BEFORE THE
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.

Admin. Proc. File No. 3-17758

In the Matter of the Application of

CYNTHIA C. REINHART, CPA

For Review of Disciplinary Action Taken By the

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

RECEIVED
MAR 28 2017
OFFICE OF THE SECRETARY

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD'S OPPOSITION TO APPLICATION FOR COMMISSION REVIEW

March 27, 2017

J. Gordon Seymour
Luis de la Torre
Jerome P. Sisul
Office of the General Counsel
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006
202-207-9100 (phone)
202-862-8435 (facsimile)
seymourg@pcaobus.org
delatorrel@pcaobus.org
sisulj@pcaobus.org

TABLE OF CONTENTS

INTRODUCTION 1

FACTS 4

I. Reinhart Led the 2007 Audit and, Due to the August 2007 Events, Elevated Her Risk Assessments. 4

A. Reinhart understood Thornburg's business practice of short-term borrowing through reverse repurchase agreements. 4

1. Thornburg securitized mortgage loans, which it designated as "available for sale securities" under GAAP. 4

2. The August 2007 events underscored the risks of Thornburg's rev repo borrowing. 5

3. Following the August 2007 Events, Reinhart elevated her risk assessments for the 2007 audit and identified going concern and OTTI/ability to hold as high-risk audit areas. 6

II. Reinhart Delayed Her Evaluations Until Late February 2008, and Learned Certain Information About Thornburg's Deteriorating Financial Condition, Including Its Diminishing Liquidity Position, Falling Securities Values, and Rising Margin Calls. 7

A. Reinhart knew Thornburg's going concern memo lacked a discussion of its readily available liquidity, securities values, and margin calls in the Subsequent Period. 8

B. Reinhart's going concern evaluation lacked any meaningful assessment of Thornburg's diminishing readily available liquidity, declining securities values, and increasing margin calls in the Subsequent Period. 9

1. Reinhart relied on Thornburg's year-end liquidity in the face of contrary evidence. 9

2. Reinhart overestimated Thornburg's ability to meet margin calls by another $900 million and failed to consider the impact of another 2% to 3% decrease in Thornburg's securities values. 11

3. Reinhart's consideration of margin calls ultimately rested on uncorroborated management representations that Thornburg was meeting all of its margin calls. 12

C. Reinhart's evaluation of management's OTTI/ability to hold conclusion failed to adequately assess Thornburg's liquidity position and ability to meet margin calls in light of available information and was internally inconsistent.............. 14

D. Thornburg Failed To Meet Margin Calls Within Hours of Filing Its 2007 Form 10-K, and Five Days Later Reinhart Withdrew KPMG's Audit Report. 15

ARGUMENT 16

I. The Board's Findings of Violations Were Based on Straightforward Application of PCAOB Auditing Standards to Reinhart's Seriously Flawed Audit Work. 16

II. Reinhart Violated PCAOB Rules and Standards in Her Audit Work on the Going Concern and OTTI/Ability To Hold Issues. 22

A. In Reinhart's going concern evaluation, she failed to adhere to fundamental auditing principles in considering "relevant conditions and events." 22

1. Reinhart's consideration of Thornburg's diminishing readily available liquidity was deficient. 22

2. Reinhart's consideration of Thornburg's declining securities values was deficient. 26

3. Reinhart's consideration of Thornburg's margin call activity was deficient 29

B. In Reinhart's OTTI/ability to hold evaluation, she failed to adhere to fundamental auditing principles in considering relevant information and obtaining audit evidence about management's conclusion 31

III. The Board's Findings of Violations Were Based on Reinhart's Conduct, and the Information Known by or Reasonably Available to Her, in the Audit, Not Hindsight. ... 35

IV. There Was No Error In Excluding From Evidence Two Internal Thornburg Emails 38

V. Reinhart Engaged in Repeated Instances of Negligent Conduct, Warranting the Sanctions the Board Imposed. 40

CONCLUSION 44

TABLE OF AUTHORITIES

CASES

Barry C. Scutillo, SEC Rel. No. 34-48238, 2003 WL 21738818 (July 28, 2003)............ 30

Bid for Position, LLC v. AOL, LLC, 2008 WL 5784151 (E.D. Va. July 11, 2008).......... 41

Davy v. SEC, 792 F.2d 1418 (9th Cir. 1986)... 20

Ernst & Ernst, SEC Rel. No. AS-248, 1978 WL 207542 (May 31, 1978)...................... 30

Gregory M. Dearlove, SEC Rel. No. 34-57244, 2008 WL 281105 (Jan. 31, 2008) *aff'd* 573 F.3d 801 (D.C. Cir. 2009).. 18, 20, 43

Heath v. SEC, 586 F.3d 122 (2d Cir. 2009).. 20, 21

John J. Aesoph, CPA, SEC Rel. No. 34-78490, 2016 WL 4176930 (Aug. 5, 2016) *appeal filed*, No. 16-3830 (8th Cir. Oct. 3, 2016).. 34, 43

Kabani & Co., SEC Rel. No. 34-80201, 2017 WL 947229 (Mar. 10, 2017) 38

Kevin Hall, CPA, SEC Rel. 34-61162, 2009 WL 4809215 (Dec. 14, 2009).................... 37

KPMG Peat Marwick LLP, SEC Rel. No. 34-43862, 2001 WL 47245 (Jan. 19, 2001) *aff'd*, 289 F.3d 109 (D.C. Cir. 2002) 25, 37

Mark E. Laccetti, CPA, SEC Rel. No. 34-79138, 2016 WL 6137057 (Oct. 21, 2016).... 44

Marrie v. SEC, 374 F.3d 1196 (D.C. Cir. 2004)... 19, 20

McCurdy v. SEC, 396 F.3d 1258 (D.C. Cir. 2005)... 18, 21

Michael J. Marrie, CPA, SEC Rel. No. 34-48246, 2003 WL 21741785 (July 29, 2003) *rev'd on other grounds*, 374 F.3d 1196 (D.C. Cir. 2004).............................. 27-28

Philip L. Pascale, SEC Rel. No. 34-51393, 2005 WL 636868 (Mar. 18, 2005).............. 37

Robert D. Potts, CPA, SEC Rel. No. 34-39126, 1997 WL 690519 (Sept. 24, 1997) *aff'd*, 151 F.3d 810 (8th Cir. 1998) 16

Rudolph v. Arthur Andersen & Co., 800 F.2d 1040 (11th Cir. 1986).............................. 43

Russell Ponce, SEC Rel. No. 34-43235, 2000 WL 1232986 (Aug. 31, 2000) *aff'd*, 345 F.3d 722 (9th Cir. 2003) 31, 38

S.W. Hatfield, CPA, SEC Rel. No. 34-69930, 2013 WL 3339647 (July 3, 2013)........ 3, 18

Salman v. United States, 137 S. Ct. 420 (2016)... 20

Sweet v. United States, 53 Fed. Cl. 208, (2002) *vacated on other grounds sub nom. MIT. v. United States*, 75 Fed. Cl. 129 (2007).. 41

Thomas W. Heath, III, SEC Rel. No. 34-59223, 2009 WL 56755 (Jan. 9, 2009) *aff'd*, 586 F.3d 122 (2d Cir. 2009) 20

Touche, Niven, Bailey & Smart, SEC Rel. No. AS-78, 1957 WL 3606, (Mar. 25, 1957).37

Wendy McNeeley, CPA, SEC Rel. No. 34-68431, 2012 WL 6457291 (Dec. 13, 2012) 20, 23, 24

William F. Moody, SEC Rel. No. 34-36700, 1996 WL 15653 (Jan. 11, 1996)....39

STATUTES

15 U.S.C. 7215(b)(4) 40

15 U.S.C. 7215(c) 40

15 U.S.C. 7215(c)(4).... 40

15 U.S.C. 7215(c)(5).... 43

15 U.S.C. 7215(c)(5)(A) 41

15 U.S.C. 7215(c)(5)(B) 40

15 U.S.C. 7215(e) 44

15 U.S.C. 7217(a)(c).... 40

15 U.S.C. 7217(c)(2).... 3

15 U.S.C. 7217(c)(3).... 4

15 U.S.C. 78d-3 40

15 U.S.C. 78j-A1(a).... 21

15 U.S.C. 78s(d)(2).... 3

15 U.S.C. 78s(e)(1) 3

17 C.F.R. 201.102(e)....20, 40, 42-43

RULES

PCAOB Rule 3100.... 17

PCAOB Rule 3200T 17

PCAOB Rule 5441.... 38

OTHER AUTHORITIES

AS No. 3 34

AU 110 39

AU 150 .... 18, 20, 23, 39

AU 230 .... 16, 18, 20, 21, 23, 35, 39

AU 316 .... 20, 39

AU 326 .... 18, 19, 20, 21, 22, 23, 30, 39

AU 328 40

AU 332 .... 2, 17, 18, 19, 20, 25, 27, 31, 33, 40, 41

AU 333 .... 18, 19, 20, 23, 31, 40

AU 341 .... 1, 17, 18, 19, 20, 23, 25, 27, 29, 41

AU 530 27

AU 561 43

FAS 5 27

FAS 115 .... 4, 41

Montgomery's Auditing 26·17 (12th ed. 1998) 21

SEC Rel. No. 48730, 2003 WL 22478774 3

SAP No. 33 (1963) 21

SAS No. 2 (1974) 21

SAS No. 34 (1981) 21

SAS No. 59 (1988) 21

The Public Company Accounting Oversight Board (Board or PCAOB) opposes Cynthia C. Reinhart's application for review by the Securities and Exchange Commission (Commission or SEC) of disciplinary sanctions ordered against her by the Board.

INTRODUCTION

This matter involves serious misconduct by Reinhart, formerly a certified public accountant at KPMG LLP, a registered public accounting firm. Reinhart committed multiple violations of PCAOB rules and auditing standards in her role as the auditor with final responsibility, or engagement partner, for KPMG's audit of the December 31, 2007 financial statements of Thornburg Mortgage, Inc. (Thornburg or Company), a now-defunct publicly traded home mortgage lender and real estate investment trust that was then the second largest independent mortgage company in the United States with over $30 billion in assets.

In August 2007, Thornburg faced severe financial difficulties, stemming from steep declines in the market price of securities it pledged as collateral for certain short-term borrowing used to finance its mortgage-backed securities (MBS) business. The declines prompted its lenders to issue margin calls that it failed to meet with its available liquidity, causing defaults with its lenders, liquidations of its collateralized securities, and over $1.1 billion in losses.

These August 2007 events were the first red flag encountered by Reinhart, leading her to identify for the year-end audit Thornburg's liquidity position and margin calls as specific fraud risks, prone to misrepresentation by management. She also assessed as high-risk: (1) whether substantial doubt existed about Thornburg's ability to continue as a going concern for a reasonable period of time (AU 341), and (2) whether Thornburg had the ability to hold its securities that had fallen in value (impaired securities) until they recovered their value, and needed to recognize in earnings its unrealized losses on them as an "other than temporary impairment" (OTTI) (AU 332). As a result, Reinhart delayed her evaluations of these matters until near the audit report date in late February 2008 to consider the most current information about Thornburg's financial condition and the market.

Yet, as the Board found in its final decision (FD), Reinhart was, at best, "alarmingly careless" in her evaluations, disregarding important information. FD 89; *see* Index to the Record, Record Document (RD) 133 at 89. When conditions similar to August 2007 were again affecting Thornburg between December 31, 2007 and the audit report date of February 27, 2008 (the Subsequent Period), Reinhart failed to respond as required by PCAOB auditing standards. Instead, before issuance of the audit report, she consistently downplayed or, in some cases, ignored negative indicators in favor of ostensible support for Thornburg's ability to continue as a going concern and ability to hold its impaired securities. She also made gross errors in her evaluations and ultimately relied on uncorroborated management representations about Thornburg's available liquidity, securities values, and margin calls, despite contrary evidence.

The Board found that Reinhart violated fundamental auditing principles in both audit areas at issue. Despite multiple red flags calling for greater scrutiny, she failed to obtain and evaluate sufficient audit evidence to support the unqualified audit opinion she authorized to be issued, improperly relied on management representations, and failed to exercise due professional care, including professional skepticism. To further the public interest in the preparation of informative, accurate, and independent issuer audit reports and to protect the interests of investors, the Board barred Reinhart from association with a registered public accounting firm, with leave to petition to associate after two years, and restricted her activities for a further year, including from serving as an engagement partner on issuer audits.

On appeal, Reinhart employs countless tactics to shift the focus away from her actual audit work in the two high-risk areas. Her particular arguments about notice, professional judgment, hindsight, and a now-dismissed SEC action against Thornburg executives are all clear attempts to avoid scrutiny of her work. This case is about her conduct, not management's, about the information available to her at the time of audit, not events that occurred later, and about fundamental auditing principles that she both ignores in her brief and transgressed in the audit, not any "new" standards. Tellingly, when Reinhart does engage the Board's detailed findings of violations, she constantly defaults to the untenable proposition, rejected by her own experts, that because she postponed her evaluations until the Subsequent Period, she was allowed to rely all but exclusively on uncorroborated management representations. Finally, she attempts to create out of whole cloth a new statutory sanctioning standard to place her misconduct beyond any sanction, when sanctions are authorized even under her strained view. *See* FD 88 n.36, 91 n.37.

The record overwhelmingly establishes, under the standards governing Commission review of Board sanctions, that Reinhart "engaged in such acts or practices" or "omitted such acts" as the Board "has found [her] to have engaged in or omitted" by a preponderance of the evidence; such acts or practices "are in violation of" the rules and auditing standards "specified in the [Board's] determination"; and "such provisions are, and were applied in a manner, consistent with the purposes" of the Securities Exchange Act of 1934 and Title I of the Sarbanes-Oxley Act of 2002. *See* 15 U.S.C. 78s(d)(2), (e)(1), 7217(c)(2); *S.W. Hatfield, CPA*, SEC Rel. No. 34-69930, 2013 WL 3339647, *1 (July 3, 2013); SEC Rel. No. 48730, 2003 WL 22478774, *1-2 (Oct. 31, 2003) (approving PCAOB Rule 3100). And there is no basis for a finding that, "having due regard for the public interest and the protection of investors," the sanctions ordered are "not necessary or appropriate in furtherance of [the Sarbanes-Oxley Act] or the securities laws" or are "excessive, oppressive, inadequate, or otherwise not appropriate to the finding or basis on which" they were imposed (15 U.S.C. 7217(c)(3)). Reinhart's serious auditing failures deprived investors and the public of the protection that a properly performed audit provides. The sanctions imposed are necessary and appropriate and should be sustained.

FACTS

I. Reinhart Led the 2007 Audit and, Due to the August 2007 Events, Elevated Her Risk Assessments.

Reinhart led the audit of Thornburg's financial statements for the year ending December 31, 2007, including the duties of audit planning, performance of adequate procedures, and gathering sufficient evidence in light of the risks presented. She also authorized the issuance of KPMG's audit report expressing an unqualified opinion on those financial statements, which report was included in Thornburg's 2007 Form 10-K filed on February 28, 2008. FD 3-4.

A. Reinhart understood Thornburg's business practice of short-term borrowing through reverse repurchase agreements.

1. Thornburg securitized mortgage loans, which it designated as "available for sale securities" under GAAP.

As Reinhart knew, Thornburg's business was "to acquire, originate, and retain primarily [adjustable rate mortgage (ARM)] assets to hold in its portfolio, fund them using equity capital and borrowed funds, and generate earnings from the difference...between the yield on [its] assets and [its] cost of borrowings." FD 5. Among such holdings were Purchased ARM Assets, comprised of ARM loans that were publicly traded and issued by third-party lenders. FD 5-6.

Thornburg designated all of its Purchased ARM Assets as "available-for-sale" (AFS) securities under Statement of Financial Accounting (FAS) 115 of generally accepted accounting principles. FD 6. Consequently, the recognition and reporting of any unrealized losses on its

Purchased ARM Assets depended on whether those losses were a "temporary" impairment or an OTTI. *Id.* If the latter, Thornburg reported the unrealized losses against its earnings. *Id.*

Thornburg's 2007 Form 10-K identified the OTTI determination as a "critical accounting estimate." Thornburg concluded that $427.8 million in unrealized losses on its Purchased ARM Assets at year end were not an OTTI because it possessed "the ability and intent to hold" its impaired securities until recovery of their fair value. *Id.*

2. The August 2007 events underscored the risks of Thornburg's rev repo borrowing.

In 2007 and early 2008, Thornburg increasingly relied on reverse repurchase (rev repo) agreements, a form of short-term borrowing, to finance its business. FD 7. A rev repo agreement involved Thornburg's sale of its Purchased ARM Assets to a lender for an agreed-upon price, along with Thornburg's promise to repurchase the same securities at a future date and at a higher price. *Id.* These agreements had margin call requirements, which Reinhart knew presented heightened risks in the volatile markets of 2007-2008. FD 7-8, 11-12.

Under the agreements, the fair value of Thornburg's collateralized Purchased ARM Assets had to exceed its level of borrowing by a specified percentage (*i.e.*, the margin requirement). FD 7. If the value fell below that, the lender could initiate a "margin call," requiring Thornburg to pledge additional cash or collateral to meet the call. Thornburg could also receive margin calls when it renewed a rev repo agreement, if the lender raised the margin requirements. *Id.* Thornburg had to meet margin calls within one business day. FD 7-8. Failure to timely meet a call authorized the lender to declare Thornburg in default and liquidate its collateralized securities. FD 8. A default with any one lender triggered "cross-defaults" with other lenders, allowing them to liquidate the securities collateralizing those agreements. *Id.*

To promptly respond to margin calls, Thornburg relied on its "readily available liquidity": cash, cash equivalents (overnight investments), unpledged securities, and unused whole loan financing. *Id.* Thornburg's SEC filings stated that if it lacked sufficient readily available liquidity to meet a margin call, "[it] may need to sell assets under adverse market conditions or at losses to satisfy [its] lenders." *Id.*

These risks materialized in August 2007, when Thornburg experienced severe financial difficulties related to downgrades of certain MBS and the freezing of the commercial paper market. FD 9. Market conditions drove down the value of Thornburg's collateralized securities below margin requirements. *Id.* Its lenders responded by issuing substantial margin calls. At the same time, when Thornburg renewed its rev repo agreements, lenders nearly doubled the margin requirements, resulting in additional calls. *Id.*

Thornburg had insufficient readily available liquidity to meet the calls, forcing it to sell securities it had intended to hold. When it still could not meet the calls, several lenders liquidated its collateralized securities to satisfy debts. Thornburg incurred a reported $1.1 billion in losses on the forced sales, its portfolio of Purchased ARM Assets shrank by two thirds, and its total assets fell about 38% in the third quarter 2007. FD 9-11.

3. Following the August 2007 Events, Reinhart elevated her risk assessments for the 2007 audit and identified going concern and OTTI/ability to hold as high-risk audit areas.

Reinhart understood that the circumstances raised the risk that management would override internal controls and manipulate information provided to her during the audit, particularly regarding Thornburg's liquidity, the value of its securities, and its receipt of margin calls. FD 11-12. Reinhart also identified Thornburg's ability to continue as a going concern and its ability to hold its impaired assets as critical, high-risk audit areas. FD 11. As she had observed, management was surprised by the August 2007 events, had not believed Thornburg would be subject to rising levels of margin calls before that time, and did not foresee the forced sales. She recognized that the events raised "going concern uncertainties." *Id.* Relevant to the OTTI/ability to hold issue, she understood that "[i]t was never management's intent to sell" "those assets sold in Q3," "but [they] lost the ability" to hold the assets. *Id.*

II. Reinhart Delayed Her Evaluations Until Late February 2008, and Learned Certain Information About Thornburg's Deteriorating Financial Condition, Including Its Diminishing Liquidity Position, Falling Securities Values, and Rising Margin Calls.

Reinhart deliberately delayed her evaluations of going concern and OTTI/ability to hold until shortly before the audit report date "to have the greatest amount of information available regarding the state of the market for MBS securities and Thornburg's liquidity." FD 14. KPMG internal guidance warned, given market conditions, to exercise greater vigilance in evaluating the reasonableness of management's conclusions on going concern and OTTI and in performing procedures in the Subsequent Period. FD 12-13.

Between the end of third quarter 2007 and the end of the Subsequent Period, Thornburg's financial condition continued to deteriorate. FD 14-16. The value of its securities dropped 20%, resulting in additional margin calls. FD 15. The value of its Purchased ARM Assets decreased 5-10% in the Subsequent Period alone causing Thornburg to receive nearly $1 billion in margin calls. *Id.* Notwithstanding efforts to raise capital, its readily available liquidity steadily fell, from $700 million at the end of the third quarter 2007 to $587.2 million at year-end 2007 to somewhere between $150 million and $27 million by February 27, 2008, according to information known or available to Reinhart during the audit. FD 15, 21, 23, 25.

It was in this context that Reinhart evaluated the going concern and OTTI/ability to hold issues. FD 16. The two principal work papers on these issues were (1) Thornburg's going concern memo, provided by management to the auditors; and (2) KPMG's going concern memo, which Reinhart reviewed, edited, and ultimately approved on February 27, 2008. FD 16, 32. Those memos were deeply flawed, as discussed below.

A. Reinhart knew Thornburg's going concern memo lacked a discussion of its readily available liquidity, securities values, and margin calls in the Subsequent Period.

Ten days before issuance of the audit report, Reinhart received the first draft of Thornburg's going concern memo, as support for management's view that Thornburg had the ability to continue as a going concern for a reasonable period of time. FD 16-17. The memo also stated that the $427.8 million in unrealized losses on its impaired securities were temporary because it had the intent and "ability to hold" these securities until recovery based on its "on-going profitab[ility], liquidity position, and ability to continue to make margin calls." FD 41.

The auditors, however, noted a number of concerns about Thornburg's memo. FD 16-19. The focus of the auditors' review was on Thornburg's liquidity position, margin calls, and the potential for further declines in Thornburg's Purchased ARM Assets. FD 18. Reinhart's notes flagged the "need to conclude about [the] ability to meet margin calls in Jan + Feb (to date) and future expectations." *Id.* Thornburg's memo referenced only readily available liquidity of $587.2 million on December 31, 2007, with no analysis of the dramatic decline in the Subsequent Period. *Id.* As to the other factors, management summarily stated that "margin calls...are being met" and securities values are "being verified on a normal basis." FD 19. A KPMG reviewer wrote in notes read by Reinhart: "[W]hat happens if there is another Aug 2007 event?" and "how much can [the securities values] decline before [Thornburg] runs out of money?"—questions unanswered by Thornburg's memo. *Id.*

B. Reinhart's going concern evaluation lacked any meaningful assessment of Thornburg's diminishing readily available liquidity, declining securities values, and increasing margin calls in the Subsequent Period.

As noted, Reinhart left open her evaluations of going concern and OTTI/ability to hold until late February 2008. While she and other KPMG personnel were reviewing Thornburg's going concern memo and drafting their own memo, she encountered numerous red flags about its financial condition in the Subsequent Period. FD 19-31. Yet KPMG's going concern memo failed to meaningfully address them and made serious errors. FD 32-45.

1. Reinhart relied on Thornburg's year-end liquidity in the face of contrary evidence.

Like management's memo, KPMG's going concern memo also relied on Thornburg's claimed year-end liquidity of $587.2 million. FD 33. But on February 20, 2008, Reinhart learned that Thornburg had an alarmingly low cash balance. FD 24. A Thornburg daily Cash Liquidity Report—designed by management after the August 2007 events—showed that the cash balance (cash and overnight investments) had dropped to a period low of $1.8 million, down from $5 million the day before and $213 million on January 29, 2008. *Id.* (At year-end 2007, the balance was about $149 million. FD 18 n.10.) The February 20 report projected an even lower figure of $476,000 for the next day. FD 24. Reinhart and the senior manager on the audit viewed the extremely low cash balance as a "red flag" and soon spoke with management, who informed them that the low level was caused by an "unusual, abnormal, and large" amount of margin calls Thornburg began receiving around February 14, 2008. FD 24, 26.

The low cash balance was particularly troubling because, as the senior manager testified she and Reinhart knew, Thornburg had exhausted most of its other forms of readily available liquidity (unpledged mortgage securities and unused whole loan financing) in the Subsequent

Period, leaving cash as the vast majority by end of February. FD 22. Reinhart viewed the daily Cash Liquidity Reports as the "best estimate" of Thornburg's cash on the date of the report. *Id.*

Although Thornburg's Cash Liquidity Report showed an uptick to $10.5 million on February 22, this was still relatively low. FD 24. The report projected higher levels in the days leading up to February 28, 2008. *Id.*

Despite the earlier red flag, Reinhart did not review another Cash Liquidity Report between February 22, 2008 and issuance of the audit report. FD 22, 24. Nor is there any documentation that she monitored, inquired about, or discussed any such reports during that period. FD 24-25. Those reports showed that the cash balances remained low and well below projections in the days before the audit report issued. FD 25, 59 (noting Thornburg had $61 million on February 26, not the projected $219.5 million, and had $27 million on February 27, not the projected $284.9 million). KPMG's going concern memo only described the cash balance "around February 22, 2008" as "relatively tight," without assessing the low balance in relation to Thornburg's remaining readily available liquidity. FD 33, 36, 65.

On February 26, 2008, management informed Reinhart that Thornburg had "$150 million in readily available liquidity" as of February 27, 2008, describing this amount as "historically low" and a "substantially reduced" position compared to December 31, 2007—a 74% decrease from the year-end figure, which itself was a substantial decrease from the level at the end of the third quarter. FD 19-20. As Thornburg had described those amounts, the $700 million represented "protection" against future margin calls for up to a 6% decrease in the value of the collateralized securities and the $587.2 million as "protection" for up to a "4.5% decrease" in the value of those assets. FD 18-19. KPMG's going concern memo mentioned nothing about the "substantially reduced" liquidity or the steady decline since third quarter 2007. FD 33-34.

Reinhart admittedly performed no audit procedures to ascertain what Thornburg's readily available liquidity was on February 27, 2008, or for anytime during the Subsequent Period, accepting without question management's $150 million representation. FD 20-21. The Cash Liquidity Report for February 27, however, indicated an even lower level of readily available liquidity, given the depletion of other sources, showing a cash balance of $27 million. FD 25.

2. Reinhart overestimated Thornburg's ability to meet margin calls by another $900 million and failed to consider the impact of another 2% to 3% decrease in Thornburg's securities values.

KPMG's going concern memo erroneously claimed that Thornburg could draw from an additional 7% "cushion" to meet future margin calls, on top of the 4.5% protection against margin calls provided by the $587.2 million year-end readily available liquidity, for an aggregate 11.5% "protection" against margin calls. *Id.* The inclusion of the 7% was wrong because, as Reinhart has admitted, it was not a "cushion" but Thornburg's baseline margin requirement, which had to be maintained and could not be used to pay calls. *Id.* At the hearing, she offered no explanation for how the error was included or how it was not detected in the audit. FD 34-35.

The 7% error represented a $900 million overestimation of Thornburg's ability to meet future obligations. *Id.* The error was repeated in the memo's analysis of Thornburg's then "current economic and financial position" under "the Base Scenario" stress testing:

> In a base scenario, Thornburg has more than adequate assets to repay the current level of short-term debt. They have collateral in excess of <u>7%</u> plus another <u>4.5%</u> in cash and liquid, unpledged investments. Thus, a decline in fair value of available cash and securities greater than <u>11.5%</u> would require the Company to either raise more capital or sell assets to satisfy lenders (because they could not satisfy margin calls)....The decline in security values during January and February 2008 of 5% to 10% has caused additional margin calls, which the Company has met, mainly, from raising capital. The effect of meeting the margin calls is that the Company maintains the <u>7%</u> cushion. It is management's position that the likelihood that collateral values decrease by more than <u>another 2 to 3% is remote.</u>

Ex. J-19 at 5-6; FD 33, 35-37 (emphasis added). The 11.5% figure erroneously included the 7% cushion and the year-end protection of 4.5%.

Removing the 7% error and updating Thornburg's readily available liquidity to account for the "substantial" decrease in the Subsequent Period meant that Thornburg had very little "protection" against future margin calls on February 27, 2008. FD 36-37. Even the $150 million in remaining available liquidity represented by management constituted protection against only a 1.17% drop in the value of Thornburg's collateralized securities. *Id.* The $27 million in the corresponding Cash Liquidity Report indicated protection against just a 0.2% decrease. *Id.*

The final sentence in the above-quoted paragraph exacerbated these errors. FD 37. Although audit documentation and hearing testimony show that before issuance of the audit report management informed Reinhart that it was reasonably possible for Thornburg's securities to decrease another 2-3% in value in the near future, KPMG's memo cast this information in the more favorable terms that a decrease by <u>more</u> than another 2-3% was <u>remote</u>. *Id.* Reinhart concededly did not know at the time whether Thornburg had enough readily available liquidity to withstand margin calls associated with just a 1% or 2% decrease, let alone a 2-3% decrease. *Id.* A 2-3% drop represented $250-$375 million in margin calls, far exceeding even the claimed $150 million liquidity figure. *Id.* Reinhart also obtained little, if any, evidence about how Thornburg derived those percentages and did not reconcile those relatively stable percentages with its Form 10-K disclosures she reviewed describing a volatile market. FD 38.

3. Reinhart's consideration of margin calls ultimately rested on uncorroborated management representations that Thornburg was meeting all of its margin calls.

Reinhart testified that during the audit she considered margin calls as presenting "the most significant risk" to Thornburg's going concern and OTTI/ability to hold analyses, a risk underscored by the August 2007 events. FD 18. From her discussion with management about the low February 20 cash balance, Reinhart first learned that Thornburg had received margin calls in the Subsequent Period. FD 26. In response, Reinhart, through her senior manager, asked Thornburg to provide a list reflecting margin calls it had received since year end, information intended to be included in KPMG's going concern memo. FD 26-27. But management demurred, it said, because it did not maintain a list of margin calls in the "form" requested. FD 27. Reinhart accepted this without asking follow-up questions. *Id.*

On February 27, 2008—the day Reinhart concluded her going concern and OTTI/ability to hold evaluations and the day before she authorized issuance of the audit report—Thornburg provided the audit team with three margin call "schedules" that were partially responsive to Reinhart's initial request for margin call information. FD 27-28. Although she knew the schedules had been received, there is no evidence she reviewed them. FD 26-29, 62.

The schedules (Ex. J-1 at 40-42) showed that Thornburg: (1) was untimely paying margin calls in the final days of the Subsequent Period, subjecting it to possible default and suggesting insufficient liquidity; (2) had possibly sold assets to meet margin calls; and (3) had received a high amount of margin calls in the first two weeks of February 2008, at odds with management's claim that margin calls in the last two weeks of February were "unusual." FD 28-29. KPMG's going concern memo gave no consideration to the margin call schedules. FD 38-39.

Instead of a list to confirm margin call activity, KPMG's memo stated that the audit team "reviewed" "daily cash settlements" with rev repo lenders, "noting that Thornburg has met all margin calls" since August 2007. FD 39. But Reinhart concedes no such "review" was ever performed. *Id.* Thus, she relied on management's representation that Thornburg was meeting its margin calls. FD 61-62. She admittedly did not know until after the audit that it had received nearly $1 billion in margin calls during the Subsequent Period. FD 30.

C. Reinhart's evaluation of management's OTTI/ability to hold conclusion failed to adequately assess Thornburg's liquidity position and ability to meet margin calls in light of available information and was internally inconsistent.

Reinhart conducted little, if any, analysis of the OTTI/ability to hold issue separate from that contained in KPMG's going concern memo and a brief summary in the audit completion document. FD 40-41. To the extent KPMG's going concern memo addressed the stated bases for management's conclusion that Thornburg had the ability to hold its impaired securities until they recovered their value—(1) the Company's "on-going profit[ability]" (which factor Reinhart disregarded as inconsequential); (2) its "liquidity position"; and (3) its "ability to continue to make margin calls"—the analysis suffered from similar deficiencies as in the going concern context. FD 41-42, 74. The memo also contained internal inconsistencies between the going concern and OTTI/ability to hold evaluations that Reinhart never sought to resolve. *Id.*

Regarding Thornburg's liquidity position, Reinhart's analysis relied on year-end data. FD 42. But information supplied by Thornburg indicated its liquidity had decreased even further in the Subsequent Period and was critically low. *Id.* As in August 2007, insufficient liquidity meant that, to meet margin calls, it could be forced to sell securities it intended to hold. FD 8-11, 45, 77. Reinhart's evaluation did not consider the contrary evidence presented by Cash Liquidity Reports and the representation about the "substantially" reduced position. FD 43.

Additionally, Reinhart accepted without question management's representation that the high margin calls in the last two weeks of February were "unusual." FD 26, 28, 61. No consideration was made of the margin call schedules received on February 27, 2008, which contradicted that representation and cast doubt on Thornburg's ability to hold its impaired securities. FD 38, 43-44, 75. The schedules showed Thornburg went days without meeting substantial margin calls subjecting it to liquidation of its collateralized securities and that the Company was possibly selling securities to meet the calls. *Id.* Nor did Reinhart confirm that margin calls were being met by consulting the cash settlements, as noted above. FD 39.

Reinhart's OTTI/ability to hold evaluation was further marred by the 7% error discussed above. FD 44. Reliance on the error was repeated in the audit completion document, a summary work paper stating the conclusion of the evaluation. FD 44. Correcting that error and reducing the 4.5% protection to even the 1.17% protection against future margin calls suggested by management's $150 million representation meant that Thornburg had inadequate resources to meet a 2-3% drop in securities values. *Id.* Instead of investigating how it could meet margin calls in the near term without selling assets, Reinhart conducted no analysis. *Id.*

Finally, Reinhart's evaluation suffered from unresolved discrepancies. FD 44-45. KPMG's going concern memo cited as a positive factor Thornburg's ability to survive the August 2007 events by "selling a significant portion of its assets." *Id.* Two scenarios of the memo's stress testing were premised on Thornburg being "forced to sell assets" to survive. FD 45. Yet her analysis never addressed the implications of such sales for Thornburg's ability to hold conclusion. At the hearing, she gave no coherent explanation for these discrepancies. *Id.*

D. Thornburg Failed To Meet Margin Calls Within Hours of Filing Its 2007 Form 10-K, and Five Days Later Reinhart Withdrew KPMG's Audit Report.

Within hours of filing the 2007 Form 10-K on February 28, 2008, Thornburg again failed to meet margin calls. FD 49. That day, Thornburg received a total of $157.5 million in margin calls, meeting only $31.6 million, an outlay of funds that was much closer to its stated $27 million cash balance on February 27 than $150 million. FD 50. One lender issued a notice of a default, triggering cross-defaults. FD 25, 49-50. On February 29, Thornburg received another $128.7 million in margin calls but met only $15.7 million. *Id.*

On March 4, 2008, Reinhart withdrew KPMG's 2007 audit report. FD 50. In the withdrawal letter, Reinhart stated that the originally filed financial statements "contain[ed] material misstatements associated with [Thornburg's AFS] securities" and that the original audit report should have contained a going concern paragraph. *Id.* KPMG reached these conclusions based on "conditions and events that were known or should have been known to [Thornburg] as of the date of [KPMG's] auditors' report." *Id.*

One week later, Thornburg filed an amended Form 10-K, restating portions of its 2007 financial statements. FD 51. The 2007 Form 10-K/A reclassified its impaired Purchased ARM Assets as an OTTI because "we may not be able to hold these securities for the foreseeable future," but rather "we may sell them to satisfy margin calls from lenders or to otherwise manage our liquidity position." The roughly $427.8 million in previously unrealized losses on these securities were included in Thornburg's net loss for 2007. KPMG's restatement audit report included in Thornburg's filing contained a going concern paragraph. *Id.*

ARGUMENT

I. The Board's Findings of Violations Were Based on Straightforward Application of PCAOB Auditing Standards to Reinhart's Seriously Flawed Audit Work.

The Board reached its decision in this case by straightforward application of PCAOB auditing standards, including fundamental auditing principles familiar to all auditors. FD 83 n. 34; *see, e.g., Robert D. Potts, CPA*, SEC Rel. No. 34-39126, 1997 WL 690519, *10 n.55 (Sept. 24, 1997) ("well-established professional and auditing standards"), *aff'd*, 151 F.3d 810 (8th Cir. 1998); *see generally* AU 230.06 ("[t]he auditor with final responsibility for the audit should know, at a minimum, the relevant professional accounting and auditing standards"). In now claiming lack of notice of what was required (Br. 24-25), Reinhart ignores particular language in the two standards she challenges, ignores the other four standards the Board found she violated, and ignores the factual framework she herself used for each of her audit evaluations, all of which provided ample granularity to the charges and should have guided any exercise of her judgment.

PCAOB Rules 3100 and 3200T require that in performing an issuer audit, associated persons of registered public accounting firms comply with PCAOB interim auditing standards, which include all of the standards at issue here. This case involves two high-risk audit areas: going concern and OTTI/ability to hold. As to the first, AU 341.02 required the auditor to "evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited...based on his or her knowledge of relevant conditions and events that exist at or have occurred prior to the completion of fieldwork." As to the second, AU 332.48 required the auditor to "evaluate" whether management "considered relevant information in determining whether factors" exist that indicate that an impairment loss for an "other than temporary" decline in fair value of an "available-for-sale security" (*i.e.*, Thornburg's Purchased ARM Assets) has been incurred at the end of the reporting period and needs to be recognized in earnings. Among the "factors" noted in that regard are whether the impaired security "is significantly below cost" and "[m]anagement does not possess both the intent and the ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value." AU 332.47. Only ability to hold is at issue in this case. FD 41 n.20, 73.

Also charged are certain standards that are fundamental to all audits, such as requirements that an auditor (1) exercise due professional care, which includes observing the standards of field work, "diligently perform[ing]" the "gathering and objective evaluation of evidence," and exercising professional skepticism, "an attitude that includes a questioning mind and a critical assessment of the audit evidence," according to which the auditor "should not be satisfied with less than persuasive evidence because of a belief that management is honest" (AU 150, 230); (2) adhere to the principle that management representations are "not a substitute for the application of those auditing procedures necessary to afford a reasonable basis" for an audit opinion, and "investigate the circumstances and consider the reliability" of a management representation that is "contradicted by other audit evidence" (AU 333); and (3) be "thorough" in his or her "search for evidential matter" and "unbiased in its evaluation," "consider relevant evidential matter regardless of whether it appears to corroborate or to contradict the assertions in the financial statements," and "obtain sufficient competent evidential matter to provide him or her with a reasonable basis" for the audit opinion (AU 150, 326). *See, e.g.*, *McCurdy v. SEC*, 396 F.3d 1258, 1262 (D.C. Cir. 2005)); *Hatfield*, 2013 WL 3339647, *2 (the "core deficiency" of failing to exercise "the professional skepticism essential to evaluate the reliability and pertinence of the [audit] evidence ... led to Applicants' more specific auditing violations"). These requirements are not static; they are applied based on the risks and circumstances faced by the auditor. *See, e.g.*, *McCurdy*, 396 F.3d at 1261("red flags" are "particular factors that arouse suspicion and call for focused investigation"); *Gregory M. Dearlove*, SEC Rel. No. 34-57244, 2008 WL 281105, *29 (Jan. 31, 2008) ("As audit risk increases, so does the need for care and skepticism."), *aff'd* 573 F.3d 801 (D.C. Cir. 2009).

Moreover, specific language in AU 341 and 332, omitted from Reinhart's brief, expressly demonstrates the interplay of those two standards with the fundamental audit disciplines just noted. For example, AU 341.02 explains, "Information about [relevant] conditions and events is obtained from the application of auditing procedures planned and performed to achieve audit objectives that are related to management's assertions embodied in the financial statements being audited, as described in section 326, *Evidential Matter*." AU 341.02; *see* AU 341.03.a, .05 (giving examples of such procedures, including "analytical procedures," "review of subsequent events," "review of compliance with the terms of debt and loan agreements"). Similarly, AU 332 requires the auditor to evaluate whether management has "considered relevant information" in its OTTI assessment and to "obtain evidence" about such factors that "tend to corroborate or conflict with management's conclusions" regarding OTTI. AU 332.48; *see* AU 332.58 (cross-referencing AU 333); *see also* AU 332.57 (f) (auditor should determine whether "the entity's financial condition provide[s] evidence of its ability" to hold its impaired securities).

Furthermore, in the context of the 2007 audit, Reinhart herself recognized that Thornburg's readily available liquidity, securities values, and margin call activity were critical factors in her evaluations under AU 341 and 332. FD 12, 18, 57-58, 73. She also admitted that, because Thornburg based its ability to hold conclusion on its "liquidity position and ability to continue to make margin calls," she was obligated to evaluate the specific grounds cited by management in reaching its conclusions (FD 41), an obligation clarified by her experts to mean obtaining sufficient audit evidence. *See* Tr. 1555; Tr. 2399 ("you have to evaluate whether [management's] assessment is reasonable and you have to get evidence").[1]

---

[1] Indeed, "in conducting the audit," Reinhart displayed in various ways an "appreciation of what was required of [her]," even as she failed to do it. *See Marrie*, 374 F.3d at 1206 (auditors' conduct in requesting certain documentation about "unusually large" write-off "near [year] end" suggested an "appreciation of what was required of them in conducting the audit" but they "failed to follow up on their own request"). For example, after the August 2007 events, Reinhart identified "going concern uncertainties" (AU 341) and that Thornburg had then lost the ability to hold its impaired securities (AU 332). FD 11. Further, her Subsequent Period notes, discussed

In disregarding the applicability of AU 150, 230, 326, and 333 to these specific AU 341 and 332 considerations, Reinhart's notice argument runs afoul of a case she cites (Br. 30). That SEC Rule 102(e) case rejected a "vagueness" argument similar to hers. The court deemed compelling that "[t]he duties to exercise due care,...AU § 230.02, to obtain sufficient evidential matter,... AU § 150.02, and to exercise professional skepticism, AU § 316.16, are 'standards to which all accountants must adhere.'" The court concluded that these standards, well known to all auditors, put respondents on notice of what was required of them. *Marrie v. SEC*, 374 F.3d 1196, 1205-06 (D.C. Cir. 2004); *see Davy v. SEC*, 792 F.2d 1418, 1422 (9th Cir. 1986). Reinhart's expert, cited for her notice argument (Br. 24-25), did not even opine on whether she violated these standards. Tr. 1544-46. Nor is the Board bound by expert testimony. *See, e.g., Wendy McNeeley, CPA*, SEC Rel. No. 34-68431, 2012 WL 6457291, *18 n.54 (Dec. 13, 2012).

Reinhart's failures to perform basic auditing procedures in response to obvious red flags fall within "the heartland" of noncompliance and do not present any close question about her violations. *See, e.g., Salman v. United States*, 137 S. Ct. 420, 429 (2016); *Thomas W. Heath, III*, SEC Rel. No. 34-59223, 2009 WL 56755, *6 (notice "'where reasonable persons would know that their conduct is at risk'"), *aff'd, Heath v. SEC*, 586 F.3d 122 (2d Cir. 2009). The problem was not that she did not know what to do in the two audit areas at issue; the problem was that she did not do anything or that what she did do was done so negligently, calling for sanctions.[2]

---

above, reflected her understanding of the importance of "liquidity risk," "ability to meet margin calls in Jan + Feb (to date)," and "future expectations." FD 18, 26-27.

[2] The focus here has always been on Reinhart's evaluation of subject matter she herself identified as significant, not on her "ultimate conclusions" (Br. 17) about whether a going concern paragraph or recognition of unrecognized losses was needed. *See Dearlove*, 2008 WL 281105, *14 n.51. This case of such flawed audit work need not, and does not, turn on the

The foregoing discussion likewise disposes of Reinhart's related argument that, in essence, her audit work was so dependent on professional judgment that it defies scrutiny. Br. 2, 24. She calls out findings in the Board's decision that she failed to perform audit work "adequately" or "meaningfully," as if to suggest that so long as she can claim to have done some work in the areas at issue, based on an exercise of judgment, that work cannot be questioned without engaging in "unfair[,]" "improper second-guessing." Br. 31-32. In fact, "an auditor must exercise, not [her] 'inclination,' but [her] 'professional judgment' and that judgment must be 'guided by sound' auditing principles, among which are a 'thorough...search for evidential matter, AU § 326.23, and an 'attitude that includes a questioning mind and a critical assessment of audit evidence,' AU § 230.07." *McCurdy*, 396 F.3d at 1263. Reinhart's own expert acknowledged that Reinhart's professional judgments "ha[d] to be reasonable in the circumstances and ha[d] to be formed within the framework of the authoritative standards.... [I]t's not the kind of thing where I can say I just made my professional judgment, that's it, end of day, and it rules the day." Tr. 1662. Yet that is exactly what Reinhart is now saying, citing language in auditing standards that instead simply reflects the unremarkable fact that decisions about procedures to be performed in an audit depend on engagement-specific facts that an

---

precise contours of the concepts "substantial doubt" and "going concern" (Br. 24). *Heath*, 586 F.3d at 140 (vagueness claims are judged by "'[applicant's] actual conduct' and not...[by] hypothetical situations at the periphery of the [regulation's] scope or with respect to the conduct of other parties who might not be forewarned'"). And those concepts have been ingrained in the accounting literature for a long time. *Montgomery's Auditing* 26·17 (12th ed. 1998) (going concern is "one of the basic tenets of financial accounting"); *see* Statement of Auditing Procedure No. 33 (1963); Statement of Auditing Standards (SAS) No. 2 (1974); SAS No. 34 (1981); SAS No. 59 (1988); Exchange Act Section 10A, 15 U.S.C. 78j-A1(a).

auditor learns during the audit process and require the exercise of informed judgment about how to respond to such information as it becomes available. *See, e.g.*, AU 326.13.[3/]

II. Reinhart Violated PCAOB Rules and Standards in Her Audit Work on the Going Concern and OTTI/Ability To Hold Issues.

A. In Reinhart's going concern evaluation, she failed to adhere to fundamental auditing principles in considering "relevant conditions and events."

In evaluating Thornburg's ability to continue as a going concern, Reinhart made "fundamental errors in her analysis," repeatedly failing to apply basic auditing procedures to relevant conditions and events, including Thornburg's diminishing readily available liquidity, declining securities values, and escalating margin calls in the Subsequent Period. FD 57-58.

1. Reinhart's consideration of Thornburg's diminishing readily available liquidity was deficient.

Reinhart lacked "good clarity" on Thornburg's remaining liquidity before authorizing issuance of the audit report. FD 47, 50, 58-59 & n.26. She relied on Thornburg's higher level of readily available liquidity ($587.2 million) at year-end 2007, compared to the Subsequent Period, despite contrary information known or reasonably available to her. For example, Reinhart knew Thornburg's liquidity had been decreasing since the end of third quarter 2007 (then $700 million); that Thornburg had represented it had a "substantially reduced," "historically low level" of readily available liquidity at the end of February 2008 ($150 million); and that its Cash Liquidity Reports were showing an alarmingly low level of cash. FD 63. Had Reinhart

---

3/ Reinhart's emphasis in her brief (Br. 7-8) on several high-level reviewers with limited involvement in the audit does not vindicate her asserted exercise of audit judgment. FD 69-71, 95. These individuals did not know various damaging details about the audit work, nor key information to which Reinhart had access about Thornburg's margin calls and remaining liquidity. Tr. 1753-59, 1783-84, 1994, 2018-19, 2025-26, 2379-81. Neither reviewer who testified read the final version of KPMG's going concern memo, signed by Reinhart.

adequately assessed Thornburg's remaining readily available liquidity, she would have known that Thornburg had little protection against future margin calls on February 27, 2008. FD 60. Her acceptance of uncorroborated management assertions in place of sufficient audit evidence and in the face of contrary evidence violated AU 150, 326, and 333. Her repeated inclusion in her analysis of a 7% liquidity cushion that did not exist was another example of her opting for ostensible support for Thornburg's ability to continue as a going concern instead of assessing contrary information. It also illustrated her failure to exercise due professional care in a high-risk area, in violation of AU 150 and 230. FD 60. As the Board found, Reinhart's failures to address "important information in a high-risk area" were inconsistent with her duty to exercise "due professional care" under AU 150 and 230, contributing to "her uncritical, often cursory, and overall deficient evaluation of, and reaction to circumstances" under AU 341.02. FD 63.

Reinhart's brief asserts that the senior manager "regularly review[ing]" the Cash Liquidity Reports and that Reinhart had "regular communication" with her about "Thornburg's liquidity position." Br. 38. This just re-words a claim the Board already rejected as "unsupported and non-specific." FD 59 n.27. The work papers reflect no attention to the reports after February 22, 2008. FD 36, 59 n.27 (citing *McNeeley*, 2012 WL 6457291, *13 ("'[T]he absence of work papers [is] evidence that the audit team did not devote substantial, if any, effort to review the areas in question.'")). If anything, Reinhart's assertion emphasizes her direct involvement in the overall going concern analysis without showing that these reports were properly considered as part of it, despite the "red flag" identified on February 20. FD 62-63. Her dismissal now of the importance of the "precise number" of the cash balance (Br. 37) is inconsistent with her reaction then to the low February 20 cash balance. "Precise" or not, that the cash balances in the days leading up to issuance of the audit report were significantly lower than near-term projections indicated a liquidity issue to which careful, ongoing attention needed to be paid. FD 22-23, 36. According to Reinhart, the whole point of delaying her going concern evaluation until late February was to have access to the most complete, up-to-date information.

Reinhart now tries to elevate to importance certain other factors and overstate her reliance on them during the audit. Br. 4, 11, 38. First, she claims she relied on a "principal and interest payment on February 25, 2008," estimated at $114 million. But she never determined that it improved Thornburg's cash position and, in fact, the cash balances remained significantly below that figure from February 25 through 27. FD 65-66. Second, her claim now to have relied on "an expected securitization on February 28" and "an anticipated common stock offering" is contrary to the audit work papers and her testimony. FD 66, 80. As to the securitization, she misleadingly asserts (Br. 4) it had an expected yield of "$1 billion," when she had testified it was expected to provide only $40 million in added liquidity, a fraction of the margin calls Thornburg had been receiving and well below the $250-$375 million needed to meet a further 2-3% drop in securities values. Tr. 348. Third, the purported other "source of cash" (Br. 11) was not cited as support in KPMG's going concern memo (Ex. J-19), was cited only in the audit completion document (Ex. J-5 at 23) as part of a discussion about Subsequent Period disclosure, not going concern (Ex. J-5 at 19), and in any event, there is no evidence that "securities currently pledging repo" (Ex. J-5 at 23) was considered part of Thornburg's "readily available liquidity." *See* Ex. J-21 at 5 (defining that term to include "unpledged securities"). Reinhart's citation of these factors now simply reflects "after-the-fact rationalization." *McNeeley*, 2012 WL 6457291, *11.

Reinhart also claims that all of the references to the 7% "cushion" should be dismissed as simply a "mathematical error" by the senior manager. Br. 27-28. But Reinhart reviewed this on multiple occasions, even directly commenting on it, and signed off on KPMG's going concern memo, representing that the work it reflected had been adequately performed. FD 34-35. Others' testimony belies her claim that the error was unimportant. Tr. 1783-84, 1994, 2018-19, 2380. Indeed, the repeated error—amounting to a $900 million overstatement of liquidity—was "serious" and "arose from [her] failure to exercise ordinary care." *See KPMG Peat Marwick LLP*, SEC Rel. No. 34-43862, 2001 WL 47245, *16 (Jan. 19, 2001) (rejecting "attempts to minimize" misconduct as simple "mistake"), *aff'd*, 289 F.3d 109 (D.C. Cir. 2002).

Reinhart relies heavily on the notion that AU 560 permitted "greater reliance on management representations" in the Subsequent Period. Br. 35. This position simply underscores her reliance on uncorroborated management representations in an area she identified as prone to misrepresentation. As the Board explained, nothing in AU 560 (or any other PCAOB standard) allowed her to deliberately delay her going concern evaluation (or her OTTI/ability to hold evaluation) until the end of the Subsequent Period and then base her evaluation on uncorroborated management claims. AU 560.10 "makes clear that 'some phases of the audit will be performed during the subsequent period,' noting that '[a]s the audit approaches completion, the auditor will be concentrating on unresolved auditing and reporting matters.'" FD 72. The going concern issue and the OTTI/ability to hold issue were such "unresolved" matters.

Ignoring AU 560.10, Reinhart misreads AU 560.12 to claim she could rely exclusively on management inquiries, but that provision refers to making such inquiries only "for the purpose of ascertaining the occurrence of subsequent events." Once she became aware of a subsequent event—such as Thornburg's high margin calls and liquidity deterioration—she needed to evaluate the event and obtain audit evidence to perform the procedures under AU 341 and 332. Two of her experts and a KPMG audit program document that she read during the audit also contradict her narrow view of her obligations. FD 72; *see* Tr. 1645-46, 1651 (recognizing that

PCAOB standards do not allow an auditor to accept representations at the 11th hour that are contradicted by other information the auditor received); Tr. 2348-49.

2. Reinhart's consideration of Thornburg's declining securities values was deficient.

The Board correctly found that Reinhart's assessment of the possibility of further declines in the value of Thornburg's securities was seriously flawed. Clearly, there was a relationship—vividly demonstrated by the August 2007 events—between a decrease in the value of Thornburg's collateralized Purchased ARM Assets and its receipt of margin calls. FD 9, 30, 61. Reinhart knew (*e.g.*, Ex. J-19 at 5-6) that Thornburg's securities had decreased "5% to 10%" in the Subsequent Period, and before issuance of the audit report, management informed her that a further decline of 2-3% was reasonably possible in the near term. FD 36-37. She not only failed to consider how Thornburg would meet margin calls associated with a further 2-3% decline—or even a 1% decline—but she also obtained little, if any, evidence about how Thornburg derived the 2-3% figure. FD 37, 60-61. And although Reinhart viewed the statement about the 2-3% as suggesting that the market was stabilizing, she did nothing to reconcile it with contrary disclosures in the Form 10-K, indicating that the markets would remain volatile. FD 37-38, 60-61; *see, e.g.*, Ex. J-1 at 23 ("There is no assurance that [market conditions] have stabilized or that they will not worsen."). "Reinhart's inadequate reaction to what management told her in this high-risk area demonstrated a failure to exercise due care, including an attitude lacking the necessary 'questioning mind' and 'critical assessment of audit evidence.'" FD 61.

The Board's discussion of the 2-3% point, far from being a "fundamental error" (Br. 32-33), is entirely correct. Reinhart's contention is based solely on KPMG's going concern memo, which chose to cast the statement in the more favorable light that more than a 2-3% decline was remote (FD 37). As the senior manager's notes from a face-to-face conversation with Reinhart and management show, management's view was that a "2-3% drop = maybe." *Id.* At the hearing (Tr. 930), when the senior manager was specifically asked if management "believed there was a possibility that there might be a 2 to 3 percent decline," she responded, "Right, over...the foreseeable future" (*id.)* or, as Reinhart testified, over "a very short period of time" (Tr. 237). *See* Tr. 929 (view was "not that they wouldn't decline"). The Board's finding on the 2-3% point is wholly consistent with FAS 5, defining "reasonably possible" as "more than remote but less than likely" and "remote" as "slight." The statement in KPMG's memo itself—"decrease by <u>more than</u> another 2 to 3% is remote" (emphasis added)—contemplates up to a 2-3% decline. Yet Reinhart has admitted she did not know whether Thornburg could meet margin calls associated with even a 1% further decline in securities values. FD 37.

While Reinhart claims the 2-3% information was merely a "prediction" of future events that "was not 'susceptible to audit work,'" she also describes it as a "data point to consider" on which she supposedly "did obtain other audit evidence." Br. 34-35. She testified that management's prospective view of the market was a "key assumption" and that the 2-3% information was "significant" in her going concern evaluation. Tr. 245, 617. Indeed, AU 341 contemplates a prospective evaluation: "for a reasonable period of time," "based on [her] knowledge of relevant conditions and events that exist at or have occurred prior to completion of fieldwork." AU 341.02; *see* AU 530.01 (that date is generally the audit report date); *see also* FD 78-79 (discussing AU 332). During an audit, an auditor is often required to evaluate, "with an attitude of professional skepticism, the reasonableness of management's estimates" about future events, including the "implications" of management's assertions. *Michael J. Marrie, CPA*, SEC Rel. No. 34-48246, 2003 WL 21741785, *10 (July 29, 2003) (discussing AU 342), *rev'd on* *other grounds*, 374 F.3d 1196 (D.C. Cir. 2004). As noted, AU 560, invoked here again by Reinhart (Br. 34, 35), did not excuse her uncritical acceptance of management assertions bearing directly on a high-risk area left unresolved until February 27, 2008. FD 72.

Reinhart did not probe the basis for management's statement or consider the implications of the potential decrease in light of Thornburg's already low readily available liquidity. FD 61 n.28. Although she claims to have consulted with management about its view that the market was stabilizing (Br. 35), she made no attempt to test the bases underlying that view, including management's assertion that "recent purchases" confirmed that "the fair values of these securities are at or approaching bottom." FD 37-38. By contrast, disclosures Thornburg prepared for its Form 10-K, which Reinhart read at the time, stated that "security market valuations remain volatile" and that there had been "increased difficulty in obtaining market prices." *Id.* Her failure even to consult with KPMG's valuation experts on management's view about its securities values underscores her undue reliance on management's representations.[4/]

Finally, Reinhart incorrectly suggests that the component of her going concern evaluation called "stress testing," under so-called Scenarios 1 and 2, excused any inadequacy in her response to the 2-3% information, mentioned in the analysis of the Base Scenario (Ex. J-19 at 6). Br. 33. But contradicting that broad assertion is her unequivocal testimony (Tr. 241) that she did not know at the time whether Thornburg could meet margin calls associated with even a slight dip in securities values and that no audit assistant performed any such calculation. Scenarios 1

[4/] Although Reinhart claims (Br. 34) that "management's opinion" about a stabilizing market was consistent with what one of the KPMG reviewers had heard "during the course of his engagement for another company," the cited testimony (Tr. 1715-16) shows that this was simply a management representation from another large mortgage lender. Further, there is no evidence that the reviewer mentioned any such assertion to Reinhart at the time of the Thornburg audit.

and 2 are highly generalized hypotheticals, with no mention of specific percentage changes in securities values, while the Base Scenario contained specific data, albeit flawed, purportedly reflecting Thornburg's then-current financial condition. Ex. J-19 at 6-7. And even if those other scenarios suggested survival, they assumed debt restructurings and sales of substantial disposition of assets outside the ordinary course of business, which "significantly contradict[]" the assumption that an entity will continue as a going concern. AU 341.01.

3. Reinhart's consideration of Thornburg's margin call activity was deficient.

The Board also correctly determined that Reinhart violated PCAOB auditing standards in her work on Thornburg's margin calls in the Subsequent Period. FD 61-62. Identifying multiple deficiencies in this aspect of her going concern evaluation, the Board found Reinhart first "displayed a lack of professional skepticism" when she accepted Thornburg's initial explanation that it could not provide a margin call list in the "form requested" without asking any follow-up questions. Then she compounded her initial failure to press for this information by "failing to do anything" when Thornburg provided margin call schedules late in February 2008. FD 62. Reinhart took a similarly lax approach to Thornburg's "daily cash settlements," the only evidence cited as support for management's representation that it "has met all margin calls...subsequent to August 2007." FD 39, 62. She conceded no one on the audit team ever reviewed those settlements. *Id.* Consequently, her consideration of whether Thornburg was meeting margin calls rested on an uncorroborated assertion from the very same people whom she had determined presented a high risk of material misstatement on the subject.

Ignoring the margin call schedules' substantive content, Reinhart argues that they were delivered to "a junior member" of the audit team "for the limited purpose of tying out" information added to Thornburg's footnote disclosure. Yet, in the context of this audit, Reinhart had identified margin calls as a specific fraud risk, prone to misrepresentation, specifically sought confirmation about Thornburg's margin calls after learning of the low February 20, 2008 cash balance, and testified that she sought this information "to understand the company's ability to meet margin calls and what they had received in that time period." Tr. 298-99. Irrespective of the "purpose" of the schedules, AU 326.25 specifies that "the auditor should consider relevant evidential matter regardless of whether it appears to corroborate or to contradict the assertions in the financial statements." And regardless of who received the schedules, Reinhart knew they had been received. The in-depth reviewer testified (Tr. 1819) that Reinhart and the senior manager informed him "they had this list...a schedule of—of the dates and amounts of the margin calls" covering the final two weeks. FD 27. Based on that statement, the in-depth reviewer "expected" they had "read it." *Id.* Additionally, Reinhart's restatement memorandum cited the margin call schedules as evidence the auditors had obtained to support the original audit opinion. FD 27-28.

Reinhart also makes a semantic attempt to distinguish the "list" covering January and February, which she had earlier requested, from the "schedule[s]" received covering February. Br. 36. Management's ability to provide information that was even "partially responsive" (FD 27) to the initial request should have raised a red flag with a diligent auditor, especially given the earlier inconsistent response, the heighted risk involved, and the "last-minute nature" of the information. *Ernst & Ernst*, SEC Rel. No. AS-248, 1978 WL 207542, *17, *29 (May 31, 1978); *see Barry C. Scutillo*, SEC Rel. No. 34-48238, 2003 WL 21738818, *8 (July 28, 2003).

Reinhart's claim that the Board speculated about "what these margin call schedules reveal[ed]" (Br. 36) is belied by her and her expert's testimony. Both confirmed the obvious red flags in the schedules, while neither showed any confusion. FD 28-29 & n.13; *see* Tr. 317-332

(Reinhart), Tr. 2102-2106 (Reinhart expert); *see also* Ex. D-128 at 48-49, 52-53 (Division's expert report). And Reinhart conceded the information demanded follow up. Tr. 327. She incorrectly asserts (Br. 36) that the Board faulted her for not acting on red flags in schedules she did not review. The Board faulted her for failing to follow up on her initial request and to give attention to the schedules when they did arrive, given the circumstances. FD 62.

Additionally, Reinhart asserts without citation (Br. 37) that she obtained signed representations from management that "the Company had been meeting all its margin calls." If she is referring to Exhibits J-4, J-16, and J-17, those generalized representations do not support her specific assertion. And her mere procurement of letters in a high-risk area, prone to management misrepresentation, did not fulfill her auditing obligations. *See e.g.*, *Russell Ponce*, SEC Rel. No. 34-43235, 2000 WL 1232986, *10 (Aug. 31, 2000), *aff'd*, 345 F.3d 722 (9th Cir. 2003). Reinhart again misapplies AU 560.12. FD 72 (citing AU 560.10 and 333.02).

B. In Reinhart's OTTI/ability to hold evaluation, she failed to adhere to fundamental auditing principles in considering relevant information and obtaining audit evidence about management's conclusion.

The Board correctly found that Reinhart's evaluation of Thornburg's ability to hold its impaired Purchased ARM Assets was "seriously flawed" (FD 75), in violation of fundamental auditing principles and the express requirements of AU 332. Despite deliberately delaying her evaluation of this issue until the end of the Subsequent Period to consider the most up-to-date information, Reinhart failed to consider "relevant information" and "obtain evidence" that "tend[ed] to corroborate or conflict with management's conclusion." AU 332.48.

Reinhart subsumed her OTTI/ability to hold evaluation within her going concern evaluation, despite the separate and distinct natures of the two. FD 74. Regarding Thornburg's "liquidity position," she failed to adequately address the steady deterioration from August 2007 through late February 2008 and erroneously relied on the year-end $587.2 million liquidity figure when she knew it had decreased "substantially." *Id.* And she failed to exercise professional skepticism when she failed to question management's asserted $150 million figure, despite lack of support, contrary evidence, and the importance of Thornburg's liquidity to its ability to hold its impaired assets. *Id.* As Form 10-K disclosures told Reinhart, Thornburg's "reduced" liquidity position in the Subsequent Period meant it "might need to selectively sell assets…to raise cash," yet she never reconciled that with Thornburg's claimed ability to hold. FD 76.

Regarding Thornburg's "ability to continue to make margin calls," Reinhart rested on unsubstantiated management representations. She failed to consider the margin call schedules, which contained information that directly contradicted Thornburg's assertion that it had the ability to hold its impaired securities. Nor were the "cash settlements" examined. FD 39.

Reinhart also repeated the 7% error that substantially overestimated Thornburg's ability to meet future margin calls, an error contained in KPMG's going concern memo and in part of another document summarizing her OTTI/ability to hold conclusion. FD 75. Information available to Reinhart indicated that Thornburg's cushion was between 1.17% and 0.2%, not the 11.5% noted in KPMG's going concern memo. FD 75-76. That information, combined with management's stated judgment about a further decrease in securities values, should have indicated to her that Thornburg would have difficulty holding its impaired assets until recovery given its remaining liquidity, circumstances demanding greater scrutiny. *Id.*

The Board also properly faulted Reinhart's failure to address glaring inconsistencies within her OTTI/ability to hold evaluation, which further show her lack of due care and deficient consideration in a high-risk area. FD 76-77. Although she said KPMG's going concern memo reflected her evaluation of the OTTI/ability to hold issue, she failed to reconcile discussions about "forced sales" of securities in that document with Thornburg's ability to hold. *Id.*

Devoting only about four pages of her brief to this audit area, Reinhart relies on her expert witness to assert that her audit work "was reasonable and appropriate." Br. 28. But the Board, not being bound by expert testimony, expressly rejected his unfounded view of an auditor's responsibilities under AU 332.47 regarding "estimating the outcome of future events." FD 77-79. The testimony Reinhart cites is utterly non-specific about her audit work, suggests the unremarkable point that typically the auditor's OTTI analysis is conducted at year end, and disagrees with Reinhart's view that AU 560 permits an auditor to forego audit testing by simply waiting until the Subsequent Period. In fact, Reinhart did not learn Thornburg's bases for its ability to hold conclusion until February 18, 2008, and continued to become aware of information that called for greater scrutiny. FD 16-17, 26.

When Reinhart's brief gets around to discussing what work she supposedly did, the brief proceeds to recite (Br. 28-29) the same laundry list of ten bullet points from her prior briefs in this case, many of which points, as the Board determined, "do not directly pertain to the ability to hold issue, were not cited in the principal work paper addressing the issue, and in any event fail to present reliable evidence" and all of which the Board explained were inadequate (FD 80-83).

In summary, bullet points one, two, three, seven, nine, and ten relate to intent to hold or another factor under AU 332, not ability to hold, and the mitigating factors Reinhart cites there did not prevent Thornburg from being forced to sell assets to meet margin calls in August 2007, from continued deterioration in its liquidity position since then, or from experiencing losses on its securities in the Subsequent Period. FD 80-83. The bullet points five and six concern credit quality of Thornburg's Purchased ARM assets and her claim that the eventual recovery of the securities "did not appear to be in question," yet eventual recovery was not the issue but whether Thornburg could hold them until that time, and they had declined in value 20% since August 2007 based on market reasons unrelated to credit quality. FD 80-81. The work papers and firm guidance, as well as testimony by Reinhart (Tr. 342-46), cautioned against reliance on the fourth bullet point, Thornburg's capital raising endeavors. FD 13, 66, 80. As to the eighth bullet point, although the audit completion document stated that "it appears that the existing impairment in the securities portfolio has a short duration (less than 6 months)," this view was contradicted by disclosures in Thornburg's Form 10-K that more than $201 million (or 47%), of Thornburg's total impairment in its Purchased ARM Assets had been in a loss position for "12 months or more." FD 82-83. In any event, the statement focused on just 3% of its Purchased ARM Assets, and only 3.3% of those securities were impaired as of December 31, 2007. *Id.*

Reinhart claims she documented her OTTI/ability to hold evaluation not only in KPMG's going concern memo but also "in other work papers," yet cites only the audit completion document (Br.14), which essentially cross-reference that memo. FD 40-41, 74, 78. Reinhart testified that the going concern and OTTI/ability to hold "analyses were pulled together into one document." FD 40, 74. The lack of documentation of audit work specific to ability to hold disposes of whatever is left of Reinhart's claim to have obtained "extensive" evidence on that issue. *See John J. Aesoph, CPA*, SEC Rel. No. 34-78490, 2016 WL 4176930, *11 (Aug. 5, 2016) ("'[I]f audit documentation does not exist for a particular procedure or conclusion related to a significant matter, it casts doubt as to whether the necessary work was done.'") (quoting AS No. 3 ¶ 6, App. A ¶ A10), *appeal filed*, No. 16-3830 (8th Cir. Oct. 3, 2016).

III. The Board's Findings of Violations Were Based on Reinhart's Conduct, and the Information Known by or Reasonably Available to Her, in the Audit, Not Hindsight.

As evident from the foregoing, the Board's decision was based on information that was known or reasonably available to Reinhart, or that she did not make the necessary effort to obtain, in the audit. Outside review of an auditor's conduct and enforcement of auditing standards will almost inevitably have to take place after the audit is conducted. While it is certainly true, for example (*see* AU 230.13), that "the subsequent discovery that a material misstatement, whether from error or fraud, exists in the financial statements does not, in and of itself, evidence" a violation of PCAOB auditing standards, neither does eventual discovery of a material misstatement after issuing the audit report exonerate an auditor for a violation. Reinhart's broadside, groundless accusations (*e.g.*, Br. 2, 19, 21-24, 30, 36, 38) that the Board was somehow unable or unwilling to distinguish the evidence bearing on her conduct during the audit from after-the-fact developments simply amount to an insupportable attempt, like her notice and judgment arguments, to distract from what she actually did and did not do and to try to dismiss evidence inconvenient to her litigation positions.

Reinhart complains that the Board cited "a compilation of daily Cash Liquidity Reports dated between January 29, 2008 and February 27, 2008" that was "put together by the Division" from the restatement work papers. Br. 38. But what matters is the date and contents of the reports. Reinhart admits to having Cash Liquidity Reports during the Subsequent Period and that the reports from that period were available for review by the senior manager (*id.*), whether they were added to the original audit work papers or not (*see* RD 79). Reinhart has never claimed Thornburg did not provide all of the reports at the time. FD 23-24.

Equally hollow is Reinhart's objection that it is "impossible," absent hindsight, to make the points the Board did about the contents of margin call schedules Thornburg provided in late February 2008. Unmentioned by her are paragraphs of detailed discussion on that in the Board's decision (FD 28-29, 67). If she is claiming (Br. 36) that in the audit she did not care "how these schedules were prepared or what they were intended to show" and that their plain language could simply be disregarded without inquiry, then her work was even worse than the Board thought.

Reinhart protests (Br. 22-23) the Board's observation that she withdrew the audit report based on conditions and events Thornburg knew or should have known when it was issued. But the Board did this to <u>focus attention back</u> on existing information that she did not make a diligent effort to obtain, on the information that was provided by Thornburg, and on what she did or did not do with it, <u>during the audit</u>, in response to her persistent attempts to diminish the significance of all this by irrelevantly contending that the precise post-filing events were "unforeseeable" and were based on "facts that developed in the following days" (Br. 15, 22). FD 51, 68-69 & n.30.

Reinhart also dislikes that the Board pointed out that major margin call information was provided before issuance of the audit report yet Reinhart failed even to consider it on the burning issues for which she had earlier asked for it. Br. 22. But it was Reinhart who sought information about the margin calls, which she herself describes as "critical to both the going-concern and ability-to-hold evaluations" and as capable of having "wide-ranging effects" on the audit (Br. 20, 39, 40, 42). And Reinhart relied on Thornburg Cash Liquidity Reports. *E.g.*, FD 18, 22, 24.

The Board did not "f[a]ll prey" to an "economic fallacy" (Br. 22) by taking seriously the margin call information and cash reports Thornburg provided in the audit. Rather, the Board rejected the fallacies, urged by Reinhart, to which the initial decision apparently succumbed.

The first fallacy is that the only way margin call information could possibly be used would be to try to make a straight-line prediction of the precise level of future margin calls (Br. 22). Instead, margin call data could provide valuable information—against the backdrop of the August 2007 events—bearing on, for example: (1) Thornburg's representation that certain of its margin calls were "unusual" or "abnormal" (FD 28-29, 31, 61, 75); (2) the existence of events of default (FD 29, 39 n.19, 68); (3) Thornburg's actual level of liquidity, given the lack of "clarity" Reinhart believed to exist around that and what the margin call volume could signify about both demands on funds and a decline in value of securities used to meet those demands (FD 9, 12, 26-27, 30-31, 43-44; Tr. 298-99); and (4) the general risk environment it could be facing in the near term and its ability to withstand that over time (*id.*). It was in these latter four respects, not the first (*see* Br. 23), that the Board discussed margin call information and used a chart (FD 31).

The second fallacy is that audit work may be assessed based only on information the auditor "has" immediately in front of him or her (Br. 21, 38). Instead, it is what the auditor "knew or should have known" at the time. *See, e.g., Kevin Hall, CPA*, SEC Rel. 34-61162, 2009 WL 4809215, *7 (Dec. 14, 2009); *Philip L. Pascale*, SEC Rel. No. 34-51393, 2005 WL 636868, *9 (Mar. 18, 2005); *KPMG*, 2001 WL 47245, *22; *Touche, Niven, Bailey & Smart*, SEC Rel. No. AS-78, 1957 WL 3606, *11. *30 (Mar. 25, 1957).[5]

[5] Contrary to suggestions in Reinhart's brief that she could become passive in various respects late in the Subsequent Period (*E.g.*, Br. 36, 38), she had been directly and intimately involved in the evaluations of Thornburg's ability to continue as a going concern and its ability to hold its impaired assets, and those audit areas required her sustained care and attention. *E.g.*, FD 60 n.27, 62-63, 71. She assessed those areas as high risk, purposely delayed her evaluations until late February to have the most current and complete information, became directly aware in the final two weeks of February of multiple warning signs that called for greater scrutiny, and substantially edited and on February 27 signed the principal audit work paper on both issues.

IV. There Was No Error In Excluding From Evidence Two Internal Thornburg Emails.

The Board rejected Reinhart's challenge to an evidentiary ruling by the hearing officer. It excluded two unauthenticated documents, purporting to be a Thornburg email chain and email, between parties who were not called to testify, which were not copied to Reinhart, and of which she was not aware at any time relevant to this case. FD 85-88, citing PCAOB Rule 5441 (hearing officer "shall exclude all evidence that is irrelevant, immaterial or unduly repetitious").

In briefing to the Board, Reinhart devoted a one-sentence footnote (R.D. 118 at 33 n.15) and two text sentences (R.D. 121 at 12) to the issue. Now she puts this on par with her other arguments as a "dangerous" matter that "will have a significant and deleterious precedential effect on the auditing profession." Oral Argument Reply Brief at 2. She labels (Br. 21) the hearing officer's ruling "irrational" and ignores the Board's analysis, even though it is "only the Board's decision on appeal" that the Commission reviews. *Kabani & Co.*, SEC Rel. No. 34-80201, 2017 WL 947229, *8 n.7 (Mar. 10, 2017). According to her, the PCAOB was compelled to (1) admit those selective, isolated emails, divorced from their context in hotly contested other litigation and (2) find that the emails and a "complaint" the SEC "ultimately decided to dismiss" "unambiguously demonstrate" that "senior Thornburg management had intentionally misrepresented information" to her. Br. 20, 37, 39, 41 & n.4. She gives no valid reason.

Contrary to Reinhart's either/or view (Br. 40), there is nothing inconsistent or unfair, if circumstances warrant, in charging management with misconduct, including lying to auditors, and also charging the auditors with violating auditing standards. Deliberate deception of the auditor by management, even if it occurs in the exact area charged against the auditor, "does 'not relieve [auditors] of their auditing responsibilities.'" FD 87 (citing SEC decisions); *compare, e.g., Ponce*, 2000 WL 1232986, *10 (failure to "test" management assertions about "critical asset") *with William F. Moody*, SEC Rel. No. 34-36700, 1996 WL 15653, *6 (Jan. 11, 1996) (management misrepresentations to auditor on same issue) (settlement). For example, even if management had intentionally deprived Reinhart of information—and she ignores that Thornburg did provide margin call information to KPMG in late February 2008 but she failed to consider it—she still needed to obtain sufficient evidence to afford a reasonable basis for any audit opinion she formed. AU 150.02, 326.22. And if she "remain[ed] in substantial doubt about any assertion of material significance," she should have "refrain[ed] from forming an opinion" until she had "obtained sufficient competent evidential matter to remove such substantial doubt" or "express a qualified opinion or a disclaimer of opinion." AU 326.25. The Board clearly explained what Reinhart was and was not being held responsible for. FD 87.

Thus, auditors may find themselves in the "unfair" situation of being misled, but that does not excuse them from doing their jobs. Reinhart herself recognized that the audit areas at issue were prone to management misrepresentation. The inapposite case she cites (Br. 42) did not involve auditors or an attempt to overcome findings of violations with an "unfairness" claim. Contrary to her attempt to minimize the auditor's role, PCAOB auditing standards do <u>not</u> "recognize" that an audit opinion is "only as good as the information supplied by management" (Br. 41). The very standard she mis-cites for that proposition provides, "The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud." AU 110.02. PCAOB standards require that the auditor "not be satisfied with less than persuasive evidence because of a belief that management is honest." AU 230.09; *see* AU 326.25 ("[i]n designing audit procedures to obtain competent evidential matter, [the auditor] should recognize the possibility that the financial statements may not be fairly presented...."); AU 316.13

(requiring the auditor to maintain a "mindset" that a material misstatement due to fraud could be present, "regardless of any past experience with the entity and regardless of the auditor's belief about management's honesty and integrity"). And AU 333.02 and 333.04, quoted in Argument I above, are likewise pertinent here, as are AU 332.58 and 328.17. In light of this, Reinhart's recitation of a series of management representations that "had wide-ranging effects on the KPMG audit" (Br. 42) simply underscores her overreliance on management representations.[6]

V. Reinhart Engaged in Repeated Instances of Negligent Conduct, Warranting the Sanctions the Board Imposed.

Based on extensive, detailed analysis, including citations to Commission guidance, the Board determined that Reinhart's misconduct constituted, at a minimum, "repeated instances of negligent conduct," each resulting in a violation of PCAOB rules and auditing standards, under Sarbanes-Oxley Act Section 105(c)(5)(B), 15 U.S.C. 7215(c)(5)(B). FD 89-94. Accordingly, under Section 105(c)(4), 15 U.S.C. 7215(c)(4), Reinhart was properly subject to the sanctions the Board imposed. Reinhart's only specific challenge to the sanctions is her unfounded, one-page argument that in no event did she engage in "repeated instances" of negligent conduct.

As the Board explained, this case not only involves two distinct, high-risk audit areas, implicating considerations of liquidity, securities values, and margin calls, but also multiple instance of misconduct within each area. *E.g.*, FD 89, 93 & n.39. Nothing supports Reinhart's view that "under the [Sarbanes-Oxley Act], sanctions are only proper for more extreme conduct" of an auditor that "rises to the level of recklessness" or "reveals a pattern of negligence that is

---

[6] There is no way to know what it means, if anything, that "the Commission itself decided not to charge Reinhart" (Br. 2). It could simply have been a matter of division of labor and resources. The SEC and the PCAOB have parallel authority under the Sarbanes-Oxley Act to bring disciplinary action against public auditors. 15 U.S.C 78d-3; 17 C.F.R. 201.102(e); 15 U.S.C. 7215(c); *see* 15 U.S.C. 7215(b)(4); 15 U.S.C. 7217(a)(c).

repeated on multiple occasions." Br. 43. It is Section 105(c)(5)(A), not Section 105(c)(5)(B), that mentions recklessness. And Section 105(c)(5)(B) says "repeated instances," not "pattern" and certainly not "repeated pattern." The Board's approach is consistent with the plain meaning of the word "instance," commonly defined as a "single occurrence."[7/]

Reinhart's various other linguistic formulations also have no grounding in the statutory language or legal authority and do not hold up under the facts of this case. The Board explained the flaws in vague, formless generalities such as "single set of facts," "same set of facts," and "single situation." *E.g.*, FD 92-93. Reinhart's attempt to reduce her conduct to "closely-related audit judgments based on the same set of facts" or a "single" failure to consider "whether the Company had sufficient readily-available liquidity" fails for many reasons.

First, Reinhart's argument duplicates the flawed approach she took during the audit of treating OTTI/ability to hold as the same as going concern. FD 40, 74, 93. Different conduct was required in each area because it was necessary to look at the circumstances through the lens of the two distinct kinds of evaluations required. She herself testified to the different analytical frameworks under AU 332 and 341. FD 41; *Compare* Tr. 47-50 (acknowledging that Thornburg needed to affirmatively demonstrate it possessed the ability to hold its impaired securities and that under FAS 115 there is no presumption that an entity has the ability to hold) *with* Tr. 86-87, 365, 599-600 (testifying that her going concern evaluation focused on whether events and conditions significantly contradicted the going concern assumption and on management's plan for mitigating liquidity risk). Her expert witness agreed. Tr. 2321-22, 2399-2400; Ex. R-160 at

---

[7/] *Bid for Position, LLC v. AOL, LLC*, 2008 WL 5784151, *11 (E.D. Va. July 11, 2008) (citing dictionaries); *Sweet v. United States*, 53 Fed. Cl. 208, 220-221 (2002) ("occurrence" is "instance of occurring") (citing dictionary), *vacated on other grounds sub nom. MIT. v. United States*, 75 Fed. Cl. 129 (2007).

16, 18, 29. And KPMG separately issued guidance, which Reinhart admittedly read, on the two standards reflecting varied considerations and nowhere suggesting collapsing the two standards into one consideration, as she did in practice in the audit. FD 13; *see* Ex. J-56 at 4; Ex. J-64 at 7-8. Even in her brief, Reinhart claims the issues were "closely related," not identical.

Differences in the standards bore out in the obvious internal inconsistencies in KPMG's going concern memo regarding forced sales. FD 76, 93. Also, such information as untimely paid margin calls, possible asset sales, an estimated drop in securities values, and disclosure that Thornburg "might need to selectively sell assets...to raise cash" given its low liquidity have different ramifications depending on the standard applied, with immediate implications on Thornburg's ability to hold its impaired securities. FD 75-76, 82.

Second, Reinhart's argument ignores the importance of margin calls and securities values, as well as liquidity. She testified that margin calls presented "the most significant risk" to Thornburg's going concern and OTTI/ability to hold analyses. FD 18. She conceded that if she had known that Thornburg was taking several days to meet margin calls she would have followed up with management and asked for more information. Tr. 327; *see* Tr. 1820, 2027. She also viewed the stabilization of its securities values—embodied in the 2-3% discussion—as a "key assumption" and "significant" to KPMG's going concern memo. Tr. 244-45, 617.

Third, Reinhart ignores the findings about her multiple failures to apply fundamental audit principles to relevant factors within the two high-risk areas, even if the two areas were collapsed into one. The Board identified numerous instances of negligent conduct within the going concern and OTTI/ability to hold areas, "each resulting in a violation" of PCAOB standards. FD 93. The Board's focus on the "individual audit tasks, each requiring knowledge, skill, and judgment as an auditor in a high-risk environment," tracks the Commission's SEC Rule

102(e) precedent. FD 90, 93; *see Dearlove*, 2008 WL 281105, *30; *Aesoph*, 2016 WL 4176930, *14-*16 ("numerous instances" of negligent conduct in audit work on one account).

As support, Reinhart cites the initial decision, but neglects to mention that it concluded that she engaged in repeated instances of negligent conduct. *See* FD 92. She also cites the Board member's partial dissent, but fails to explain how it helps her when it: (1) concurred with the Board's findings of violations, which included that "part of the problem with the audit work was that it did not properly differentiate between the two areas" of going concern and OTTI/ability to hold (FD 94 n.39); and (2) did not address the third point above, that "within each of the two areas there were important distinctions, both factual and in terms of the necessary audit procedures, among the multiple violations Reinhart committed" (*id.*).[8/]

Because the Board correctly found that Reinhart's misconduct met the requirements of Section 105(c)(5) and were otherwise appropriate, the sanctions should be upheld.

[8/] If Reinhart seeks sanctions credit for withdrawing KPMG's original audit report (Br. 1, 3), it bears noting that such corrective action is mandated by law. *See Rudolph v. Arthur Andersen & Co.*, 800 F.2d 1040, 1043 (11th Cir. 1986); AU 561. Even so, the Board did credit her timely and responsible withdrawal of the report, while noting this did "not excuse the violations she already committed or eliminate the harm that already occurred." FD 99 n.43.

CONCLUSION

The Commission should sustain the Board's order imposing strong sanctions for Reinhart's serious violations to protect investors and further the public interest.[9]

Dated: March 27, 2017

Respectfully submitted,

J. Gordon Seymour
General Counsel

Luis de la Torre
Associate General Counsel

Jerome P. Sisul
Assistant General Counsel

Public Company Accounting Oversight Board
1666 K St., NW
Washington, DC 20006
202-207-9100 (phone)
202-862-8435 (facsimile)

---

[9] Regarding the stay under 15 U.S.C. 7215(e) on the Board's sanctions and reporting to the public, see *Mark E. Laccetti, CPA*, SEC Rel. No. 34-79138, 2016 WL 6137057 (Oct. 21, 2016).

CERTIFICATION OF COMPLIANCE WITH RULE 450(c)

I, Jerome P. Sisul, certify that the foregoing brief of the Public Company Accounting Oversight Board filed in opposition to Applicant's application for Commission review complies with the word count limitations set forth in Rule 450(c) of the Commission's Rules of Practice, 17 C.F.R. 201.450(c), and that the foregoing brief contains 13,995 words, exclusive of pages containing the Table of Contents and Table of Authorities, as counted by the Word Count feature of our Microsoft Word word-processing program used to prepare the brief.

Jerome P. Sisul
Assistant General Counsel
Public Company Accounting Oversight Board
Office of the General Counsel
1666 K Street, N.W.
Washington, D.C. 20006

CERTIFICATE OF SERVICE

I hereby certify that on the 27th of March, 2017, I caused to be sent to George A. Salter and Ira M. Feinberg via Federal Express a copy of the foregoing brief (the original and three copies of which were filed today via hand delivery with the Commission's Office of the Secretary) addressed as follows:

George A. Salter
Ira M. Feinberg
Hogan Lovells US LLP
875 Third Avenue
New York, NY 10022

I have also transmitted today courtesy copies of the brief to the above-named counsel at george.salter@hoganlovells.com and ira.feinberg@hoganlovells.com.

Jerome P. Sisul
Assistant General Counsel
Public Company Accounting Oversight Board
Office of the General Counsel
1666 K Street, N.W.
Washington, D.C. 20006