

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 84983 / January 14, 2019

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 4014 / January 14, 2019

ADMINISTRATIVE PROCEEDING
File No. 3-18967

In the Matter of

**LBB & ASSOCIATES LTD.,
LLP and
CARLOS LOPEZ, CPA,**

Respondents.

**ORDER INSTITUTING PUBLIC
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 4C OF THE
SECURITIES EXCHANGE ACT OF 1934 AND
RULE 102(e) OF THE COMMISSION'S RULES
OF PRACTICE, AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that public administrative proceedings be, and hereby are, instituted against LBB & Associates Ltd., LLP (“LBB”) and Carlos Lopez, CPA (“Lopez”) (collectively, “Respondents”) pursuant to Section 4C¹ of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 102(e)(1)(ii)² of the Commission’s Rules of Practice.

¹ Section 4C provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct.

² Rule 102(e)(1)(ii) provides, in pertinent part, that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

II.

After an investigation, the Division of Enforcement and the Office of the Chief Accountant allege that:

A. SUMMARY

1. For annual audits of years 2012, 2013 and 2014, Respondents engaged in a pattern of improper professional conduct as auditors. Specifically, Respondents failed to comply with Public Company Accounting Oversight Board (“PCAOB”) standards in their audit of Behavioral Recognition Systems, Inc. (now known as Giant Gray, Inc.) (“BRS”) for fiscal year 2012 and in their engagement quality reviews (“EQR”) of the 2013 and 2014 fiscal year audits. Lopez, LBB’s managing partner and majority owner, served as LBB’s engagement partner for the 2012 audit and as its EQR partner for the 2013 and 2014 audits.

2. During the 2012 audit, Lopez did not comply with PCAOB standards regarding: (i) the identification of related party transactions or (ii) the audit procedures required when examining known related party transactions.

3. First, Lopez relied exclusively on BRS’s management to disclose related party transactions to him, despite the fact that he was aware of certain red flags indicating that additional related party transactions existed. As a result, although Blackstone Group, Inc. (“Blackstone”) received payments of approximately \$1.5 million in 2012 and was one of BRS’s largest vendors that year, Lopez failed to apply the audit procedures set forth in AU § 334 and failed to identify those payments as transactions involving a related party controlled by BRS’s then-CEO, Ray Davis (“Davis”).

4. Second, Lopez also failed to comply with PCAOB standards in Respondents’ 2012 audit of known related party transactions because, among other things, he did not (i) properly assess the risks associated with those transactions; (ii) complete audit procedures designed to confirm the business purpose, nature, and extent of the payments made; or (iii) exercise due professional care in performing his audit work. Here, again, Lopez relied exclusively on BRS management to explain an almost three-fold increase in expenses to an individual he knew was related to Davis (“Related Party A”) without, for example, reviewing any invoices or taking any other steps to determine the purpose, nature, and extent of the expenses and their effect on the financial statements.

5. Respondents also failed to comply with PCAOB standards in connection with their EQRs for both the 2013 and 2014 BRS audits. In particular, PCAOB standards prohibit a person who served as the engagement partner on either of the two preceding audits from serving as the EQR partner on an audit. Thus, because Lopez served as the engagement partner on the 2012 BRS audit, Respondents failed to comply with these PCAOB standards when Lopez served as the EQR partner on the 2013 and 2014 audits.

6. By failing to conduct the BRS audits in accordance with PCAOB standards, LBB and Lopez engaged in improper professional conduct.

B. RESPONDENTS

7. LBB & Associates Ltd., LLP, is a PCAOB-registered accounting and auditing firm based in Houston, Texas with approximately 28 public company clients. LBB has two partners and approximately eight accountants on staff.

8. Carlos Lopez, age 55, is LBB's managing partner and majority owner. He is a Certified Public Accountant ("CPA") licensed in Texas and resides in Houston. Lopez served as the engagement partner for BRS's 2012 audit and as the EQR partner for its 2013 and 2014 audits.

C. OTHER RELEVANT ENTITIES

9. Behavioral Recognition Systems, Inc., now known as Giant Gray, Inc., is a private, Texas corporation with its principal place of business in Houston, Texas and has never had an obligation to file audited financial statements with the Commission. BRS was founded in 2005 and sold video analytic software that allowed linked video cameras or other systems to recognize certain abnormal or suspicious events chosen by the user. For all three fiscal years relevant to this Order, Ray Davis served as BRS's CEO and Chairman. On December 14, 2017, the Commission filed a complaint against BRS, Davis, and several relief defendants alleging that BRS and Davis engaged in a fraudulent scheme to divert BRS investor funds for Davis's personal use, including millions of dollars paid to Blackstone, a company controlled by Davis. *SEC v. Davis et al.*, No. 17-cv-03774 (S.D. Tex. Dec. 14, 2017). Davis is now deceased, and Giant Gray was forced into Chapter 7 bankruptcy proceedings in April 2018.

D. FACTS

i. Background

10. Lopez first met Davis when he was working for another audit firm and was assigned to the team responsible for auditing a company for which Davis served as CEO.

11. Years later, after Lopez formed LBB in 2004, Davis hired LBB to conduct a review of BRS's 2009 financial statements. Subsequently, Davis hired LBB to conduct audits for BRS, which LBB did for the years 2010 through 2014. Lopez served as the engagement partner for the 2010 through 2012 audits and, as noted, as the EQR partner for the 2013 and 2014 audits.

ii. Respondents Were Aware that BRS Audits Were High Risk and that BRS Planned to Provide Its Audited Financial Statements to Investors

12. For the 2012 audit, Respondents were aware that BRS was a high-risk audit client based in part on their prior audit work for BRS. BRS had no chief financial officer and relied on a single part-time bookkeeper to maintain its accounting records. BRS never had an audit committee, and the board of directors consisted only of Davis and another BRS executive. As Lopez knew, BRS's board did not hold a single meeting in 2012.

13. At the time of the 2012 audit, Respondents were also aware of control deficiencies in BRS's internal controls, including a lack of any controls over Davis's unrestricted ability to authorize, approve, and direct payments and expenses. Respondents noted in the 2012 audit's Risk Assessment Summary Form that management override of internal controls presented a significant risk in connection with the audit. Respondents further indicated that they would not test or rely on BRS's internal controls during the audit, but rather would base the audit on substantive audit procedures.³

14. Respondents knew when they conducted the 2012 audit and EQRs for the 2013 and 2014 audits that BRS planned to provide its investors with the audited financial statements. Moreover, in each of the signed audit reports for the 2012 through 2014 audits, Respondents stated: "We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States)."

iii. Respondents Failed to Conduct the 2012 BRS Audit in Accordance with PCAOB Standards

a. *Failure to Conduct Audit Steps for Identifying Related Party Transactions*

15. PCAOB audit standard ("AU") § 334.07 provided that determining the existence of related party relationships that are not clearly evident required the application of specific audit procedures.⁴ Such procedures may include evaluating the client's process for identifying related parties, requesting names of related parties from management, and reviewing stockholder lists. (AU § 334.07.) The standard also outlined audit procedures designed to provide guidance for identifying material transactions with unidentified related parties, including reviewing the nature of transactions with major customers for indications of previously undisclosed relationships and reviewing accounting records for large, unusual, or nonrecurring transactions, particularly those transactions recognized at or near the end of the reporting period. (AU § 334.08(e) and (g).)

16. During the 2012 audit, Lopez was aware of several red flags indicating the possible existence of unidentified related party transactions. In particular, in response to an audit questionnaire, BRS claimed that there were no related party transactions in 2012, but Lopez knew that response was not accurate because he was aware of recurring transactions with at least two

³ Under PCAOB standards, the audit procedures performed in response to the assessed risks of material misstatement can be classified into two categories: "test of controls" and "substantive procedures." (AS § 13.10.) For significant risks, the substantive procedures should be specifically responsive to the assessed risks and include tests of details. (AS § 13.11.) On the other hand, if the auditor plans to assess control risk (at less than the maximum) by relying on controls, the auditor must obtain evidence that the controls selected for testing are designed effectively and operated effectively for the entire period during which those controls were relied upon. (AS § 13.16.)

⁴ Citations to "AU" and "AS" refer to PCAOB standards in effect at the time of the conduct discussed herein.

related parties from his work on prior BRS audits. Lopez also identified control deficiencies concerning BRS's authorization of payments, including Davis's unrestricted ability to direct payments.

17. Despite his awareness of these red flags, Lopez did not take any audit steps during the 2012 audit to identify whether material transactions were with related parties. Rather, Lopez relied exclusively on BRS management to identify related party transactions and did not evaluate BRS's procedures for identifying related parties. In fact, BRS had no policies for identifying related parties.

18. In 2012, BRS paid Blackstone approximately \$1.5 million – comprising approximately 9.2% of BRS's total operating expenses – making Blackstone one of BRS's largest vendors for the year. Yet, Lopez did not perform the relevant audit steps outlined in AU § 334 to evaluate whether BRS's payments to Blackstone, which were purportedly for “web site optimization,” involved a related party. For example, Lopez did not review stockholder lists or examine the nature of the transactions between BRS and Blackstone by reviewing the accounting records for large transactions. Similarly, Lopez never requested or reviewed any contract between BRS and Blackstone.

19. Had Lopez conducted the relevant audit steps outlined in AU §§ 334.07 and 334.08, he may have identified that these material transactions involved a corporation created, owned, and controlled by BRS's CEO and Chairman, Ray Davis.

b. *Respondents Also Failed to Conduct Appropriate Audit Steps for Known Related Party Transactions*

20. For known related party transactions, the PCAOB standards required the auditor to apply the procedures he or she considered necessary to obtain satisfaction regarding the purpose, nature, and extent of the transactions and their effect on the client's financial statements. The procedures should be directed towards obtaining and evaluating sufficient appropriate evidence to support BRS's accounting treatment and were required to extend beyond simply an inquiry of management. Specifically, the audit procedures that Respondents should have considered included: obtaining an understanding of the business purpose of the transaction; examining invoices, contracts, and other pertinent documents; determining whether the transactions had been approved by the board of directors; and testing the amounts for reasonableness. (AU § 334.09.)

21. For the BRS audit in 2012, Respondents knew about the related party transactions involving Related Party A and were aware of significant red flags surrounding those transactions. Yet, Respondents failed to take appropriate audit steps to understand their purpose, nature, or effect on BRS's financial statements and simply relied on BRS management's representations.

22. In particular, Lopez was aware that Davis approved the payments to Related Party A, who he knew was related to Davis. Although BRS management disclosed in its notes to its financial statements that Related Party A was paid for consulting services and for efforts selling BRS securities to investors, Lopez knew that there was no written agreement outlining the services

to be provided by, or the fees to be paid to, this related party. Lopez also was aware that BRS's board of directors did not hold any board meetings in 2012, calling into question whether the board had approved payments to Related Party A.

23. Moreover, during the 2012 audit, Lopez conducted an analysis showing that BRS's consulting expenses had increased almost ten-fold from 2011 to 2012, including a three-fold increase in expenses for Related Party A. Specifically, consulting expenses increased from approximately \$113,000 in 2011 to approximately \$1.17 million in 2012 (approximately 7.2% of BRS's total operating expenses for the year). In both years, the majority of BRS's consulting expenses concerned Related Party A. The results of this analysis should have prompted Lopez to conduct additional audit steps, including gathering additional evidence so that Lopez could understand what caused such a significant increase in consultant expenses. Lopez, however, did not complete any such steps.

24. In fact, notwithstanding the red flags outlined above, Lopez failed to obtain any invoices, contracts, or other documents related to payments from BRS to Related Party A. Lopez never determined whether BRS's board of directors had approved the payments. Again, Lopez relied exclusively on BRS's management to explain the nature of the payments to Related Party A, noting in his audit work papers as part of substantive analytical procedures performed that: "Per inquiry, the increase of consulting fee is mostly due to BRS utilized [Related Party A] more this year to help out with investor relations. Appears reasonable as the revenue is not enough to cover the operating expenses and company needs funding through out [sic] the year."

25. In short, Lopez failed to perform any of the audit procedures outlined in AU § 334.09, or any other procedures, and, thus, failed to obtain an adequate understanding of the approximately \$951,000 in 2012 consulting expenses for Related Party A—which comprised approximately 7.7% of BRS's net loss for that year. Accordingly, Respondents had no basis for concluding that the consulting expenses regarding Related Party A were fairly presented in BRS's 2012 financial statements.

c. Other 2012 Audit Failures

26. Respondents failed to comply with other PCAOB audit standards in connection with their work on the 2012 BRS audit.

27. Audit standard AU § 9334 provided that the risk associated with management's assertions about related party transactions is often assessed higher than many other types of transactions because of the possibility that the parties to the transaction are motivated by reasons other than those that exist for most business transactions. (AU § 9334.18.) That audit standard further noted that, the higher the assessment of risk, the more extensive or effective the audit tests should be. (AU § 9334.19.) In addition, AU § 9334 provided: "In assessing the risk of the related party transactions the auditor obtains an understanding of the business purpose of the transactions. Until the auditor understands the business sense of material transactions, he cannot complete his audit." (*Id.*)

28. For significant risks, the PCAOB auditing standard § 13.11 explained that the auditor should perform substantive procedures, including tests of details that are specifically responsive to the assessed risks. (AS §13.11.)

29. Respondents failed to comply with both AU § 9334 and AS § 13.11. Lopez did not assess the audit risk associated with related party transactions at BRS as high during the 2012 audit despite the fact that he was aware of the significant red flags described above, including the lack of contracts and controls regarding management override of payments. Payments to Related Party A, for example, could have been motivated by Davis's desire to funnel money to a relative. Under these circumstances, Respondents should have expanded procedures to obtain audit evidence regarding the services Related Party A performed and how the amounts paid for each service were determined. Had Lopez reviewed invoices from Related Party A, he would have seen that they only generically described the services provided as "Consulting" or "Financial Services" with no other details or descriptions of what services, if any, were performed or how the amounts invoiced were determined. Respondents also failed to conduct audit steps that would have allowed them to understand the nature of the transactions.

30. Moreover, the PCAOB standards memorialized in AU § 329 provided that, when an auditor performs substantive analytical review procedures, its expectations should be "precise enough to provide the desired level of assurance that differences that may be potential material misstatements, would be identified for the auditor to investigate." (AU § 329.17.) The standards also noted that expectations developed at a detailed level generally have a greater chance of detecting misstatement of a given amount than do broad comparisons. (AU §§ 329.17 and 329.19.) Accordingly, the auditor should evaluate significant unexpected differences, and management's responses should ordinarily be corroborated with other evidence. (AU § 329.21.)

31. Respondents failed to comply with AU § 329. In particular, Respondents failed to perform audit steps with sufficient precision to adequately evaluate unexpected differences, including, for example, the significant increase in consulting expenses from 2011 to 2012 that was identified through the analysis described above. For the same reason, Lopez also failed to corroborate management's assertions that significant payments for two related parties (Related Party A and an entity associated with a BRS executive) were made for legitimate business purposes. In fact, Lopez did not apply any substantive audit procedures at all. Rather, he only compared year-over-year changes in total expenses. Establishing expectations and analysis of those changes at a more precise level was required, however, in order for the analytics to be considered substantive audit tests.

32. Additionally, AS § 15 required that the auditor plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion. (AS § 15.04.) Notably, as the risk in an audit increases, the amount of evidence that the auditor should obtain also increases. Ordinarily, more evidence is needed to respond to significant risks. (AS § 15.05.)

33. Respondents did not obtain sufficient appropriate audit evidence in their 2012 audit of BRS and therefore failed to comply with AS § 15. As noted, rather than gather evidence

sufficient to understand the above-described transactions, Lopez instead relied on management's assertions.

34. Lastly, AU § 230 required auditors to exercise due professional care when conducting an audit and preparing a report. (AU § 230.01.) Under AU § 230, auditors were required to maintain an attitude of professional skepticism, which included "a questioning mind and a critical assessment of audit evidence." (AU § 230.07.) The standard noted that gathering and objectively evaluating audit evidence required the auditor to consider the competency and sufficiency of the evidence. (AU § 230.08.)

35. By failing to gather and objectively evaluate audit evidence as described above, however, Respondents also demonstrated their failure to conduct the 2012 BRS audit with due professional care and an attitude of professional skepticism. Therefore, Respondents violated AU § 230.

iv. Respondents Failed to Conduct the 2013 and 2014 BRS EQRs in Accordance with PCAOB Standards

36. As noted, after serving as the engagement partner for the 2012 audit, Lopez served as the EQR partner for both the 2013 and 2014 audits. In order to maintain the objectivity of the EQR partner, PCAOB standards do not permit a person to serve as the EQR partner on an audit if they served as the engagement partner on either of the two prior audits. (AS § 7.8.) Thus, Respondents failed to comply with AS § 7.8 in connection with the EQRs of the 2013 and 2014 BRS audits.

E. VIOLATIONS

Section 4C of the Exchange Act and Rule 102(e)

37. As a result of the conduct described above, Respondents engaged in improper professional conduct within the meaning of Section 4C of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice. Section 4C of the Exchange Act and Rule 102(e)(1)(ii) provide, in pertinent part, that the Commission may censure or deny, temporarily or permanently, the privilege of appearing or practicing before the Commission to any person who is found by the Commission to have engaged in improper professional conduct. Exchange Act Section 4C(b) and Rule 102(e)(1)(iv) define improper professional conduct with respect to persons licensed to practice as accountants.

38. Under Section 4C(b) and Rule 102(e)(1)(iv)(B), the term "improper professional conduct" means one of two types of negligent conduct: (1) a single instance of highly unreasonable conduct in circumstances for which heightened scrutiny is warranted; or (2) repeated instances of unreasonable conduct that indicate a lack of competence.

39. Respondents' failures in the 2012 BRS audit to abide by the applicable professional standards concerning the identification of related party transactions and audit of known related party transactions (articulated in AU § 334 and AU § 9334) constitute multiple instances of highly

unreasonable conduct in circumstances that warranted heightened scrutiny. Those violations, Respondents' other failures during the 2012 audit to conform to applicable professional standards (articulated in AU § 230, AU § 329, AS § 7, AS § 13, and AS § 15), and their failures in connection with the EQRs for the 2013 and 2014 BRS audits (articulated in AS § 7) also constitute repeated instances of unreasonable conduct.

III.

In view of the allegations made by the Division of Enforcement and the Office of the Chief Accountant, the Commission deems it necessary and appropriate that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations; and

B. Whether pursuant to Section 4C of the Exchange Act and Section 102(e) of the Commission's Rules of Practice, Respondents LBB and Lopez should be censured or denied, temporarily or permanently, the privilege of appearing or practicing before the Commission as an accountant.

IV.

IT IS ORDERED that a public hearing before the Commission for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed by further order of the Commission, pursuant to Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.220(b).

IT IS FURTHER ORDERED that the Division of Enforcement and Respondents shall conduct a prehearing conference pursuant to Rule 221 of the Commission's Rules of Practice, 17 C.F.R. § 201.221, within fourteen (14) days of service of the Answer. The parties may meet in person or participate by telephone or other remote means; following the conference, they shall file a statement with the Office of the Secretary advising the Commission of any agreements reached at said conference. If a prehearing conference was not held, a statement shall be filed with the Office of the Secretary advising the Commission of that fact and of the efforts made to meet and confer.

If Respondents fail to file the directed Answer, or fail to appear at a hearing or conference after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310.

This Order shall be served forthwith upon Respondents by any means permitted by the Commission's Rules of Practice.

Attention is called to Rule 151(b) and (c) of the Commission's Rules of Practice, 17 C.F.R. § 201.151(b) and (c), providing that when, as here, a proceeding is set before the Commission, all papers (including those listed in the following paragraph) shall be filed with the Office of the Secretary and all motions, objections, or applications will be decided by the Commission. The Commission requests that an electronic courtesy copy of each filing should be emailed to APFilings@sec.gov in PDF text-searchable format. Any exhibits should be sent as separate attachments, not a combined PDF.

The Commission finds that it would serve the interests of justice and not result in prejudice to any party to provide, pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), that notwithstanding any contrary reference in the Rules of Practice to filing with or disposition by a hearing officer, all filings, including those under Rules 210, 221, 222, 230, 231, 232, 233, and 250 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.210, 221, 222, 230, 231, 232, 233, and 250, shall be directed to and, as appropriate, decided by the Commission, and that any motion for summary disposition shall be filed under Rule 250(a) or (b).

The Commission finds that it would serve the interests of justice and not result in prejudice to any party to provide, pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), that the Commission shall issue a decision on the basis of the record in this proceeding, which shall consist of the items listed at Rule 350(a) of the Commission's Rules of Practice, 17 C.F.R. § 201.350(a), and any other document or item filed with the Office of the Secretary and accepted into the record by the Commission. The provisions of Rule 351 of the Commission's Rules of Practice, 17 C.F.R. § 201.351, relating to preparation and certification of a record index by the Office of the Secretary or the hearing officer are not applicable to this proceeding.

The Commission will issue a final order resolving the proceeding after one of the following: (A) the completion of post-hearing briefing in a proceeding where the public hearing has been completed; (B) the completion of briefing on a motion for a ruling on the pleadings or a motion for summary disposition pursuant to Rule 250 of the Commission's Rules of Practice, 17 C.F.R. § 201.250, where the Commission has determined that no public hearing is necessary; or (C) the determination that a party is deemed to be in default under Rule 155 of the Commission's Rules of Practice, 17 C.F.R. § 201.155, and no public hearing is necessary.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not “rule making” within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary