SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 68431 / December 13, 2012

ACCOUNTING AND AUDITING ENFORCEMENT
Rel. No. 3427 / December 13, 2012

Admin. Proc. File No. 3-13797

In the Matter of the Application of

WENDY MCNEELEY, CPA
c/o Robert L. Michels, Esq.
Winston & Strawn LLP
35 Wacker Dr.
Chicago, IL 60601

OPINION OF THE COMMISSION

102(e) PROCEEDING

Grounds for Remedial Action

Improper Professional Conduct

Certified public accountant acting as audit manager engaged in improper professional conduct in the audit of the financial statements of a private company and a related fund. *Held*, it is in the public interest to deny the accountant the privilege of appearing or practicing before the Commission for six months.

APPEARANCES:

Robert L. Michels, Scott P. Glauberman, and *J. Malcolm Cox*, of Winston & Strawn LLP, for Wendy McNeeley.

Andrea Wood and *Robert Moye*, for the Division of Enforcement.

Appeal filed: February 11, 2011
Last brief received: May 2, 2011
Oral Argument: November 2, 2011

I.

Wendy McNeeley, a licensed certified public accountant and former audit manager at Ernst & Young ("E&Y"), appeals from the decision of an administrative law judge. The law judge found that McNeeley engaged in improper professional conduct as defined in the Commission's Rule of Practice 102(e)[1] while serving as the audit manager during E&Y's audit of AA Capital Partners, Inc. ("AA Capital"), a registered investment adviser, and AA Capital Equity Fund, L.P. (the "Equity Fund") for the year ended December 31, 2004. The law judge found that McNeeley's improper professional conduct was the result of a single instance of highly unreasonable conduct that resulted in a violation of generally accepted auditing standards ("GAAS") in circumstances in which McNeeley knew, or should have known, that heightened scrutiny was warranted.[2] The law judge determined that, because of this conduct, McNeeley should be denied the privilege of appearing or practicing as an accountant before the Commission for one year. We base our findings on an independent review of the record, except for findings that the parties do not challenge on appeal.

II.

A. AA Capital and its Affiliates

This matter involves McNeeley's audit of a series of transactions through which AA Capital transferred approximately $1.9 million from client trust accounts to its president and co-founder, John Orecchio, purportedly to pay a tax assessment by the Internal Revenue Service. At the time of the audit, AA Capital was headquartered in Chicago, Illinois, and co-owned, equally, by Orecchio and his business partner, Paul Oliver, Jr. In addition to being president, Orecchio served as AA Capital's director and secretary and exercised day-to-day management and control over AA Capital. Oliver served as AA Capital's chairman and treasurer. AA Capital's chief financial officer and chief compliance officer was Mary Beth Stevens, who was responsible for AA Capital's entire accounting function.[3]

AA Capital had several affiliated private equity funds into which AA Capital's clients invested money. The largest of these funds was the Equity Fund, which had approximately $131 million in assets under management as of December 31, 2004. The Equity Fund was governed by an Amended and Restated Limited Partnership Agreement (the "Partnership Agreement"), which gave the Equity Fund's general partner, AA Private Equity Investors Management, LLC

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1 17 C.F.R. § 201.102(e)(1)(ii).

2 GAAS are standards of conduct relating to how auditors should perform an audit. *See SEC v. Arthur Young & Co.*, 590 F.2d 785, 788 n.2, 789 n.4 (9th Cir. 1979). GAAS are generally described in the American Institute of Certified Public Accountants ("AICPA") Codification of Statements of Auditing Standards, hereinafter cited as "AU § __."

3 None of AA Capital's employees testified at the hearing.

("AA Investors Management LLC"), control over the Equity Fund. Orecchio and Oliver each owned twenty percent of the general partner. The Equity Fund's limited partners were three pension funds, which had their investment commitments deposited into separate bank trust accounts ("Investor Trust Accounts") in the name of each investor. The Equity Fund could call capital from the Investor Trust Accounts for three primary purposes: (i) to make investments; (ii) to pay management fees; or (iii) to pay overhead expenses.

B. E&Y's Audits

E&Y became AA Capital's auditors in 2002, but in 2004, became concerned about whether it had the resources to staff those engagements. This concern caused some delay, but E&Y eventually agreed to audit AA Capital and its affiliated funds for the fiscal years ended December 31, 2003 and 2004. Because of the delay, however, E&Y had to conduct the 2003 and 2004 audits concurrently. AA Capital also requested a June 30, 2005 deadline so that investors would have the financial statements necessary to complete their tax filings. The deadline required E&Y to conduct ten audits simultaneously by June 30, 2005.

E&Y began the audits during the spring and early summer of 2005 and assigned McNeeley as audit manager. The audit team also included an independent review partner, John Kavanaugh; an engagement partner, Gerard Oprins; two audit seniors; and two audit staff. McNeeley was twenty-nine-years old at the time and had been licensed as a certified public accountant for approximately eight years. As audit manager, McNeeley reported to the engagement partner, Oprins, but McNeeley was responsible for overseeing day-to-day audit planning and executing audit strategy. McNeeley also supervised the audit staff and reviewed audit workpapers in significant risk areas.

As part of the planning process, E&Y's audit team determined not to rely on AA Capital's internal controls because E&Y determined those controls to be "ineffective" for purposes of E&Y's audit. McNeeley explained that this determination was primarily due "to the lack of sophistication with the client's accounting function and that they kept all their books and records in Excel format." This determination meant that E&Y's audit would need to test all account balances substantively and verify (or "vouch") all capital calls and distributions.

McNeeley also expressed concern early in the audit process about meeting the June 30 deadline because of staffing constraints, another audit engagement McNeeley was conducting by herself, and a two-week vacation McNeeley intended to take (and did take) starting May 20, 2005. McNeeley, for instance, wrote in an e-mail to Oprins in May 2005 that she was "very concerned about the wrap up of this engagement." In a subsequent email in June 2005, McNeeley again wrote "to convey that the June 30th deadline will be challenging to meet," but added that she believed "that we will be able to meet the June 30 deadline" and "just wanted to prepare Mary Beth [Stevens]" for the fact "that things may be pulled together at the last minute."

C. Discovery of Orecchio's Purported Tax Loans

Sometime during the audit, the E&Y team noticed that AA Capital's accounts receivable schedule (the "Receivable Schedule")[4] listed four cash transfers to Orecchio (collectively, the "Transfers"). The Receivable Schedule described the transfers as "John – tax payment" and totaled approximately $1.92 million. The Transfers were spread over approximately six months, at uneven intervals, in varying amounts, and with slightly different structures:

- On May 19, 2004, $987,000 was transferred from two Investor Trust Accounts to AA Capital's primary bank account. The same day, $602,150 was transferred from AA Capital's primary bank account to Orecchio's personal bank account.

- On August 2, 2004, $190,000 was transferred from three Investor Trust Accounts to AA Capital's primary bank account. The same day, $190,154 was transferred from AA Capital's primary bank account to Orecchio's personal bank account.

- On September 20, 2004, $600,000 was transferred from three Investor Trust Accounts to AA Capital's primary bank account. The same day, $579,000 was transferred from AA Capital's primary bank account to Orecchio's personal bank account.

- On November 5, 2004, $550,000 was transferred from three Investor Trust Accounts to the Equity Fund's bank account. The same day, $550,000 was transferred from the Equity Fund's bank account to Orecchio's personal bank account.[5]

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On or around May 7, 2005, an E&Y audit staff member, Corina Rojas, had a conversation with Stevens about the Transfers. Rojas documented the conversation with a note on the Receivable Schedule:

> Per conversation w/ Mary Beth Stevens, CFO, all of the funds held under AA Capital Inc. had not finalized their audits, tax filings, and therefore John Orrechio [sic], (managing member) did not have a final tax return draft that included taxable income w/ set figures. Therefore he had to estimate his tax liability [and] made a payment to the IRS for 1,921,150 . . . . The 1,921,150 is essentially a loan made to John Orrechio [sic]. Mary Beth Stevens expects to receive payment from either Mr. Orrechio [sic] or the IRS after taxes are finalized.

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[4] McNeeley explained that the Receivable Schedule was prepared by Stevens and contained a list "of disbursements from the entity and gives further detail and break out of what those amounts related to."

[5] The parties stipulated to these details, although an e-mail dated June 16, 2005, from Stevens to McNeeley, described the Transfers in slightly different amounts: $596,129 (May 19, 2004); $188,100 (August 2, 2004); $573,210 (September 20, 2004); and $544,500 (November 5, 2004).

Rojas, who did not testify, further noted on the Receivable Schedule that Orecchio's co-owner, Oliver, had also received a tax advance – for $18,228.

D. McNeeley's Audit Steps Regarding the Transfers

McNeeley testified that, "at some point," she saw the Receivable Schedule listing the four transfers to Orecchio. She could not remember, however, precisely when she first learned of the Transfers, explaining that "it is hard for me to remember exactly when I learned things throughout the audit." McNeeley recalled meeting with Stevens to discuss the Receivable Schedule, but could not recall when that meeting occurred. McNeeley remembered asking Stevens during their meeting to provide "any and all documentation that she had regarding the tax advances." According to McNeeley, Stevens responded to the request for documents by directing McNeeley to the tax advance amounts listed in the Receivable Schedule. McNeeley added that she and the audit team "also had other documentation that we had previously been provided that also reflected and supported [the Transfers]."

The first document was a general ledger. McNeeley explained that the ledger was a document prepared by Stevens reflecting "all transactions going through the company for a set period of time." The ledger showed the detail of the individual purported tax payments, dollar amounts, and dates paid.

The second document was a management representation letter (which was actually two documents: one each for AA Capital and the Equity Fund). The letters were signed by Stevens and Orecchio and represented to E&Y that AA Capital's and the Equity Fund's accounting records were complete and accurately reflected all transactions. The management letter for the Equity Fund included a general representation that all related-party transactions were properly recorded or disclosed in the financial statements. Neither management representation letter, however, explicitly mentioned the Transfers.

The third document was the Partnership Agreement, which allowed tax-related transfers in certain situations. Section 7.3.1 of the agreement provided that "if net income of the [Equity Fund] is allocated to [its] Partners in any fiscal year," then the Equity Fund could make "tax distributions" to satisfy any tax liability such partner "would actually have incurred."[6] Here, however, the Equity Fund had a net investment loss in both 2003 and 2004, and neither of the other two parties involved in the Transfers (Orecchio and AA Capital) were partners in the Equity Fund.

McNeeley testified that she "read through" the Partnership Agreement at the beginning of the audit and "gained an understanding of all the significant provisions within the limited partnership agreement." She could not recall, however, whether she reviewed the Partnership Agreement when evaluating the Transfers. As she explained, "I don't have a specific recollection of looking at [the Partnership Agreement] while . . . looking at the accounts receivable schedule,

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6 The Partnership Agreement's Section 7.3.3, which was subject to Section 7.3.1, similarly provided for advances to partners to satisfy estimated taxes.

but I had previously looked at the [Partnership Agreement] at the beginning of field work and had an understanding of the provision allowed for in the agreement."

When asked during the hearing, McNeeley also testified that she and the audit team never sought nor received any third-party confirmation regarding the Transfers, such as documentation from the IRS evidencing a tax liability assessment. McNeeley also could not remember whether she ever asked about Orecchio's ability to repay the Transfers. As McNeeley explained, "we had no reason to question the collectibility of the receivable from John Orecchio to AA Capital Partners. We understand him to be a successful wealthy business man. He had capital in the [E]quity [F]und as well as investments and various other funds." McNeeley added, "Based on my recollection of the transaction, we understood it to be an erroneous tax liability that had been assessed to John Orecchio; and therefore, he anticipated settlement with the IRS and was going to use that to repay it."

McNeeley also could not recall contacting the E&Y tax department for any reason. E&Y's tax department prepared AA Capital's tax returns at the time of the audits and, therefore, likely could have confirmed whether AA Capital had reported income in 2003 or 2004 on which Orecchio would owe taxes. McNeeley testified, however, that she "d[id]n't know why I would go and inquire [of] the E&Y tax team . . . when the tax liability that John Orrechio [sic] received advances for related to his personal tax return . . . and our tax department wouldn't have all the information necessary to make the evaluation of his personal tax position."

McNeeley testified at various points during the hearing that she was comforted by her understanding that Oliver and Orecchio "would have full knowledge about each other's tax advances." McNeeley could not recall, however, ever confirming whether Oliver actually knew about the Transfers. In fact, McNeeley could not recall whether she or any other member of the audit team ever spoke with Orecchio or Oliver about any aspect of the Transfers. McNeeley instead testified that she "understood" that the two partners "would have full knowledge of each other's tax advances" and that she based this understanding "on Paul Oliver being the treasurer of the company and having full access to the records." McNeeley later added that Oliver "had the opportunity to become aware of such transaction and had a fiduciary . . . obligation as a co-owner of AA Capital Partners to be aware of all the transaction [sic] and ongoing of the business [sic]."

Near the end of the audit, McNeeley went on vacation for approximately two weeks, beginning May 20, 2005. After her return, McNeeley e-mailed Stevens "to get clarification as to exactly what the tax liability related to." In her initial email, sent June 7, 2011, McNeeley expressed confusion to Stevens about who owed the tax liability and whether any payment had been made. McNeeley, for example, asked Stevens to clarify that accruals "labeled as 'John's Tax Payment' . . . are accruals for the Corporation's tax payments and not personal tax liabilities of the Shareholders." McNeeley also asked "when are the actual payments expected to be made[?]"

Stevens responded that Orecchio had been "dinged by the IRS and incurred multiple fees and tax payments." Stevens added that most of the supposed tax assessment amounts were not correct, but could not be settled with the IRS until the audit and tax work were completed.

Stevens explained, "Payments for which [Orecchio] is truly liable for he will pay and a majority, if not all, will be refunded back to him which he will then repay the company."

McNeeley expressed continued confusion in a follow-up email about what she described as "these hefty tax assessments." McNeeley wrote to Stevens that "it's my understanding that no money has actually been paid from or received by AA Capital in relation to the payment of John [Orecchio]'s taxes," and asked "if it is proper to present a liability on the books of AA Capital for which AA Capital does not currently have obligation to pay." Stevens wrote back to clarify that AA Capital was owed an accounts receivable from Orecchio and, in turn, AA Capital owed an accounts payable to the Equity Fund.

On the same day as her email exchange with Stevens, McNeeley documented her understanding of the Transfers with a note in the workpapers:

> [T]he Equity fund made approx. [$]1,921,304 of tax payments for John Orrechio [sic] during 2004. [T]he Equity fund has set up a receivable from AA Capital Partners for reimbursement of this amt. E&Y verified that AA Cptl Ptnrs has a reciprocal payable balance to Equity. E&Y also noted that AA Cptl has an offsetting receivable balance from John Orrechio [sic]. Appears proper.

Oprins testified that he saw McNeeley's note, but he could not recall "one way or the other" whether McNeeley ever discussed the Transfers with him. Oprins could recall only that McNeeley kept him informed about what was happening during the audits, but not the specific audit steps taken regarding the Transfers or whether he had discussed the Transfers with the audit team.

E. E&Y's Subsequent Review Testing

As part of the 2004 audit, the E&Y audit team conducted "subsequent review testing" of transactions that occurred after the 2004 year end. E&Y's workpapers showed that the audit team looked at AA Capital's cash receipt and disbursement records for "significant" or "unusual" items that may have occurred between January 1, 2005 and March 31, 2005. McNeeley wrote in the workpapers that "no unusual items" were uncovered during this subsequent review.

AA Capital's 2005 accounts receivable schedule, however, showed that AA Capital made nine more disbursements to Orecchio in January and February 2005, totaling $482,000. The 2005 accounts receivable schedule described these transfers as "J.O. taxes," "JO Tax Distrib," or "JO Tax Dist." The record is not clear, however, whether McNeeley saw these subsequent transfers. The only document in the record that lists the subsequent transfers is the 2005 accounts receivable schedule. That document, however, includes entries dated as late as December 31, 2005 and therefore could not have existed at the time McNeeley was completing the audit in June 2005.

F. The 2004 Financial Statement

E&Y completed the audits by the end of June 2005 and issued unqualified audit opinions for AA Capital's and the Equity Fund's 2004 financial statements. E&Y's audit opinion represented that E&Y had conducted its audit in accordance with GAAS and that the audit provided a reasonable basis for E&Y's opinion that AA Capital's and the Equity Fund's financial statements fairly presented the firms' financial positions, results of operations, and cash flows.[7]

The audited financial statements provided no specifics about the $1.92 million tax advance to Orecchio. Instead, AA Capital's 2004 financial statements disclosed only that the company had $2.534 million in "[f]ee and accounts payable" and $2.251 million in "[a]ccounts receivable from affiliates." The notes to AA Capital's financial statements also provided no mention of transfers to Orecchio. The notes instead discussed only that the company had paid $264,176 in "certain reimbursable expenses" for several of AA Capital's related funds. The Equity Fund's financial statements similarly listed a $1.92 million "[a]ccounts receivable from AA Capital Partners, Inc.," with no other details such as the terms or manner of settlement.

E&Y's internal GAAP Disclosure Checklist stated that "[n]otes or accounts receivable from officers, employees or affiliated companies must be shown separately and not included under a general heading such as notes or accounts receivable." In response to this item, McNeeley checked a box indicating "not applicable." McNeeley explained that she checked "not applicable" because she believed the requirement was limited to making sure that "accounts receivable with related parties is not grouped in with other accounts receivables from trade creditors and that was not the case in either one of these financial statements."

G. Discovery of Orecchio's Fraud

AA Capital engaged E&Y to audit the company and its related funds again the following year, 2005. Jennifer Aquino replaced McNeeley as the audit manager because McNeeley was on maternity leave. Most of the 2005 E&Y audit team otherwise remained the same.

During the 2005 audit, Aquino asked Stevens for documentation supporting the tax transfers to Orecchio, but never received anything in return. Aquino testified that the E&Y audit team had several internal meetings regarding the transfers and sent Orecchio an e-mail, but the record provides no indication that Orecchio ever responded. Those steps, Aquino recalled, were

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[7] The audit opinion for AA Capital's financial statements included a disclaimer that AA Capital's policy was to prepare its financial statements on a tax basis of accounting. The financial statements, the audit opinion explained, were not intended to be presentations in conformity with generally accepted accounting principals ("GAAP"). Despite this disclaimer, Oprins and McNeeley both acknowledged that GAAP disclosure requirements for related-party transactions were the same no matter whether the financial statements were tax-based or GAAP-based. The audit opinion for the Equity Fund's financial statements did not include a tax basis disclaimer.

"the best that we felt we could do at that time." She explained that, because the audit team "didn't have anything to audit," they could only wait to receive something more from AA Capital. Aquino also learned during the audit that, by the end of 2005, the tax transfers to Orecchio had grown to $5.7 million. As McNeeley's expert witness testified, AA Capital's financial statements expressly identified the Transfers as "accounts receivables," which indicated that the Transfers were short-term advances repayable within one year. Aquino, therefore, found it significant that the 2004 transfers not only still existed on AA Capital's books in 2005, but had, in fact, increased.

The audit team eventually decided that they would not continue with the 2005 audit until Orecchio paid back the "tax loan" and E&Y had received enough documentation to audit the transfer balance. On June 30, 2006, Oprins informed Stevens and Orecchio that E&Y would not release its 2005 audit opinions until Orecchio repaid the transfers. The E&Y audit team also raised a "going concern" issue regarding AA Capital's ability to fund its operations. The audit team was unable to resolve these issues, and E&Y never issued its 2005 audit reports.

In August 2006, the Commission conducted a "for cause" on-site examination of AA Capital to investigate a tip from the U.S. Department of Labor about a kickback scheme. During the examination, Commission staff learned that Orecchio had misappropriated approximately $5 million through a fraudulent tax-loan mechanism. In September 2006, the Commission filed a complaint in U.S. District Court against AA Capital and Orecchio. The complaint alleged that AA Capital and Orecchio misappropriated at least $10.7 million from AA Capital's advisory clients, and the U.S. District Court placed a receiver over AA Capital.[8] The U.S. Department of Justice subsequently brought criminal charges against Orecchio in 2009 for wire fraud and theft of funds from an employee benefit plan. Orecchio pleaded guilty in February 2010, and a U.S. District Court sentenced Orecchio to more than nine years in prison.[9] The Commission also instituted administrative proceedings against Stevens and Oliver for their involvement in the fraud. Stevens and Oliver eventually consented to, among other things, a bar and twelve-month suspension, respectively; civil penalties; and a cease-and-desist order.[10]

H. Rule 102(e) Administrative Proceeding

In March 2010, the Commission issued an Order Instituting Proceedings ("OIP") against McNeeley and her supervisor, Gerard Oprins, in connection with their audit of AA Capital. The OIP charged McNeeley and Oprins with engaging in improper professional conduct as defined in Rule 102(e) "in that their conduct constituted (A) intentional or knowing conduct, including

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8 *SEC v. AA Capital Partners, Inc.*, No. 06-C-4859 (N.D. Ill. Sept. 8, 2006).

9 *United States v. Orecchio*, No. 09-CR-622 (N.D. Ill. 2010).

10 *Mary Beth Stevens*, Investment Advisers Act Rel. No. 2973 (Jan. 5, 2010), 97 SEC Docket 24420; *Paul W. Oliver, Jr.*, Advisers Act Rel. No. 2903 (July 17, 2009), 96 SEC Docket 19124.

reckless conduct, that resulted in a violation of the applicable professional standards, or in the alternative, (B) negligent conduct, consisting of a single instance of highly unreasonable conduct that resulted in a violation of applicable professional standards in circumstances in which Respondents knew, or should have known, that heightened scrutiny was warranted." After an eight-day hearing, an administrative law judge issued an initial decision finding that McNeeley's actions did not constitute reckless conduct, but did constitute highly unreasonable conduct in circumstances warranting heightened scrutiny that resulted in a violation of the applicable professional standards. The law judge found that Oprins also violated the applicable professional standards, but that his actions were neither reckless nor highly unreasonable. McNeeley appeals the law judge's decision.[11]

III.

Rule of Practice 102(e) permits us to censure or deny (either permanently or temporarily) the privilege of appearing or practicing before the Commission to persons found to have engaged in improper professional conduct. The rule defines three classes of "improper professional conduct" for accountants, but this appeal concerns only one: whether McNeeley engaged in "a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted."[12] We find, for the reasons below, that McNeeley engaged in such improper professional conduct.

A. Heightened Scrutiny Was Warranted

Our Rule 102(e) analysis first considers whether the Transfers warranted heightened scrutiny. Under Rule 102(e), "heightened scrutiny" is warranted "when matters are important or material, or when warning signals or other factors should alert an accountant" to a heightened risk.[13] These factors were clearly present here.

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[11] Because the law judge's decision regarding Oprins was not appealed, the only issue before us on appeal is whether McNeeley engaged in improper professional conduct. *See Gerard A.M. Oprins, CPA*, Securities Exchange Act Rel. No. 63931 (Feb. 18, 2011) (giving notice, "pursuant to Rule 360(d) of the Commission's Rules of Practice, that the initial decision of the administrative law judge has become the final decision of the Commission with respect to Gerard A.M. Oprins").

[12] 17 C.F.R. § 201.102(e)(1)(iv)(B)(*1*). The other two classes of improper professional conduct are "intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards;" and "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." 17 C.F.R. § 201.102(e)(1)(iv)(A), (e)(1)(iv)(B)(*2*).

[13] *Amendment to Rule 102(e) of the Commission's Rules of Practice* ("*Amendment to Rule 102(e)*"), 63 Fed. Reg. 57,164, 57,168 (Oct. 26, 1998).

First, the Transfers were related-party transactions, which we and the courts have repeatedly held require heightened scrutiny.[14] The reason for this, the D.C. Circuit has explained, "is apparent: Although in an ordinary arms-length transaction, one may assume that parties will act in their own economic self-interest, this assumption breaks down when the parties are related. A company that would perform a thorough credit-risk assessment before extending a loan might not do so if the loan were to one of its officers or directors."[15] That is the case here. AA Capital essentially extended a loan from clients' trust accounts to Orecchio, who was not only an officer and director of AA Capital, but also a founder and co-owner. Transactions involving such strong related-party relationships, the D.C. Circuit has explained, alert auditors that a firm may not have thoroughly vetted those transactions and that, as a result, heightened scrutiny is needed – exactly the case that faced McNeeley.[16]

Second, the Transfers were plainly material, which we have also stated triggers heightened scrutiny.[17] McNeeley counters that materiality "is irrelevant" because, she contends, auditors are concerned only with material transactions. She claims that to hold that materiality warrants heightened scrutiny would therefore mean that every transaction would warrant heightened scrutiny. She argues that multi-million dollar tax liabilities are not unusual for private equity firm partners and do not necessarily require heightened scrutiny. Even if we accepted this latter proposition regarding the absolute amount of the tax liabilities, the Transfers here were more than 100 times greater than a transfer to Orecchio's equal partner in a year in which the Equity Fund had no net income.[18] Even McNeeley described the $1.9 million transfers combination warrants heightened scrutiny.[19]

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[14] *McCurdy v. SEC*, 396 F.3d 1258, 1261 (D.C. Cir. 2005) (citing *Howard v. SEC*, 376 F.3d 1136, 1149 (D.C. Cir. 2004)) (noting that related-party transactions "are viewed with extreme skepticism in all areas of finance"), *aff'g James Thomas McCurdy, CPA*, 57 S.E.C. 277 (2004); *see also Gordon v. Comm'r*, 85 T.C. 309, 326-27 (1985) (explaining "heightened" skepticism for related-party transactions); AU § 334 (recognizing need for care in the examination of material related-party transactions).

[15] *McCurdy*, 396 F.3d at 1261.

[16] *McCurdy*, 396 F.3d at 1264 ("The related-party interest underlying the transaction was not minor: Bagwell was the founder and CEO of the fund, a trustee, and its investment advisor.").

[17] *Amendment to Rule 102(e)*, 63 Fed. Reg. at 57,168 (stating that heightened scrutiny is warranted "when matters are important or material").

[18] *Cf. McCurdy*, 396 F.3d at 1264 (affirming Commission's finding of recklessness where auditor failed to investigate adequately a related-party receivable that "was nearly ten times the amount of the GAAS-dictated materiality threshold").

[19] *See McCurdy*, 57 S.E.C. at 295 (finding heightened scrutiny to be warranted where, among other things, the receivable at issue "arose from a related party transaction" and

(continued...)

Finally, McNeeley argues that the material, related-party nature of the Transfers cannot provide a basis for finding that the Transfers warranted heightened scrutiny because, she claims, the Division failed to make such allegations in the OIP. To the contrary, however, the OIP expressly alleged that "McNeeley identified Orecchio's 'tax loan' as a related party transaction, [but] failed to apply heightened scrutiny or perform any additional audit steps to evaluate it." Moreover, the standard for determining whether notice is adequate is whether "the respondent 'understood the issue' and 'was afforded full opportunity' to justify [her] conduct during the course of the litigation."[20] We find that McNeeley, who has been represented by counsel throughout these proceedings, adequately understood the allegation that the Transfers warranted heightened scrutiny because of their material, related-party nature and that she had ample opportunity to defend herself against those allegations.

B. McNeeley Violated Applicable Professional Standards

Our analysis of whether McNeeley engaged in improper professional conduct next addresses whether McNeeley violated applicable professional standards. Here, we find that McNeeley violated three professional standards: (i) exercising due professional care, (ii) obtaining sufficient competent evidence, and (iii) rendering an accurate audit report.[21]

1. Failure to Exercise Due Professional Care

GAAS require auditors to exercise due professional care when conducting an audit and preparing a report.[22] Under this standard, auditors must maintain an attitude of professional skepticism, which includes "a questioning mind and a critical assessment of audit evidence."[23] Until an auditor obtains an understanding of the business purpose of material related-party

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19 (...continued)
was "clearly material"); AU § 334.07 ("The auditor should place emphasis on testing material transactions with parties he knows are related to the reporting entity."); *cf. McCurdy*, 396 F.3d at 1263-64 (finding that auditor's failure to investigate material, related-party transaction was reckless under Rule 102(e)).

20 *Aloha Airlines, Inc. v. Civil Aeronautics Bd.*, 598 F.2d 250, 262 (D.C. Cir. 1979).

21 AU § 230.01 (professional care); AU § 326.22 (sufficient competent evidential matter); AU § 508.07 (accurate audit report).

22 AU § 230.01 ("Due professional care is to be exercised in the planning and performance of the audit and the preparation of the report.").

23 AU § 230.07; *see also* AU § 230.08 ("[P]rofessional skepticism should be exercised throughout the audit process."); AU § 330.15 (requiring auditors to exercise an appropriate level of professional skepticism in designing and conducting the confirmation process).