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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Application of	Admin. Proc. File No. 3-17758
CYNTHIA C. REINHART, CPA	PCAOB File No. 105-2012-003
For Review of Action Taken by	April 10, 2017
PCAOB	

REPLY BRIEF OF CYNTHIA C. REINHART

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INTRODUCTION

Cynthia Reinhart respectfully submits this Reply Brief in further support of her application for Commission review of the PCAOB decision imposing sanctions against her.

As Reinhart demonstrated in her Opening Brief ("Br."), Reinhart and her team at KPMG performed a careful audit of Thornburg's 2007 financial statements in accordance with PCAOB standards. At the outset of the audit, Reinhart immediately identified the two issues involved here – whether Thornburg would be able to continue as a going concern for at least one year, and whether it had the ability to hold its Available For Sale ("AFS") assets until recovery or maturity (and therefore that the impairment in their market value was not "other than temporary") – as the crucial issues KPMG's audit would have to address. She focused on those issues with great diligence, and consulted extensively with senior KPMG partners. She exercised her best good faith audit judgment on these issues, and did so at a time of great uncertainty in the financial markets, on the eve of the Great Recession but before it had ripened into a severe recession.

The Board's Final Decision imposing sanctions – and the Board's Opposition Brief ("Opp.") supporting that decision – are overwhelmingly based on hindsight, based on the Board's perfect, after-the-fact knowledge of how things turned out. With that knowledge, the Board identified a set of alternative audit procedures applicable to Subsequent Period information that it asserts were *required* by the auditing standards and would have led to the "correct" audit conclusions. But those things were simply not apparent to a careful auditor forced to do her best to make sound decisions at the time, or to the many experienced KPMG professionals she consulted with. Devising alternative audit procedures after the fact and faulting Reinhart for not performing them is grossly unfair, and inconsistent with the Board's proper role.

Moreover, the Board *starts* with the assumption that Reinhart must have done something wrong because she decided to withdraw her opinion shortly after issuance, and then tries to find "facts" that help build a case against her. As a result, the Board's Opposition Brief is forced to distort and mischaracterize the evidence in order to justify the Board's decision. In this Reply Brief, Reinhart will attempt to set the record straight. The Board's Final Decision sets a dangerous precedent for the audit profession, and should be reversed.

I. Reinhart Complied with the Relevant Auditing Standards.

As demonstrated in her Opening Brief, Br. 24-29, Reinhart complied with the key PCAOB standards at issue here—AU § 341, on the going-concern issue, and AU § 332, on the ability-to-hold/OTTI issue. Those auditing standards provided little prescriptive guidance to Reinhart and her team, as the Hearing Officer found, ID at 37, 45, and as Reinhart's experts explained, R-162 at 21-24.[1] The standards instead relied heavily on auditor judgment, which Reinhart and her team exercised in good faith.

The Board dismisses the significance of auditor judgment, arguing that the problem is not that Reinhart's judgments were wrong, but instead "that she did not do ***anything*** or that what she did do was done ***so negligently***." Opp. 20-21 (emphasis added). But Reinhart is not arguing that her audit work "defies scrutiny" because it was dependent on auditor judgment. Rather, the point is that the Board cannot properly evaluate those judgments "in the stark light of hindsight," as the Board has done here. *See* SEC, Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57,168 (Oct. 26, 1998). The Board's reliance on hindsight is particularly evidenced by the Board's explicit reliance on a claimed trend in margin calls during

1 The citation references in this brief are the same as those in Reinhart's Opening Brief.

the Subsequent Period that Reinhart and her team allegedly should have known would continue – which is unsound as a matter of economic principle, ID at 37 – as well as by the Board's reliance on documentation received by KPMG during the restatement period, *after* completion of the audit. FD at 30-31. The Board asserts that Reinhart should have been monitoring the daily cash balance and margin call activity during the Subsequent Period through the day of filing. But the audit approach suggested by the Board is not the *only* reasonable approach to the going-concern and ability-to-hold issues and was certainly not required by the relevant standards.

Moreover, the Board's claim that Reinhart did not "do anything" or "ignored negative indicators," Opp. 2, 20, is simply untrue. The KPMG team performed a thorough analysis of the Company's ability to continue as a going concern and ability to hold its AFS securities, and considered both positive and negative factors relating to those analyses. KPMG's analysis focused on the Company's efforts to restructure its borrowing to reduce its exposure to margin calls, as well as its ability to raise capital to maintain adequate liquidity. The Division's expert *admitted* that many of the factors evaluated in the KPMG Memo were positive—for instance, the facts that the Company had returned to profitability in the fourth quarter of 2007, had raised equity in excess of $230 million in January 2008, was on the verge of closing a substantial securitization at the end of February 2008, had been able to meet all of its margin calls since August 2007, had rolled over its rev repo debt through February 2008, had reduced its exposure to rev repo financing since August 2007, and continued to have high-quality assets rated predominantly AAA-rated or above. J-19; Tr. 1312-23. The KPMG team weighed those positive factors against a number of negative ones, including dislocation in the money markets, declining securities values, the margin calls received in the Subsequent Period, and the

Company's low cash balance. J-19; Tr. 1307-12. The Board's Final Decision and Opposition Brief merely second-guess the audit team's weighing of those factors, based on its own hindsight judgment.

Reinhart is not attempting "to shift the focus away from her actual audit work," as the Board claims. Opp. 3. As explained in Reinhart's Opening Brief, her audit approach complied fully with the applicable PCAOB standards. The Board, though, in its Opposition Brief does try "to shift the focus away" from the two key standards at issue in this case—AU §§ 341 and 332—and to focus now on other standards "fundamental to all audits," regarding the exercise of due professional care, the exercise of professional skepticism, reliance on management representations, and evidential matter (AU §§ 150, 230, 326, 333). That shift is telling, because it shows that the Board is unable to articulate any provision in AU § 341 or AU § 332 that Reinhart violated and cannot demonstrate that the standards *require* the alternative audit approach the Board has devised in hindsight. Instead, the Board claims that Reinhart "disregarded" and "ignored" core auditing standards in her Opening Brief and, apparently, in her audit by not performing the audit procedures suggested by the Board. This is nonsense. In demonstrating that she complied with AU §§ 341 and 332, Reinhart addressed the very alleged violations of AU §§ 150, 230, 326, and 333 that the Board is now claiming she ignored.

Moreover, in finding that Reinhart violated AU §§ 341 or 332 or the "core standards" that underlie them, the Board based its decision on critical factual errors that undermine its analysis.

A. The Board's Erroneous Reliance on the Estimated 2-to-3% Future Decline in Thornburg's Securities Values.

Perhaps the most important error in the Board's Final Decision, which is repeated throughout the Board's Opposition Brief, is the Board's insistence that "management informed

Reinhart that it was ***reasonably possible*** for Thornburg's securities to decrease another 2-3% in value in the near future," Opp. 12 (emphasis added), 26. The Board in effect is claiming that Thornburg management told Reinhart that what happened in the two days *after* the 10-K filing—declines in securities values leading to an extraordinary volume of margin calls that could not be satisfied—was considered by management a real possibility in the days *before* the filing. This assertion is wholly unsupported by the record.

In fact, Reinhart testified that "a further decline in a very short period of time by another two to three percent would be ***unlikely***, given the type of collateral" held by Thornburg, Tr. 237 (emphasis added), because it would "result in an unreasonable return to an investor based on the high quality nature of the underlying assets." Tr. 243. Reinhart therefore explained that KPMG "would ***not*** expect that the value of the collateral would decline in such a fashion, that it would be a sudden decline." Tr. 239 (emphasis added). Reinhart's testimony was based on her conversations with Shawn Buniel, Jane Starrett, Clay Simmons, and Larry Goldstone of Thornburg, Tr. 615-16, and thus reflects what she learned from Thornburg management.

The Board's Opposition Brief relies (Opp. 27) almost exclusively on one piece of evidence: that the Senior Manager's notes of a conversation she and Reinhart held with Thornburg management state as follows: "2-3% drop = maybe." FD at 37. But this cryptic note does not provide any support for the Board's claim that Thornburg told Reinhart that a 2-3% decline was "reasonably possible . . . in the near future." Even if someone replied "maybe" as to whether there could be a 2-3% drop in the value of Thornburg's securities, that does not mean such a drop was reasonably possible in the near term. Indeed, when the Senior Manager was asked whether "there was a possibility that there might be a 2 to 3 percent decline," she testified that it was possible, but only "over the foreseeable future," Tr. 930—not in the near term, as the Board claims. To the extent the Board is relying on the FAS 5 definition of "reasonably possible," as suggested by its Brief, Opp. 27, this drop was "less than likely"—or, in Reinhart's words, "unlikely"—further undermining the Board's reliance on this point.

Based on its unsupported conclusion about a 2-3% decline being reasonably possible in the short term, the Board argues that "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." Opp. 15. But the logic behind this argument is flawed: It effectively assumes that Thornburg management was forecasting a 2-3% drop the very next day—which, as discussed above, it was not—and disregards Thornburg's demonstrated ability to raise cash when necessary. By the Board's flawed logic, the Company, at year-end, had just a 4.5% protection against future margin calls, comprised of $587 million in readily available liquidity as of December 31, 2007, yet Thornburg was able to satisfy nearly a billion dollars in margin calls between year-end and the filing of its financial statements, with approximately $150 million to spare. That is because Thornburg had access to funds from a variety of sources, as documented in the KPMG Memo, J-19 at 4-5 (describing upcoming securitization, offering, and principal and interest payments), and other work papers, J-5 at 23 (discussing cash and available securities of ~$150 million as of February 27, plus ~$120 million additional cash anticipated from moving certain securities and upcoming securitization on March 5, and common stock offering to close on March 7). Reinhart's citation of these factors is not an "after-the-fact rationalization," as the Board claims, Opp. 24; these facts are documented and relied upon in the very work papers the Board has criticized.

The Board also challenges Reinhart's position that the 2-3% figure was merely a "'prediction' of future events" that is not subject to audit testing. Opp. 27. But even the Hearing Officer noted that this figure was a "prediction of future events," Tr. 940-41, or a "forecast," Tr. 795-96. And Reinhart testified at the hearing that this figure was "an opinion of management as to the value of their collateral." Tr. 614-15. The Board faults Reinhart for "obtain[ing] little, if any, evidence about how Thornburg derived those percentages." Opp. 12, 26. But Reinhart testified that the Company's assertion was reasonable based on her discussions with Thornburg management about their views of the market, her own knowledge of the value of Thornburg's collateral, and the underlying quality of Thornburg's assets, confirmed through KPMG's audit work. Tr. 796; *see* Tr. 242-44, 793-95. Management's prediction was also consistent with information that the In-Depth Review Partner had learned during his audit of another client, whose capital markets group also predicted that markets had leveled off. Tr. 1715-16. Again, the Board's heavy reliance on the supposed reasonable possibility of a 2-3% decline is based on 20/20 hindsight – this is not the conclusion that informed people drew at the time.

The Board also rehashes its claim that Reinhart's "failure to consult with KPMG's valuation experts" resulted in "undue reliance on management's representations." Opp. 28. But consultation with valuation experts was not required by PCAOB standards, and was neither necessary nor practicable under the circumstances. KPMG does not have "experts" who assist audit teams by forecasting the future direction of securities prices. Further, Reinhart's auditing expert testified that it was not necessary because "even without that sentence ["that the likelihood that collateral values decrease by more than another 2 to 3% is remote"], . . . the work was overwhelmingly supportive of the conclusions . . . that the company's accounting was appropriate and that there was a going concern." Tr. 2186-87. And it was not practicable because "the only thing [a third-party consultant] could offer would be the same amount of information you have already in your general knowledge of market conditions, because they wouldn't have the time to get a detailed understanding of the portfolio to give you any better information." Tr. 2188.

The Board also argues that a disclosure in the MD&A section of Thornburg's 2007 Form 10-K is inconsistent with the position set out in the KPMG Memo, but there is no basis for this contention, and it makes inappropriate use of the disclosure. The disclosure stated, in part, that "There is no assurance that [market conditions] have stabilized or that they will not worsen." J-1 at 23. The Board argues that this was "contrary" to the Company's opinion, documented in the KPMG Memo, that "the likelihood that collateral values decrease by more than another 2 to 3% is remote," and that "the fair values for these securities are at or approaching bottom," J-19 at 6. Opp. 26. But these statements are not in any way inconsistent. While the Company may have had an opinion on the likely course of the market, there was obviously no "assurance" that its opinion was correct. And the Company was required by law to make a disclosure of this risk in its 10-K, whether or not it believed the risk would come to pass and whether or not the Company had a solid basis for believing that the risk would not materialize.

The Board's Opposition tries to minimize the importance of KPMG's stress testing, dismissing Reinhart's reference to it as an attempt to "excuse[ ] any inadequacy in her response to the 2-3% information." Opp. 28. But in fact, the stress testing was a critically important foundation for KPMG's going-concern conclusion, which the Board all but ignored. The stress testing section of the KPMG Memo analyzed the impact of a decline in securities values *far* *beyond* a 2-3% decline, and concluded that the Company would survive. As Reinhart's auditing expert explained, "the stress testing was particularly compelling evidence" that KPMG had reached the correct conclusion on the going-concern issue. Tr. 2153.

The Board criticizes the scenarios in KPMG's stress testing, arguing that "they assumed debt restructuring and sales of substantial disposition of assets outside the ordinary course of business," which the Board claims "'significantly contradict[ ]' the assumption that an entity will continue as a going concern." Opp. 29 (quoting AU § 341.01). That argument fails. As the Hearing Officer found, PCAOB standards did not define "substantial doubt" or "going concern" at the time. ID at 45. And the Board incorrectly assumes that sales of securities to satisfy lenders and loss of access to a source of financing equate to "substantial doubt" regarding the Company's ability to continue as a going concern. All three of the auditing experts in this matter – including the Division's expert – testified that the standard KPMG applied for what constitutes a "going concern" was a valid interpretation of AU § 341 at the time. Tr. 1347-48, 1534-35, 2148-49. In fact, Thornburg *did* continue as a going concern for more than a year. R-160 at 63.

B. The Board's Flawed Discussion of KPMG's Analysis of the Company's Liquidity.

The Board's discussion of KPMG's consideration of the Company's liquidity position is also riddled with errors and misrepresents the evidence. In fact, the record shows that Reinhart and KPMG gave careful attention to the Company's liquidity position during the Subsequent Period.

The Board starts its analysis with the claim that Reinhart's analysis of Thornburg's liquidity position improperly "relied on Thornburg's year-end liquidity." Opp. 9; *see also* Opp. 14, 22. This claim is nonsense, and should be rejected out of hand. Of course, the KPMG Memo *began* by noting the Company's cash position at year-end—as it had to, since KPMG was opining on Thornburg's December 31, 2007 financial statements. But that doesn't mean that KPMG stopped there and "relied" on year-end data "in the face of contrary evidence," as the Board claims. Opp. 9. Instead, the KPMG Memo thoroughly documented the events in the Subsequent Period—namely, the declines in the Company's securities values, the margin calls the Company had received, and the Company's resulting "tight" liquidity position. J-19.

The Board continues to emphasize that Reinhart failed to follow the audit approach devised by the Board and "did not review another Cash Liquidity Report between February 22, 2008 and issuance of the audit report," and claims that there is not "any documentation that she monitored, inquired about, or discussed any such reports during that period." Opp. 10. However, the Senior Manager reviewed the daily cash liquidity reports on a near-daily basis from February 20, 2008 through the filing of Thornburg's 2007 Form 10-K on February 27. Tr. 909-10. And the testimony revealed that the Senior Manager discussed "a number of them with Ms. Reinhart subsequent to February 20th," that Reinhart "reviewed some" of the Cash Liquidity Reports during that period, and that Reinhart and the Senior Manager "walked through some" of them. Tr. 910-11. The Board's reliance on review of the daily Cash Liquidity Reports as the crucial audit procedure is misplaced. Those reports were new, started during the Subsequent Period as a management tool to monitor the Company's liquidity, J-19 at 5; they were untested and they were not considered a part of the Company's books and records. Tr. 1078-79. Indeed, as the Hearing Officer noted, even the Division did not consider the reports to be accurate in projecting the following day's cash balances. ID 22 n.10. In this light, the Board's complaint that Reinhart's review and discussion of the Cash Liquidity Reports is not documented in the work papers is simply misguided.

The Board next makes the outlandish claim that "KPMG's going concern memo mentioned ***nothing*** about the 'substantially reduced' liquidity or the steady decline since third quarter 2007." Opp. 10 (emphasis added). In fact, however, the KPMG Memo notes at the outset that "[t]he significant risk for the Company, in relation to going concern, is liquidity risk," J-19 at 2, and the ***primary focus*** of the memo was the Company's liquidity. The KPMG Memo discusses in detail the very facts the Board claims are omitted. The KPMG Memo notes that the Company had cash and unpledged securities of $587 million as of December 31, 2007, but that the cash balance as of February 22, 2008 was "relatively tight, at ~$45.5 million (excluding short term investments)." J-19 at 5. In other words, the KPMG Memo explicitly referenced the decline in Thornburg's cash balance from year-end. The KPMG Memo also discussed the "decline in security values during January and February 2008 of 5% to 10%," which "caused additional margin calls" that "the Company has met, mainly, from raising capital." J-19 at 5.

The Board also argues that "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." Opp. 11. While it is true that KPMG did not "confirm" the Company's cash balance as of February 27, the Division's own expert ***conceded*** that confirmation of that balance on the day before the Company issued its 2007 10-K would have been impossible. Tr. 1455-56. Equally important, KPMG did perform other "audit procedures" relating to the Company's liquidity position. As discussed above, the Senior Manager reviewed the Company's daily cash liquidity reports on a near-daily basis from February 20 through

February 27, Tr. 910-11, and specifically reviewed the February 27 daily cash liquidity report, in particular. Tr. 918-22. Asked whether she did "anything to reconcile the projected end-of-day 93.8 million cash balance [on the February 27 report] with management's representation that it had approximately $150 million in liquidity," the Senior Manager explained that she had considered that balance, along with her knowledge that the Company had a $35 million minimum balance in a BlackRock reserve account, and concluded that the Company's estimate of its liquidity position was consistent with the information she had. Tr. 918-22. Though not a *confirmation* of the Company's cash balance, these were appropriate *audit procedures* that KPMG performed in assessing the Company's liquidity position.

Finally, the Board repeatedly emphasizes an admitted error in the KPMG Memo, but vastly overstates its significance. As Reinhart has acknowledged, one sentence addressing the Base Scenario in the stress testing section of the KPMG Memo erroneously identified the 7% margin requirement in the Company's rev repo contracts as protection against future margin calls: After noting that as of year-end, the Company had "collateral in excess [of debt] of 7% plus another 4.5% in cash and liquid, unpledged investments," the KPMG Memo states: "Thus, a decline in fair value of available cash and securities greater than 11.5% would require the Company to either raise more capital or sell assets to satisfy lenders . . . ." J-19 at 5. The Board claims that this single sentence resulted in a "$900 million overestimation of Thornburg's ability to meet future obligations." Opp. 11.

In reality, this was a drafting error with zero impact on KPMG's analysis of the going-concern or ability-to-hold issues. Though Reinhart admitted she did not notice this error until the restatement period, Tr. 231, both Reinhart and the Senior Manager understood that the margin required by the Company's rev repo debt (also referred to as the "haircut" or "cushion") was not available to meet future margin calls. As Reinhart explained, "the haircut or margin requirements represented the amount of collateral that was required to support the company's borrowing arrangements," Tr. 604-05, and "was not an amount Thornburg could use to meet margin calls," Tr. 236. The Senior Manager said the same. Tr. 974.

Moreover, notwithstanding this one sentence, the Base Scenario accurately reflected the Company's position as of December 31, 2007: The Company had "collateral in excess of debt of 7% plus another 4.5% in cash and liquid, unpledged investments." J-19 at 5. The Base Scenario also accurately summarized events since year-end: "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." *Id.* The bottom line: Because the Company had met the margin calls as of the date of the KPMG Memo, "the Company maintain[ed] the 7% cushion." *Id.*

The Board's claim that this sentence "represented a $900 million overestimation of Thornburg's ability to meet future obligations" is absurd. Taken seriously, the Board's claim implies that KPMG believed that Thornburg had an extra $900 million of protection against future margin calls, even at the end of the Subsequent Period. Of course, Reinhart believed no such thing, which is why the KPMG team was carefully monitoring and discussing with management the Company's liquidity, including the cash balance, during the final weeks of the audit. As the Board has acknowledged, the KPMG Memo described the Company's liquidity position as of February 22 as "relatively tight, at ~$45.5 million," J-19 at 5, and this number was subsequently updated as of February 27, in the Completion Document, J-5 at 23.

C. The Board's Improper Reliance on the Margin Call Schedules KPMG Received on February 27, 2008.

The Board's Opposition also errs in its reliance on the Board's unsubstantiated claims about the schedule of margin calls received by KPMG on the final day of the audit.

The Board's first criticisms relate to the request made by the Senior Manager to Thornburg management for a list of margin calls received by the Company, organized by counterparty, for the Subsequent Period. Opp. 12-13. When management responded that "it did not maintain a list of margin calls in the 'form' requested," the Board contends that "Reinhart accepted this without asking follow-up questions." Opp. 13. And the Board faults Reinhart "for failing to follow up on her initial request." Opp. 31.

But the Board has its facts wrong. The Senior Manager testified that she was the one who made the original request, not Reinhart. And it is not true that she did not ask follow-up questions; rather, when she was told that Thornburg did not have a list in the requested format, the Senior Manager asked employees in Thornburg's Capital Markets group for more information about how the Company received its margin calls. Tr. 848-49. Moreover, Reinhart reviewed these conversations with the Senior Manager, and reasonably determined that further follow-up was not necessary at that time: As Reinhart explained: "Considering the information that we learned in terms of how the company managed its margin calls . . . [i]t seemed to be reasonable to us that the explanation provided by Mr. Fellers was, in fact, truthful." Tr. 304.

The Board's Opposition also emphasizes the margin call schedule that KPMG later received, on February 27, 2008, in connection with the tie-out of the recently-updated Subsequent Events footnote in the 10-K. The Board doubles down on its own conclusions—uncorroborated by any evidence in the record—that the schedule "showed" that Thornburg "was untimely paying margin calls" and "had possibly sold assets." Opp. 13, 15. First, there is no evidence to support the Board's intimation that the margin call schedule received on February 27 was provided in response to the Senior Manager's request to Mr. Fellers for a list of all margin calls in the Subsequent Period. And there is also no evidence to support the Board's interpretation of that schedule. The Board argues that Reinhart and her auditing expert "[b]oth confirmed the obvious red flags in the schedules, while neither showed any confusion." Opp. 30. But the hearing testimony indicates otherwise. When asked to explain the information in the schedules, Reinhart's responses were a mix of conjecture and uncertainty, Tr. 317-20; likewise for her expert, Tr. 2102-06. And to the extent Reinhart was able to explain the schedule at all, her understanding was based on information learned in the restatement period, not because of any "obvious red flags" on the face of the schedule. Tr. 321.

The Board also argues that "Reinhart accepted without question management's representation that the high margin calls in the last two weeks of February were 'unusual.'" Opp. at 14. But the fact is that those margin calls *were* unusual, for the reasons described by nearly all of the witnesses at the hearing. The margin calls during the last two weeks of February were caused by a decline in the value of Thornburg's securities backed by Alt-A collateral, due to a specific event that occurred on February 14, 2008—a disclosure by UBS regarding its write-down of assets backed by Alt-A collateral, which caused particular concern in the market. Tr. 311, 738-39, 1175-76, 1221, 1417, 1715-16, 1719-20, 2072, 2182-83. Reinhart's expert economist explained that the UBS announcement was "the first time there was concern expressed about Alt-A securities as opposed to subprime mortgage-backed securities." Tr. 2072. Reinhart's principal audit expert, Mr. Lawton, agreed that this was "unusual." Tr. 2180.

Moreover, apart from the margin calls that began on February 14, Reinhart and her team knew that Thornburg had received margin calls earlier in the Subsequent Period, in an amount corresponding to the decline in the market value of the assets pledged as collateral. Tr. 268-69, 843, 1719-20. Reinhart and her team also understood that those margin calls had been met in accordance with the agreements. Tr. 330-31, 1719-20. Thornburg management specifically represented as much. Tr. 399. In addition, Reinhart and her team verified that the Company was able to roll over its rev repo debt in the Subsequent Period, an indicator that Thornburg could meet its margin calls in the ordinary course. Tr. 330-31, 401, 803.

D. The Board's Factual Errors Similarly Undermine Its Conclusion on Ability to Hold.

The Board's Opposition devotes little independent discussion to the ability-to-hold issue, reinforcing Reinhart's contention that the going-concern and ability-to-hold issues are so closely intertwined that Reinhart's conduct could involve at most one instance of alleged negligence, not "repeated instances." *See* Point III, *infra*. The Board argues that KPMG's OTTI/ability-to-hold analysis "suffered from similar deficiencies as in the going concern context," Opp. 14, and cites the same purported flaws in the KPMG Memo to support its position on this issue. *See* Opp. 14-15, 31-34.

The Board's only independent argument regarding ability-to-hold is its contention that there were "internal inconsistencies between the going concern and OTTI/ability to hold evaluations." Opp. 14. Specifically, the Board argues that two scenarios addressed in the stress testing section of KPMG's going-concern memo "were premised on Thornburg being 'forced to sell assets' to survive," that this was inconsistent with KPMG's ability-to-hold conclusion, and that, "[a]t the hearing, [Reinhart] gave no coherent explanation for these discrepancies." Opp.

15. Not true: Reinhart and the Senior Manager both testified that the stress testing sections of the KPMG Memo applied only to the going-concern analysis. Tr. 228, 258, 613-14, 1145, 1148. It was added at the request of the BUPP Partner, who was consulted only on that issue. Tr. 1708-09. And Reinhart's audit expert explained that it would be illogical to apply those scenarios to the ability-to-hold issue, because an auditor is not required to predict future market movements when analyzing a company's ability to hold. Tr. 2173, 2332. In contrast, the engagement team utilized stress testing for the going-concern analysis because the going-concern standard specifically contemplates consideration of what might happen up to one year from the balance sheet date. Thus, there was no "internal inconsistency" in the analysis on these two issues.

The Board also argues that the factual points cited by Reinhart in support of her conclusion that the Company had the ability to hold, *see* Br. 28-29, in fact relate principally to Thornburg's *intent* to hold, and "do not directly pertain to the ability to hold issue." Opp. 33. But the facts Reinhart cited correspond exactly with the types of evidence listed in AU §§ 332.47 and 332.57(f) as relevant to a company's ability to hold. Moreover, many of the listed points do relate to ability to hold rather than intent. For example, AU § 332.57(f) directs auditors to "[d]etermine whether management's activities . . . provide evidence of its ability," and bullet points seven and nine address Thornburg's plans to mitigate liquidity risk, concluding that they "did not depend on the sale of assets," "appeared reasonable and w[ere] already being implemented." Br. 29. AU § 332.57(f) also directs auditors to look at the entity's "alternate sources of liquidity" in determining "ability," and as bullet point four indicated, "Thornburg's past ability to raise equity and consummate securitization transactions, and its plans for another offering in early March 2008, supported the view that it would be able to meet margin calls and continue to hold its AFS assets." Br. 29.

E. Reinhart's Audit Work Was in Accordance with AU § 560.

The Board also criticizes Reinhart for relying on management representations during the Subsequent Period, and claims that "Reinhart misreads AU 560.12 to claim she could rely exclusively on management inquiries." Opp. 25. Reinhart has claimed no such thing. Reinhart has simply referred to the language of the applicable standard, AU § 560.12, which explicitly provides that to ascertain the occurrence of subsequent events, the auditor should, among other things, "[i]nquire of and discuss with officers and other executives," and "[o]btain a letter of representations" from appropriate officials. Moreover, for Subsequent Period events, AU § 560.12(f) provides that the auditor should "[m]ake such additional inquiries . . . as he considers necessary and appropriate." Inquiry of management is therefore a required procedure under AU § 560.12.

The Board argues that Reinhart is using AU 560 to justify her alleged decision 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." Opp. 25. These criticisms are unfair and unfounded. Reinhart deferred her conclusion on the going-concern and OTTI/ability-to-hold issues because it was the right thing to do, "in order to obtain as much information as possible" regarding the state of the market and Thornburg's liquidity. ID 16. While Reinhart deferred her *conclusion* until as close to the issuance date as possible, the process of gathering evidence on these issues was ongoing, starting in the third quarter of 2007 when she first requested that Thornburg perform a going-concern analysis (*see* J-33) and extending throughout the Subsequent Period. Reinhart's approach was in accordance with PCAOB standards, including AU § 560.

The Board derides the representations that Reinhart obtained from the Company, claiming that they were "generalized representations [which] do not support her specific assertion," Opp. 31, but in fact those representations were very specific and in writing. The Thornburg Memo itself represented that Thornburg continued to meet all margin calls and returned to profitability in the fourth quarter of 2007. J-21. In addition, Thornburg's three key officers – Chief Executive Officer Larry Goldstone, Chief Financial Officer Clay Simmons, and Chief Accounting Officer Jane Starrett – each signed Thornburg's February 27, 2008 management representation letter to KPMG, stating that Thornburg had complied with all aspects of its contracts that would have a material effect on its consolidated financial statements; that Thornburg had the intent and ability to hold its impaired securities for a sufficient time to allow for their recovery in market value; that there had been no subsequent events requiring adjustment to or disclosure in the Company's financial statements; and that Thornburg's financial statements disclosed all matters relevant to Thornburg's ability to continue as a going concern. J-4 at 2, 5, 6, 7. And when Goldstone, Simmons, and Starrett were each asked by the audit team on or about February 27 whether there were any contractual breaches or noncompliance issues, each misrepresented the facts and failed to disclose Thornburg's violation of its lending agreements. *See* Complaint, *SEC v. Goldstone*, No. 12-0257 (D.N.M. filed Mar. 3, 2012), ¶ 58.

F. Reinhart Properly Consulted and Relied Upon Other Members of the KPMG Audit Team.

Though the Board places blame on Reinhart for all of the alleged faults of KPMG's going-concern and ability-to-hold evaluations, Reinhart did not conduct those analyses alone. She had a team of highly qualified and experienced auditors, including the Senior Manager, SEC Review Partner, In-Depth Review Partner, and BUPP Partner, whom she consulted and relied upon in addressing these issues. *See* Br. 6-9.

With respect to the three senior reviewing partners, the Board claims that "[t]hese 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." Opp. 22 n.3. But there is no evidence that Reinhart withheld any "key information" from these senior partners. Moreover, the Board misses the point of Reinhart's emphasis on those consultations: they demonstrate how diligent and careful Reinhart was in addressing the difficult going-concern and ability-to-hold issues. The three senior partners were fully aware of the audit approach taken by the team, and none believed that auditing standards required the alternative audit approach now suggested by the Board. As Reinhart's audit expert explained (and as any reasonable regulatory authority would agree), "such consultations with senior auditors are prudent and reflect a careful audit approach." R-160 at 55.

The Board points out that the BUPP Partner had written notes on a copy of the Thornburg Memo, asking questions such as "what happens if there is another Aug 2007 event?" and "how much can [the securities values] decline before [Thornburg] runs out of money?" Opp. 8. The Board asserts that these questions were "unanswered by Thornburg's memo," *id.*, but the more important point is that these questions *were* addressed by KPMG. In fact, the evidence shows that the KPMG team discussed those questions with the BUPP Partner on a conference call attended by Reinhart, the Senior Manager, and the SEC Review Partner, Tr. 1156-58, and that the BUPP Partner was satisfied that his questions were answered. Tr. 1158; Tr. 1925. Indeed, the BUPP Partner documented this in an email that was appended to the KPMG Memo. J-19 at 9 ("You answered all my questions, and I agree with the conclusions.").

II. The Board Erred in Excluding Evidence that Thornburg Intentionally Withheld and Misrepresented Information Critical to the Audit.

Reinhart attempted to introduce evidence at the hearing which demonstrated that three of KPMG's key contacts at Thornburg—CEO Larry Goldstone, CFO Clay Simmons, and CAO Jane Starrett—intentionally failed to disclose information or misrepresented information to KPMG that was highly relevant to its going-concern and ability-to-hold analyses. Specifically, the proffered evidence showed that these senior executives falsely represented that Thornburg had timely met all margin calls and that the Company had not been required to sell any assets to meet its margin calls, as the Commission charged in its lawsuit against them. The Hearing Officer excluded this evidence, however, and the Board upheld his ruling, holding that this evidence is irrelevant. FD 85-88.

To support this ruling, the Board contends that "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." Opp. 38. That argument misses the point. While it may be possible for an auditor to violate auditing standards in spite of management deception, the notion that management deception is not ***relevant*** to that determination is preposterous. The Board's refusal to consider this clear evidence of management deception on the going-concern and ability-to-hold/OTTI issues was a fundamental error, and profoundly undermines the validity and fairness of the Board's imposition of sanctions against Reinhart.

III. Reinhart's Conduct Did Not Involve "Repeated Instances" of Negligent Conduct.

Finally, the Board's Opposition provides no basis for its claim that the facts here involve "repeated instances" of misconduct, as required under the Sarbanes-Oxley Act to support the imposition of sanctions against an auditor. The Board's brief completely ignores the dissent by former Board member Jay Hanson, who found there was no basis for concluding that Reinhart's conduct involved "repeated instances" of negligence. FD at 101. But Hanson was correct: as he explained, the Final Decision "fails to articulate adequately how Reinhart's assessment of her client's available liquidity to meet its financial obligations involved discernably different conduct in the context of each auditing area, and the record does not support such a finding." FD at 101.

Indeed, much of the Board's Opposition *supports* Hanson's conclusion. As the Board itself contends, Reinhart's ability-to-hold/OTTI "analysis suffered from similar deficiencies as in the going concern context." Opp. 14. The Board's discussion of the alleged deficiencies in the ability-to-hold/OTTI analysis demonstrates as much. The Board simply recycles the same purported audit failures it discusses in the going-concern context: the audit team's alleged failure to properly evaluate Thornburg's liquidity position, KPMG's alleged failure to consider the Company's cash position and its ability to meet margin calls, and the related "errors" in the KPMG Memo. Opp. 14-15, 31-34.

Ultimately, the Board's position depends upon its erroneous interpretation of the Sarbanes-Oxley Act. The Act on its face permits sanctions only where an auditor commits "repeated instances" of negligence – by this language, Congress plainly intended to authorize sanctions only where an auditor's conduct involved repeated instances of negligent work, and did not authorize the Board to impose sanctions for an auditor's alleged negligence in a single situation. The Board's position would effectively read this language out of the statute. The Board claims that it can slice and dice an auditor's conduct into multiple component instances of negligence such that *any* case would permit it to impose sanctions. The Board thus claims that Reinhart committed "multiple" violations of auditing standards, and "numerous instances" of negligent conduct with respect to the going-concern and ability-to-hold issues, and that "each result[s] in a violation of PCAOB standards." Opp. 42. This is not a reasonable interpretation of the statute, and is inconsistent with congressional intent. On the record here, where Reinhart's conduct relates to her handling of two closely-related issues over a single short span of time for a single client involving a single audit, where her performance has otherwise been exemplary over a long and distinguished career, there is no basis for the Board's assertion that this involves "repeated instances" of negligence sufficient to warrant the imposition of sanctions.

CONCLUSION

Accordingly, the Commission should reverse the Board's Decision and dismiss this proceeding with prejudice.

Dated: April 10, 2017

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Application of CYNTHIA C. REINHART, CPA For Review of Action Taken by PCAOB	Admin. Proc. File No. 3-17758 PCAOB File No. 105-2012-003 April 10, 2017

CERTIFICATE OF COMPLIANCE OF REPLY BRIEF

Pursuant to Rule 450 of the Commission's Rules of Practice, 17 C.F.R. § 201.450, I hereby certify that the Reply Brief of Cynthia C. Reinhart ("Reinhart") filed in support of Reinhart's application for review of the Final Decision and Order Imposing Sanctions issued by the Public Company Accounting Oversight Board on November 18, 2016, complies with the length limitation set forth in paragraph (c) of Rule 450. According to the Word Count feature of Microsoft Word, which is the word-processing system used to prepare the brief, the Reply Brief contains 6,943 words, excluding the Table of Contents and Table of Authorities, which is within the 7,000 word limit.

Dated: April 10, 2017

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Application of	Admin. Proc. File No. 3-17758
CYNTHIA C. REINHART, CPA	PCAOB File No. 105-2012-003
For Review of Action Taken by	April 10, 2017
PCAOB	

CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of April 2017, I caused to be served via hand delivery the following documents to the recipients listed below.

Documents Served:

1) Reply Brief of Cynthia C. Reinhart, Dated April 10, 2017

2) Certificate of Compliance of Reply Brief, Dated April 10, 2017

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