UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 51607 / April 26, 2005

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2238 / April 26, 2005

ADMINISTRATIVE PROCEEDING
File No. 3-11911

In the Matter of
DELOITTE & TOUCHE LLP,
STEVEN H. BARRY, CPA, and
KAREN T. BAKER, CPA,
Respondents.

ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that public administrative proceedings be, and hereby are, instituted against Deloitte & Touche LLP (“Deloitte”), Steven H. Barry, CPA (“Barry”) and Karen T. Baker, CPA (“Baker”) (collectively, the “Respondents”) pursuant to Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.¹

II.

In anticipation of the institution of these proceedings, each Respondent has submitted an Offer of Settlement (the “Offers”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over them and the subject matter of these proceedings, Respondents consent to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission’s Rules of Practice, Making Findings and Imposing Remedial Sanctions (“Order”), as set forth below.

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

The Commission may censure a person or 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.
III.

On the basis of this Order and Respondents’ Offers, the Commission finds that:

A. SUMMARY

1. This matter concerns improper professional conduct within the meaning of Rule 102(e)(1)(ii) of the Commission’s Rules of Practice by the Respondents in connection with the audit of Just for Feet, Inc.’s (“Just for Feet” or the “Company”) financial statements for the Company’s 1998 fiscal year ended January 30, 1999 (the “1998 financial statements”).

2. Just for Feet’s 1998 financial statements included in its annual report for fiscal 1998 on Form 10-K, filed with the Commission on April 30, 1999, were materially false and misleading, overstated net income and net assets, and failed to comply with generally accepted accounting principles (“GAAP”). Just for Feet falsified its financial statements by (1) improperly recognizing unearned and fictitious receivables and revenue from its vendors, (2) failing to properly account for and to disclose problems with obsolete inventory, and (3) improperly recording as income the value of display booths provided by its vendors. These fraudulent financial statements were also included in a Form S-8 registration statement Just for Feet filed with the Commission on May 3, 1999, through the incorporation by reference of the Company’s 1998 Form 10-K. They were also included in a Form S-4 registration statement the Company filed with the Commission on June 14, 1999.

3. The Respondents reasonably should have known that Just for Feet’s 1998 financial statements had not been prepared in accordance with GAAP. They nonetheless issued an unqualified audit report on Just for Feet’s 1998 financial statements that represented that Just for Feet’s financial statements were free of material misstatements and were presented in conformity with GAAP and that the auditors had adhered to generally accepted auditing standards (“GAAS”) when they performed the 1998 audit. This audit report was included in Just for Feet’s 1998 Form 10-K and was incorporated by reference in the Form S-8 registration statement. The audit report was also included in the Form S-4 registration statement. Deloitte issued consent letters agreeing to the inclusion of its audit report with these registration statements.

4. The Respondents did not comply with GAAS in the conduct of the audit and engaged in improper professional conduct as described herein within the meaning of Rule 102(e)(1)(ii) of the Commission’s Rules of Practice through repeated instances of unreasonable conduct.

2 The findings herein are made pursuant to the Respondents’ Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.
B. RESPONDENTS

5. Deloitte & Touche LLP is a national accounting firm headquartered in New York, New York with offices located throughout the United States, including Birmingham, Alabama.


7. Karen T. Baker, CPA, 43, of Birmingham, Alabama, is licensed as a certified public accountant in Alabama. She joined the Birmingham office of Touche Ross in 1989, becoming a manager in 1995. Baker was initially assigned to the Just for Feet engagement in 1993 as an audit senior and became the Just for Feet audit manager in 1995. She was the audit manager during Deloitte’s audit of Just for Feet’s 1998 financial statements.

C. THE COMPANY

8. Just for Feet, Inc., a Delaware corporation based in Birmingham, Alabama, was a national retailer of athletic and outdoor footwear and apparel. The Company was founded in 1977 and hired Deloitte as its independent auditor in 1993. Deloitte was Just for Feet’s independent auditor when Just for Feet went public in 1994 and audited Just for Feet’s financial statements for the Company’s fiscal years between January 31, 1995 and January 30, 1999. Just for Feet expanded rapidly during these years, showing rising asset, revenue and earnings trends between 1994 and 1998 that reflected this rapid growth. The Company’s common stock was traded on the NASDAQ National Market System. Just for Feet’s fiscal 1998 financial statements included a balance sheet with assets of $689.4 million and an income statement showing net income of $26.6 million, based on revenues of $774.9 million. Just for Feet claimed in its fiscal 1998 Form 10-K that it had become the leading operator of large format superstores specializing in brand-name athletic and outdoor footwear and apparel. In November 1999, only a few months after presenting this positive financial picture, Just for Feet filed for protection under Chapter 11 of the Bankruptcy Code. Deloitte resigned as Just for Feet’s auditor in December 1999, after earning $351,756 in fees for its work on the fiscal 1998 audit. Just for Feet’s bankruptcy case was converted to a Chapter 7 liquidation proceeding in 2000.

9. After Just for Feet filed for bankruptcy protection, it emerged that several of the Company’s officers had been fraudulently increasing its income by using a variety of schemes, at times in collusion with outside vendors who provided false confirmation responses to Deloitte, from at least late 1996 through the filing of the fiscal 1998 Form 10-K in April 1999. The revelation of these schemes has resulted in a number of civil and criminal prosecutions by the Commission and the Department of Justice, respectively.
D. JUST FOR FEET AS A “GREATER THAN NORMAL” ENGAGEMENT RISK AUDIT CLIENT

10. In connection with the audit of Just For Feet’s financial statements for fiscal year 1997, the Respondents identified Just for Feet’s engagement risk as “greater than normal.” One workpaper stated that Just for Feet’s “management accepts high levels of risk, places significant emphasis on earnings, and has historically interpreted accounting standards aggressively.” The workpaper further stated that there had been a “significant number of misstatements noted in past audits.” Another Deloitte audit workpaper assessing fraud and engagement risk stated that Just for Feet’s management appeared willing to accept unusually high levels of risk, appeared to place undue emphasis on achieving the planned amount of earnings or growth targets, had excessive interest to maintain the entity’s stock price through the use of unusually aggressive accounting practices, and engaged in unique and highly complex transactions close to year end. Another Deloitte audit workpaper from fiscal 1997 entitled “Risk Factors Worksheet” indicated that Just for Feet management had “one man rule (autocrat)” and that Just for Feet practiced “creative accounting.”

11. The Respondents were therefore aware of numerous risk factors prior to and during the audit of the 1998 financial statements. The audit workpapers prepared as part of that audit and reviewed by Barry and Baker listed some of the same risk factors that had been identified the previous year and rated the level of audit risk as “greater than normal.”

12. Deloitte maintained a National Risk Management Program for audit engagements assessed to have “much greater than normal” audit risk and for select engagements assessed to have “greater than normal” audit risk. Just for Feet was included in this program beginning in 1997 and continuing after that. Under this program, a Deloitte partner designated as a National Review Partner was to provide an additional level of consultation and review. This partner’s duties included discussing specific risk areas and plans to respond to them, consulting with the engagement and concurring partners, reviewing the audit workpapers concerning risk areas of the engagement, and reviewing the financial statements and Deloitte’s audit report with an emphasis on the identification of specific risk areas as well as the adequacy of the audit report and disclosures regarding these risk areas. At the end of an engagement, the National Review Partner was to complete a memorandum to Deloitte’s National Office confirming that he had completed his duties as National Review Partner and assessing whether adequate attention and resources had been dedicated to the management of the risks of the engagement.

13. The Respondents were also aware of two specific identified audit risk areas that pertained to Just for Feet. Deloitte’s audit procedures manual included a 1996 Risk Alert identifying vendor allowances as a high risk area for retailers in general. The Risk Alert specifically stated that “Although there are variations in practice for the treatment of vendor allowances, we would assume that most allowances would be regarded as a reduction of merchandise cost in order that the inventory is carried at the lowest and most conservative value. However, in practice many retailers will treat allowances for reimbursement of advertising costs and market development as a direct offset to the P&L.” Just for Feet’s disclosed practice was to
treat its allowances as reductions in advertising expense. In addition, “Client Risk Profile” forms prepared by Deloitte concerning Just for Feet for 1997 and 1998 each identified inventory valuation as a risk area.

14. In planning for the audit of Just for Feet’s fiscal 1998 financial statements, the Respondents appropriately identified risks presented by the audit and planned the conduct of the audit to address them. However, the Respondents did not properly implement this plan in that they failed to exercise due professional care and skepticism, failed to obtain sufficient competent evidential matter, and placed undue reliance on estimates provided by Just for Feet’s management. As a result, Respondents improperly stated that they had conducted their audit in accordance with GAAS and that the Just for Feet financial statements were prepared in conformity with GAAP. Further, as to Deloitte, the firm’s National Risk Management Program did not function adequately in connection with this audit.

E. JUST FOR FEET’S 1998 VENDOR ALLOWANCES AND CO-OP RECEIVABLES

15. Just for Feet incurred large amounts of advertising expenses. Most of the Company’s vendors offered financial assistance through unwritten agreements to Just for Feet to help pay for these expenses. This assistance was termed “advertising co-op” or “vendor allowances.” After Just for Feet advertised a product and paid for the advertising, the Company often was required to submit an advertisement to the vendor for approval before a co-op credit was recorded. Each vendor limited the amount of advertising co-op dollars it allowed to Just for Feet over a given period of time because co-op dollars were usually based on the amount of merchandise that Just for Feet purchased from that particular vendor. Another type of co-op described as “discretionary” co-op was only provided at the discretion of the vendor. Still another type of co-op known as “margin enhancement” was provided by vendors to assist retailers when profit margins on goods sold were not as great as expected.

16. Generally, Just for Feet was required by GAAP to refrain from recognizing these vendor allowances and the related receivables until the revenue was earned or realizable. By booking unearned and bogus vendor allowances, often recorded as discretionary or margin enhancement co-op, and by offsetting all of these vendor allowances against advertising expense, the Company overstated its net assets and net income before taxes by at least $19 million for fiscal 1998.

17. The Respondents identified these vendor allowances as a specific identified risk area in which Just for Feet might recognize invalid receivables and income, but nonetheless failed to comply with GAAS by failing to obtain sufficient, competent evidential matter to determine whether these co-op receivables and the related income were actually earned. Deloitte, Barry and Baker were presented with a series of factors that called for heightened professional skepticism. These factors included:

   a. Just for Feet claimed that it had approximately $28.9 million in outstanding co-op credits due to it on January 30, 1999, the end of fiscal 1998. This figure was more than seventy times greater than the $408,000 in outstanding co-op credits due to Just for
Feet at the end of the previous fiscal year. Just for Feet reported total co-op credits of $32.7 million for fiscal year 1998 and $14.4 million for fiscal year 1997.

b. Of the total amount claimed, $23.8 million, purportedly due from forty vendors, was booked with the involvement of a particular Just for Feet Vice-President (the “Vice-President”) who worked in neither the Accounting nor the Advertising Departments.

c. Of this $23.8 million, $14.4 million, equivalent to one-third of Just for Feet’s claimed pre-tax income, was the result of adjustments recorded approximately five weeks after the end of the 1998 fiscal year.

d. Just for Feet’s Director of Financial Reporting brought to Baker’s attention a journal entry recording $11.3 million in co-op receivables on which he noted that the Vice President would provide supporting information to justify recording the receivable. No such information was provided to Respondents.

e. Just for Feet collected none of these purported co-op receivables due to it from the January 30, 1999 end of its fiscal 1998 year through April 23, 1999, the date of Deloitte’s audit report.

f. The Respondents were aware that Just for Feet offset its co-op receivables against advertising expense or cost of sales, allowing them to be used to increase income immediately. This was troublesome because many of the purported receivables were for “discretionary” or “margin enhancement” co-op, both of which depended on merchandise purchases by Just for Feet. In a Risk Alert issued in January 1996, Deloitte specifically identified vendor allowance transactions as a risk factor. The Risk Alert stated, “Although there are variations in practice for the treatment of vendor allowances, we would assume that most allowances would be regarded as a reduction of merchandise cost in order that the inventory is carried at the lowest and most conservative value. However, in practice many retailers will treat allowances for reimbursement of advertising costs and market development as a direct offset to the P&L.” The Risk Alert noted that offsetting allowances against advertising expense could cause a retailer to get “ahead” by reducing its operating expense faster than the allowances were actually earned.

18. The Respondents decided to confirm the receivables claimed from thirteen of the vendors who purportedly owed $22 million of the $28.9 million. As part of this process, the auditors sent out thirteen confirmation requests in March 1999 relating to the claimed receivables. Each letter asked that the recipient confirm that Just for Feet had a credit due of a particular amount as of January 30, 1999 and that these amounts related to advertising that ran or merchandise sold prior to January 30, 1999. Five vendors returned non-standard letters that, instead of unambiguously confirming amounts owed to Just for Feet at the end of the fiscal 1998 year, as requested by the auditors, provided ambiguous information on amounts of co-op that the Company had earned, accrued, or had available during the year. One of the letters affirmatively stated that the “total amount, according to [the vendor allowance] agreement is $741,271.00. No additional funds are due to JFF” and included information listing the credits that had been awarded
during the year. If the Respondents had more fully evaluated this vendor response, they would have seen that it was related to vendor allowances other than those they were trying to confirm. Another vendor returned a confirmation prior to the date of the audit report for only a portion of Just for Feet’s claimed receivable. This vendor returned a confirmation for the amount Just for Feet had earned during the year approximately six weeks after Just for Feet filed its fiscal 1998 Form 10-K. Despite having no written confirmation of the entire purported receivable, the Respondents accepted the amount claimed by Just for Feet. Despite these and other flaws, the Respondents nonetheless accepted these letters as confirming approximately $16 million in receivables claimed by Just for Feet. Certain vendors, acting in collusion with members of Just for Feet’s management, deliberately returned letters that falsely confirmed to Deloitte amounts of co-op receivables that their companies purportedly owed to Just for Feet.

19. The Respondents issued the audit report despite the presence of unresolved questions. In May 1999, an audit senior sent an e-mail message to Just for Feet’s Vice President, which was copied to Barry and Baker, updating the Vice President on the status of the confirmations and noting the need for explanations of discrepancies in the amounts confirmed by some vendors and the lack of responses from others. In early October 1999, another audit senior sent an e-mail message to the Vice-President asking for his assistance in resolving a number of open items that remained from the audit. One of the open items was “Explanations of differences in CO-OP confirmations received and amounts recorded.” Thus, approximately five months after the filing of Just for Feet’s fiscal 1998 Form 10-K, and several months after Deloitte’s audit report was included in Just for Feet’s Forms S-8 and S-4, the Respondents were still attempting to resolve questions concerning co-op receivables that should have been addressed before the auditors issued their report. The Respondents did not perform alternative procedures with respect to differences in confirmation amounts or non-replies sufficient to resolve such questions.

F. JUST FOR FEET’S INVENTORY REPORTING AND OBsolescence RESERVE

20. Just for Feet had a material amount of excess or obsolete inventory at the end of fiscal 1998, but failed to disclose this in its Form 10-K for that year and also failed to adjust its inventory obsolescence reserve to reflect the increase in its excess and unsaleable inventory. The Company left its inventory obsolescence reserve at $150,000, the same level it had been the previous year, despite the fact that its reported inventory almost doubled during fiscal 1998 from $206 million to $400 million. GAAP states that when the utility of goods is no longer as great as cost, due to obsolescence or other causes, the difference should be recognized as a loss in the current period by valuing the goods at market. Just for Feet failed to value its inventory at the lower of cost or market as required by GAAP.

21. The Respondents’ testing of Just for Feet’s inventory and its proposed reserve was inadequate and did not comply with GAAS. Just for Feet and its officers, at the end of fiscal 1998, failed to prepare an aging analysis of the Company’s inventory, a tool for determining obsolescence and in recording the value of inventory at the lower of cost or market. Deloitte’s audit manual provided guidance that auditors should review inventory aging to determine what part of the inventory might be obsolete and, if an aging report did not exist, should inquire as to what
the retailer used to age its inventory so they could measure the quality and performance of the inventory.

22. Deloitte tested Just for Feet’s obsolescence reserve for fiscal 1997 by testing the reasonableness of Just For Feet’s three-prong methodology for determining its reserve: (1) shoe styles and types with only four pairs or less, (2) shoes and apparel selling for less than cost, and (3) items that had not been sold in the previous twelve months. All of these items were to be written down to the lower of cost or market as required by GAAP. For the fiscal 1998 audit, the Respondents documented Just for Feet’s methodology and listed the same three assumptions as elements to be used in determining the reasonableness of the reserve. The Respondents, however, did not effectively test items that had not been sold in the previous twelve months.

23. For fiscal 1998, the Respondents accepted a reserve analysis that was prepared by the Company’s Vice President. This analysis, however, explicitly included only two of the items used in the three-prong test from the previous year. Just for Feet provided no information to the Respondents establishing that this analysis included goods that had not sold within the last year but that had not been written down to the lower of cost or market. Nonetheless, the Respondents accepted this analysis.

24. At the end of its fiscal 1998, Just for Feet stored $11.1 million in merchandise inventory in a warehouse location in northern New Jersey. While the inventory in this warehouse was observed by Deloitte personnel, it was not included in the reserve analysis because this warehoused inventory was not included in the Company’s inventory system, a feature reflected in a Deloitte workpaper. As a result, this inventory was not in the inventory analysis provided by the Vice President and accepted by the auditors.

25. Even using the flawed inventory analysis provided by the Vice President and the deficient inventory information that excluded the goods in the New Jersey warehouse, the Respondents concluded that Just for Feet’s obsolescence reserve should have been in the range of $441,000 to over $1 million. While the Respondents proposed that the obsolescence reserve be increased by $441,000, Just for Feet did not increase its reserve.

G. JUST FOR FEET’S ACCOUNTING FOR VENDOR BOOTH DISPLAYS

26. Just for Feet encouraged its merchandise vendors to set up their own display booths inside Just for Feet stores to showcase products. Although Just for Feet and the vendors held periodic meetings to determine the number of booths each vendor would provide to Just for Feet, there were no written contracts and very little documentation concerning the booths.

27. In December 1996, Just for Feet developed a fraudulent accounting scheme concerning these display booths that enabled it to increase net income. Just for Feet ostensibly began to “buy” the booths it had previously received free of charge from the vendors. The Company did this by having each vendor bill Just for Feet for the booths it supplied while issuing to Just for Feet a corresponding “booth” co-op credit which could be applied against the cost of a merchandise purchase. This credit had the effect of reducing advertising expense and thereby
increasing net income. These booth transactions were so structured for the purpose of generating income, and were not accounted for in conformity with GAAP.

28. For the fiscal 1998 year, Just for Feet changed its process of accounting for booth assets and income to eliminate the involvement of the vendors. During the first month of fiscal year 1998, the Vice President simply estimated the dollar amount of booths that he expected Just for Feet to receive during the year, divided the amount by twelve months, and started recording $174,362 per month of booth income. When it recognized this income, Just for Feet also claimed a corresponding increase in its assets through its “purchase” of the booths. At the October 31, 1998 end of the third quarter, in addition to the $174,362 per month, Just for Feet recorded another $5.2 million of booth income for a total of approximately $5.4 million for that month. Just for Feet then recorded an additional $2.2 million of booth income over the remaining three months of the fiscal year. Although no cash or co-op credits actually changed hands between Just for Feet and the vendors during fiscal year 1998, the Company nonetheless increased its income before taxes by $9 million during that fiscal year, approximately 20% of pre-tax income, through its new method of accounting for vendor booths.

29. Although the Respondents received indications of how Just for Feet was accounting for booths, they failed to respond accordingly. An audit workpaper dated March 25, 1999, described Just for Feet’s accounting methodology for booths. An analysis at the end of the workpaper, which Baker reviewed, showed that the net effect of Just for Feet’s booth-related journal entries was to increase assets with a corresponding increase in income. The Respondents performed no further analysis to determine the basis and propriety of these journal entries. The Respondents accepted management representations that pre-existing co-op credits were being used to pay for the booths and that the booth transactions therefore did not affect net income.

30. Because the vendors did not bill Just for Feet for the booths during fiscal 1998, and because it received no corresponding co-op credits during the year, neither the Company nor the auditors had internal evidence supporting the recording of $9 million of booth assets. To substantiate this $9 million asset amount, the Company’s Vice President or the auditors prepared confirmation requests to the vendors to verify $8.4 million in amounts purportedly owed by Just for Feet for the booths. The Vice President determined the amounts on the requests and another Just for Feet officer signed and sent them to various sales directors and corporate officers of the vendors.

31. The confirmation requests asked the vendors to confirm that “the balance owed by Just for Feet, Inc. as of January 30, 1999 for store booths and fixtures shipped to them during the year ended January 30, 1999 is $[amount varied by vendor].” Although the letters actually were intended to confirm “payables,” the Respondents used the confirmation replies from the vendors to verify the value of the booths on Just for Feet’s books and records. They compiled a running total of these confirmations as they were returned as proof that Just for Feet had purchased the specified amount of booths. The Respondents used the confirmations to support the recorded $9 million booth asset amounts, which was equal to the amount of income Just for Feet had already recorded relating to its acquisition of the booths.
32. As with the co-op receivables, the Respondents also received and accepted ambiguous replies to Just for Feet’s requests that its vendors confirm the amounts Just for Feet purportedly owed for the booths. One vendor, for example, in response to a confirmation request sent a letter stating the value of the booths Just for Feet had received in 1998, but failed to confirm any amount the Company purportedly owed for these booths at the end of the year. A second vendor supplied confirmations for differing amounts thereby causing Respondents to propose an adjustment to the financial statements. Another vendor replied to a confirmation request by stating that Just for Feet had in fact billed the vendor for booth construction costs when Just for Feet’s claim was that it had bought the booths from the vendor. An audit senior reviewed these confirmations and informed Barry and Baker that she was in some cases sending multiple confirmation requests to the vendors because many of their initial responses came back in forms different from that requested. The Respondents failed to discover from these indications that Just for Feet might not actually be purchasing the booths as it claimed.

H. OTHER ASPECTS OF THE JUST FOR FEET AUDIT

33. Just for Feet’s inclusion in Deloitte’s National Risk Management Program required the appointment of a National Review Partner to assist in planning the audit of specific risk areas, review the workpapers related to these areas, review the financial statements and Deloitte’s report regarding these areas and complete a memorandum to the National Office assessing whether adequate attention had been devoted to these risk areas.

34. In connection with the audit of Just for Feet’s fiscal 1998 financial statements, Deloitte did not determine that the National Review Partner had performed his prescribed procedures. There is no documentation showing that the National Review Partner reviewed the audit workpapers relating to the specific risk areas identified for Just for Feet. Moreover, the National Review Partner did not prepare a post-audit memorandum, as required by Deloitte’s procedures, assessing Deloitte’s efforts to address the audit risks associated with the Just for Feet engagement. This lack of a written assessment by the National Review Partner is particularly notable as to Just for Feet’s inventory valuations and vendor allowances, as these were identified as risk areas in the Just for Feet audit.

I. THE RESPONDENTS ENGAGED IN IMPROPER PROFESSIONAL CONDUCT WITHIN THE MEANING OF RULE 102(e) OF THE COMMISSION’S RULES OF PRACTICE

35. Rule 102(e)(1)(ii) of the Commission’s Rules of Practice provides, in 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. Rule 102(e)(1)(iv) defines improper professional conduct with respect to persons licensed to practice as accountants.

36. As applicable here, improper professional conduct means “[r]epeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.” Rule 102(e)(1)(iv)(B)(2). As
stated below, the Respondents acted unreasonably in failing to require Just for Feet to comply with GAAP and in failing to comply with GAAS during its audit of the Company’s fiscal 1998 financial statements.

(a) Professional Care and Skepticism, Evidential Matter and Management Representations and Estimates.

37. GAAS provides that “[d]ue professional care is to be exercised in the planning and performance of the audit and the preparation of the report.” AU § 230.01. Among other things, due professional care requires that an auditor exercise professional skepticism, defined as “an attitude that includes a questioning mind and a critical assessment of the audit evidence.” AU § 230.07. “Gathering and objectively evaluating audit evidence requires the auditor to consider the competency and sufficiency of the evidence.” AU § 230.08. “In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest.” AU § 230.09.

38. GAAS also requires that "sufficient competent evidential matter is to be obtained through inspection, observations and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit." AU § 326.01. “To be competent, evidence, regardless of its form, must be both valid and relevant.” AU § 326.21. In addition, the auditor should recognize "the possibility that the financial statements may not be fairly presented in conformity with generally accepted accounting principles" and should "consider relevant evidential matter regardless of whether it appears to corroborate or contradict the assertions in the financial statements." AU § 326.25. Management representations “are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements.” AU § 333.02.

39. For information obtained through the confirmation process to be competent, it must be reliable and relevant. AU § 330.11. “When the auditor has not received replies to positive confirmation requests, he or she should apply alternative procedures to the nonresponses to obtain evidence necessary to reduce audit risk to an acceptably low level.” AU § 330.31. For accounts receivable, alternative procedures may include an examination of subsequent cash receipts. Alternative procedures for accounts payable may include an “examination of subsequent cash disbursements, correspondence from third parties, or other records to provide evidence for the completeness assertion.” AU § 330.32. Finally, after any alternative procedures have been performed, the auditor should evaluate the combined evidence provided by the confirmations and alternative procedures, considering in particular “the nature of any exceptions, including the implications, both quantitative and qualitative, of those exceptions. . . .” AU § 330.33.

40. AU § 342 provides guidance on obtaining sufficient competent evidential matter to audit significant accounting estimates in an entity’s financial statements. “The auditor is responsible for evaluating the reasonableness of accounting estimates made by management in the context of the financial statements taken as a whole.” AU § 342.04.
41. The Respondents departed from these GAAS standards in each of the areas at issue in the audit of Just for Feet’s 1998 financial statements: (1) the co-op receivables; (2) the reserve for excess or obsolete inventory; and (3) booth accounting.

42. Regarding the co-op receivables, the Respondents failed to exercise professional care and skepticism and failed to obtain sufficient, competent evidential matter either in the form of reliable and relevant confirmations or through alternative means. They accepted certain co-op receivable confirmations as confirming amounts owed to Just for Feet when in fact they contained information that was ambiguous at best about how much co-op the Company had accrued or had available. The Respondents failed to respond adequately to an assertion from one vendor that it owed “[n]o additional funds” to Just for Feet and failed to consider this language as an exception to the confirmation request and its implications. They accepted Just for Feet’s recognition of another co-op receivable it claimed after receiving a written confirmation for only part of the amount claimed; a confirmation for the full amount the Company had earned during the year was finally received seven weeks after the date of the audit report. They performed no alternative procedures, such as determining if any of these claimed receivables had been collected, to verify the amount of receivables Just for Feet claimed. In addition, except to confirm that other vendor allowances were related to “advertising that ran or merchandise sold prior to January 30, 1999,” the Respondents failed to adequately consider whether Just for Feet’s practice of offsetting discretionary and margin enhancement co-op allowances against advertising expense or cost of sales, thus immediately increasing income, complied with GAAP.

43. Regarding Just for Feet’s reserve for excess or obsolete inventory, the Respondents failed to exercise due professional care and skepticism, failed to obtain sufficient, competent evidential matter, substituted management’s representations for such competent evidential matter and, to that extent, failed adequately to evaluate management’s estimates in the context of the financial statements as a whole. They failed to test Just for Feet’s reserve adequately to the extent they accepted a defective obsolescence reserve estimate from management and relied upon an inventory system that failed to include certain warehoused goods.

44. Regarding Just for Feet’s booth accounting, the Respondents failed to exercise professional care and skepticism and failed to obtain sufficient, competent evidential matter in the form of reliable and relevant confirmations or through alternative means. The Respondents did not heed sufficiently indications that Just for Feet may have been improperly recognizing income through the acquisition of vendor display booths and failed to consider that this would mean that the financial statements did not conform to GAAP. They accepted management representations that pre-existing co-op credits were being used to pay for the booths and that the booth transactions therefore did not affect net income. Respondents also accepted confirmations from vendors that confirmed amounts payable by Just for Feet rather than amounts purportedly spent buying the display booths and, in some instances, that contained evidence contradicting Just for Feet’s representations.

45. GAAS requires that an auditing firm should establish “quality control policies and procedures to provide it with reasonable assurance of conforming with generally accepted auditing standards in its audit engagements.” AU § 161.02. An auditing firm should have in place a
process to provide it with “reasonable assurance that its personnel comply with applicable professional standards and the firm’s standards of quality.” AICPA Professional Standards, QC § 20.03. As part of its system of quality control, an audit firm is required to establish policies and procedures to provide it with “reasonable assurance that the work performed by engagement personnel meets applicable professional standards [and] regulatory requirements.” QC § 20.17. In connection with the fiscal 1998 audit, Deloitte’s National Risk Management Program was not adhered to and did not function properly, and so did not determine if identified risk areas had been adequately addressed, despite Just for Feet's status as a “greater than normal” risk client.

(b) Standards of Reporting

46. GAAS provides that “[t]he report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.” AU § 410.01. GAAS also requires that the auditor’s report express an opinion on the financial statements as a whole and contain a clear indication of the character of the auditor’s work. AU § 508.04. An auditor can issue an audit report with an unqualified opinion only if he has conducted the audit in accordance with GAAS. AU § 508.07. The Respondents departed from these GAAS provisions through the expression of the opinion that Just for Feet’s financial statements were presented in conformity with GAAP and through the statement that the auditors had conducted the audit in accordance with GAAS. As discussed above, the Respondents should reasonably have known that Just for Feet’s financial statements were not presented in conformity with GAAP and that they had not conducted their audit in accordance with GAAS.

K. CONCLUSION AND UNDERTAKING

47. Based on the foregoing, the Commission finds that the Respondents engaged in improper professional conduct within the meaning of Rule 102(e)(1)(ii) of the Commission’s Rules of Practice. Specifically, the Respondents engaged in repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

48. Within 10 days of the issuance of this Order, Deloitte undertakes to pay $375,000 to the U.S. Treasury. The payment shall be delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Mail Stop 0-3, Alexandria, Virginia 22312, and shall be accompanied by a letter identifying Deloitte as a respondent in this action, setting forth the title and Exchange Act Release Number of this action and specifying that payment is made pursuant to this undertaking.

49. In determining to accept Deloitte’s offer, the Commission has considered the undertaking set forth above and Deloitte’s willingness to undertake measures to enhance its National Risk Management Program as detailed in another order issued simultaneously concerning Deloitte’s audit of the financial statements of Adelphia Communications Corporation entitled In the Matter of Deloitte & Touche LLP, Exchange Act Release No. 34-51606 (April 26, 2005).
IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the Respondents’ Offers.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Deloitte is censured pursuant to Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.

B. Barry and Baker are each denied the privilege of appearing or practicing before the Commission as an accountant.

C. After two years from the date of the Order, Barry may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company’s financial statements that are filed with the Commission. Such an application must satisfy the Commission that Barry’s work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity, and/or

2. an independent accountant. Such an application must satisfy the Commission that:

   (a) Barry, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board (the “Board”) in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

   (b) Barry, or the registered accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in Barry’s or the firm’s quality control system that would indicate that Barry will not receive appropriate supervision or, if the Board has not conducted an inspection, has received an unqualified report relating to his, or the firm’s, most recent peer review conducted in accordance with the guidelines adopted by the former SEC Practice Section of the American Institute of Certified Public Accountants Division for CPA Firms or an organization providing equivalent oversight and quality control functions;

   (c) Barry has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

   (d) Barry acknowledges his responsibility, as long as he appears or practices before the Commission as an independent accountant, to comply with all requirements of the
Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

D. The Commission will consider an application by Barry to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission’s review may include consideration of, in addition to the matters referenced above, any other matters relating to Barry’s character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

E. After one year from the date of the Order, Baker may request that the Commission consider her reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company’s financial statements that are filed with the Commission. Such an application must satisfy the Commission that Baker’s work in her practice before the Commission will be reviewed either by the independent audit committee of the public company for which she works or in some other acceptable manner, as long as she practices before the Commission in this capacity, and/or

2. an independent accountant. Such an application must satisfy the Commission that:

   (a) Baker, or the public accounting firm with which she is associated, is registered with the Public Company Accounting Oversight Board (the “Board”) in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

   (b) Baker, or the registered accounting firm with which she is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in Baker’s or the firm’s quality control system that would indicate that Baker will not receive appropriate supervision or, if the Board has not conducted an inspection, has received an unqualified report relating to her, or the firm’s, most recent peer review conducted in accordance with the guidelines adopted by the former SEC Practice Section of the American Institute of Certified Public Accountants Division for CPA Firms or an organization providing equivalent oversight and quality control functions;

   (c) Baker has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

   (d) Baker acknowledges her responsibility, as long as she appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.
F. The Commission will consider an application by Baker to resume appearing or practicing before the Commission provided that her state CPA license is current and she has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission’s review may include consideration of, in addition to the matters referenced above, any other matters relating to Baker’s character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Jonathan G. Katz
Secretary