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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	January 12, 2018
PCAOB	

SUR-REPLY OF CYNTHIA C. REINHART IN RESPONSE TO THE COMMISSION'S NOVEMBER 16, 2017 ORDER

January 12, 2018

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INTRODUCTION

Cynthia C. Reinhart, CPA ("Reinhart") respectfully submits this sur-reply in response to the Board's Sur-Reply filed pursuant to the Commission's November 16, 2017 order.[1]

In its Sur-Reply, the Board – plainly aware of the weakness of its position – does its best to avoid answering the questions posed by the Commission. Instead, the Board spends its first 14 pages rehashing the same criticisms of Reinhart's conduct it emphasized in its principal brief. When the Board finally turns to the key questions posed by the Commission, whether Reinhart's conduct amounts to "repeated instances" of negligent conduct, the Board's response acknowledges that Reinhart's alleged audit failures all involve a single issue, her alleged failure to adequately address whether Thornburg had the ability to manage its liquidity risk so as to meet its obligations, including margin calls.

Unlike the Board, Reinhart will answer the Commission's questions directly and in order. In so doing, Reinhart will demonstrate why the Board is wrong in claiming that Reinhart's audit approach was unreasonable, and why, in any event, her going-concern and ability-to-hold evaluations were based on the same core set of facts, involve the same alleged conduct, and constitute only one alleged instance of unreasonable conduct. In the absence of "repeated instances" of negligent conduct, the Board's sanctions cannot stand.

I. Reinhart's Going-Concern and Ability-to-Hold Evaluations Were Not Separate Instances of Alleged Misconduct.

The first issue the Commission asked the Board to address is how Reinhart's allegedly negligent conduct with respect to the going-concern and ability-to-hold evaluations constitute separate instances of negligent conduct. The Board begins by claiming that Reinhart "misunderstands the statute" and that she allegedly contends that absent "repeated instances," the

[1] The citation references in this brief are the same as in Reinhart's Opening and Reply Briefs.

Board may not impose any sanctions at all. Sur-Reply 15. This is not, and has never been, Reinhart's argument. While the Board could potentially impose *other* sanctions under 15 U.S.C. § 7215(c)(4) without a finding of "repeated instances," there is no dispute that the Board is *not* authorized to impose *the sanctions at issue here* without a finding of repeated instances. The Board admits that "[f]or the 'repeated instances' language to serve its purpose, it must meaningfully distinguish more serious from less serious auditor conduct." Sur-Reply 15. But the Board fails to demonstrate that the conduct of Reinhart here meets this statutory test.

The Board concedes that Reinhart's alleged audit failures all pertain to one interrelated set of issues concerning Thornburg's ability to manage its liquidity and satisfy margin calls. Sur-Reply 17-18 (acknowledging that this information "was pertinent to both evaluations"). Instead, the Board's principal argument is that it is irrelevant that Reinhart's alleged misconduct relates only to one set of issues, because her alleged mistakes in handling these issues affected more than one audit area. Thus, the Board argues that "[j]ust because an auditor may encounter facts with implications for more than one audit area does not transform those areas into one." Sur-Reply 16. And the Board emphasizes that "[t]he going-concern and OTTI evaluations are distinct processes, governed by substantively different auditing standards, and related to separate financial statement and auditor reporting considerations." Sur-Reply 17.

The Board's position is wrong, and inconsistent with the statutory scheme. The fact that alleged errors in a single course of conduct may affect more than one audit area does not demonstrate that an auditor engaged in "repeated" instances of negligent conduct. There is no dispute that the going-concern and ability-to-hold evaluations are separate and governed by different auditing standards—AU 341 for going-concern and AU 332 for ability-to-hold. But in the 2007 Thornburg audit, Reinhart and her team recognized that the primary driver of each evaluation was the same: whether Thornburg would be able to manage its liquidity in order to meet its financial obligations, particularly margin calls. If it could, then Thornburg had the ability to continue as a going concern for a reasonable period of time *and* the ability to hold its available-for-sale securities until recovery or maturity. The mere fact that these two audit conclusions were based on the same evaluation does not mean that Reinhart's conduct was "repeated."

The Board's approach is completely at odds with the Commission's guidance. In amending SEC Rule 102(e) in 1998 and creating the "repeated instances" framework subsequently codified by Congress, the Commission explained that "a single error that results in an issuer's financial statements being misstated in more than one place would not, by itself, constitute" "repeated instances" of unreasonable conduct. Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57,169 (Oct. 26, 1998). The same reasoning applies here: if there is one set of alleged errors impacting multiple areas of an audit, it still constitutes a single "instance" of alleged misconduct. As former Board member Jay Hanson—the sole Board member who was an audit partner with experience in public company audits—correctly concluded, there is, at most, one single instance of alleged misconduct in this case, Reinhart's analysis of Thornburg's ability to manage its liquidity to meet its financial obligations, which impacted both the going-concern and ability-to-hold evaluations.

The Board acknowledges that this single issue was the driver of both evaluations. The Board admits that "information regarding Thornburg's liquidity, margin calls, and securities values was pertinent to both evaluations," Sur-Reply 17-18, and criticizes Reinhart's ability-to-hold analysis as "suffer[ing] from similar deficiencies" as her going-concern analysis, Opp. 15. Moreover, the specific factual points that the Board repeatedly relies upon to support its conclusion that Reinhart's going-concern and ability-to-hold evaluations were "inadequate"—Reinhart's analysis of the margin calls received during the Subsequent Period, the Company's readily available liquidity and protection against future margin calls as of the audit report date, and management's prediction of securities values and related margin call activity in the future—all relate to one topic, the Company's ability to manage its liquidity in the face of margin calls.

The Board also suggests that Reinhart committed misconduct by combining the liquidity analysis into one memo, because she "engaged in no differentiated audit analyses" of that information in making the two evaluations. Sur-Reply 17. This is simply untrue. While it is true that the KPMG Memo, which contained a thorough analysis of the Company's liquidity management, was used as a basis for both conclusions, there were differences in how that information informed Reinhart's going-concern and ability-to-hold conclusions. For instance, the stress-testing section of the KPMG Memo analyzed whether the Company would be able to survive as a going concern in scenarios where the Company would be forced to sell assets—a scenario obviously at odds with an ability-to-hold analysis—and KPMG concluded that, even in those extreme circumstances, the Company would survive as a going concern for a reasonable period of time. J-19 at 5-6. In contrast, KPMG's conclusions about the Company's ability to hold were not premised on the potential sale of assets, but on Thornburg's ongoing ability to manage liquidity. J-5 at 9. The Board criticizes this as an inconsistency, Sur-Reply 16-17, but the record makes clear KPMG's expectation was that the Company would be able to manage its liquidity and meet margin calls, and the stress testing was an extra check the audit team applied to the going-concern evaluation, Reply 17.

Perhaps recognizing the weakness of its argument, the Board now argues, for the first time, that "[t]here is no OTTI/ability-to-hold evaluation in the work papers." Sur-Reply 16.

This again is untrue. The Thornburg Memo analyzed the Company's ability to hold and concluded that the Company's ability to hold was supported by its ongoing profitability, liquidity position, and ability to continue to make margin calls. J-21 at 10. After reviewing the Thornburg Memo and finalizing the KPMG Memo, KPMG concluded that the Company had the ability to hold the securities to maturity or recovery. J-5 at 9. KPMG's ability-to-hold evaluation was further supported by other audit evidence, including consideration of every relevant factor identified by the applicable auditing standard, AU 332. Br. 28-29.

Thus, Reinhart's analysis of Thornburg's liquidity management involved a single course of conduct that informed both the going-concern and ability-to-hold evaluations.

II. <u>Reinhart's Conduct Did Not Result in Repeated Instances of Negligent Conduct.</u>

The second issue the Commission asked the Board to address is why the "individual audit tasks" underlying Reinhart's alleged violations constitute "repeated instances of negligent conduct" instead of a single instance of Reinhart being "negligent in failing to adequately consider, in light of contrary evidence, whether the company had sufficient readily available liquidity to meet its financial obligations." This question overlaps with the first, and much of the discussion above is equally pertinent here. But the Board uses its response to this question to set out the legal precedent it relies upon. In fact, the two cases cited by the Board do not support its position, and instead support Reinhart's position that the facts do not show "repeated instances" of alleged misconduct. Indeed, there is no case where the Commission has upheld the serious sanctions imposed here based on similar facts.

The Board starts by claiming that "[u]nder SEC precedent, individual audit tasks in <u>one</u> audit area . . . can constitute repeated instances of negligent conduct." Sur-Reply 18. This is not true, and the cases the Board cites indicate the opposite. While *Dearlove* demonstrates that there can be "repeated instances" of negligent conduct in one *audit*, the SEC's opinion detailed how

Dearlove engaged in unreasonable conduct in four entirely distinct *audit areas*. *Gregory M. Dearlove, CPA*, SEC Rel. No. 34-57244, 2008 WL 281105 (Jan. 31, 2008). First, Dearlove allowed Adelphia to present only a net figure for related-party payables and receivables, in violation of FIN 39, which hid more than $1 billion in related-party obligations, "without devoting any attention to the matter." *Id.* at *8-*9, *28. Second, Dearlove "summarily approved" Adelphia's accounting for $1.6 billion in related-party contingent debt after a "cursory review"; "fail[ed] to test any of several assumptions underlying his conclusion that Adelphia was unlikely to have to repay that debt," and "acquiesced in management's formulation of the disclosure," which violated FAS 5. *Id.* at *15, *28. Third, Dearlove "did not himself review, or ensure that his team reviewed, three significant reclassifications of related party debt that did not comply with GAAP and that should have been subject to careful attention as post-closing journal entries," violating FAS 125. *Id.* at *21-*22, *28. And fourth, Dearlove approved the accounting treatment for two sizeable direct placements of Adelphia stock with related parties, in violation of FAS 125, "without inquiring about . . . the specifics of those transactions." *Id.* at *28.

Dearlove is thus easily distinguishable, and provides no support for a finding of "repeated instances" here. The Commission found the misconduct in *Dearlove* was "extensive," "not just with respect to one auditing area, but several." *Id.* at *29. The Commission emphasized that "Dearlove repeatedly engaged in at least unreasonable conduct during his audit of four critical areas of Adelphia's financial statements." *Id.* at *28. *See also id.* at *30 ("Dearlove engaged in repeated instances of at least unreasonable conduct during his audit of four critical areas"). Moreover, each of those audit areas was distinct and unrelated, and the nature of Dearlove's errors was egregious. *Id.* at *28 (noting "frequency and gravity of Dearlove's negligent failures"). Dearlove failed to perform basic audit procedures in four critical areas, and the Commission sanctioned Dearlove for failing to take steps that GAAP and GAAS explicitly required. *Id.* at *28-*29. Unlike the Board here, the Commission was not quarreling with a well-conceived audit approach, picking apart audit documentation, inventing new audit procedures in hindsight, or second-guessing good faith auditor judgments.

Finally, the Commission found that "no reasonable auditor could conclude that Dearlove satisfied" his professional obligations. *Id.* at *29. In contrast, as discussed further below, Reinhart's conduct *was* reasonable: Reinhart focused on the going-concern and ability-to-hold issues throughout the audit, planned, supervised, and executed extensive audit procedures relating to each issue, consulted with senior partners at KPMG regarding those issues, and exercised good faith audit judgment in reaching her conclusions. John Lawton, an audit partner at PricewaterhouseCoopers and an expert on the going-concern and ability-to-hold issues, explicitly found that Reinhart's conduct was reasonable. R-160; Tr. 2146-47. In contrast, the Division's expert had no public company auditing experience since Sarbanes-Oxley became law, had never issued a going-concern opinion, and suggested alternative procedures that were entirely unreasonable. ID at 35; Tr. 1351.

The Board also cites *John J. Aesoph, CPA*, SEC Rel. No. 34-78490, 2016 WL 4176930 (Aug. 5, 2016), but *Aesoph* similarly provides no support for its position. In *Aesoph*, the Commission found that respondents violated PCAOB auditing standards in three areas relating to their audit of TierOne Bank: (1) their audit of the bank's internal controls over financial reporting; (2) the substantive audit work on the bank's allowance for loan and lease losses ("ALLL"); and (3) their failure to take any steps to address their post-audit discovery of appraisals that called into question their audit opinion. *Id.* at *6. The Board claims that *Aesoph* involved "only one audit area" (*i.e.*, related to ALLL), Sur-Reply 19, but this oversimplifies the Commission's decision which, before it could reach a determination of "repeated instances," found that the negligent conduct took place in three distinct areas involving two distinct time periods: the substantive audit work on the ALLL account; audit of internal controls over loans; and, after the audit itself had been completed, the auditors' failure to take any action when they became aware of appraisals that should have called their audit opinion into question. It was the "recurrence of unreasonable conduct *in so many audit areas* concerning the ALLL" that the Commission found "demonstrate[d] a lack of competence." *Id.* at *16 (emphasis added).

Indeed, perhaps the most important aspect of *Aesoph* is that the Commission – while finding that respondents' audit work on the ALLL was negligent in numerous respects and violated several different auditing standards – nevertheless grouped all the defects in this area together as merely *one* of the "instances" of negligent conduct on which its decision rested. *Id.* at *9-*12. The Commission found that Aesoph violated AU 328 and AU 342 by failing to inquire why no discount was taken on numerous FAS 114 loans for which appraisals were stale; failing to note any exceptions in the FAS 114 testing, even where many estimates were based on undiscounted stale appraisals; failing to note that Tier One's procedures for determining when an appraisal was current were inconsistent with KPMG's testing standards; accepting that management's fair value estimates were reasonable, without questioning them or obtaining corroborating evidence; and documenting that "market conditions have not materially deteriorated," even though they knew that the market had dropped drastically. *Id.* at *10-*11. Yet the Commission treated all of these manifestations of negligent conduct as merely *one* instance – all relating to the substantive audit work on the ALLL – in determining whether there were "repeated instances." The same logic compels the conclusion that Reinhart's alleged failures here – which are far more closely related to her handling of a single issue, Thornburg's ability to manage its liquidity and satisfy margin calls – also constitute a single "instance" of allegedly negligent conduct.

It is also important to note that the Commission's decision in *Aesoph* was largely based upon finding a *lack* of audit work on the part of respondents, *e.g.*, finding that the respondents failed to obtain evidence as to why appraisals were not discounted, *id.* at *9-*10; identified no controls addressing an identified risk of collateral overvaluation, *id.* at *8-*10; and, "perform[ed] *no procedures* when they discovered two new appraisals" that raised serious questions about their audit opinion, *id.* at *13 (emphasis added).

Unlike *Dearlove* and *Aesoph*, the issue here is not that Reinhart performed no audit procedures or obtained no audit evidence in multiple audit areas. Instead, the Board faults Reinhart's analysis of Thornburg's liquidity, and the audit procedures performed, simply because they were allegedly "inadequate." FD 2, 56-57, 59-60. The Board's approach is unprecedented, and inconsistent with other Commission decisions analyzing the "repeated instances" prong of Rule 102(e). The reported decisions typically involve auditor misconduct on more than one engagement, involving multiple clients and/or audit years. This includes the only other case that the Board cites, *S.W. Hatfield, CPA*, SEC Rel. No. 34-69930, 2013 WL 3339647 (July 13, 2013), which involved pervasive audit violations on two audit clients for multiple audit years. Most other cases involving "repeated instances" are similar in scope. *See, e.g.*, *David S. Hall, PC*, SEC Rel. No. 1114, 2017 WL 894965, at *27 (Mar. 7, 2017) ("repeated instances" during seven audits and nineteen reviews); *Philip L. Pascale, CPA*, SEC Rel. No. 34-51393, 2005 WL 636868, at *1, *13 (Mar. 18, 2005) ("repeated instances" during audits "for the fiscal years ending June 30, 1999, through December 31, 2001"); *Ernst & Young LLP*, SEC Rel. No. 249, 2004 WL 824099, at *53 (Apr. 16, 2004) ("repeated instances" during "audits from fiscal years 1994 through 1999"). And the reported decisions involving a single audit year typically describe misconduct far more egregious than presented here. *See, e.g.*, *Halpern & Associates LLC*, SEC Rel. No. 939, 2016 WL 64862, at *1, *26 (Jan. 5, 2016) (finding "repeated instances" where respondents did not properly plan, staff, or supervise audit, and placed non-CPA, "with no auditing experience and no knowledge" of key issues in charge of "critical" tasks).

The Board concludes this section of its Sur-Reply by reprising again its same criticisms of Reinhart's handling of the liquidity/margin call issue: her alleged failure to adequately assess Thornburg's readily available liquidity or challenge management's representations on that issue; her alleged failure to adequately track Thornburg's margin calls; her alleged failure to take into account the possibility that Thornburg's securities would decline by 2-3% in the near term; and her alleged reliance on the 7% "cushion" that Thornburg was required to maintain under its agreements as a potential source of liquidity to meet margin calls. Sur-Reply 19-21. The Board insists that these are "multiple varied, compounding and high-stakes instances of negligence." *Id.* at 20. We address each of these claims in the next section, but the important point for the "repeated instances" issue is that each of these alleged audit failures arose during a limited ten-day period in the Subsequent Period and relates to a single issue, whether Thornburg had the ability to manage its liquidity in order to meet its obligations, including margin calls. At most, they amount to a single instance of allegedly negligent conduct.

III. Reinhart's Approach to the Going-Concern and Ability-to-Hold Evaluations Was Reasonable.

The Commission's third question asks the Board for its response to Reinhart's argument that her audit represented a "reasonable approach" to the going-concern and ability-to-hold evaluations. In response, Sur-Reply 1-15, the Board does not really address KPMG's overall audit approach, and does not answer the Commission's question. Instead, the Board repeats once again its same criticisms of the audit team's evaluation of Thornburg's liquidity in the Subsequent Period. The Board has missed the point.

As the Commission has noted, there is "room for debate among auditors regarding the best way to tailor an audit," *Dearlove*, 2008 WL 281105, at *29, and many auditing standards provide "some leeway over the specific actions to be taken in a particular case," *Aesoph*, 2016 WL 417693, at *13, as the applicable auditing standards here (AU 341, 332, and 560) explicitly do. AU 341.02, 06 (going-concern evaluation "based on [auditor] knowledge of relevant conditions and events," the significance of which "will depend on the circumstances"); AU 332.47 ("judgment is required in determining whether factors exist that indicate that an impairment loss has been incurred"); AU 560.04 (evaluation of subsequent events "calls for the exercise of judgment"). Thus, even the fact that an auditor does not follow what might be called "best practices," or chooses one approach over an alternative that (with the benefit of hindsight) might have been preferable, does <u>not</u> mean that the auditor's approach was unreasonable. The Commission's decision in *Kevin Hall, CPA*, SEC Rel. No. 34-61162, 2009 WL 4809215 (Dec. 14, 2009), makes that clear. Even though the Commission in *Hall* "[did] not believe that . . . Respondents' conduct exemplifies best audit practices," the Commission was still "unable to conclude that Respondents' conduct . . . was unreasonable." *Id.* at *9.

Reinhart's approach to the Thornburg audit was reasonable, even though the Board thinks Reinhart should have done certain things differently. Unlike the other Rule 102(e) cases the Board cites, this is not a case where the audit team did nothing on a key issue or violated clear auditing standards. Reinhart and her team identified the going-concern and ability-to-hold issues as significant audit issues, developed a plan to address them, executed that plan, documented the relevant considerations, consulted with other senior KPMG audit partners, and reached a professional judgment that Thornburg had the ability to hold its available-for-sale securities and that there was no substantial doubt about Thornburg's ability to continue as a going concern—conclusions that, to this day, the Board does not question. ID 36-37, 77; Tr. 1494-98. Reinhart's approach to both issues was reasonable, and in compliance with the applicable auditing standards, AU 341 and AU 332, and she should not be sanctioned for her conduct.

A. Reinhart's Going-Concern Approach Was Reasonable

Reinhart's approach to the going-concern evaluation is summarized in her Opening Brief, at 9-13. In sum, Reinhart identified the going-concern issue during the third quarter of 2007 (after the August 2007 event), and requested that Thornburg prepare a document to support its position that it had the ability to continue as a going concern, J-33; Reinhart requested Thornburg to update that analysis for the year-end audit, J-21; Reinhart and others at KPMG, including the In-Depth Review Partner and Senior Manager, reviewed and commented on that year-end analysis; Reinhart directed the Senior Manager to prepare an analysis of the Thornburg Memo and KPMG's own evaluation of Thornburg's ability to continue as a going concern, the KPMG Memo, J-19; and Reinhart, the In-Depth Review Partner, the SEC Reviewing Partner, and the BUPP Partner all analyzed and commented on the KPMG Memo before Reinhart reached her conclusion on the going-concern issue. The KPMG Memo noted that "[t]he significant risk for the Company, in relation to going concern, is liquidity risk," particularly "the Company's ability to repay or rollover . . . existing short-term debt . . . and whether the Company could survive a situation of high margin calls similar to August 2007." J-19 at 2. The KPMG Memo contained an assessment of the Company's liquidity position as of year-end and in the Subsequent Period, and concluded that there was no substantial doubt about Thornburg's ability to continue as a going concern for a reasonable period of time. The KPMG Memo noted that while it was difficult, if not impossible, to predict future market movements, the Company had taken a number of steps to reduce its exposure to margin calls, had demonstrated access to a variety of sources of funds to meet potential margin calls, and, even in the most extreme of circumstances, would still survive as a "going concern." J-19 at 3-7.

Reinhart's approach focused on these aspects of Thornburg's successful management of its liquidity in the aftermath of the August 2007 event. Because predicting the timing and volume of future margin calls and measuring the daily changes in readily available liquidity cannot be done by simply "look[ing] at the actual primary books and records" of a company on February 27 or any other day after year-end, Sur-Reply 4 n.1, Reinhart's approach did not focus on the precise amount of cash that Thornburg had in its bank account on the final day of the audit, the approach that the Board now claims was required. Reinhart's approach was found reasonable by three other senior partners at KPMG, and by her auditing and accounting expert, John Lawton, R-160.

In arguing that Reinhart's approach was not reasonable, the Board says nothing about any of this and does not address Reinhart's approach. Instead, the Board repeats the same baseless criticisms of Reinhart's assessment of Thornburg's changing daily cash position and ability to meet margin calls that the Board has relied upon throughout these proceedings.

First, the Board returns to one admitted error in one sentence of the KPMG Memo. Sur-Reply 2-3. The KPMG Memo correctly noted that, as of December 31, 2007, Thornburg had "collateral in excess of debt of 7%" – the 7% representing the margin requirement on its debt (referred to interchangeably as the haircut, cushion, or overcollateralization, *see* Tr. 974) – "plus another 4.5% in cash and liquid, unpledged investments." J-19 at 5. The next sentence reads: "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 (because they could not satisfy margin calls)." *Id.* As Reinhart has already explained, Reply 12-13; Tr. 236, the 7% margin requirement was not available to satisfy future margin calls, and thus this sentence should have stated that, as of year-end, a decline greater than 4.5% (not 11.5%) would require the Company to raise more capital or sell assets.

But there is no evidence that this is anything more than an error in drafting the Memo, and there is no evidence that Reinhart or anyone else at KPMG actually believed that the 7% margin requirement was available to meet margin calls. The Board's attempt to convince the Commission otherwise is disingenuous and based on mischaracterizations of the record. The Board argues that "[t]he auditors themselves affirmatively developed the point about the 7% 'cushion,' calculating it to be $900 million," Sur-Reply 2, but this is simply untrue. While $900 million may be a reasonable approximation of how much the 7% cushion was, no one at KPMG calculated that amount, and no one at KMPG relied on the availability of this $900 million to meet margin calls. The first time this "$900 million" number appeared was when *the Board* calculated and relied on it in the Final Decision. FD 34.

In contrast, all of the calculations by Thornburg and KPMG were based on the 4.5% figure for the amount of cash and liquid assets at year-end that Thornburg could in fact use to meet margin calls. The Thornburg Memo recognized that 4.5% was the correct figure. J-21 at 5 ("The $587.2 million provides an estimated protection against additional margin calls for up to 4.5% decrease in the market price of the assets collateralizing the short-term borrowings."). And so did the KPMG Memo, earlier on *the same page* on which the error appears. J-19 at 5 ("As of December 31, 2007, the Company had securities valued at $12.8 million [sic] held as collateral for the $11.9 billion of rev repo and CP debt, which is collateralization of approximately 107%.

The Company also had cash and unpledged securities of $587 million, providing additional protection against margin calls for changes in fair value of the securities up to a 4.5% decrease in the market price of the pledged securities."). If Reinhart and her team thought that Thornburg had an additional $900 million to meet margin calls, that information would have been mentioned in the KPMG Memo. It is not.

Moreover, the two sentences at issue merely described the position of the Company as of year-end. Circumstances had changed since year-end, but the KPMG Memo recites (correctly) that as of the date of the memo, "the Company maintain[ed] the 7% cushion" by meeting its margin calls during the Subsequent Period. J-19 at 5-6. The Board claims that this reference to a "cushion" in the KPMG Memo meant that KPMG was relying upon the 7% as "additional protection against additional margin calls," Sur-Reply 2-3, but that is not how the audit team used that term, Tr. 974 (and the Board knows it). This reference to the "7% cushion" was simply another way of stating, accurately, that during the Subsequent Period, Thornburg had successfully maintained the 7% over-collateralization required under its agreements. *Id.*

The Board next takes issue with KPMG's procedures relating to Thornburg's cash balance at the end of the Subsequent Period. Sur-Reply 3-5. First, it is important to emphasize that the going-concern evaluation prepared by Reinhart and her team was not dependent upon Thornburg having, and KPMG confirming, some specific amount of cash at the end of February. KPMG took a broader approach that focused on Thornburg's ability to manage its liquidity on an ongoing basis, including its demonstrated ability to generate cash through operations, securitizations and equity offerings. Br. 37-38. Thornburg's cash balance at the end of the Subsequent Period was included in the analysis, but it was one of many factors that the team considered in the going-concern evaluation. Many of the Board's criticisms thus disregard that

KPMG's overall approach was sound and that the specifics the Board points to were not required audit procedures under PCAOB standards, nor considered by Reinhart to be of critical importance at the time (and seem more important only with the benefit of hindsight).

In any event, there is no merit to the Board's criticisms. Contrary to the Board's claims, Reinhart and her audit team *were* monitoring Thornburg's cash and available securities: the KPMG Memo noted that Thornburg had ~$45.5 million in cash as of February 22, J-19 at 5, and the Completion Document noted ~$150 million in cash and available securities as of February 27, J-5 at 23. KPMG did perform audit procedures to test these approximate amounts, though not the hypothetical procedures the Board now insists were required. KPMG obtained the estimate of ~$150 million as of February 27 from management inquiry – a valid audit procedure under AU 560 – and the Senior Manager corroborated that estimate and found it to be reasonable. Reply 12. The Board criticisms that Reinhart "did not test that figure" and "lacked clarity" on the readily available liquidity at the end of the Subsequent Period, Sur-Reply 5, are unrealistic and mistakenly assume that the liquidity position of the Company could be precisely determined at any moment in the Subsequent Period. This is not true; there is a reason why the Commission provides 60 days for companies to close their books-and-records and file audited year-end financial statements. The Board claims that "[t]he $31.6 million Thornburg mustered the next day, faced with $157.5 million in margin calls, underscores the shoddiness of the estimate," Sur-Reply 5, but there is no evidence to support this claim. There is no evidence that Thornburg exhausted *all* of its available cash and securities the following day to meet its margin calls, nor any logical reason why it would do so.

Under the Board's simplistic view, Thornburg would have only been able to continue as a going concern if it had readily available liquidity on February 27 sufficient to satisfy margin calls resulting from an estimated 2-3% drop in securities values the next day. There is no basis in the auditing standards for this position, and it ignores Thornburg's historical ability to raise funds and manage its liquidity, which Reinhart and her audit team had observed since the August 2007 event. For example, Thornburg had only approximately $587.2 million dollars of readily available liquidity as of December 31, 2007, J-1 at 55, yet was able to pay nearly $1 billion dollars in margin calls during the Subsequent Period, J-35.

The Board spends much of its Sur-Reply discussing Thornburg's prediction "that the likelihood that collateral values decrease by more than another 2 to 3% is remote," J-19 at 6. Sur-Reply 5-9. The Board now claims that Thornburg told KPMG that a further 2-3% decline in the value of its securities was "possible," Sur-Reply 5, backing off its previous (and strongly emphasized) claim that management said that such a decline was "reasonably possible," FD 37, 44, 60, 67-68, 90, 93. It is not at all clear that Thornburg ever made any such prediction of a 2-3% drop in securities values, Reply Br. 4-6; as Reinhart testified, management's statement that the likelihood of any further decline was remote was instead a reassuring indication that market prices were stabilizing. Tr. 244-45. The In-Depth Review Partner testified that this view was consistent with that of another client, who confirmed that the market was stabilizing at that time. Tr. 1716, 1773.

Nevertheless, the Board chastises Reinhart for not calculating whether Thornburg could meet margin calls associated with a 2-3% decline (arguably $250-$375 million). Sur-Reply 6. The Board's argument misses the whole point of KPMG's approach. As already discussed, KPMG was not relying on some specific dollar figure for readily available cash in determining whether Thornburg would be able to continue as a going concern. The team was evaluating Thornburg's ability to manage its liquidity. And as Reinhart testified, Thornburg believed "that the collateral would not further decline at a rate that [Thornburg] would not be able to manage its liquidity," Tr. 243, a conclusion supported by their going-concern evaluation.

Moreover, KPMG *did* corroborate the statement that the likelihood of market prices falling by more than 2-3% was remote. It was corroborated by multiple people at Thornburg, in separate conversations, and was consistent with other work that the audit team had already performed. Reply 7. In particular, the audit team had evaluated Thornburg's collateral and concluded that it was still of a very high quality, with extremely low delinquency rates. *Id.* And at current market prices, Thornburg's securities would provide an overwhelming return to investors, supporting the conclusion that prices were bottoming out. *Id.*

Finally, the Board again criticizes Reinhart for her failure to request and/or review additional detail about the margin calls the Company received in the Subsequent Period. Sur-Reply 9-11. First, the Board criticizes Reinhart for failing to obtain a list of all margin calls received and paid during the Subsequent Period. Sur-Reply 9-10. While Reinhart and the Senior Manager discussed obtaining such a list, and the Senior Manager made that request, Tr. 295-96, 300, the request was not "critical" to KPMG's going-concern evaluation, as the Board claims, Sur-Reply 9; the request was made, along with others, as part of KPMG's broad information-gathering process around Thornburg's management of its liquidity during the Subsequent Period, in accordance with AU 560. When the Company informed the Senior Manager that it did not keep track of its margin calls in the form requested, Reinhart did not deem it necessary to follow up at that time. Tr. 303-04. In contrast, when the amount of margin calls paid during the last two weeks of February was going to be included in the Subsequent Events footnote in the 10-K, Reinhart *did* deem it necessary to request, and obtain, a list of margin calls to support that disclosure, and KPMG did so. Tr. 308-09, 314-16, 849-50. If Reinhart felt that a list of margin calls for the full Subsequent Period were "critical," she would have made sure that the Company provided one, just as she did for the Subsequent Events footnote.

Next, the Board criticizes Reinhart for failing to review the margin call schedules that KPMG did obtain for the purpose of tying out the Subsequent Event footnote in the 10-K, J-1 at 40-42. The Board argues that the schedules contained "vitally important content," "clear on their face," allegedly showing that Thornburg was "untimely" in paying margin calls "over multiple days," and "may have been selling assets to meet margin calls." Sur-Reply 10. The Board's argument that Reinhart "ignored that information" (Sur-Reply 11) is unfounded. Reinhart did not *see* those margin call schedules until the restatement period, and without evidence that Reinhart saw this information, the Board cannot conclude that it was unreasonable for her to have failed to follow up on it. *See Hall*, 2009 WL 4809215, at *10 (finding that "[w]ithout evidence that [Respondents] saw" certain documents, "we cannot conclude that it was unreasonable for Respondents to have failed to follow up on those red flags" and that "Respondents cannot be found to have failed to exercise due care or maintain an attitude of professional skepticism with respect to the information"). Moreover, the Board failed to introduce any evidence to explain the content of the schedules. The Board argues that the schedules showed on their face that Thornburg was "untimely" in paying margin calls, Sur-Reply 10, but whether these payments were untimely would depend on the payment terms Thornburg had negotiated with its counterparties, and there is no evidence on that issue. The Board also speculates that the schedules indicated that Thornburg "may have been selling assets to meet margin calls," *id.*, but presented no evidence to support that claim.

In any event, Reinhart did not act unreasonably in not reviewing the schedules. KPMG requested and obtained that list in support of the Subsequent Event footnote disclosure relating to the total amount of margin calls met by Thornburg since February 14, Tr. 316, 849-50, and the schedule was reviewed, appropriately, by a KPMG staff accountant and manager, who confirmed that the schedule supported the information in the note. J-1 at 40; Tr. 850-52. Contrary to the Board's claim (Sur-Reply 11), Reinhart did not rely solely on management representations – in both the Thornburg Memo, J-21, and the management representation letter, J-4 – that Thornburg was meeting its margin calls. Reinhart reviewed other audit evidence from the Subsequent Period related to the Company's assertion. The KPMG Memo noted that Thornburg had rolled over 69% of its rev repo debt during the Subsequent Period, indicating that there were no outstanding margin calls. J-19 at 4; Tr. 401, 608. KPMG also received confirmations from Thornburg's outside counsel, which did not indicate any outstanding claims by rev repo counterparties. J-16; J-17; R-306; Tr. 619-24.

Finally, the Board's emphasis on the margin call schedules ignores the fact that the number of margin calls already met – whether in the last two weeks of February, the Subsequent Period, or all of 2007 – was not predictive of potential future margin calls, a simple economic truth that the Board refuses to accept. Tr. 2057-64.

B. Reinhart's Ability-to-Hold Approach Was Reasonable

Reinhart's approach to the ability-to-hold evaluation was also reasonable, as Reinhart explained in her opening brief. Br. 13-15, 28-29. Thornburg's asserted basis for its ability to hold was "its ongoing profitab[ilit]y, liquidity position and ability to continue to make margin calls," as discussed in the Thornburg Memo. J-21 at 10. The KPMG Memo analyzed the assertions in the Thornburg Memo, and KPMG concluded that "consistent with the going concern analysis performed by the Company, the Company appears to have the intent and ability to hold the securities to maturity or recovery." J-5 at 9. In evaluating the Company's assertion, Reinhart and her team obtained audit evidence about every relevant factor identified by the applicable auditing standard, AU 332, Br. 28-29, and also considered each of the factors relied upon in the Thornburg Memo, *i.e.*, Thornburg's ongoing profitability (J-19 at 2, 7), liquidity position (*id.* at 5, 7), and ability to continue to make margin calls (*id.* at 4-6).

The Board claims that Reinhart did "next-to-nothing" to analyze the Company's ability to hold its available-for-sale securities, and that the KPMG Memo "said nothing about ability to hold." Sur-Reply 12. According to the Board, "[t]here is no OTTI/ability-to-hold evaluation in the work papers," *id.* 16, and it was only "[i]n testimony [that] Reinhart attempted to divine an OTTI/ability-to-hold evaluation from the going-concern memo." *Id.* 12. These claims are again untrue. The work papers on ability-to-hold explicitly reference the going-concern analysis. D-47 at 8 ("The Company does believe that it has the intent and ability to hold all their securities to maturity as discussed in the going concern analysis at GB G10 series."); J-5 at 9 ("[C]onsistent with the going concern analysis performed by the Company, the Company appears to have the intent and ability to hold the securities to maturity or recovery."); Tr. 130-34. This was not something that Reinhart created in her testimony. Rather, Reinhart simply confirmed it at the hearing. As she explained: "The analyses were pulled together into one document, but the analysis of intent and ability was – was predicated on an understanding of the types of assets and – and activities that the company had undertaken to be able to hold those assets, which we described in our going concern memorandum." Tr. 133.

The Board argues that "[a] complete overlap of the separate, distinct evaluations of going concern and OTTI/ability-to-hold was not a reasonable approach," and points to the stress-testing section of the going-concern analysis as the prime example. Sur-Reply 12, 14. Reinhart has already addressed this point in her reply brief, Reply 16-17, and the record is clear. Those sections of the KPMG Memo were hypothetical scenarios, added at the request of the BUPP

Partner to "stress" the going-concern conclusion, and had no bearing on the ability-to-hold analysis. *Id.* As Reinhart's expert John Lawton further clarified, auditors are not required to predict future market movements when analyzing ability to hold (though the Board thinks otherwise), so these hypothetical scenarios would not have made sense in the ability-to-hold context. *Id.* Further, as already discussed, the KPMG Memo was intended to address both the going-concern and ability-to-hold issues because the primary driver of each evaluation was the same: whether Thornburg would be able to manage its liquidity in order to meet its financial obligations, particularly margin calls. But KPMG's conclusion as to each was separate. *Compare* J-19 at 7 (finding no "significant doubt on the Company's ability to continue as a going concern"), *and* J-5 at 18-19 (finding that "[m]anagement's conclusion that there is not substantial doubt about the entity's ability to continue as a going concern is reasonable"), *with* J-5 at 9 (finding that "consistent with the going concern analysis performed by the Company, the Company appears to have the intent and ability to hold the securities to maturity or recovery").

CONCLUSION

For all of the reasons stated above, and in Reinhart's prior briefing, the Board's sanctions of Reinhart were improper and this proceeding should be dismissed.

Dated: January 12, 2018

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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	January 12, 2018
PCAOB	

CERTIFICATE OF COMPLIANCE OF
SUR-REPLY BRIEF OF CYNTHIA C. REINHART

Pursuant to Rule 450 of the Commission's Rules of Practice, 17 C.F.R. § 201.450, I hereby certify that the Sur-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 Sur-Reply Brief contains 6,996 words, excluding the Table of Contents and Table of Authorities, which is within the 7,000 word limit.

Dated: January 12, 2018

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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 January 12, 2018

CERTIFICATE OF SERVICE

I hereby certify that on this 12th day of January 2018, I caused to be served via hand delivery the following documents to the recipients listed below.

Documents Served:

1) Sur-Reply Brief of Cynthia C. Reinhart, Dated January 12, 2018

2) Certificate of Compliance of Sur-Reply Brief of Cynthia C. Reinhart, Dated January 12, 2018

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