies that his conduct was wrongful in nature. However, [respondent] continues to demonstrate either a misunderstanding or a lack of recognition of an investment adviser's affirmative duties and regulatory obligations.").

In any event, basing sanctions, in part, on a respondent's failure to recognize misconduct during litigation is entirely proper, and does not violate due process. Respondents point to a smattering of decisions in civil injunctive actions to support their argument. [AB Opp. 6-7; BB Opp. 36 & n.22.] In those cases, the courts chose not to rely on a defendant's lack of remorse or insistence of innocence in assessing whether to enter a permanent injunction. But those cases are inapposite, for at least three reasons.

First, the cases are inconsistent with clear Commission precedent. Recognition of wrongdoing is one of the public interest factors the Commission routinely considers when assessing whether and what sanctions are appropriate. See, e.g., Steven Altman, Esq., 99 S.E.C. Docket 2744, 2010 WL 5092725, *19 (2010) (citing Steadman v. SEC, 603 F.2d 1126 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981)). In addition, the Commission has specifically looked to respondents' positions and arguments during litigation as evidence of a continuing failure to acknowledge their misconduct. See Toby G. Scammell, Rel. No. IA-3961, 2014 WL 5493265, *6 (Oct. 29, 2014) (upholding collateral bar because, among other things, respondent

did not fully recognize misconduct, and noting that respondent's opening brief on appeal continued to characterize "egregious insider trading" as mere "lapse in judgment"); Michael C. Pattison, CPA, Rel. No. 34-67900, 2012 WL 4320146, *10 (Sept. 20, 2012) (upholding permanent denial of privilege of practicing before Commission because, among other things, respondent "continues to dispute that his conduct was egregious," noting respondent's "failure to appreciate the gravity of his misconduct raises troubling questions about his fitness to appear and practice before the Commission"). Respondents do not acknowledge this Commission precedent.

Second, none of the cited cases stands for the proposition Respondents advance: that due process is violated when a court considers denial of wrongdoing in imposing sanctions. Indeed, the law is to the contrary. As the Seventh Circuit explained in rejecting a similar due process argument that the lower court was improperly influenced in its sanctions analysis "by the fact that [the defendant] steadfastly maintained his innocence and claimed to be the victim of a government vendetta,"

> acceptance of responsibility for illegal conduct is a routine and unexceptionable feature even of criminal, let alone of civil, punishment.... The criminal who in the teeth of the evidence insists that he is innocent, that indeed not the victims of his crime but he himself is the injured party, demonstrates by his obduracy the likelihood that he will repeat his crime, and this justifies the imposition of a harsher penalty on him.

SEC v. Lipson, 278 F.3d 656, 664 (7th Cir. 2002); see also Michael C. Pattison, Rel. No. ID-434, 2011 WL 4540002, *9 (Sept. 29, 2011) (considering respondents' failure to recognize wrongful nature of conduct at the time of the conduct or during litigation, and citing SEC v. Seghers, 548 F.3d 129, 136-37 (D.C. Cir. 2008) for proposition that "due process is not violated by giving a respondent a choice between recognizing the wrongfulness of his conduct, or refusing to do so and thereby risking more severe remedial action").

Third, the fact that a handful of courts have chosen not to rely on a defendant's failure to acknowledge wrongdoing in assessing injunctive relief is of limited, if any, value in assessing proper administrative remedies.[5] As the Commission has recognized, "'injunctive and administrative remedies serve different purposes; one restrains further violative activity, the other seeks to determine whether it is in the public interest to exclude somebody from the securities business or to limit his activities in it.'" Conrad P. Seghers, 2007 WL 2790633, *6 (quoting Samuel H. Sloan, 45 S.E.C. 734, 738-39 (1975)). Put simply, Respondents' cases have little relevance to the issue here, which is the appropriate remedial sanction.

In addition, there is no merit to Aesoph's incendiary claim that basing sanctions, in part, on a failure to acknowledge wrongdoing would "confirm widely-held concerns" that administrative proceedings "deprive respondents of due process." [AB Opp. 5-6.] As a general matter, "broad attacks on the procedures of the administrative process have been repeatedly rejected by the courts." Harding Advisory LLC, Rel. No. 33-9561, 2014 WL 988532, *8 (March 14, 2014). More specifically, the fact that respondents in administrative proceedings are sanctioned based on, among other things, failure to recognize their misconduct is unremarkable: as explained above, consideration of acceptance of responsibility is a "routine and unexceptionable feature" of our system of justice. Lipson, 278 F.3d at 664. Examining whether a respondent has recognized wrongdoing in assessing sanctions is the sort of thing courts – administrative and otherwise – do each and every day.

---

[5] Notably, Respondents fail to mention that other courts do consider recognition of wrongdoing when assessing injunctive relief. See, e.g., SEC v. McNulty, 137 F.3d 732, 741 (2d Cir. 1998) ("[I]t is within the district court's discretion to enter … an injunction if it considers that relief warranted by a culpable defendant's continued protestations of innocence….") (citation and quotations omitted); SEC v. Holschuh, 694 F.2d 130, 144-45 (7th Cir. 1982) (imposing injunction because, inter alia, "[t]hroughout the proceedings he has failed to admit his culpability or to provide any adequate assurance against future violations, but rather has steadfastly professed his innocence of wrongdoing.").

As a final point, it is telling that even on appeal Respondents continue to fail to recognize their misconduct, instead attempting to minimize their actions by ignoring the audit workpapers and in some cases their own prior admissions. For example, Bennett argues the Division improperly focused on the audit work done on the FAS 114 portion of the ALLL, and "ignore[d]" the work done on other portions of that account. [BB Opp. 17.] But as Respondents themselves conceded, the FAS 114 portion of the ALLL was a critically important, individually material component of the audit, and if they did not perform sufficient procedures and obtain persuasive evidence over the FAS 114 portion of the ALLL, they would not have a basis to render their audit opinion. [DB Opp. 9-10.] Plainly, then, the serious errors in the FAS 114 audit alone are sufficient to find Respondents engaged in improper professional conduct.

Both Respondents also take issue with the Division's assertion that certain audit procedures were not documented, claiming for example that the purported discussion with TierOne's controller David Kellogg and confirmation of a 30% loss recognition on Nevada loans are, in fact, documented. [AB Opp. 15; BB Opp. 26.] But again, this argument is refuted by, among other things, Respondents' own admissions. Respondents conceded at the hearing that the conversation with Kellogg and purported confirmatory procedures were not documented in the workpapers. [See Tr. 1691:5-1697:15 (Bennett); 1787:15-18 (Aesoph); see also DB Opp. 31.]

Perhaps most incredibly, Bennett argues that the Division improperly focuses on what he refers to as a "two-page workpaper," when Aesoph expressly conceded that workpaper – which is the FAS 114 procedures memo – is where he would expect the procedures and evidence regarding the audit work on the FAS 114 loans to be documented. [BB Opp. 25-26; see DB Opp. 19.] Respondents' continuing attempts to distance themselves from their audit workpapers, and indeed their own admissions, further underscores the need for significant sanctions in order to

protect the investing public and ensure appreciation for, and compliance with, professional standards.

At bottom, while Respondents have the right to contest the Division's allegations, the fact that they continue to maintain they did nothing wrong, and do so in large part by relying on purported but undocumented procedures, can and should be considered when imposing an appropriate sanction. Whether an individual recognizes wrongdoing is indicative of whether the person may repeat such misconduct in the future, a consideration that is important to determining whether and what sanctions are in the public interest.

D. Respondents' Ultimate Resignation When They Later Learned of TierOne's Fraud Does Not Excuse Their Improper Audit Conduct.

Respondents – particularly Aesoph – argue that their role in "br[inging] to light the wrongdoing of TierOne's executives," including their ultimate resignation from the engagement and purported cooperation in the investigation into TierOne management's fraud, obviates the need for any sanctions. [AB Opp. 2-3; see also id. 4-5, 26-27; cf. BB Opp. 3 (claiming role in investigation of management fraud).] It is certainly true that TierOne's management was concealing certain information from the auditors. As a threshold matter, this fact does not excuse or justify Respondents' audit failures. Rather, the Initial Decision appropriately focused on Respondents' procedures over the information they had at the time of the audit, and found those procedures lacking. [See DB Opp. 44-45.]

In addition, and specific to the arguments made in Respondents' opposition briefs, the fraud should not bear on the appropriate sanctions, given the disconnect between Respondents' audit conduct and the exposure of the fraud, as well as the fact that Respondents played a far more limited role in exposing that fraud than Aesoph's arguments suggest.

The audit conduct in question occurred in the first few months of 2009. It was not until April 2010 – more than a year later – that Respondents learned management had withheld an internal analysis of loss estimates. [See, e.g., Tr. 1752:25-1754:10.] Further, contrary to Aesoph's claim on appeal that he "discovered" the internal analysis [AB Opp. 2; see also id. 27], in fact Aesoph testified at trial that he learned of the existence of the analysis when he read about it in the Office of Thrift Supervision's ("OTS") April 2010 examination report. [Tr. 1755:25-1756:25.] And finally, contrary to Respondents' suggestion that that were willing cooperators in the investigation of management's fraud (a point which, tellingly, neither Respondent cites any evidence to support), Respondents' testimony in the investigation was taken pursuant to validly-issued investigative subpoenas. [See generally Tr. 1518:21-1520:1.] There is simply no evidence in the record to support the claim that Respondents were "cooperators" in the underlying investigation.

In sum, the fact that Respondents resigned when confronted with incontrovertible evidence – uncovered by the OTS – that management withheld critical information, and the fact that Respondents gave testimony in this matter when subpoenaed to do so, does not excuse the fact that during the audit in question Respondents repeatedly failed to exercise due care or gather appropriate evidence in a high-risk audit area. It is that conduct that formed the basis for the Division's charges, and it is that conduct that merits significant sanctions. Cf. Barry C. Scutillo, Rel. No. 34-48238, 2003 WL 21738818, *17 (July 28, 2003) (upholding three-year suspension of auditor despite auditor's arguments that he cooperated with staff in investigation of issuer, that he was deceived by issuer's fraud, that audit failure was isolated incident that occurred years ago, and that auditor had otherwise unblemished record).

E. Respondents' Other Attempts to Mitigate their Misconduct Do Not Reduce the Need for Significant Sanctions.

Many of Respondents' other arguments focus on purportedly mitigating factors, such as their recognition of the critical risks related to the FAS 114 loan losses, their consideration of a the damning OTS report, and their audit work in other areas. Respondents also attempt to downplay the seriousness of their audit failures by claiming the conduct was only negligent, not intentional, and that it was isolated. In fact, none of these arguments excuse Respondents' conduct or counsel for lesser sanctions.

1. Respondents Cannot Take Credit for Recognizing Audit Risks.

Respondents emphasize that they recognized risks associated with the FAS 114 portion of the ALLL, suggesting that they should receive credit for doing so. [See, e.g., AB Opp. 2 ("The Decision makes no finding that Respondents ... failed to recognize the importance of the [ALLL] or FAS 114 ...."); BB Opp. 31 (arguing the Division "does not dispute" ALJ's finding that KPMG "recognized risks associated with the ALLL").] But the Division never contended Respondents were unaware of the audit risks. [See Order Instituting Proceedings ¶¶ 18-29.] Indeed, the fact that Respondents' recognized the risks – and did little in response – is part of what makes Respondents' conduct so egregious. As Respondents' auditing expert conceded, these risks "absolutely" demanded increased scrutiny, more persuasive evidence, and increased audit procedures. [Tr. 2085:19-2086:23; see also DF 483.] Instead, Respondents performed only basic audit procedures: "ticking and tying," obtaining stale appraisals, and inquiring of management. [See DB Opp. 17-22.] In short, the fact that Respondents recognized the obvious, critical risks makes their cursory audit procedures more problematic, not less. See, e.g., Gregory M. Dearlove, Rel. No. 34-57244, 2008 WL 281105, *29 (Jan. 31, 2008) ("As audit risk increases, so does the need for care and skepticism.").

2. Respondents' Review of the 2008 OTS Report Further Highlighted the Need for Heightened Procedures.

In a similar argument, Respondents suggest they should get credit for having carefully considered the OTS's 2008 Report of Examination in the course of planning the audit. [AB Opp. 19-20; BB Opp. 2, 21.] Again, this argument is a strawman. The Division did not claim Respondents should have considered the Report and did not; rather, the point is that critical findings of the Report should have compelled Respondents to perform more significant audit procedures. The Report found, among other things, serious problems with the FAS 114 loan portfolio, specifically criticized TierOne's credit underwriting and administration practices, and noted there were loans with stale and unsupported appraisals. [See DB Opp. 5-6.] These are precisely the areas and issues where Respondents failed to properly audit. As a result of the examination, TierOne was downgraded from a bank that was "sound in every respect" to a bank that "generally exhibit[ed] unsafe and unsound practices or conditions." [Id. 7.] And the OTS increased TierOne's regulatory capital requirements, which were directly tied to TierOne's loan losses – recognition of more losses would put TierOne closer to breaching its capital requirements. [Id.] Put simply, the OTS's Report and subsequent actions underscored the critical risks in the FAS 114 loan portfolio, and particularly the risks that TierOne had been using stale appraisals and had incentive to understate its loan losses. [Id. 8-9.] Again, it was Respondents' response to these known risks – or lack thereof – that violated professional standards

3. Respondents' Work in Other Audit Areas Does Not Mitigate Their Serious Failures in a Critical, High-Risk Account.

Respondents – particularly Bennett – also argue that they should get credit for performing competently in other areas of the audit and devoting more time to the 2008 audit than had been spent in previous audits. [BB Opp. 31, 34-35; cf. AB Opp. 25 (noting allegations pertain to only

a single account).] Bennett extracts a portion of the Initial Decision to argue that the audit work in other areas was conducted "to the highest professional standards," but omits the next clause of the Initial Decision, which concluded that such work "***cannot save [Respondents'] deficient work over the FAS 114 portion of the ALLL***." [ID 31 (emphasis added); see also id. 34 (noting that such work does not obviate the need for a sanction).] The Initial Decision is, of course, correct. Given that the FAS 114 portion of the ALLL was a high-risk, individually material area of the audit, Respondents were required to audit that area with particular care, which they did not do. See AU 312 ¶ 17. [See also DF 54, 377, 483.] The fact that Respondents may have spent more time on other audit issues does not excuse their conduct. Nor does the fact that the Division did not charge audit failures in other less risky, less material audit areas mitigate the need for a significant sanction. See Dearlove, 2008 WL 281105, at *29-30 (suspending auditor for four years for negligent conduct despite evidence that other areas of the audit may have been properly audited; "Evidence that Dearlove spent substantial time and effort on some auditing areas does not insulate him from liability for his failure to spend enough time and effort on others that were so material to [the company's] financial statements.").

4. Bennett's Role as a Senior Manager Does Not Insulate Him from Sanctions.

Bennett argues that significant sanctions are not appropriate because he was only a senior manager on the 2008 TierOne audit. [BB Opp. 3, 31, 34.] As a threshold matter, Bennett fails to acknowledge that the sanctions the Division seeks expressly recognize that Aesoph's suspension, as the audit partner, appropriately ought to be more significant than Bennett's as the senior manager. [See DB 21 (noting that three-year suspension for Aesoph and two-year suspension for Bennett "appropriately account for their respective roles").] But the fact that Aesoph may be relatively more culpable does not mean Bennett is blameless. Bennett was not a junior staffer; at

the time of the audit, he had been with KPMG for seven years, had been involved in audits of TierOne for five years, and had been involved in about thirty other audits prior to the engagement in question. [ID 6.] Moreover, as senior manager, Bennett was responsible for the audit team's day-to-day work, and for supervising and guiding his team. [ID 6; DF 49-50.] He was essentially the "number-two" auditor on the engagement: he reported to Aesoph, while the other auditors reported to him. [DF 51.] He also had significant responsibility for auditing the ALLL account: he was intimately involved in identifying the ALLL, and specifically the FAS 114 portion, as a high-risk area; he personally reviewed TierOne's FAS 114 loans on a loan-by-loan basis; and he had control over the FAS 114 audit workpapers and could have changed them during the audit if necessary. [See DF 76-98, 132-138, 149, 153-155.] At the conclusion of the audit, Bennett (along with Aesoph) personally signed off that "all necessary auditing procedures were completed, ... support for conclusions was obtained, sufficient appropriate audit evidence was obtained, and documentation was prepared and reviewed to support the representations in the auditors' report." [DF 270.] Bennett's role in the audit was significant, his misconduct was significant, and his sanctions should be significant.

5. Respondents' Recurrent Misconduct Is No Less Serious because it was Negligent.

Respondents also attempt to downplay the significance of their misconduct by arguing they were only negligent, and only so in a single account. [AB Opp. 4, 25; BB Opp. 32.] However, as the Commission recognized in adopting the current Rule 102(e), "'a negligent auditor can do just as much harm to the Commission's processes as one who acts with an improper motive.'" Dearlove, 2008 WL 281105, at *30 (quoting Amendment to Rule 102(e), 63 Fed. Reg. 57,164, at 57,167(Oct. 26, 1998)). For this reason, negligent conduct can justify

sanctions as serious as a permanent suspension. Dearlove, 2008 WL 281105, at *30. Here, while Respondents' conduct may not have been intentional, it was egregious.

Respondents further argue their misconduct, no matter how pervasive, should not be considered recurrent because it occurred within a single account; they quote the Commission's amendment to Rule 102(e) to argue that the rule is not aimed at "single judgment error[s] or "every professional misstep." [AB Opp. 24; BB Opp. 5, 32.] But as explained in the Division's opening brief, the errors here were not isolated. Rather, Respondents violated professional standards nearly every time they performed work on the FAS 114 portion of the ALLL: their internal control work, substantive testing, and response to newly-discovered appraisals were all inadequate. [DB 25-26.] These sorts of failures constitute recurrent errors.[6] Further, even if these pervasive failures could be considered a "single judgment error," the Commission has recognized that such an error that is "highly unreasonable and made in circumstances warranting heightened scrutiny" – which the errors here were – "***conclusively*** demonstrates a lack of competence to practice before the Commission." Amendment to Rule 102(e), 63 Fed. Reg. at 57,166 (emphasis added). Thus, even assuming, for argument's sake, the multiple errors should be considered "singular" because they occurred in one account, they still merit significant sanctions.

[6] As the Commission has explained in analogous circumstances, "Rule 102(e) looks to the number of instances of unreasonable conduct, not the number of accounts." Kevin Hall, CPA and Rosemary Meyer, CPA, Rel. No. 34-61162, 2009 WL 4809215, *7 (Dec. 14, 2009). While the issue in Hall and Meyer was whether a finding of "[r]epeated instances of unreasonable conduct" had to be based on conduct in multiple accounts, its reasoning is equally applicable here. In considering whether misconduct is recurrent, the Commission should not be limited by the fact that multiple audit failures all occurred within a single account.

6. Respondents Have the Opportunity to Repeat their Misconduct.

Respondents also claim – using slightly different arguments – that their employment as auditors at KPMG should not factor in to the Commission's sanction calculus. Respondents' arguments ignore clear Commission guidance that continuation in the profession is directly relevant to the sanctions imposed.

Aesoph contends that he is unlikely to ever be faced with the precise facts of the 2008 audit again, while Bennett argues that basing a sanction, in part, on continuing in the profession is a "Catch-22" because the only way to avoid a sanction is to abandon the profession. [AB Opp. 25-26; BB Opp. 35 n.20.] Both arguments ignore that the Commission looks to a respondent's occupation generally when assessing the appropriate sanction. See McNeeley, 2012 WL 6457291, at *18 ("McNeeley's conduct also indicates a risk that she will commit future violations.... McNeeley has made clear that she intends to remain an auditor if permitted."); see also Altman, 2010 WL 5092725, at *20 (finding occupation made violation likely because "[a] significant failure to perform properly the professional's role has implications extending beyond the particular transaction involved ...."); John P. Flannery and James D. Hopkins, Rel. No. 34-73840, 2014 WL 7145625, *37 (Dec. 15, 2014) ("When determining whether remedial action is in the public interest, we consider ... the likelihood that the respondent's occupation will present opportunities for future violations.").

Similarly, Aesoph contends the record does not suggest any likelihood of future violations. Citing again to a district court case assessing the need for injunctive relief, Aesoph argues that the fact of a past violation does not demonstrate a likelihood of recurrence, and claims the conduct at issue is his one and only offense. [AB Opp. 25 (quoting SEC v. Ingoldsby, Civ. A No. 88-1001, 1990 WL 120731 (D. Mass May 15, 1990).] But again, Aesoph again fails

to recogznize that the language in Ingoldsby is inconsistent with direct Commission precedent, which notes that "'the existence of a violation raises an inference that it will be repeated.'" McNeeley, 2012 WL 6457291, at *18 (quoting Geiger v. SEC, 363 F.3d 481,489 (D.C. Cir. 2004)).

Moreover, Aesoph's disciplinary record is not as pristine as he suggests. Rather, prior to the TierOne audit, Aesoph was rated less than satisfactory by KPMG for two audit engagements. These less than satisfactory ratings were driven by a lack of performance and/or lack of documentation of substantive audit procedures. [DF 368.] In any event, "[a]n otherwise clean disciplinary history ... is not determinative for purposes of [the] sanctions analysis." McNeeley, 2012 WL 6457291, at *19.

F. Respondents' Reliance on Undocumented Procedures Underscores Their Failure to Grasp Important Rules of Audit Conduct.

Finally, Respondents insist that the Division's case for sanctions is based on little more than Respondents' violation of audit documentation standards, and that sanctions are not appropriate in such circumstances. [AB Opp. 21 (claiming the Division's charges "rapidly reduce to a challenge regarding audit documentation"); see also BB Opp. 1-2.] That is simply not the case. Respondents' fundamental misconduct was the failure to follow basic audit procedures requiring due professional care, appropriate professional skepticism, and competent audit evidence when reviewing one of the highest-risk areas of the audit. That misconduct, standing alone, merits significant sanctions. The misconduct was exacerbated when, rather than attempting to explain the audit that was documented in the workpapers, Respondents hinged their defense on claims that the workpapers were wrong and that they in fact performed significant, additional audit procedures that simply were not recorded. Such a defense flies in the face of clear PCAOB guidance emphasizing the importance of clear documentation of the procedures

performed and evidence obtained. AS No. 3 ¶ 6; see also id. ¶ A.26. Put simply, Respondents' continued reliance on undocumented procedures shows their inability – or refusal – to accept basic principles governing an auditor's conduct, and underscores the need for significant sanctions in order to "encourage [Respondents'] more rigorous compliance with [PCAOB standards] in the future." McCurdy v. SEC, 396 F.3d 1258, 1265 (D.C. Cir. 2005).

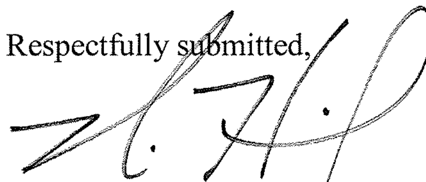
III. CONCLUSION

For all of these reasons, as well as the reasons outlined in the Division's opening brief, more significant sanctions should be imposed on Respondents than the suspensions ordered in the Initial Decision.

Rule 450(d) Certification: Undersigned counsel certifies that the above brief contains 6,830 words, exclusive of the table of contents, table of authorities, and table of record citation abbreviations.

Dated: January 23, 2015

Respectfully submitted,



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